SUMMARY OF THE REPORTS

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

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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."

GENERAL LETTER OF TRANSMITTAL

(To be inserted in Volume I)

To the Federal Reserve Board:

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Under the terms of its reference the Committee has prepared and is submitting reports on the following topics: (1) Branch Banking in the United States; (2) Branch Banking in California; (3) Branch Banking in England; (4) Branch Banking in Canada; (5) Banking Groups and Chains; (6) Changes in the Number and Size of Banks in the United States, 1834-1931; (7) Bank Suspensions in the United States, 1892-1931; (8) 225 Bank Suspensions, Case Histories from Examiners' Reports; (9) Banking Profits, 1890-1931; (10) The Dual Banking System in the United States.

The Committee also submits herewith a summary of the material in the detailed reports.

The appointment of the Committee was prompted by the banking difficulties during the preceding ten years, which had resulted in a large number of bank suspensions, and by the growing trend towards concentration through branches, chains, and groups. When the Committee began its work, speculative activity in the securities market and in other fields had recently culminated in a collapse of security prices, but the extent and scope of the decline in economic activity that had begun in the summer of 1929 was not then clearly defined. The decade just concluded had witnessed extraordinary activity in construction and rapid expansion of industrial plants, particularly the rapid growth of the automobile industry which has had profound effects on many phases of the country's life. Installment selling had developed on a large scale and had stimulated buying by the consuming public.

The decade was characterized by an abundance of credit, to which an inflow of gold from abroad greatly contributed, and by an extraordinarily large volume of security flotations, both domestic and foreign. It witnessed speculation in real estate, in securities, and in business enterprise. Throughout the period, however, commodity prices after a precipitous decline in 1920 and 1921 remained relatively stable around a level somewhat higher than the low point reached early in 1922.

Broadly speaking, the decade was one in which industrial and city populations were prosperous, while agriculture was going through a difficult adjustment.

While the Committee was conducting its investigation, there developed an economic depression of unprecedented depth and duration which has affected every part of the world. This subjected the banks of the country to new destructive forces. The impact of the depression on the banking system was severe by the end of 1930 and became more serious in 1931, the last year covered by the organized material accumulated by the Committee. Its studies of bank earnings and expenses cover the five year period 1926-1930; its studies of failures are carried through 1931, but do not include the year 1932 during which the establishment of remedial agencies, such as the Reconstruction Finance Corporation, introduced entirely new elements into the situation. Developments during 1932 are reflected in the study only in a general way and in particular cases where information was available and appeared to be essential for completeness.

The Committee's investigations were organized and directed by J. H. Riddle, the Executive Secretary and Director of Research. The various reports were written under his supervision, and the major part of the editorial work was done by him. Mr. G. W. Blattner, of the Board's Division of Research and Statistics, prepared Banking Profits, 1890-1931 and collaborated in two other reports: Branch Banking in England and Banking Groups and Chains. He also assisted in the editing of other reports and was frequently consulted as to methods and procedure in other research projects.

Other members of the research staff participated in one or more projects. Mr. Guy Greer prepared Branch Banking in Canada and Branch Banking in California. He also collaborated in the preparation of The Dual Banking System in the United States. Mr. Oliver S. Powell, of the Federal Reserve Bank of Minneapolis, prepared 225 Bank Suspensions, Case Histories from Examiners' Reports. Mr. Clarence

Hammond prepared Branch Banking in the United States, and collaborated in the preparation of Changes in the Number and Size of Banks in the United States, 1834-1931. Mr. Clark Warburton collaborated in the preparation of Bank Suspensions in the United States, 1892-1931, Changes in the Number and Size of Banks in the United States, 1834-1931, and The Dual Banking System in the United States. Mr. Richard Garlock collaborated in the preparation of Bank Suspensions in the United States, 1892-1931; Mr. Cyril B. Upham in Banking Groups and Chains; Mr. Jett Lauck in The Dual Banking System in the United States; and Mrs. Louise Sissman in Branch Banking in England. Mr. J. E. Horbett, of the Federal Reserve Board's Division of Bank Operations, helped in the preparation of much of the statistical data used in some of the reports and has participated in the planning and execution of several of the statistical projects. The Committee is indebted to Mr. Carl E. Parry, Assistant Director of the Division of Research and Statistics of the Federal Reserve Board, for having read most of the reports and for many valuable suggestions. The Committee is also indebted to the counsel of the Federal Reserve Board for the preparation of digests of various laws and to members of the Board's staff for criticisms and suggestions.

The Committee expresses its appreciation to the various Federal reserve banks, the Comptroller of the Currency, and the various State banking departments for the assistance they have rendered in this investigation. Some of the projects entailed the collection of a vast amount of statistical and other factual data, and much of these were supplied by the Federal reserve banks, or through them by the State banking departments. Without this assistance some of the projects could not have been carried out successfully.

To the various public officials, bankers, economists, and others in this country, Canada, and England, who have supplied information, given the benefit of their counsel, or rendered other assistance, the Committee expresses its thanks.

Respectfully,

E. A. Goldenweiser, Chairman
Ira Clerk
M. J. Fleming
L. R. Rounds
E. L. Smead

CONTENTS

SUMMARY

The banking system of the United States has not met successfully the test of adverse economic conditions. In the past twelve years there have been over ten thousand bank failures involving deposits aggregating nearly five billion dollars. During these twelve years, one failure has occurred for every three active banks in the country in 1920. These failures have involved deposits aggregating over one-eighth of the deposits of all commercial banks in existence in 1920. In no previous period of equal length since the establishment of the national banking system in 1863 has so large a proportion of the country's banks suspended.

The failures during the past twelve years have had far-reaching social and economic consequences. The serious disturbances to the credit and business structure of the country indicate an urgent need for greater stability of banking institutions and greater protection to depositors. The aggregate losses to depositors alone have been a disturbing factor, but this represents only a part of the damage done. It would be difficult to appraise the personal hardships, the lost opportunities, and the impediments to trade which have been occasioned by the tie-up of funds in closed banks.

The country's banking difficulties as reflected in this heavy mortality rate have been a major factor in the more serious stages of the depression following the boom of 1929, and in a measure are responsible for the extreme depths to which security prices and public confidence declined. The growing feeling of insecurity, the withdrawals of de-

posits, and the frequent suspensions led to an almost continuous sale of securities at depressed levels, thereby endangering other banks and setting up a vicious circle which it has been difficult to break.

Economic developments during the post-war period have created difficult conditions for the banks. Agriculture has been burdened by a large volume of debt incurred largely during the war and post-war booms, and during the past three years the financial machinery of the country has been subjected to extraordinary pressure on account of a world-wide depression of unusual dimension and duration. A banking structure, however, which results in the failure of banks on the scale witnessed during the past twelve years is one that challenges careful analysis with a view to determining the causes of weakness. A bank, perhaps more than any other type of institution, needs to fortify itself against depression, and the management is properly expected to strengthen its position in good years in order to be prepared for the problems of lean years. Not only must bank management cope with the short-term ups and downs of business, but it must also confront the problems presented by long-time tendencies.

Although bank closings have been running at a high rate during the entire period since 1920, the number has greatly increased during the past three years as shown in the table below.

Table 1 - National and State Bank Suspensions
1921-1932(1)

Year	Number	Gross deposits (000 omitted)
1921	461	$ 163,299
1922	343	89,274
1923	623	146,347
1924	738	202,423
1925	579	159,904
1926	924	250,434
1927	636	194,992
1928	479	139,400
1929	628	222,931
1930	1,292	821,834
1931	2,213	1,669,075
1932	1,416	698,382
Total	10,332	$4,758,295

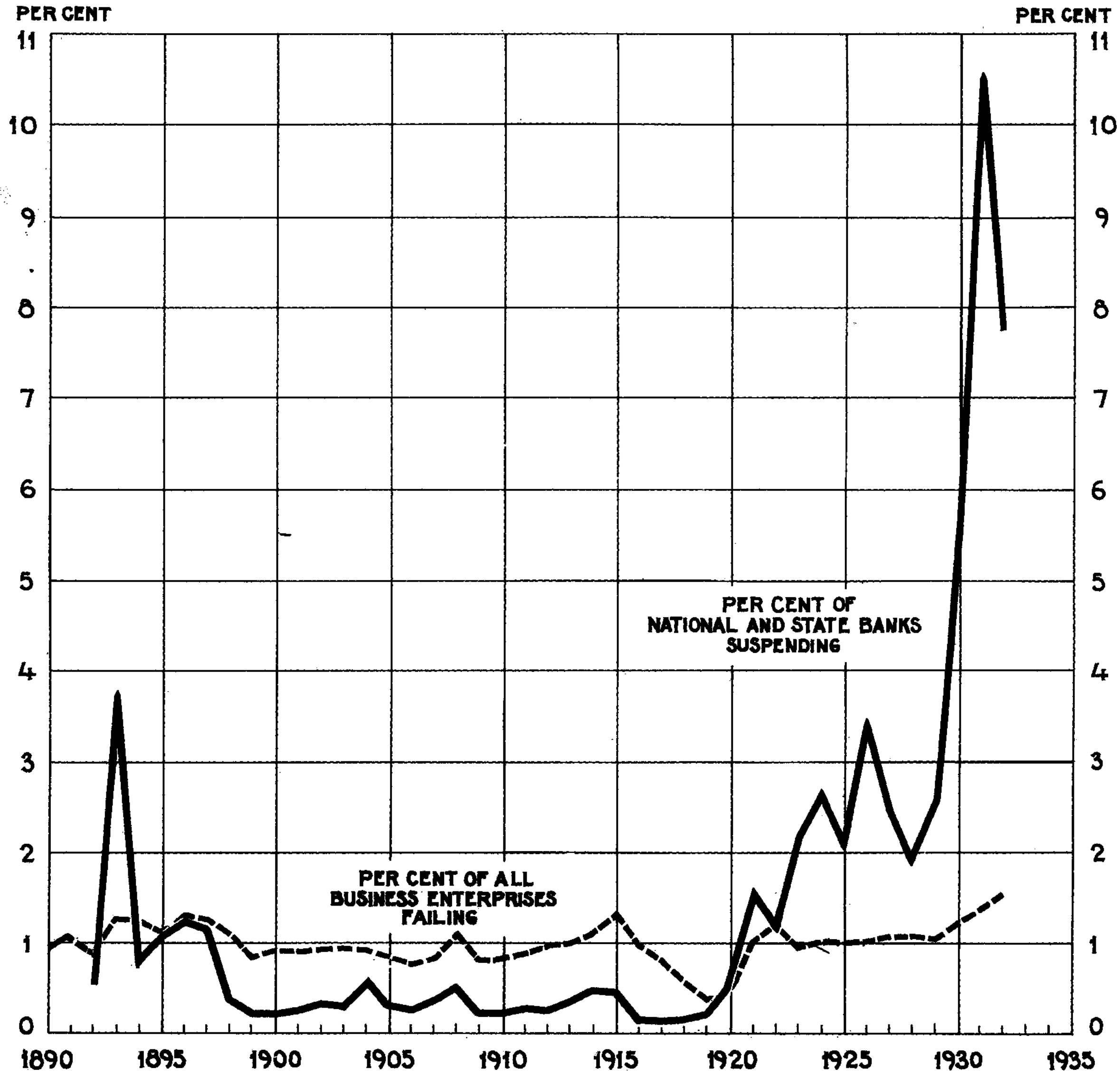
(1) During the same period 476 private banks and 8 mutual savings banks suspended. Trust companies and stock savings banks are included among the State banks.

A comparison of the percentage of bank suspensions with the percentage of failures among other business enterprises during the period 1892-1932 is shown in Chart 1. Since 1920 the percentage of bank suspensions has been on the average three times that of other business failures, bank suspensions rising in 1931 to the record figure of 10.5 per cent of the active banks. In contrast, failures of all business enterprises in 1931 were less than 1.5 per cent.

Back of the banking difficulties of the past ten years lie two decades of rapid expansion of banking facilities, nourished by a variety of favorable circumstances.

CHART 1

BANK SUSPENSIONS AND ALL BUSINESS FAILURES



Per cent of national and State banks and of all business enterprises failing each year from 1890 to 1932. The figures for business failures are those compiled by R. G. Dun and Co.

Growth in Number of Banks Prior to 1920

The number of banks operating in 1920 was two and one-half times the number in 1895. In 1895 there was one bank for every 5,800 persons, while in 1920 there was one for every 3,500 persons, as shown in the following table.

Table 2 - Number of Banks and the Population per Bank in the United States, 1877-1931

Year June 30	Number of banks		Population per bank(2)	
	Incorporated banks(1)	All banks(1)	Incorporated banks	All banks
1877	2,709	5,141	17,266	9,098
1880	2,726	5,299	18,438	9,485
1885	3,704	7,160	15,297	7,913
1890	5,734	10,039	10,997	6,281
1895	8,084	12,008	8,607	5,794
1900	8,738	13,925	8,712	5,467
1905	14,682	19,973	5,736	4,217
1910	21,486	25,155	4,294	3,668
1915	25,345	28,082	3,920	3,538
1920	28,659	30,395	3,713	3,501
1925	27,639	28,554	4,156	4,023
1930	23,045	23,643	5,346	5,211
1931	21,123	21,627	5,874	5,737

(1) Incorporated banks include State and national banks. All banks include State, national, and private banks, but exclude mutual savings banks. The precise number of private banks in any year is unknown, and these figures are therefore only approximately accurate.
(2) Population figures used were mid-year estimates as published in the Statistical Abstract of the United States.

Growth Centered in Agricultural Regions. - This growth in banks occurred largely in the agricultural States. The number of banks in New England and the Middle Atlantic States reached a peak in the first decade of this century. In the other regions, however, banks continued to increase for 10 or 15 years, or more. The greatest increase occurred in the Southeastern, Southwestern, and Rocky Mountain States, where the number of banks increased from 300 to 400 per cent between 1900 and 1920. The Western Grain and Southern Mountain sections also showed increases of about 150 per cent during the same period. In many of these States the chartering of new banks was incidental to the opening and development of new areas.

Table 3 - Geographic Distribution of Active Banks in the United States in 1900 and 1920

Geographic division	Number of banks			Population per bank		
	1900	1920	Per cent increase or decrease	1900(1)	1920(1)	Per cent increase or decrease
New England	997	751	-24.7	5,609	9,920	+76.9
Middle Atlantic	3,028	3,256	+7.5	5,649	7,537	+33.4
North Central	3,052	5,919	+93.9	5,238	3,656	-30.2
Southern Mountain	785	1,965	+150.3	8,893	4,360	-51.0
Southeastern	693	2,847	+310.8	13,505	4,329	-67.9
Southwestern	681	3,441	+405.3	9,592	2,998	-68.7
Western Grain	3,879	9,228	+137.9	2,667	1,363	-48.9
Rocky Mountain	347	1,595	+359.7	4,827	2,113	-56.2
Pacific Coast	463	1,393	+200.9	5,220	4,045	-22.5
UNITED STATES	13,925	30,395	+118.3	5,457	3,501	-35.8

(1) For 1900, census figures of population were used; for 1920, mid-year estimates.

In 1920 eighteen States had less than 3,000 persons per bank, and half of these less than 2,000. The latter 9 States constitute a solid block in the Middle West and Northwest, including Minnesota, Iowa, Kansas, Nebraska, South Dakota, North Dakota, Montana, Wyoming, and Idaho. In two of these States, the Dakotas, the population per bank was less than a thousand. This would roughly indicate an average of only two or three hundred individual customers per bank.

Years of Agricultural Expansion. - The increase of banking facilities in these regions was associated with a prosperous and expanding agriculture, which the commercial banks were financing to a considerable extent. Agricultural development during the years 1895 to 1920 was characterized by an almost continuous increase in demand for capital. With the disappearance of the frontier and the growth in the world's demand for agricultural products, the prices of farm commodities rose somewhat faster than the general price level until 1919, and on that date were over three and one-half times as high as in 1895. This was accompanied during most of the period by an even more rapid rise in farm land values.

The demand for farm products continued strong despite the increasing output of the country. Great numbers of immigrants were settling in the cities and requiring farm products. The value of exports of agricultural products increased from one billion dollars in 1910 to one and one-half billions in 1915. During the war years the foreign demand for American agricultural products increased greatly. Agriculture thus had the fortunate combination of large marketings and high prices. This resulted in a continued increase in farm income per acre.

Much of the agricultural territory, especially in the West, was comparatively undeveloped, and although the original settlement of land was nearing its close, there were wide areas with only meager improvements and the state of the country generally testified to its recent emergence from range conditions. There was a large demand for farm machinery and vehicles, and extensive amounts of fencing were needed to enclose and divide the new farms. New or better buildings were required to protect grain and live stock and more labor was hired on farms. Purchases of additional or better live stock increased as facilities became available and as better roads and railroads afforded more ready access to markets. Community improvements followed those on the farms as better roads and schools were provided and taxes were levied to include the new items. The soil was comparatively new in the West, while in the South commercial fertilizers were coming into more general use to improve long cultivated land. This added an increasingly important item to the farmer's expenses. So long as farm land remained free and abundant only limited improvement was warranted. As the country's supply of free land diminished, improvements were extended.

Competition and Indiscriminate Chartering of Banks. - In addition to prosperous and expanding agricultural regions, there were other conditions favorable to the rapid growth in the number of banks. Bank profits averaged relatively high during the early years of this century, while business failures and bank losses were low. The increase in the number of banks had legislative encouragement in the provisions of State laws, permitting in some States the organization of incorporated banks with a capital of $10,000, and in one State with only $5,000. Several States had no capital requirements at all for many years. As authorities in many regions were without legal power to deny an application for a charter, even where they felt it was desirable to do so, there was little restraint upon the number of new bank organizations. In some States there was no banking department, until well into the present century, and charters might be issued by officials and by judges whose main responsibilities lay in other fields.

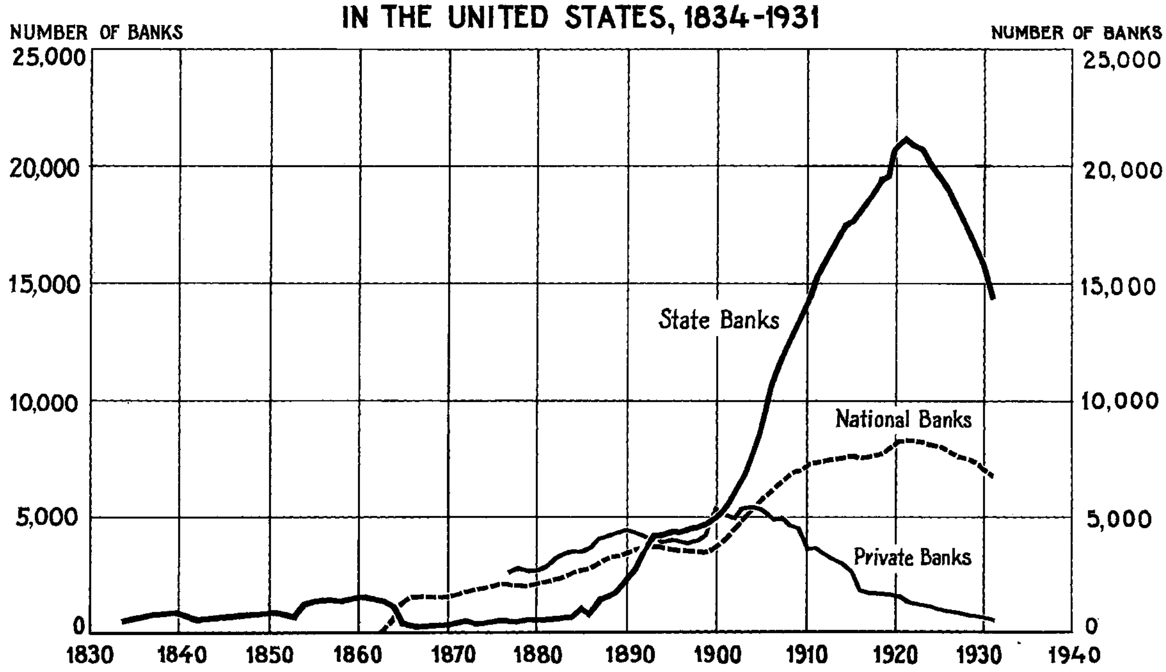
An important factor in the increase in some States, however, was the competition between the State and national systems in the granting of charters. One of the first efforts of the national system to meet the competition of State banks was the reduction in 1900 of the minimum capital requirement from $50,000 to $25,000. After that there was a rapid growth in the number of both national and State banks but the number of State banks continued to increase more rapidly. Chart 2 shows how the number of State banks outdistanced national banks after 1900.

The national supervisory authorities, as well as those of some of the States, have for years refused charters in their discretion if for any reason the proposed banks were not deemed reasonably certain of becoming sound and stable institutions. But both classes of supervisory agencies have been solicitous for the relative importance in numbers and resources of the banks under their respective jurisdictions, and this fact has had an important bearing upon the exercise of their discretionary powers. Organizers of new banks have been able to play one supervisory authority against the other. Many new charters have been granted without adequate consideration of the needs of the community or of the probable safety of the new institution for its depositors.

Too many banks were chartered in communities which could not support a bank or in communities in which banking facilities were already ample. One town in Iowa with a population of 1,300 had four banks in 1921, but only one in 1931. A town in South Dakota with a population of 300 had one State bank when the Comptroller of the Currency granted a national charter. The result was two crippled banks. Another city in South Dakota

CHART 2

NUMBER OF COMMERCIAL BANKS AND TRUST COMPANIES IN THE UNITED STATES, 1834-1931

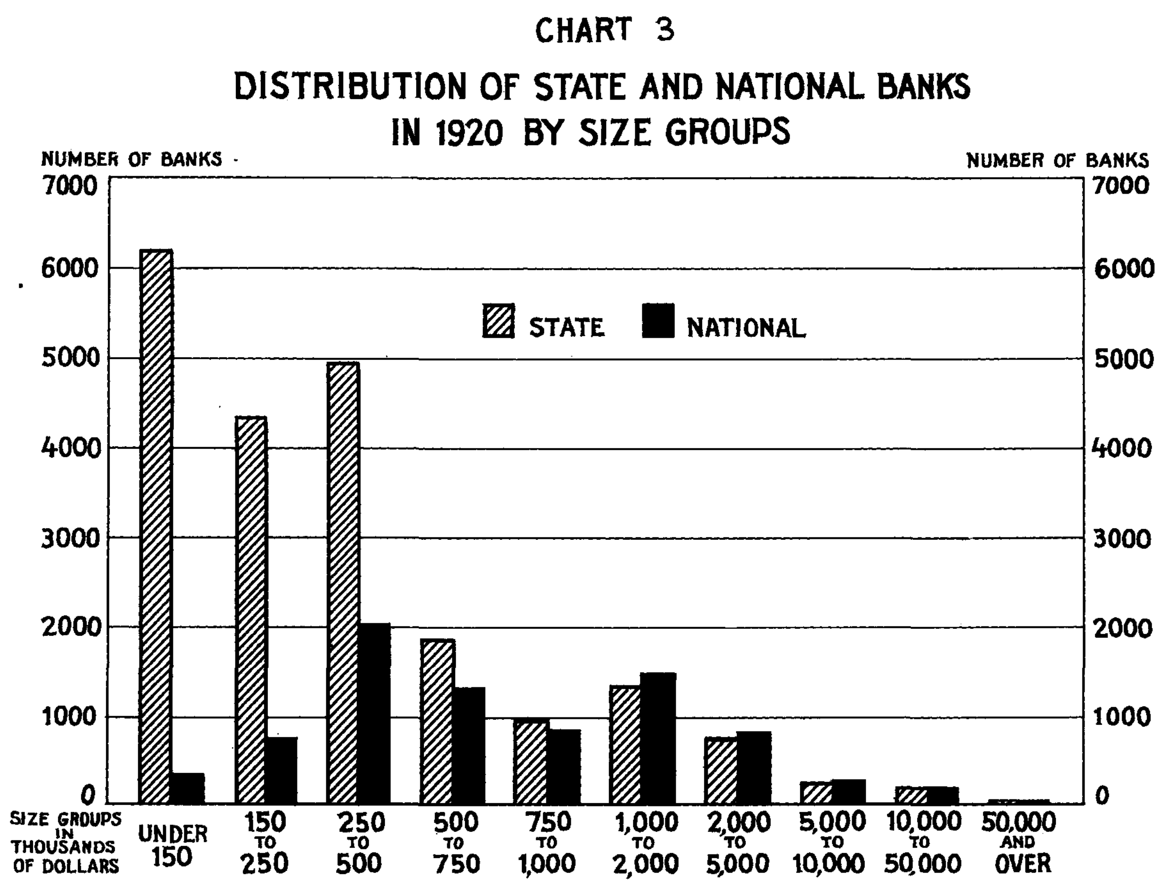


State banks include trust companies and stock savings banks. Mutual savings banks are not included. Figures are as of June 30 of each year or nearest reporting date.

with a population of 600 people had three banks. All failed. One county in North Dakota with a population of 10,000 had 18 banks. By the end of 1931 there were three banks in that county. These are not isolated cases but are typical of many communities in the agricultural States around 1920.

These charters were granted frequently with little or no regard to the qualifications of the applicants. In many cases the men running these banks knew very little about the principles or practices of banking. Many of the new banks were not only foredoomed to failure but were also likely to imperil the existence of other banking institutions. The establishment of such large numbers of small banks has in itself presented many problems, the principal of which are the difficulties of making adequate earnings, providing reasonably competent management, and exercising proper supervision over a large number of small institutions.

Chart 3 illustrates the preponderance of small banks in the country in 1920. At that time there were about 19,000 banks with loans and investments of less than $500,000, of which 83 per cent were State banks. Over 6,500 banks had loans and investments of less than $150,000. Accompanying the increase in the number of banks prior to 1920, the margin of profit per $100 of bank portfolio had been decreasing. In recent years many classes of banks were typically unprofitable.



Number of State and national banks on June 30, 1920, grouped according to amount of loans and investments

Net Profits of Banks

Over the four decades 1891-1930 the net profits of banks on invested capital, as indicated by the official figures for all national banks taken together, fluctuated between about 4 percent and about 11 percent. In 1931 they were under 1.5 percent and in 1932 a net deficit was shown. Over the period 1900-1931, for which comparison has been made between the net profits of all national banks taken together and the average yield on a group of high-grade bonds, it appears that the rate of return realized on capital invested in national banks was the higher in all years except 1931, and that the differential was seldom less than 2 percent and not infrequently more than 3 percent. Although comparable figures for all State banks were not available, it would appear that prior to the development of the current depression the banking system of the United States, considered as a whole, was fairly profitable.

The use of aggregate figures for all national banks does not afford an adequate basis for understanding the recent history of the banking system of the country, however, because these data reflect the composite experience of banks with records that vary all the way from very good to very bad. In order to develop a more adequate basis, through isolating by groups the banks that were typically profitable from those that were not, the official reports of national banks for the five-year period 1926-1930 have been analyzed in detail.

During this five-year period somewhat more than half of the banks, or about 4,000 annually on the average, having well over half of the loans and investments of all national banks, realized net profits of 6 percent or more on their invested capital. Somewhat less than half, or 3,403 banks, failed to realize as much as 6 percent. Of these there were 1,396 that earned more than 3 percent, 836 that earned less than 3 percent, and 1,171 that earned nothing or had annual net deficits.

Net Profits by Size of Banks, 1926-1930. - A majority of the banks reporting net deficits had less than $500,000 of loans and investments, and over three quarters of them had less than $1,000,000 loans and investments. Dividing the banks into size groups and beginning with the small institutions, the record of net profits showed a progressive improvement from one size group to the next. This is illustrated in Chart 4, which shows that 55 out of every 100 banks with loans and investments of less than $150,000 on the average earned less than 3 percent during the five years 1926-1930. Twenty-five percent of all national banks with loans and investments of less than $500,000 showed annual net deficits during the five years. On the other hand, less than 3 percent of the national banks with loans and investments of $50,000,000 and over showed annual net deficits.

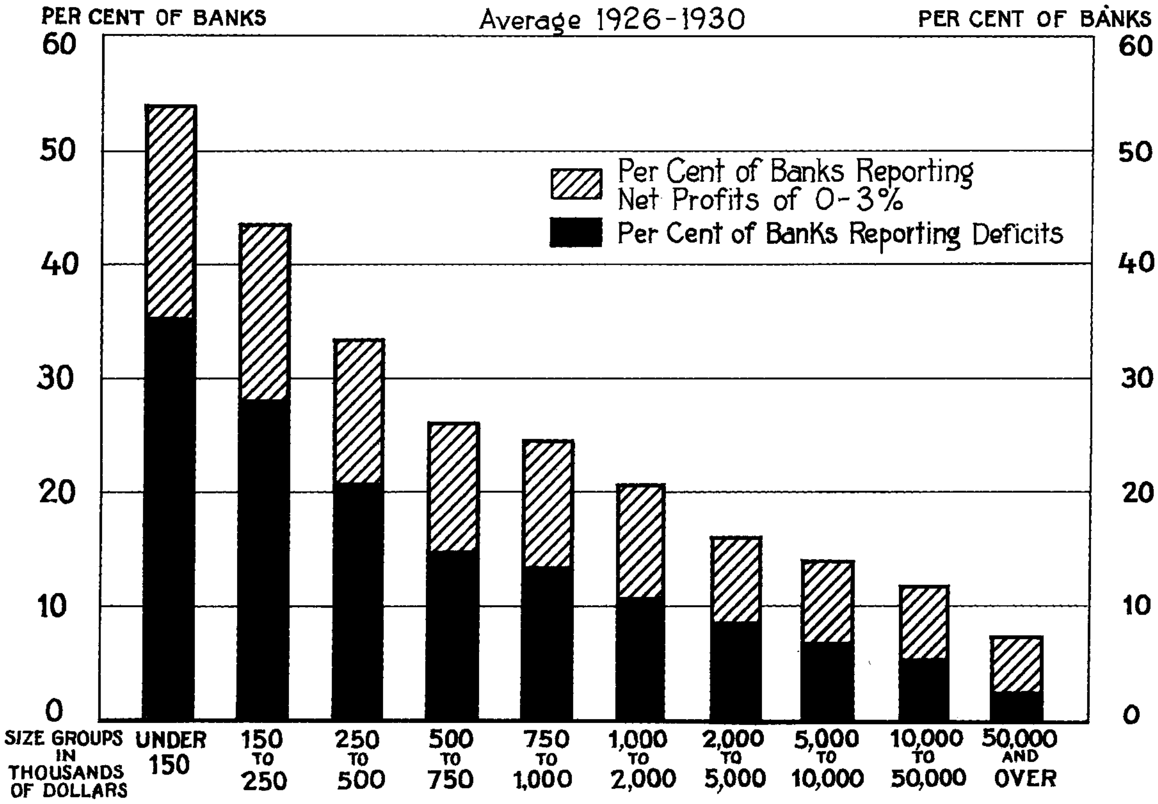
Comparing the same size groups it was found that nearly 40 percent of the banks with loans and investments of less than $500,000 against 7 percent of the banks with loans and investments of $50,000,000 and over reported annual net deficits or net profits of less than 3 percent on invested capital. Almost 60 percent of the first group of banks against 21 percent of the second group of banks reported annual net deficits or net profits of less than 6 percent. About 37 percent of all national banks in 1930 had less than $500,000 of loans and investments, but for State and

CHART 4

PERCENTAGE OF NATIONAL BANKS REPORTING ANNUAL NET DEFICITS OR NET PROFITS OF LESS THAN 3%

BANKS GROUPED ACCORDING TO SIZE OF LOANS AND INVESTMENTS

Average 1926-1930



national banks combined about 68 percent of the total number of banks, holding about 6 percent of the loans and investments of all commercial banks, was in that size group.

There were many profitable small banks in all localities, some highly profitable ones. Many small banks succeed because of good management, in some instances assisted by other particularly favorable circumstances. In the group of banks with loans and investments of less than $150,000, 26 out of 100 annually showed net profits of 6 percent or more on invested capital during the period 1926-1930 as is shown in Chart 5A. In the group with loans and investments of $150,000-$250,000, 38 out of 100 reported net profits of 6 percent or more. In the group with loans and investments of $250,000-$500,000, 47 out of 100 reported net profits of 6 percent or more.

It is not possible to draw a sharp distinction as to what rate of net profits constitutes success. Clearly, however, a rate of net profits on invested capital of less than 3 percent is unsatisfactory, and a bank which cannot average at least as much as 6 percent a year is not likely to build up reserves sufficient to insure its safety. Chart 5 shows the number of banks per hundred in each size group which did not earn as much as 6 percent annually on the average during the period 1926-1930.

The contrast between different groups of banks was apparent in each of the five years 1926-1930, although in the depression year 1930 it was somewhat less pronounced. In the Mid-continent States the comparative record of net profits of banks with loans and investments of less than $500,000 was below that for the country as a whole. Half of all banks

CHART 5

PERCENTAGE OF NATIONAL BANKS REPORTING ANNUAL NET DEFICITS OR NET PROFITS OF LESS THAN 6%

BANKS GROUPED ACCORDING TO SIZE OF LOANS AND INVESTMENTS

Average 1926-1930

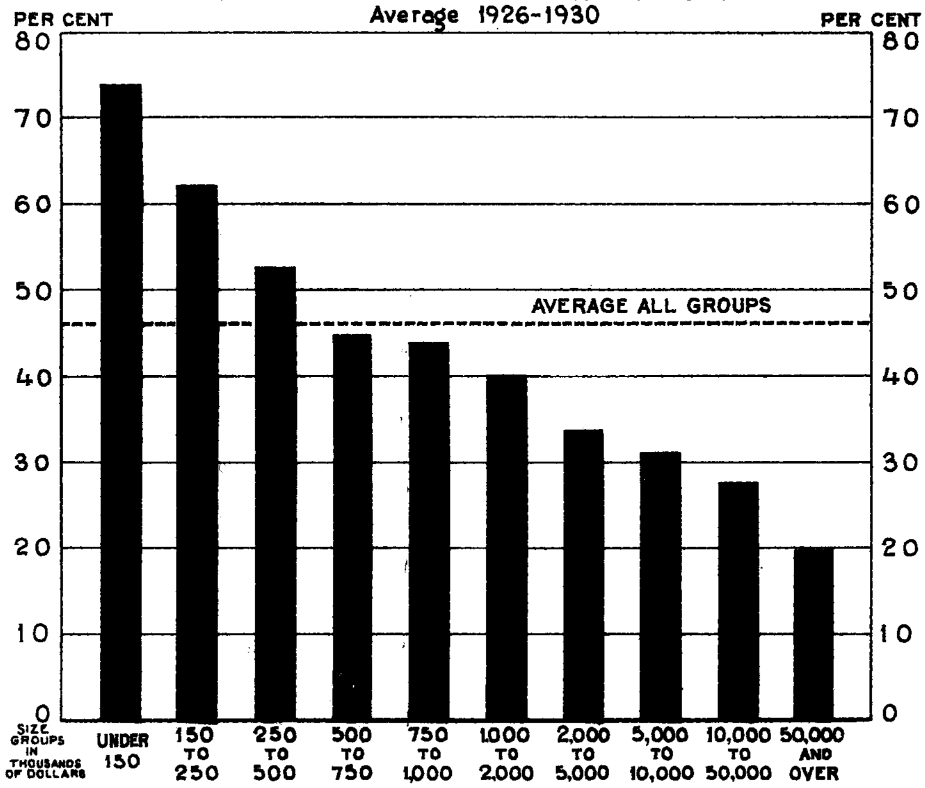
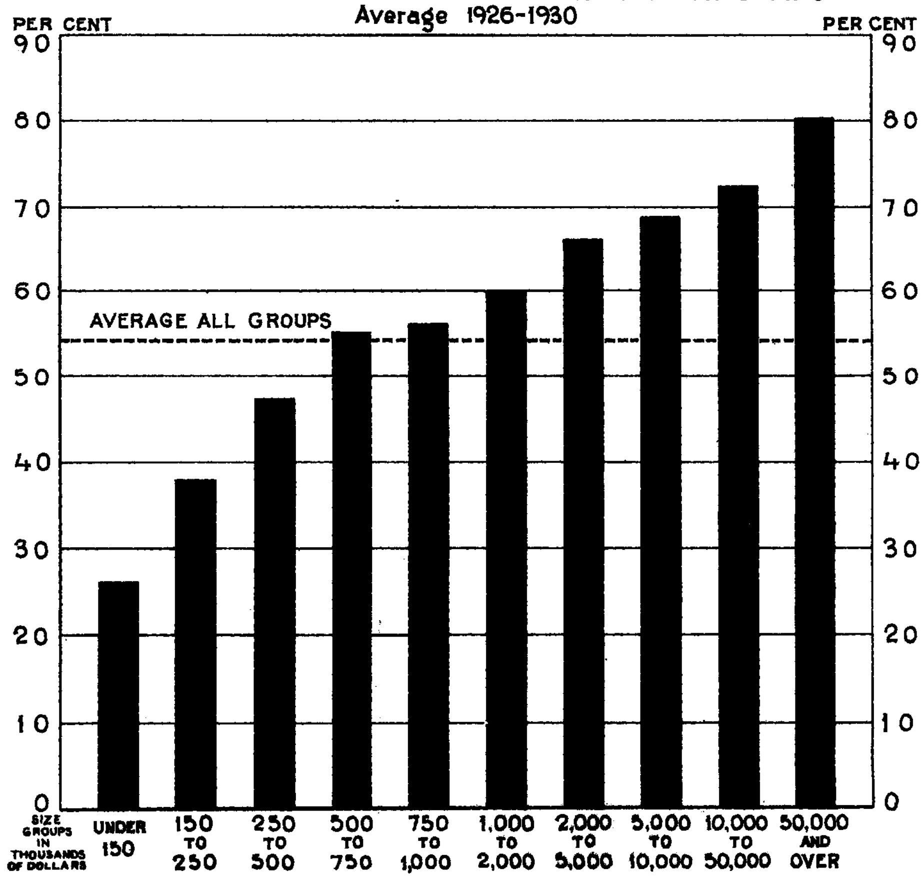


CHART 5A

PERCENTAGE OF NATIONAL BANKS REPORTING ANNUAL NET PROFITS OF 6% OR MORE

BANKS GROUPED ACCORDING TO SIZE OF LOANS AND INVESTMENTS

Average 1926-1930



with loans and investments of less than $500,000 are located in the agricultural Mid-continent States. During 1926-1930 the record of banks of this size was best in the industrialized States of the Northeastern part of the country.

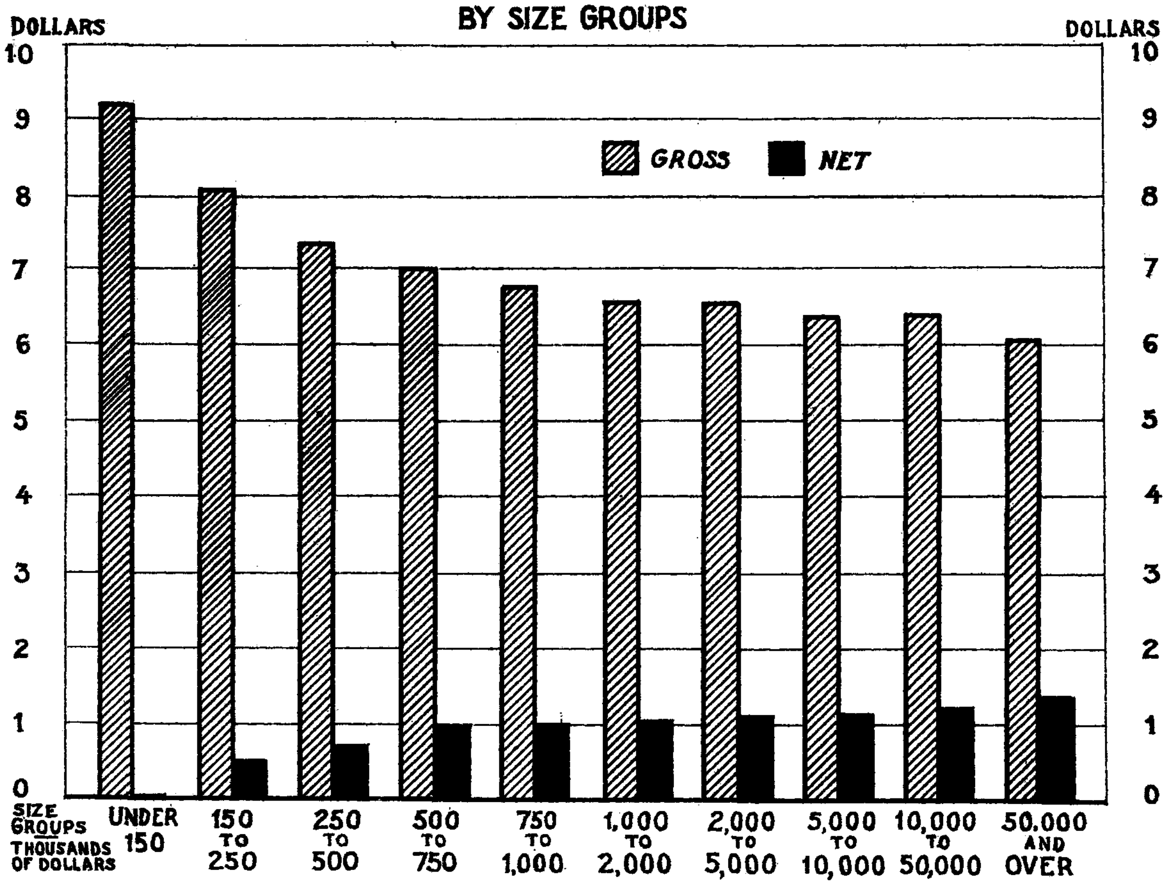
Because of a lack of data, the earnings analysis could not be made for State banks generally. For Iowa State banks, however, the necessary information was made available. Among Iowa State banks, the contrast between different groups of banks was comparable to that among national banks in that area, and in view of the relatively larger number of suspensions among State banks it is probable that a like condition obtained among State banks the country over.

Costs of Different Groups of Banks. - The unit costs of doing business, and consequently the charge upon the community per $100 of accommodation, have been generally higher among banks of limited resources than among those with more ample resources.

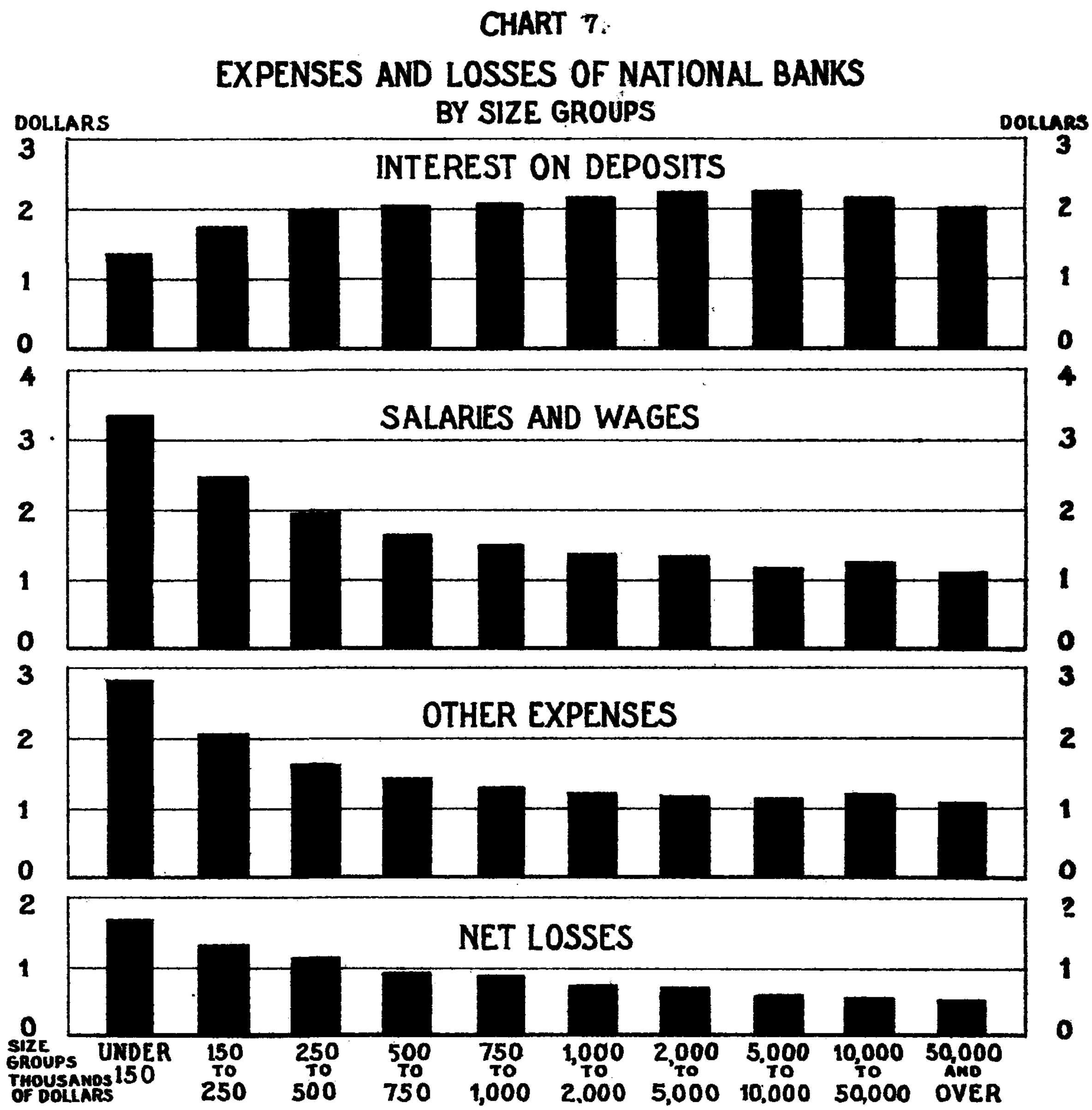
The size group $150,000-$250,000 of loans and investments may be taken as an example of small banks, and $5,000,000-$10,000,000 as an example of large banks. Among the small bank group the typical gross return during the period was $8.06 per $100 of loans and investments against $6.37 for the large banks. The small banks, however, paid out $6.23 of this amount in expenses, wrote off $1.33 in losses, and showed a margin of profit of only $0.50. The expenses of the large banks were $4.61 and their losses $0.62, leaving a margin of profit of $1.14. The relatively narrow margin of profit of the small bank results in a still less satisfactory rate of profit on invested capital compared with that of the large bank, owing to the fact that the large bank has a greater volume of business per unit of capital. These figures are illustrated in Charts 6 and 7.

CHART 6

GROSS AND NET EARNINGS OF NATIONAL BANKS
BY SIZE GROUPS



Average gross earnings and net profits available for dividends of national banks for years 1926-1930. Both gross and net are expressed as amounts per $100 of loans and investments. Banks grouped according to size of loans and investments



Average expenses and losses per $100 of loans and investments of national banks in each size group for years 1926-1930. Banks grouped according to size of loans and investments

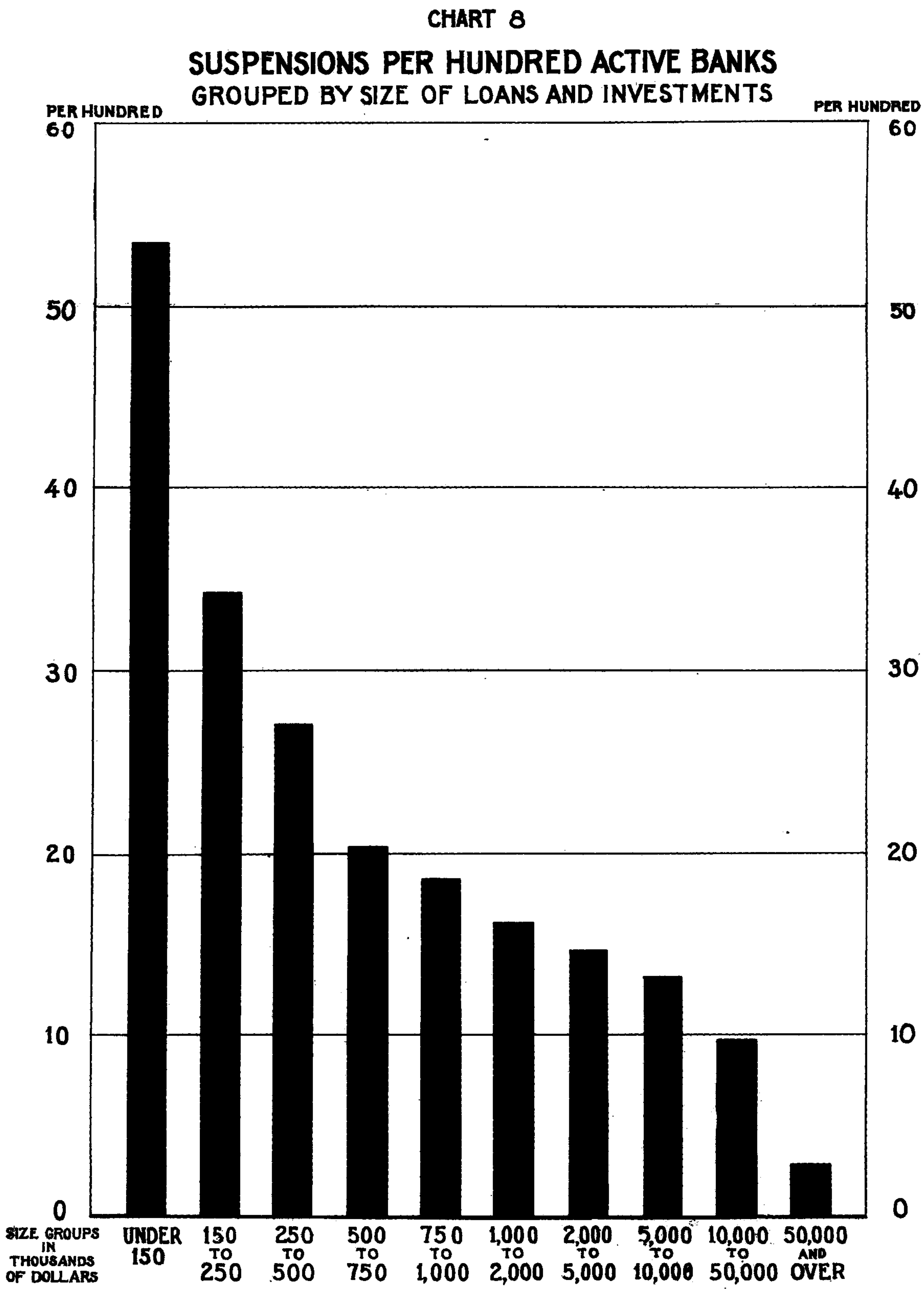
Suspension Record by Size of Banks

Banks which suspended during the years 1921-1931 involved more than 10 per cent of the average banking resources of the commercial banking system as it existed during the period. There were failures among banks of all sizes, from very small ones to large ones, and Table 4 shows that the banking resources involved in suspensions in each of the designated size groups were large. Among banks of less than $1,000,000 loans and investments, 30 per cent of the average banking resources during the period 1921-1931 were involved in bank suspensions. Among banks with loans and investments of less than $150,000, 54 per cent of the average banking resources during the period were involved in bank suspensions. Among some of the larger size groups suspensions involved less than 10 per cent of the average banking resources during the period.

Table 4 - Loans and Investments of Suspended and Active Banks by Size Groups

Size group loans and investments (000 omitted)	Loans and investments of State and national banks		
	Banks suspending during 1921-1931 (000 omitted)	Active banks averaged for three dates: June 30, 1920, 1925, and 1930 (000 omitted)	Ratio of suspensions to active banks (per cent)
Under $150	$ 298,780	$ 556,915	53.6
150 - 250	341,490	877,350	38.9
250 - 500	661,992	2,127,474	31.1
500 - 750	393,483	1,684,825	23.4
750 - 1,000	291,885	1,439,006	20.3
Total under 1,000	1,987,630	6,685,570	29.7
1,000 - 2,000	618,481	3,727,000	16.6
2,000 - 5,000	693,896	5,369,166	12.9
5,000 - 10,000	453,822	3,972,133	11.4
10,000 - 50,000	690,664	8,215,652	8.4
50,000 and over	271,829	13,826,988	2.0
Grand total	$4,716,322	$41,796,508	11.3

Nearly 40 per cent of the banks suspending during the eleven years 1921-1931 had loans and investments of less than $150,-000, and 80 per cent had loans and investments of less than $500,000. Furthermore the rate of suspensions among these small institutions has been much greater than among the large banks. Chart 8 gives by size groups the suspensions during 1921-1931 per hundred active banks on June 30, 1920. Among banks with loans and investments of under $150,000 there were 54 suspensions per hundred active banks. This rate was progressively smaller among each successive grouping of larger banks and was less than 3 per hundred for banks with loans and investments of $50,000,000 and over during the period 1921-1931. Among all banks with loans and investments of less than $500,000 the suspensions during the eleven years amounted to 38 per hundred active banks in 1920. In 1930, however, there remained more than 13,000 banks of this size in existence and they constituted nearly 60 per cent of all active banks at that time.



Number of national and State bank suspensions during 1921-1931 per hundred active banks on June 30, 1920, grouped by size of loans and investments.

Suspensions in Agricultural Districts. - The great majority of suspensions during 1921-1931 have occurred in the agricultural sections of the country where the growth of small banks prior to 1920 was greatest. During the nine years 1921-1929, 70 per cent of the suspensions occurred in 12 predominantly agricultural States. During 1930 and 1931 suspensions spread into industrial districts, but those in agricultural regions were not reduced, the number in these 12 States being greater in 1931 than in any previous year. Chart 9 shows on a map of the United States the location of suspensions during the eleven years 1921-1931. The regions showing the largest number of suspensions during 1921-1931 per hundred active banks in 1920 were the following: Southeastern States, 55 suspensions per hundred active banks; Western Grain States, 41; Rocky Mountain States, 39; and Southwestern States, 30.

The agricultural States have a large proportion of banks with limited resources. In the Western Grain States there were 62 suspensions per hundred active banks with loans and investments of less than $150,000, compared with 9 suspensions per hundred active banks with loans and investments of $5,000,000-$10,000,000, and 3 suspensions among banks with loans and investments of $10,000,000-$50,000,000. The following table shows the rate of suspensions by size groups in the four geographic divisions where fatalities were the heaviest.

CHART 9

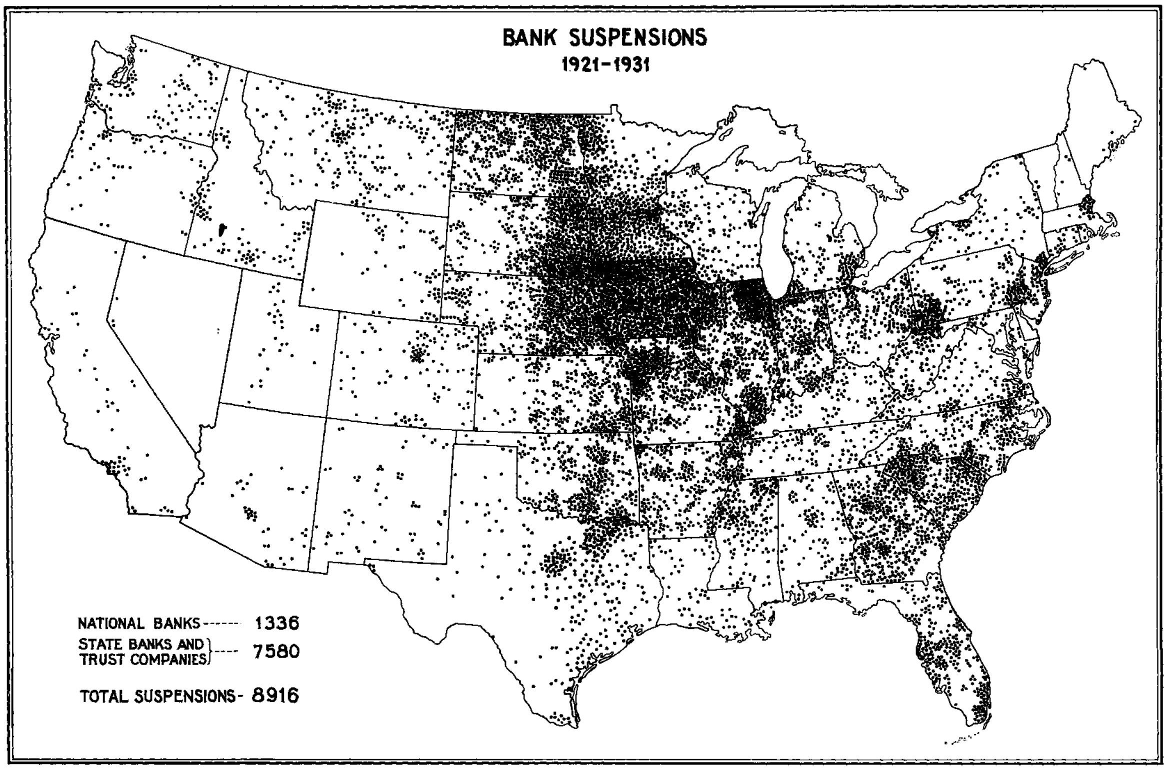

BANK SUSPENSIONS
1921-1931
NATIONAL BANKS------ 1336
STATE BANKS AND TRUST COMPANIES ---- 7580
TOTAL SUSPENSIONS- 8916

Table 5 - Number of National and State Bank Suspensions during 1921-1931 per Hundred Active Banks on June 30, 1920, Grouped by Size of Loans and Investments

Size group loans and investments (000 omitted)	South-eastern	South-western	Western Grain	Rocky Mountain	United States
Under $150	76.3	46.0	61.9	57.2	53.5
150 - 250	48.8	24.4	42.5	39.0	34.3
250 - 500	52.0	23.3	31.7	34.1	27.1
500 - 750	37.5	19.4	24.3	26.8	20.5
750 - 1,000	41.5	22.2	21.8	36.7	18.5
1,000 - 2,000	39.6	21.5	16.8	26.5	16.2
2,000 - 5,000	36.0	13.9	14.1	9.9	14.7
5,000 - 10,000	35.3	12.5	9.3	11.8	13.2
10,000 - 50,000	22.2	8.7	3.1	-	9.8
50,000 and over	-	-	-	-	2.8
Total	54.8	29.9	40.7	39.2	30.9

Suspensions in Small Towns. - Banking difficulties have been most acute in small towns and rural communities. Seventy-five per cent of the banks suspending during the eleven years were located in towns of less than 2,500 inhabitants, and 35 per cent in towns of under 500 inhabitants. In towns of less than 500 population the suspensions during the eleven years amounted to 38 per hundred active banks in 1920, while among towns and cities of over 2,500 the suspension rate was about three-fifths that large.

State and National Bank Suspensions Compared. - Suspensions have been nearly six times as numerous among State banks as among national banks. Eighty-five per cent of the suspensions in the eleven years were State banks and only 15 per cent national banks. This is not altogether due to the fact that many more State banks have been chartered than national banks, since the rate of suspensions has been more than twice as high for State banks as for national banks. During the eleven years 36 State banks suspended for every hundred active State banks in 1920, while the ratio for national banks was 17 suspensions per hundred active banks. This was due in part to the fact that among State institutions there was a larger proportion of extremely small banks. In 1920, 74 per cent of the State banks had loans and investments of less than $500,000, while only 39 per cent of national banks were of the same size.

On the other hand, further analysis brings out the fact that in every size group State banks showed a higher rate of suspensions than national banks. This is illustrated in the following table.

Table 6 - Number of Suspensions during 1921-1931
per Hundred Active Banks on June 30, 1920,
by Size of Loans and Investments

Size group loans and investments (000 omitted)	National banks	State banks	National and State banks
Under $150	44.6	54.0	53.5
150 - 250	33.3	34.5	34.3
250 - 500	20.4	29.9	27.1
500 - 750	12.9	25.9	20.5
750 - 1,000	10.3	25.9	18.5
1,000 - 2,000	11.0	21.8	16.2
2,000 - 5,000	9.1	20.7	14.7
5,000 - 10,000	7.7	19.0	13.2
10,000 - 50,000	2.7	16.8	9.8
50,000 and over	2.7	2.9	2.8
Total	16.7	36.3	30.9

Causes of Bank Suspensions since 1920

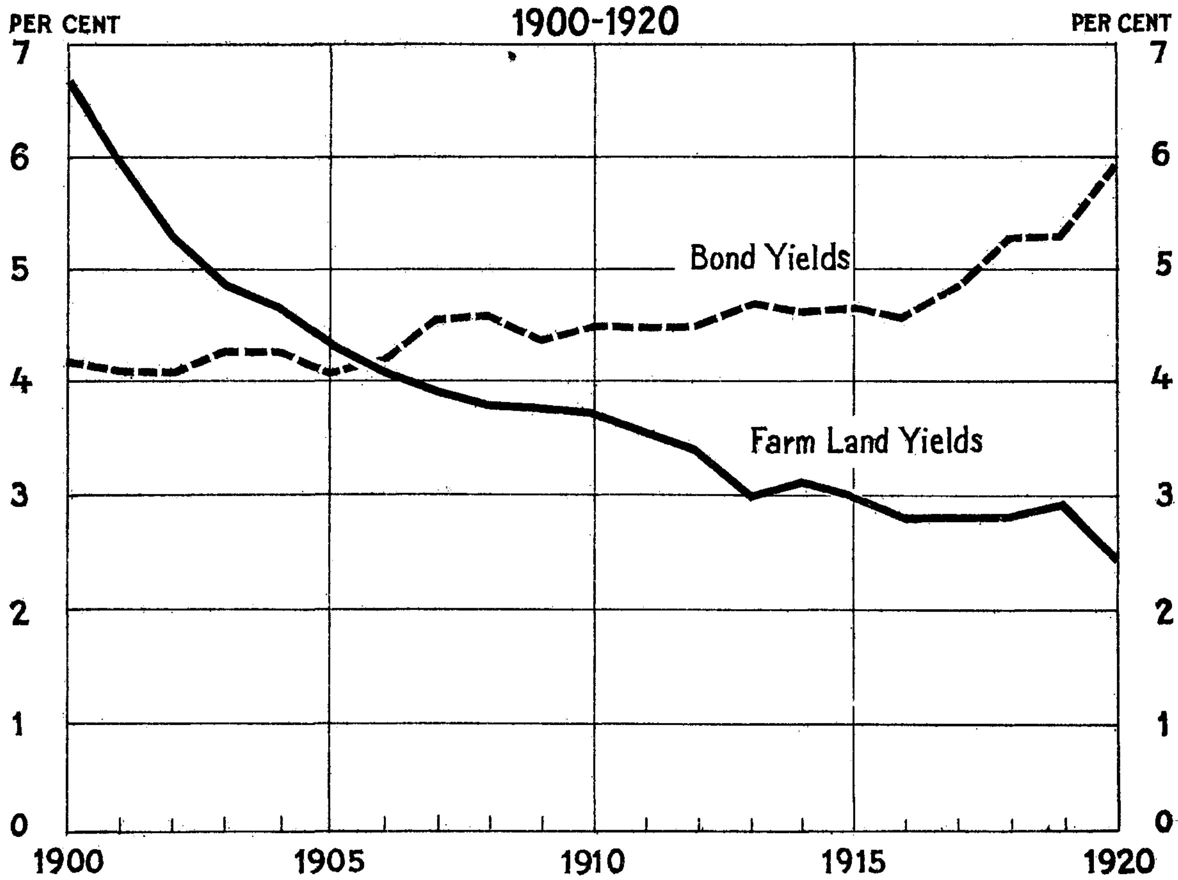
For twenty years prior to 1920, bank suspensions in the United States averaged less than one-half of one per cent of the number of active banks. That was a period of rising prices and rising land values. Following the price decline of 1920 and 1921, however, there was a sharp upturn in the number of suspensions and they have continued at an abnormally high rate for the entire ensuing period.

Agricultural Conditions. - Rising prices of agricultural commodities prior to 1920 led to a continued increase in income per acre. Land values, however, gradually outran the current income from farms, and proceeded to discount future income. The ratio of net cash rent to land value in Iowa, for example, declined from $6\frac{1}{2}$ per cent in 1900 to less than $2\frac{1}{2}$ per cent in 1920, as illustrated in Chart 10. This tendency to discount future income was based on past experience and the expectation of continued annual increases in current income. The reduction in returns on farm land, furthermore, was running counter to other capital yields. For example, bond yields during the period rose from 4 to nearly 6 per cent, as the chart shows.

The rising land values were stimulated by means of loans based upon farm real estate. Lending agencies, of which banks were the most important, increased the size of loans as land values rose. Insurance companies and other lenders considered farm real estate loans as one of their best outlets for investment funds and steadily increased their holdings of such securities. The establishment of the Federal farm loan system in 1917 added an important source of farm mortgage credit. These funds flowing into the rural communities supplemented the income from the farms and provided an increase in the amount of available funds.

CHART 10

RATE OF RETURN ON BONDS AND FARM LANDS
1900-1920



Standard Statistics Company's Annual Average Yield on 60 Bonds. Department of Agriculture's computation of the ratio of net cash rent to land value in Iowa

The lending policy of the banks reflected the trend of prices in their communities. Not only were prices of farm commodities rising but the land itself was increasing in value and constituted a generally accepted basis for loans. This created a background which was favorable to competition in the acquisition of land and the inflation of land prices.

Increase in Mortgage Indebtedness. - In the circumstance farmers increased their borrowings with confidence. The value of crops per acre moved steadily upward and the annual returns from livestock were proportionately large. The experience of finding the actual farm returns larger year after year induced borrowing not only for strictly production purposes but for buying more land, farm improvement, and other expenditures. The rising price level gave confidence for purchasing on the strength of future income, and there was a steady increase in the number of farm sales. Land required a larger dollar outlay than formerly, so that past savings were insufficient to pay for as large a part of acquired property as in earlier years and relatively more borrowing was necessary to effect transfer. The fact that more purchasers of limited means entered the land market resulted in mortgages on an increasing percentage of the farms transferred.

In the country as a whole, owner-operated farms having mortgage debt increased from 30 per cent in 1900 to 33 per cent in 1910, 37 per cent in 1920, and 42 per cent in 1930. The increase in the proportion of farms mortgaged was particularly great in the Western States, where borrowing was on a large scale in response to the urge to develop new farms. In North Dakota 71 per cent of the owner-operated farms carried mortgages in 1920, and 50 to 60 per cent of the farms of neighboring States were similarly encumbered. In over one-fifth of the counties in Montana more than 70 per cent of the owner-operated farms were mortgaged, and in nearly one-tenth of the counties in North Dakota more than 80 per cent of farms were encumbered. The westward drive which had been in process for a century had seized upon the stimulus of land scarcity and the encouragement of high prices for farm products to venture into the farthermost areas in which land might be tilled and to contract debt freely in order to acquire a base for independent farm operations and to reap the reward of rising land values. Such a rise had come to be generally expected.

From 1910 to 1920 the mortgage debt per acre of farm land increased about 135 per cent, about the same as the rise in the per acre value of ten leading crops. This is illustrated in Chart 11.

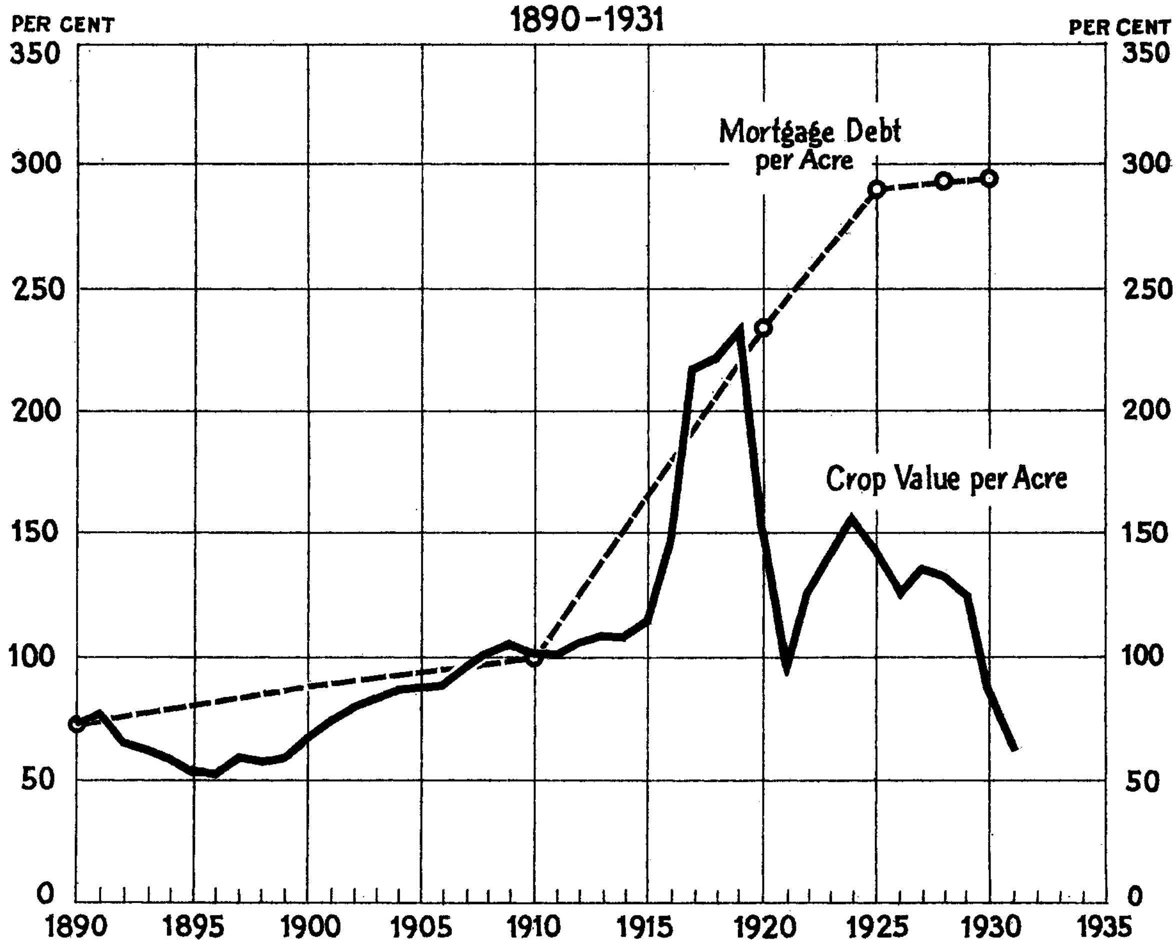
With the decline in income after 1920, however, the farmer was left with this exceedingly high mortgage debt, as well as other debts, and large numbers of foreclosures followed. The average value per acre of ten leading crops for the years 1886-1890 was $9.97. Mortgage indebtedness per acre in 1890 was $2.66. Value of crop production per acre and indebtedness went up at the same rate through the agricultural boom culminating in 1920. Subsequently, the value of crops per acre declined, while mortgage indebtedness increased. Crop values per acre have dropped below $10 against an average of $34 in the years 1917-1919, while mortgage indebtedness advanced to about $11 per acre, more than four times the figure of forty years ago.

This excessive growth of the indebtedness of farmers during years of relative prosperity greatly accentuated the difficulties with which they have had to contend in years of depression. By making a large volume of loans on farm land at high valuations banks in rural communities not only

CHART 11

CROP VALUE AND MORTGAGE DEBT PER ACRE

1890-1931



Average annual value per acre of ten leading crops, 1905-1914 = 100, and average mortgage debt per acre on all farms operated by their owners, 1910 = 100. Department of Agriculture figures.

weakened their own condition but rendered a serious disservice to agriculture.

Overbanked Condition and Unsound Assets. - The overbanked condition, which reached its peak shortly after 1920, caused banks struggling for existence to increase services to their clients, thus adding to expenses. It served to introduce into many banks high risk and marginal business, which contributed to the piling up of bank losses in the past decade.

Some of the results of indiscriminate chartering of banks and the resulting competition were stated as follows by the Study Commission for Indiana Financial Institutions:(1)

> "Authorities are unanimously agreed that the indiscriminate chartering of banks has been one of the major causes for the difficulties through which we have recently passed. Receivers, liquidating agents, and other persons familiar with the affairs of failed banks suggested, in 41 instances, that bank failures in Indiana have been due to improper chartering. . . . Intimate knowledge of individual failures, however, leads to the inescapable conclusion that many of the practices leading to bank failures, were directly caused by 'cut-throat' competition which sprang up in various communities as a result of too many banks or of the chartering, often for direct or indirect political reasons, of 'spite' banks.
>
> "Instances are known in Indiana of new bank charters being sought and obtained by church groups, lodge groups, or political groups antagonistic to the church group, lodge group or political group in control of the existing institutions. In numerous instances from 1920 to 1932, villages of less than 500 people had two or more banks operating. Competition in such communities necessarily was bitter because it was nothing less than a death struggle between the contending business groups, and consequently desperate chances were taken nearly always making for bad banking practice. In some instances, bankers with long records of successful management were driven by the emergency in which they found themselves to take 'long' chances and to indulge in practices not sanctioned by sound banking management.

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(1) Report of Study Commission for Indiana Financial Institutions, 1932, p. 87.

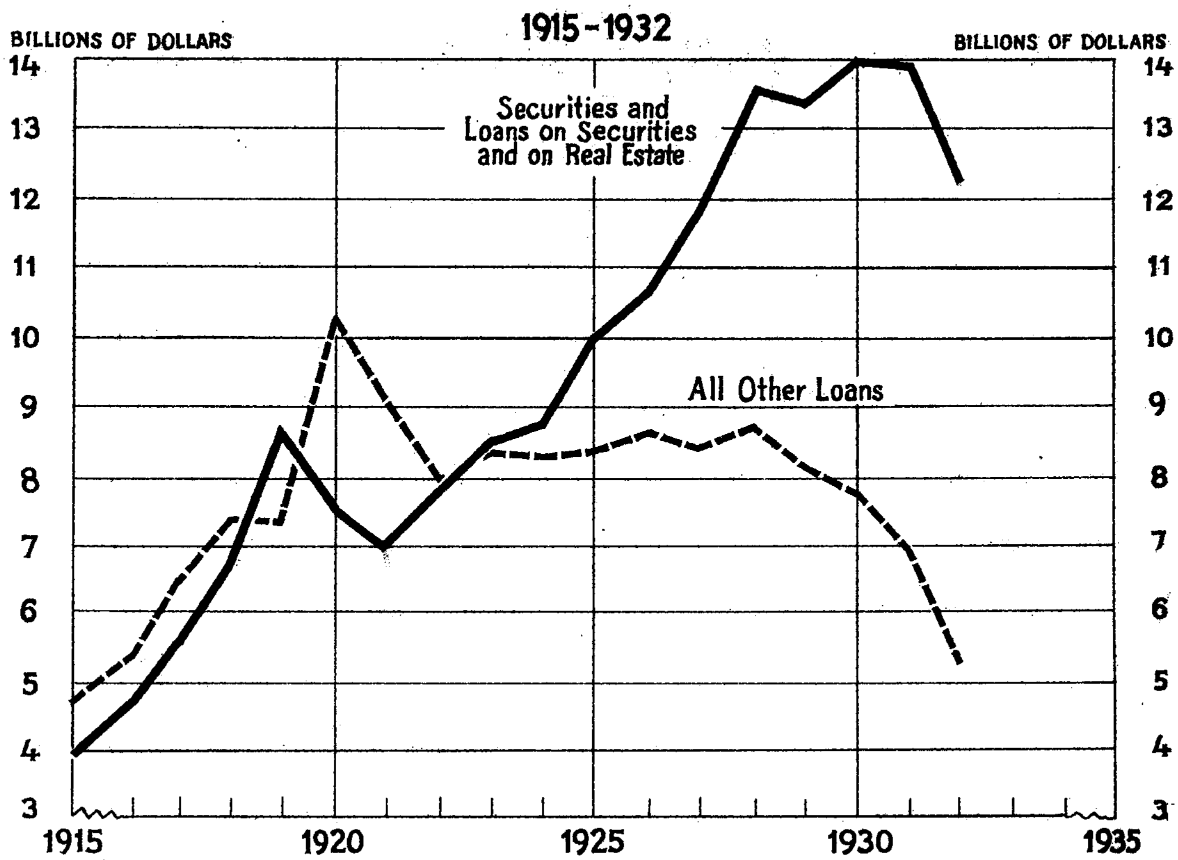
"Many of the new banks that were chartered between 1910 and 1924 were chartered by groups not in sympathy with the conservative or anti-inflationary policies of existing institutions. During this period in which the most rapid increase in banking units took place in Indiana, much 'inflation-madness' was apparent throughout the state. If certain groups were unable to satisfy their demands for banking facilities at one bank, they would threaten to take their business to competing banks where perhaps more agreeable treatment in the matter of borrowing awaited them. Many customers borrowed from several banks, but allowed each banker to think that he alone was advancing them credit. If all the bankers in a community were 'old-fashioned' and 'unreasonable', the usual procedure was to start a new bank by way of protest, a bank that would be unfettered by 'old fogey ideas' as to the caution with which banks should be operated.

"As time went on and inflation increased, deposits in all institutions mounted steadily. Funds accumulated faster than loan applications were made, and consequently competition for loans was keen. Equities seemed always to increase. As a result the new and oftentimes untried and unsound bank executive appeared to succeed as well or even better than the more experienced and conservative executive. It was not surprising, therefore, that many seasoned bankers were swept into this mad maelstrom of reckless and 'cut-throat' competition."

Furthermore, certain changes were going on during the period of expansion in the kind and quality of business transacted by commercial banks. Additions to the monetary gold stock of this country and the successive reductions in reserve requirements incidental to the Federal Reserve Act and its amendments put banks in possession of easy reserves. Additions to reserves placed the banks under temptation to expand. It would appear that these new reserves were in excess of the needs of credit to finance the flow of goods and services, and that there was a tendency to create commercial bank credit on the basis of capital commitments, or putting it the other way, a tendency to invest demand deposits in long-time enterprises. These tendencies had an important effect upon the quality of assets of many banking institutions, which were constantly reaching for high yields.

CHART 12

GROWTH OF SECURITIES AND LOANS ON SECURITIES
AND ON REAL ESTATE IN NATIONAL BANKS



trouble during a period of rising prices, but was wholly unsuited to the period of falling prices which gradually undermined equities beneath capital values. Losses accumulated gradually over a period of years and ultimately had to be dealt with. Losses incidental to loans on self-liquidating paper of business become apparent in a short time and are usually absorbed currently. This is less true with respect to long-term loans on capital values, where losses may accumulate over a period of years without being written off. When the final accounting comes, through bank suspension or otherwise, the bank's equity in many cases has largely disappeared. The effects of this tendency can be traced in the matter of losses sustained by stockholders and depositors following the liquidation of failed institutions. The estimates in the Committee's study of suspensions show that in liquidating banks the loss to general depositors has averaged from 40 to 50 per cent of their deposits.

The effects of these factors were most apparent from 1921 to 1929 in the agricultural districts where land values declined continually. The banks with small resources, limited facilities, and restricted activities found it particularly difficult to cope with the situation. Their assets came largely from one industry, and when that industry was not prosperous they suffered the consequences, especially where improvident loans had been granted. During 1930 and 1931, however, the banks in other districts were similarly affected through the decline in the prices of securities and urban real estate.

It is clear that much of the banking difficulties of recent years grew directly out of bad banking practices. In countries where a commercial banking tradition exists, such as Canada or England, it is a fundamental principle that deposits payable on demand or short notice may not with safety be locked up in long-term commitments. Many of the banks of deposit in this country, while remaining within the law, have consistently violated this fundamental principle of sound commercial banking.

For example, rural banks have not confined their financing to the current short-term needs of the farmer, but have supplied him capital in large proportion to their total loans and so eventually became heavily implicated in the farm real estate boom and its collapse. In the banking troubles that followed, one out of every two small banks in agricultural regions failed with disastrous consequences to many rural communities. Many of the large institutions have also experienced serious difficulties.

Case Studies of Bank Failures. - Many banks in this country have been so managed in periods of prosperity that they have been able to cope with the difficulties of the past twelve years and to continue to operate as sound institutions. Even in the agricultural regions where the trials have been most severe there are many sound and ably managed banks. The pressure of economic conditions has been common to all the banks in the country. In order to determine the factors which resulted in some banks being unable to resist the pressure of adverse business conditions while others have continued in operation, an intensive study has been made of 225 selected banks that have suspended during the years 1921 through 1931. The material analyzed was drawn largely from examiners' reports of the condition of these banks for a period of years prior to suspension. One hundred and twenty of the banks analyzed suspended prior to 1931, and 3 out of 4 of these were located in towns of less than 5,000 population in Federal reserve districts predominantly agricultural. One hundred and five of the banks analyzed suspended in 1931; of these, 47 were located in towns with a population of 5,000 and over, and many were in the industrial districts of the Northeast.

Assets and Liabilities of Suspended Banks. - Analysis of the balance sheets of 225 banks suspending during the years 1921-1931 indicated that the deterioration of assets which resulted in the final closing of banks was in most instances the result of a process developing over a period of years. According to bank examiners' classifications, the questionable assets of suspended banks a considerable time before failure assumed relatively large proportions when compared with the capital and surplus of these banks. In many cases these questionable assets were more than 200 per cent of the capital and surplus of the bank prior to suspension. Large borrowings were characteristic for a considerable period prior to suspension of the 225 banks. There were instances in which borrowings were several times the amount of capital and surplus. In 76 cases out of the 225, the management was criticized for continuous borrowing. The 105 banks which suspended in 1931 had for a considerable time before failure a higher proportion of loans and investments in loans to customers than did all member banks outside of central reserve cities. The suspended banks had a somewhat lower proportion of open-market loans and a somewhat lower proportion of investment securities. Among 225 suspended banks, the ratio of loans to officers, directors, and their interests was higher as compared to capital and surplus than was the case in a group of banks that did not suspend. Typically, the suspended bank prior to failure was advancing to officers, directors, and their interests a figure equivalent to about one-third of capital and surplus.

Criticisms of Loan and Collection Policies. - Examiners' reports constantly criticized officials of a majority of the 225 suspended banks because of lax and careless lending policies, which were often accompanied by slackness in collection efforts. Criticized lending practices were often associated with real estate mortgages and general loans to farmers. Frequently, loans were made to farmers without specific security, and in an effort to secure the loans junior mortgages on farms were subsequently taken. Examiners' comments showed that other types of capital commitment were common. Loans were made which could not be paid in the ordinary course of business at maturity, such loans were constantly renewed, and were thus furnishing capital to borrowers. "Placed paper" and the evasion of loan limits by splitting lines with other banks were often specifically criticized by examiners.

Criticisms of Investment Policies. - Among the 120 banks, which failed during the years 1921-1930, portfolios were heavily weighted with local loans and included relatively few investment securities. Among the 105 banks which suspended in the year 1931, however, a number had relatively large bond accounts. In this group of banks, difficulties with bond investments arose in part from purchases for yield rather than for safety. Bond trading, unlisted bonds, real estate bonds, and convertible bonds were often the specific causes of troubles. Nearly one-third of the 105 banks were criticized by examiners, more or less severely, because of their investments, and a number of others held bonds of poor quality. In several cases where bond depreciation was the primary cause of failure, investments formed a larger proportion of portfolio than loans. During the period covered by the study, depreciation in bond accounts was not found to be serious for many of the banks analyzed until the second examination of 1931. In the Northeastern part of the country especially, bond depreciation was a much larger factor in bank difficulties in 1932 than it had been in 1931 or previous years.

Criticisms of Bank Personnel. - In 135 out of 225 suspended banks evidence of disregard of banking law or regulations on the part of officers or employes was reported by the examiners. In some cases, the offenses were of the most serious nature, as in the case of 28 defalcations, 5 conversions of funds, 8 forgeries, and 27 false statements.

Exceeding the legal limitation on loans to one interest, failure to keep up legal reserves, payment of dividends not currently earned, and excessive investment in banking house were often alluded to by bank examiners. In 101 of the 225 suspended banks, bank directors were criticized because of their lack of attention to the affairs of the banks. Managing officers or influential directors of a number of the failed banks included in this study used their positions to secure favors from the bank, and at times to finance speculative or fraudulent transactions of their own. Attention was often called to the payment of excessive salaries to bank officials.

In 71 out of 225 banks, examiners' criticisms frequently referred to weak management. Weak loan, investment, and collection policies referred to in previous paragraphs are additional indications of ineffective management.

Every bank must be prepared to go through periods of declining deposits. Withdrawals may be the result of reduced business activity generally, or the flow of funds away from a region or community for economic reasons, or the loss of confidence on the part of depositors. When deposits begin to decline, a bank may be forced to dispose of some of its assets or use them as a basis for borrowing. So long as the assets are high-grade and liquid these withdrawals can be met. If the process continues until the bank has left only an inferior grade of assets, however, and cannot realize on them as rapidly as deposits are withdrawn, then it must close its doors. Many banks with a considerable proportion of their funds in long-term commitments, no matter of what origin, and having a large proportion of their liabilities payable on demand, have failed when they were subjected to withdrawals of deposits because they could not realize on their assets. The value of long-term commitments changes in response to cyclical movements and long-time trends; these assets may be stable or increase in price for long periods, but when a slump comes they are subject to heavy and widespread shrinkage.

The depreciation in investment securities and the difficulties of the banks generally during the depression have been greatly aggravated by the cumulative effects of large numbers of suspensions of weak banks over a period of years. This has been gradually wearing down public confidence, thus giving impetus to the hoarding movement and causing the contraction of credit by stronger institutions. The result has been an increase in the volume of securities thrown on the market, with the consequent spreading of the ill effects of liquidation throughout the credit structure.

Weakening Influence of the Dual Banking System

Many of the problems of commercial banking in the United States today have arisen from the division of responsibility between the Federal and State Governments in chartering and supervising banks. Competition between the two systems has not only been an important factor in the incorporation and fostering of thousands of weak banks, but it has led to the relaxation of legal regulations, tended to diminish the effectiveness of supervision, and hampered the work of the Federal reserve banks in maintaining proper standards for membership and in promoting sound banking policy.

Attempt at Unification. - At the time of the Civil War an attempt was made to bring about unified control through the establishment of the national banking system. A large measure of unified control was temporarily achieved, primarily because national banks were accorded the privilege of issuing currency while the notes of State banks were subjected to a prohibitive tax. For about twenty years the amount of banking business controlled by State incorporated institutions was negligible. If such a condition had obtained through the subsequent decades, it is likely that supervision, unaffected by the kind of competition that was later to develop, would have been able to maintain a higher standard of banking practice. The practice of deposit banking began to develop on so large a scale towards the end of the century, however, that State banks found it increasingly profitable to operate without the privilege of issuing notes; and from the early eighties State banks have grown steadily in relative importance.

It soon became evident that State banks had many competitive advantages over national banks, notably in the matter of lower minimum capital and other requirements for receiving charters, and in more extensive powers and privileges. The granting of similar powers and privileges to national banks tended to remove some of the restrictions previously imposed by the National Bank Act. Thus it was that about the beginning of the present century, or somewhat earlier, there began between the national and the several State systems a form of rivalry which has been described as a competition in laxity.

Relaxation of Restrictions on National Banks. - Lowering the minimum capital requirement in 1900 was the first important measure of the national banking system to meet the competition of State banks. Another occurred in 1913 when the Federal Reserve Act authorized national banks not situated in reserve or central reserve cities to make loans on improved and unencumbered farm land within their Federal reserve districts. At the same time legislative sanction was given to the existing practice of national banks of accepting time deposits at interest, and reserve requirements on such deposits were fixed at a lower percentage than that required for demand deposits.

Prior to 1913 national banks had been forbidden to make loans against the security of real estate. State banks everywhere could do so, however, and in most instances without any restrictions as to the amount of the loans, their duration, or the quality of the mortgages securing them. The prohibition against real estate loans by national banks was removed in 1913 with respect to farm lands, and in the course of the ensuing fourteen years, culminating with the passage of the McFadden Act in

1927, restrictions were further relaxed, until finally all national banks were permitted to make loans against any kind of improved real estate for periods up to five years and in aggregate amounts up to 50 per cent of their time deposits.

While the tendency to invest funds in long-term loans of a capital nature was accelerated by the growth of time deposits, these deposits have almost invariably been payable and actually paid on demand. This is true not only in the United States but also in England and Canada. In the latter countries, however, the fact that time deposits are in effect payable on demand is recognized as of basic importance in determining the manner in which such deposits are invested. In England bank loans of a capital nature are frowned upon as a matter of traditional principle; in Canada the banking laws contain prohibitions against loans secured by real estate and other capital assets, similar to the prohibition of real estate loans by national banks in the United States prior to 1913.

Other measures of relaxation have occurred in connection with loans to single borrowers. Prior to 1906 the amount of such a loan by a national bank was limited to 10 per cent of the paid-up and unimpaired capital of the bank. In many States there were no limitations of this character upon State chartered institutions; in others the limitation applied to both capital and surplus. To improve the competitive position of national banks the Federal law was amended in 1906 so as to make the 10 per cent limitation apply to both capital and surplus, provided the amount did not exceed 30 per cent of the capital stock alone. Most of the State laws, however, provided numerous exceptions to such limitations for State banks. To meet this situation the restriction on national banks was further relaxed by a series of amendments in 1918, 1919, and 1927.

In two other important matters Federal legislation has followed the lead of the States; namely, in the granting of fiduciary powers and branch banking privileges. In these respects, however, the powers granted to national banks are not uniform throughout the country but are adjusted to the standards set by the various States. In 1913, with the passage of the Federal Reserve Act, the Federal Reserve Board was authorized to grant limited trust powers to national banks "when not in contravention of State or local law." As a result of this act and a series of amendments in 1918, 1922, and 1927, all the varied fiduciary functions of trust companies are now commonly performed by national banks.

Limited privileges of branch banking were extended to national banks by the McFadden Act of 1927. This change in Federal legislation, like the grant of fiduciary powers, was made for the express purpose of improving the competitive position of national banks.

Various other changes in Federal legislation have removed restrictions on national banks or extended their powers. Among these are: the authorization for national banks in towns of under 5,000 inhabitants to act as insurance agents and as brokers for real estate loans; the lowering of reserve requirements against both time and demand deposits; and the authorization for Federal reserve members, including national banks, to issue bankers' acceptances. All these measures have been passed at least in part for the purpose of enabling national banks to compete with State chartered institutions. In fact, most of the important amendments to the national banking law since 1913 have been enacted in response to the competitive situation inherent in the dual banking system.

Dual Control and Supervision. - Bank officials and directors are likely to resent criticism and the ease with which they may escape existing supervision by changing from one system to the other greatly reduces the effectiveness of examining authorities. While there can be no doubt that bank supervision in general is on a higher plane than it was twenty years ago, it is nevertheless a fact that dual control of banking has tended to keep down the standards of supervision, as well as of banking law.

Effective supervision has been handicapped largely by two factors. In the first place, the supervisory authorities, whether national or State, have not been endowed with adequate powers; and in the second place, they have been unable to make full and effective use of such powers as have been granted them. To what extent the failure of legislative bodies to grant adequate powers is due to the dual system is difficult to determine, but the inability of supervisors to make full and effective use of such powers as they have arises out of the fact that banks are able to avoid the supervision of one system by leaving it and entering the other.

From the establishment of the national banking system in 1863 to the present time, successive Comptrollers of the Currency have placed before Congress recommendations for the improvement of banking supervision by specifying certain standards and providing adequate powers and penalties for their enforcement. Thus it was recommended by the first comptroller that failure of a national bank be declared prima facie fraudulent and that the officers and directors be made personally responsible as well as punished criminally unless upon investigation it was found that the bank's affairs had been honestly administered. In 1887 it was recommended that penalties be imposed for the making of loans contrary to law; in 1895 that the comptroller be authorized, with the approval of the Secretary of the Treasury and after a hearing, to remove officers and directors for mismanagement or violations of law; in 1914 that the comptroller be authorized to penalize both banks and their officers by appropriate fines for violation of the law and failure to comply with his regulations; and in 1931 that a board composed of the Secretary of the Treasury, the governor of the Federal Reserve Board, and the comptroller should have power to remove officers or directors of banks who persistently violated the law or who continued unsafe and unsound practices. Prior to the passage of the Banking Act of 1933, Congress had adopted none of these recommendations.

An important duty of both national and State supervisory authorities is to recommend legislation designed to improve the safety standards of banking. They are hampered, however, by the competitive situation into which they are forced by the existence of dual control. The dilemma of State supervisors in recommending banking legislation was aptly described by the commissioner of banks of Massachusetts in 1929 by the following remarks:(1)

> ". . . What steps are to be taken to protect the state banking system? I am a firm believer in harmony and I dislike to see the question always arising as to how the national banks can win friends from the state banking system, and on the other hand, how the state banks can get ahead of the national banks. I wish the question could be settled, so the banks could attend solely to the business in which they are engaged. . .

(1) National Association of Supervisors of State Banks, Proceedings of the Twenty-eighth Annual Convention, 1929, p. 85.

> "We are also careful in passing state legislation that nothing will be done to drive out the state banks that are now doing a good and legitimate business. If they find that the State Legislature is inclined to be a little harsh on them, it will be very simple for them to convert into a national bank and be received with open arms. . . ."

That similar considerations have frequently influenced the Congress of the United States is evident from the record of legislation actually passed and the proposed measures defeated.

State Banks and the Federal Reserve System. - Soon after its organization the Federal Reserve Board expressed the hope that a unified system of banking would develop through the Federal reserve system, and stated that, "There can be but one American credit system of nation-wide extent, and it will fall short of satisfying the business judgment and expectation of the country and fail of attaining its full potentialities if it rests upon an incomplete foundation and leaves out of its membership any considerable part of the banking strength of the country."(1)

The board extended liberal terms of admission to State banks, including the right to withdraw from membership on twelve months' notice. The State banks, however, were apprehensive of changes in the attitude of the board and hesitated about applying for membership. By June, 1917, only 53 State institutions had joined. Consequently certain amendments were passed by Congress in 1917.

Most of the provisions in the 1917 amendments dealing with State bank membership followed the spirit of the regulations issued by the board in 1915, which they extended. State bank members were permitted to with-

(1) Federal Reserve Bulletin, July 1, 1915, p. 145.

draw from the system on six months' written notice to the Federal Reserve Board. They retained their full charter and statutory rights subject to the restrictions of the Federal Reserve Act, and regulations of the board relative thereto. Their examination and supervision were delegated to the Federal reserve banks and board, which, in turn, were authorized to accept reports and examinations from State supervisory authorities in lieu of those of their own examiners. Furthermore, State member banks were relieved of the restrictions upon national banks as to the amount which could be loaned to one person, firm, or corporation, subject to the restriction that no paper of a borrower indebted to the State bank in excess of these limits could be rediscounted at the Federal reserve banks.

In spite of these concessions, only about 800 of the 12,000 State commercial banks belonged to the Federal reserve system in 1932. These 800 members included most of the very large State banks, however, and had something over 50 per cent of the loans and investments of all State banks and trust companies. It is noteworthy, on the other hand, that in the large size groups the number of nonmember banks has grown at a greater rate since 1920 than the number of member State banks. From 1920 to 1930 the number of nonmember banks with loans and investments of $10,000,000 to $50,000,000 increased from 64 to 128, while member State banks in the same size group increased from 121 to 124. The number of nonmember banks with loans and investments of $50,000,000 and over increased from 3 to 10 during the same period, while member State banks of that size increased from 32 to 49.

Competition between the two banking systems, resulting in an overbanked condition and relaxed standards, has materially hampered the effective functioning of Federal instrumentalities, i.e., the national banking system and the Federal reserve system. This has been in some measure responsible for the development of unsound banking practices, the ineffectiveness of supervision, and the serious banking difficulties during the past twelve years.

Group Banking in the United States

The trend towards concentration, so apparent in other fields of business enterprise in this country, has also been felt in the field of banking. In fact banking concentration has taken place on a substantial scale in recent years, notwithstanding the restrictions against branch banking. This concentration has been accomplished through mergers and through groups and chains.

The mergers and consolidations in most cases have occurred among institutions located in the same city, and have been more common in the larger cities. Frequently the consolidated institution has confined its operations to one office, but in some cities where branch banking is permitted the larger institutions have taken over the outlying banks and operated them as branches. The major part of the concentration through mergers, however, has not been the result of combinations of small institutions and has done little to bring the services of strong banks to the small towns and rural communities.

The bank holding company, as it has developed since 1927, is an instrument of banking concentration which aims at objectives similar to those of branch banking. Many of the managers of holding companies themselves have indicated that they would prefer to operate their organizations as branch systems if the law permitted. The most significant part of the group movement consists of less than two score holding companies, controlling at the end of 1931 about 700 banks and about $6,000,000,000 of loans and investments. These group organizations have had their greatest development in those States where branch offices are either wholly prohibited or are limited to local areas.

Of the 674 banks belonging to the leading groups, 307 are in States now prohibiting the establishment of branches, and 93 are in States where administrative ruling does not allow new branches although the statute is silent on the subject. Thus, these 400 banks could not now be operated as branches of the leading bank. Moreover, 249 of the banks in leading groups are located in States which allow branch offices only in limited areas adjacent to the head office. Because of such limitations most of these banks could not now be converted into branches of the dominant bank. Only 25 of the banks in the leading groups are located in state-wide branch banking States.

In addition to the 700 banks belonging to the major groups at the end of 1931, there were about 300 banks belonging to about 60 miscellaneous groups, many of which bear little resemblance to the major holding company groups. Many of the miscellaneous groups came into existence by reason of the association of two or three small banks with some large city bank.

Because of the relatively short experience with the bank holding company, statistical evidence is lacking with respect to what may be accomplished regarding the profits and costs of the individual banks belonging to groups. Moreover, the complicated interrelationship of many corporations makes it difficult to determine the position of the entire group through formal income statements. It is not yet clear whether the holding company will be able to operate a small separately incorporated bank more economically than it could be operated as a separate concern.

The degree of centralization of management varies greatly from group to group. Some of them approximate a well organized branch system in this respect. Others appear to leave more local autonomy to the individual banks. In organizations of this type, however, there is usually a tendency towards increasing centralization of management.

The group movement, as represented by the leading holding companies, has covered such a brief period of time that few conclusions can be drawn as to the safety record of this type of banking compared with the record of independent unit banks. Groups, however, have done little to strengthen the banking structure in the small towns and rural communities. Relatively speaking, holding companies have not acquired many banks of less than $500,000 of loans and investments.

The Problem of Groups. - The chief weakness of the holding company device as an instrument for strengthening the banking structure lies in its manipulative possibilities, and the difficulties of adequate supervision. In the period of adjustment through which the country has been passing, there have been frequent examples of the abuse of the holding company in fields other than banking. The complicated interrelationship of many corporate entities is a convenient vehicle for the activities of the unscrupulous. The major part of the bank holding company movement has been in the hands of conservative bankers, but there are examples of the consequences when conditions were otherwise. The fact that the bank holding company movement largely matured in an era of speculation makes difficult its dissociation from some of the manipulative operations of the times. Shifting of assets between different elements of a group and the splitting of credit lines are among the more important abuses to which this form of banking organization is open.

Chain Banking in the United States

The control of a number of banks by one or more individuals began to appear in this country several decades ago. This is known as chain banking. The number of such arrangements multiplied with the passage of time, and indeed they were the predecessors of the more modern groups. On December 31, 1931, the official statistics accounted for about 175 chains, including about 900 banks with an aggregate banking strength of about $1,000,000,000 of loans and investments.

The community of interest in a chain of banks is elusive, and it is quite possible that the official statistics have not recorded all of the cases. There are instances in which the investment in bank stock brings about a community of interest in several banks, without a deliberate intent to control. Chain interests in many instances do not openly avow their responsibilities as do the modern bank holding companies.

The very elusiveness of the movement presents one of its serious problems. The ease with which new banks have been chartered, partly as a result of the competition between State and national systems, and the small capital outlay needed to secure control over a string of banks are associated with the growth of chains and the high rate of incompetent management among them. Many failures of chains have resulted because they were operated by men inexperienced in banking. In many cases the chain of banks has been utilized as an avenue through which to finance the often speculative outside undertakings of the dominant interests. In some cases control has been exercised over a string of banks with a very small investment, stock owned in one institution being used as security for a loan the proceeds of which are used in the purchase of stock in another.

Branch Banking in the United States

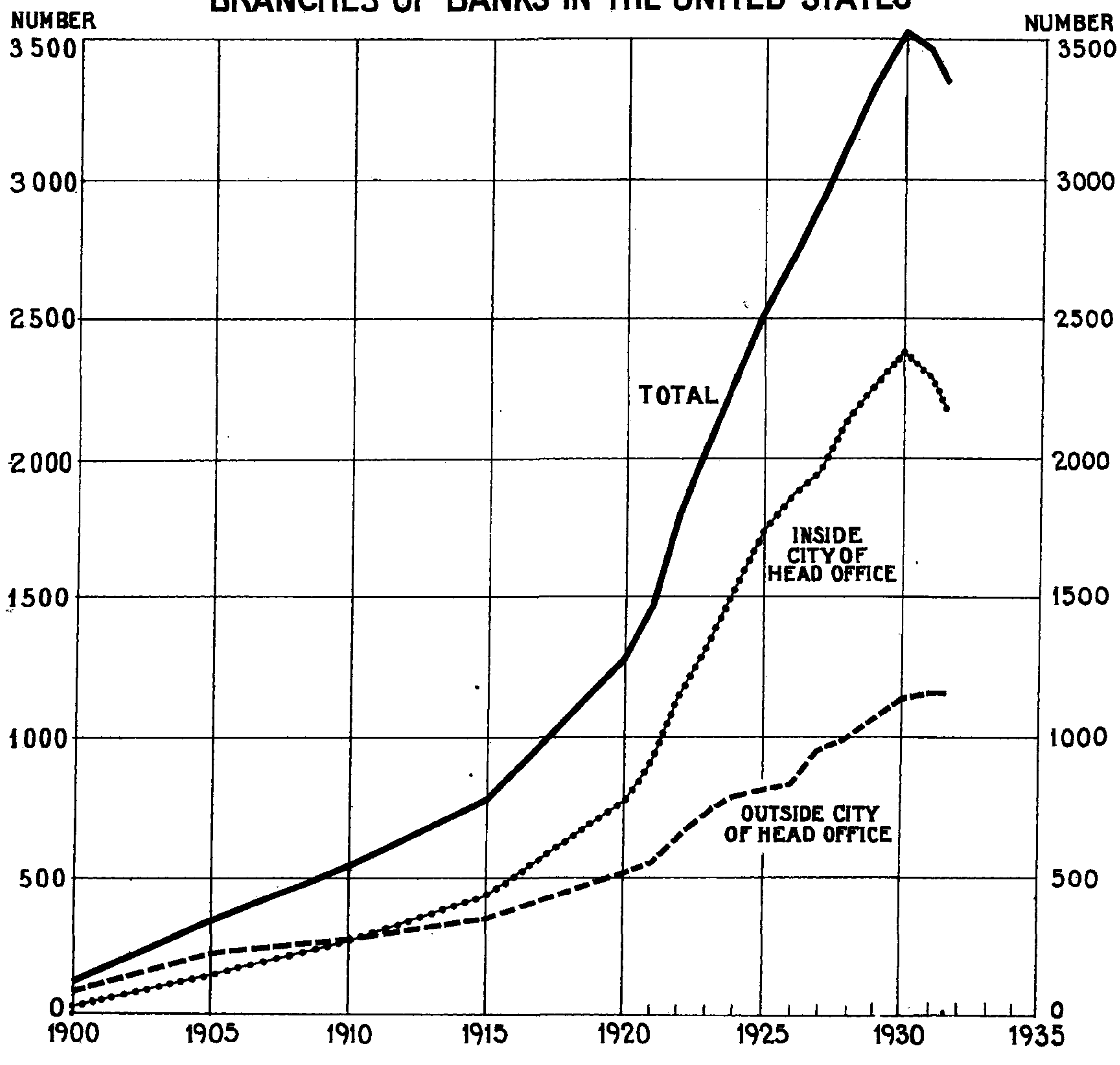
Branch banking was not uncommon in the United States prior to the Civil War. Following the passage of the National Bank Act in 1863, however, public policy became committed to the unit banking system. With banking corporations limited in general to one office, the kind of concentration which builds on branch offices was barred. From the end of the Civil War until around 1900 there was very little branch banking in the United States. The majority of State banks and their branches in existence prior to the Civil War were converted into unit national banks, failed as a result of the conflict, or liquidated because of the tax imposed on their note issues by the National Bank Act. With the growth of deposit banking, however, which gradually supplanted issue banking, the number of State banks began to increase towards the end of the century, and the development of present day branch banking in the United States may be said to date from approximately that time.

Growth of Branch Banking in the United States. - In 1900, according to the best information available, there were only about 119 branches in existence. A gradual growth brought the number to 785 in 1915, after which the increase was accelerated so that by 1920 there were 1,281 branches. During the next ten years the number nearly trebled to 3,518 in 1930. In 1931 suspensions resulted in a decrease in the number of branches as well as of unit banks, and some branches were discontinued for lack of profitable business. The thirty-one year movement is illustrated in Chart 13.

The greater part of the growth through 1930 was among branches located within the same city as the head office of the bank operating them;

CHART 13

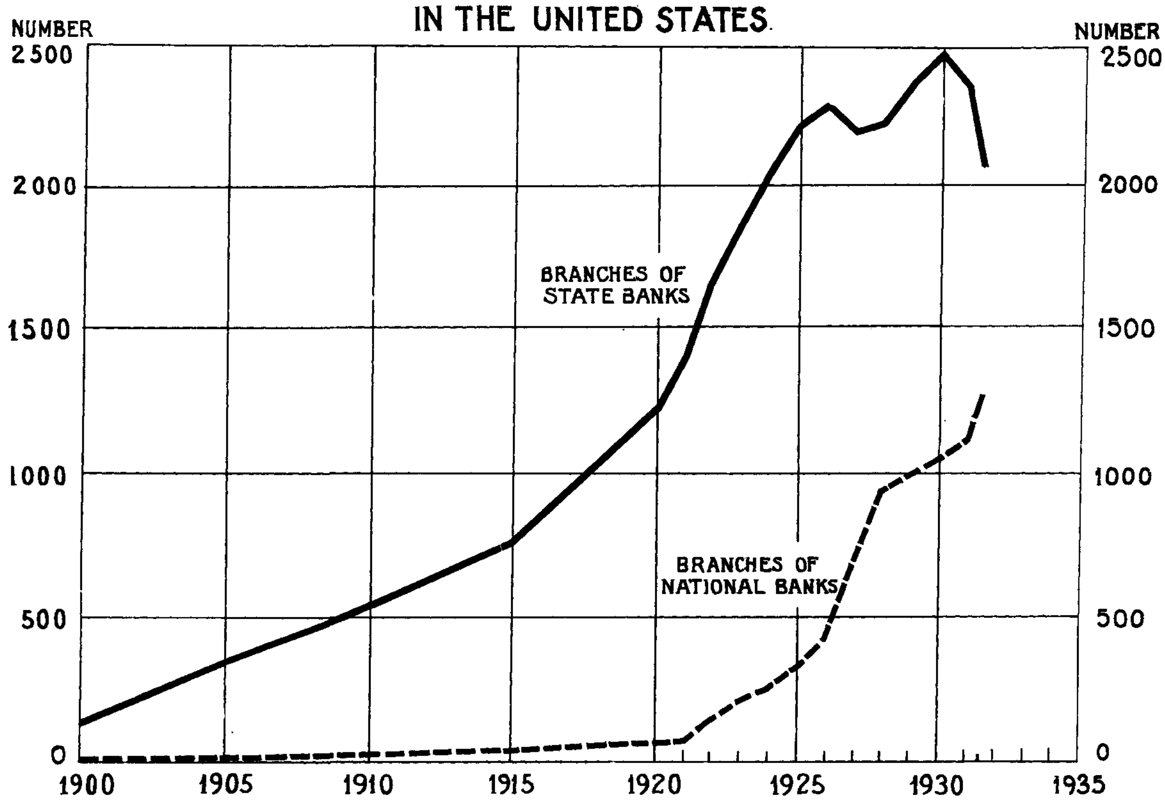
BRANCHES OF BANKS IN THE UNITED STATES



Number of branches of State and national banks in the United States, 1900-1931. From 1900 to 1920 the figures are for five year intervals, but from 1920 to 1931 they are as of June 30 each year. The final figure is for December 31, 1931.

CHART 14

BRANCHES OF NATIONAL AND STATE BANKS IN THE UNITED STATES.



Number of branches of State and national banks in the United States, 1900-1931. From 1900 to 1920 the figures are for five year intervals, but from 1920 to 1931 they are as of June 30 each year. The final figure is for December 31, 1931 at the end of that year roughly two-thirds of the branches in the country were in the city of the head office.

Prior to 1922 the development of branches was limited almost entirely to State banks, as shown by Chart 14. Occasionally a State bank with branches was converted into a national bank and retained its branches, or was absorbed with its branches by a national bank. The growth in the number of branches of national banks from this source was slow, however, and in 1921 there were only 72 branches of national banks compared with 1,383 branches of State banks. Beginning in 1922 the branches of national banks increased much more rapidly, and on December 31, 1931, aggregated 1,274 compared with 2,060 for State banks. The growth of national bank branches from 1922 to 1927 was due chiefly to the "additional offices" authorized by the Comptroller of the Currency in cities where State banks were permitted to have branches. At the same time there was an increasing number of conversions of State banks with branches into national banks and of absorptions of such State banks by national banks. The growth was accelerated by the passage of the McFadden Act on February 25, 1927, which, with certain restrictions, expressly permitted national banks to establish branches in cities where State banks may have them. The passage of this act also precipitated the conversion of certain State banks with numerous branches into national banks and caused the number of State bank branches to decline temporarily.

Safety Record. - Branch banking on an important scale in the United States has been so recent in development that it does not furnish an adequate body of data for comparing the safety record of branch operating banks with that of unit banks. In the eleven year period 1921-1931 there were 179 suspensions of banks with branches. Nearly 60 per cent of these, however, were operating only 1 branch each, and another 20 per cent were banks with only 2 branches each. Such institutions are not representative of branch banking.

Seven suspensions during the eleven year period were of banks with more than 10 branches each, and one institution with 44 branches suspended on January 2, 1932. Only 3 of these 8 banks were operating branches outside the city of the head office. The branch operations of the other 5 banks were of comparatively minor importance, since the bulk of their business was handled at the head office. Failure of these 8 institutions resulted from unwise management, bad loans, frozen loans of a capital nature, speculation in real estate, and other causes similar to those that have been mainly responsible for the inability of so many other banks to withstand adverse economic conditions.

Branch Banking in California. - California is the only State in the Union in which modern intercommunity 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. The movement developed rapidly after 1920 and within a few years the banking structure of the State was transformed. 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 about half the banking business of the State.

There are two separate but closely interrelated aspects of the growth of branch banking in California. On the one hand is the nature of the processes by which nearly two-thirds of the banks in California gave up their status as independent institutions and became branches of metropolitan banks. On the other hand is the functioning of the branch organizations as banking institutions. This second aspect of the development has thus far been largely influenced by the first.

Methods of Branch Banking Development in California. - The development of branch banking in California was so rapid that it escaped effective control by governmental agencies, and this rapidity of growth gave rise to many problems which might not have developed had the growth been more gradual. 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, and thereby retained the power to exercise 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 bank extension prescribed by the Federal Reserve

Board were rendered ineffective by the utilization of affiliated or associated nonmember 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 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.

Experience with Branch Banking in California. - 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.

Development of the Branch Banking Issue

Aside from California, branch banking in the United States has developed chiefly in the cities and metropolitan areas, and is prohibited in most of the regions where the largest number of small banks are located. These are chiefly the agricultural sections where the number of banks, especially State institutions, grew so rapidly from the 80's till about 1920. An important reason for the rapid development of State banks during the early part of that period was the need for banking services in rural communities too small to have national banks. At that time national banks could not be organized with less than $50,000 capital, a requirement which was beyond the resources of most small communities, especially in agricultural regions. The need was met by the organization under State charter of banks with smaller capital, and State banks became more numerous than national banks early in the 90's.

At the outset of this rapid increase in the number of banks the suggestion was made that the need for banking services in such regions could be more advantageously met by branch banking. The idea gained support and in 1895 both the Secretary of the Treasury and the President of the United States recommended branches for national banks. In 1896 the Comptroller of the Currency made a similar recommendation and the Secretary of the Treasury repeated his recommendation of the previous year.

The branch banking movement at that time had many advocates among economists and leading bankers, and bills containing branch bank provisions were pending in Congress for several years. In a report dated May 11, 1898, the Banking and Currency Committee of the House said:(1)

(1) United States Congress, 55th, 2nd Session, H. R. Report 1575, June 15, 1898, p. 30.

> "One of the most striking benefits of branch banking is that a branch may be created and maintained at a profit in a community without sufficient business for an independent bank. This would permit the extension of credit into many localities in the thinly settled portions of the country where it is now impossible. Branch banking, moreover, permits the more ready flow of capital from communities where it is not needed to those where it is needed than does the operation of independent banks. . . .
>
> "Branch banking in connection with reasonable freedom of note issues has produced such favorable conditions in Scotland and Canada that interest rates are almost uniform throughout those countries, even in the most remote sections, and disclose none of the striking differences disclosed in this country between rates in the money centers and in certain remote sections."

About 1898, however, many banks, especially the small banks, began vigorously to oppose the branch banking movement. It was then suggested that a reduction of the minimum capital requirements for national banks would meet the exigencies of the situation and obviate the necessity for branches. In 1900 Congress reduced the minimum capital requirement for national banks in small communities to $25,000. The agitation for branch banking then subsided while the rapid growth of small unit banks continued for twenty years.

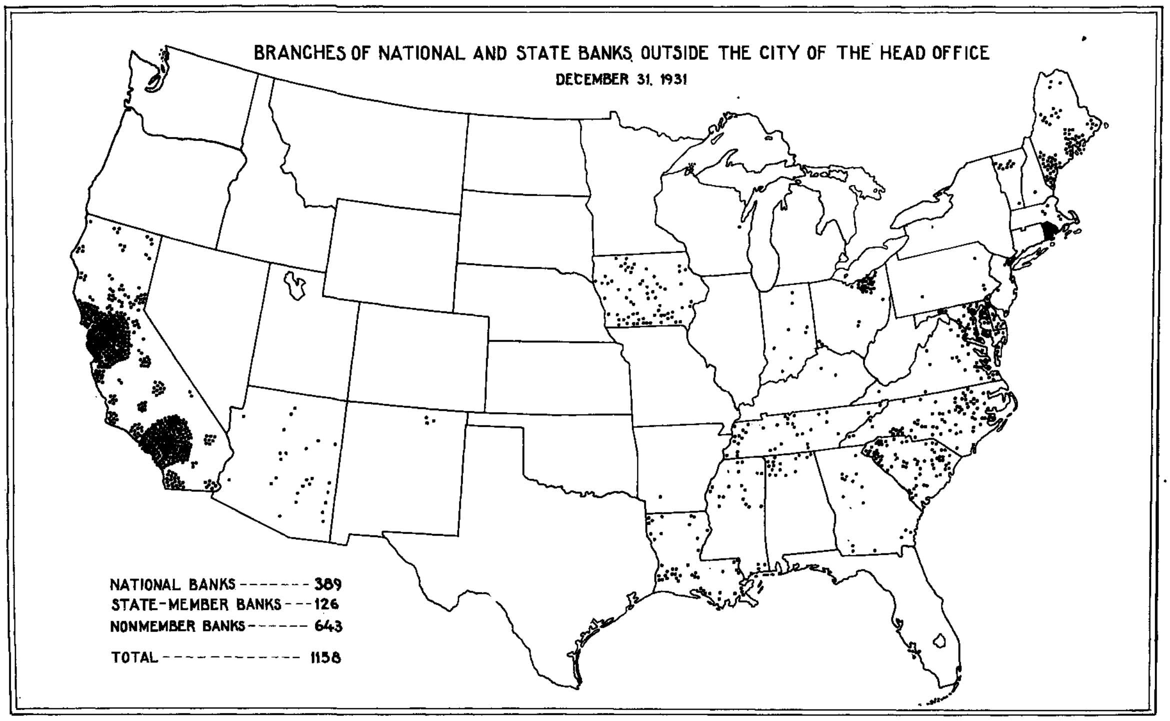
Growth of City Branches. - Although the proponents of branch banking had failed to accomplish their aim and the establishment of branches remained illegal for national banks, an increasing number of branches of State banks came into operation. This growth in branch banking, however, occurred chiefly in the large cities, rather than in the rural and agricultural communities for which it had been advocated. At the end of 1931, for example, there were over 1,900 branches in 13 large cities of the country as compared with 1,400 in the remainder of the United States.

The branch banking developments which began about 1900 in the four States, New York, Massachusetts, Ohio, and Michigan, have shown a steady subsequent growth and have been almost exclusively urban. City branches have also been established in substantial numbers in Pennsylvania and New Jersey. For the first twenty years or more the establishment of branches was wholly a State bank activity. As its competitive force began to be felt by national banks, however, it impelled them to acquire branches in the two ways open to them: i.e., either directly, by the absorption of State banks with branches, or indirectly, by affiliation with them. Neither compensated for the lack of power to establish branches on the same terms as the State banks, however, and the inequality created problems for both the Comptroller of the Currency and the Federal Reserve Board.

Intercity Branch Banking. - Meanwhile rural as well as urban branch banking was developing in California, as described above, and in Maine, Maryland, Virginia, North Carolina, South Carolina, Georgia, Tennessee, and Louisiana. In none of these States except California has there been a marked tendency towards the building up of extensive systems. Most of the branches in those States belong to banks with less than a half dozen branches each. The location of branches of national and State banks outside the city of the head office on December 31, 1931, is shown on Chart 15.

The growth of branches under State laws was much more pronounced in urban than in rural areas, even where laws permitted it in both. This may have been due in part to the fact that prejudice against "absenteeism" in management was less forceful in respect to the branches of a bank in the same city than in the case of branches in a different town.

CHART 15



In California there are numerous branches in the metropolitan areas centering around San Francisco and Los Angeles, but technically outside their city limits. On the map the dots extend much beyond the territory in which the branches are actually located around these cities.

<u>Bearing of State Bank Branches on the Controversy</u>. - In States where state-wide branches were permitted the national banks did not offer important opposition except in California, where both the national banks and the small State banks resisted the movement. In States like New York, Massachusetts, Ohio, Michigan, and others, where urban branch banking has had its greatest development, the national banks sought to secure the same right for themselves.

In the States where banks did not have branches there was a strong movement to keep branch privileges out of the Federal laws. This was directed not merely at keeping branches of national banks from being permitted in States locally opposed to branch banking, but at keeping them from being permitted anywhere, so far as possible. The contention was that branch banking was inherently undesirable and should be prevented from gaining any more foothold lest it spread uncontrollably.

This opposition to branches not only affected Federal legislation, but found expression in the enactment of State legislation between the years 1919 and 1929, prohibiting branch banking in Arkansas, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Minnesota, Montana, Nebraska, Oregon, Washington, and West Virginia and restricting it in Tennessee and Virginia. In some of these States there were a few branches in existence at the time the prohibitions were enacted, but in most States there was either no branch banking at all, or it was on a very small scale. The Cook County Bankers' Association was as aggressive as the California independent bankers in leading the efforts to keep branch privileges from being given to national banks.

Policy of the Federal Reserve Board. - In the annual report of the Federal Reserve Board for 1915, the first report covering actual operations, there was a recommendation for branches which read: "Permission should be granted to national banks to establish branch offices within the city, or within the county, in which they are located."[(1)] Similar recommendations were made by the board in its reports for the years 1916, 1917, 1918, and 1919, with the reservation, however, that the branch privilege apply only in those States whose laws permitted State banks to have branches. In 1922 the recommendation was renewed. In the 1917 report the board said: "There seems to be no reason for such discrimination between members of the Federal Reserve System, and with the view of placing them more nearly upon terms of equality, besides affording in many cases better service to the public, it is recommended that provision be made for the establishment of branches by national banks, under proper limitations."[(2)] In 1918 the board said: "As the law now stands national banks are at a serious disadvantage in meeting the competition of State banks with branches."[(3)]

No branch banking legislation for national banks was passed, however, prior to 1927. Resolutions adopted by the board on November 7, 1923, provided that "as a general principle," State banks should not be admitted to membership unless they relinquished all branches established after February 1, 1924, they might have outside the city of their main office, and that after becoming members they might not establish branches, except within the city. A little later, March 27, and April 7, 1924, the regulations were modified somewhat to allow for branches in suburban areas.

(1) Second Annual Report of the Federal Reserve Board, 1915, p. 22.
(2) Ibid., 1917, p. 33.
(3) Ibid., 1918, p. 83.

The Policy of the Comptroller of the Currency. - In 1915 the Comptroller of the Currency, Mr. John Skelton Williams, like the board, recommended branch banking and repeated the recommendation each year from 1916 through 1920. In the report for 1915, under the head of legislation recommended "to prevent bank failures," twelve amendments to existing legislation were suggested, one of which applied to branch banking. It was suggested that national banks be allowed to establish branches "within certain limits, for example, within city or county lines, but not without the boundaries of the State" or of the Federal reserve district in which the "parent bank" was situated; that no national bank should have more than twelve domestic branches; and that the capital of the bank should be increased in proportion to the number of branches.

In 1921 another comptroller, Mr. D. R. Crissinger, noted in his annual report that the legislation previously recommended had been introduced in Congress, and indicated his hope for a liberalization of the National Bank Act "so as to put national banks on an equal footing with State institutions."(1) In June 1922, he authorized national banks to have "additional offices" in cities where the State laws permitted State banks to have branches. The immediate reaction to the announcement that the comptroller was going to authorize "additional offices" was one of alarm among the State bankers who opposed branch banking. The Chicago and Cook County Bankers' Association promptly convened in a special meeting and adopted resolutions strongly condemning the comptroller's ruling.

The McFadden Act. - In February 1924, the McFadden bill was introduced in Congress proposing among other things to give national banks additional

(1) Annual Report of the Comptroller of the Currency, 1921, p. 4.

branch banking powers. This bill was the subject of a three year controversy and was not enacted until February 25, 1927. The American Bankers Association went on record in opposition to "branch banking in every form."[1] The principal opposition originated with the small bankers. They desired to protect their competitive position, and were supported by many of their large city correspondents, who preferred to continue existing relationships.

The branch banking provisions of the McFadden Act embodied substantially the regulations formulated in 1923-1924 by the Federal Reserve Board and the Comptroller of the Currency for administrative purposes. This law specifically legalized local branches in States which permit State banks to have branches, but prohibits any further extension of rural branches. It not only restrained State members from establishing branches outside the city of the head office--in this respect following previous regulations--but it also deprived the board of the power it had formerly exercised to make exceptions for such banks. Furthermore, in allowing State banks to come under national charter either by conversion or consolidation with only such out-of-town branches as had been in existence when the act became effective, it tended to restrict branches for national banks more than had been the case before.

<u>Growth of Branch Banking Sentiment</u>. - The McFadden Act did not settle the branch banking issue. Bank failures increased and group banking developed rapidly, particularly in those States where the opposition to branch banking was especially strong. The effect of these factors and the generally adverse conditions suffered by all banks was to diminish the opposition to branch banking on the part of many bankers who no longer found it

(1) United States Congress, 68th, 2nd Session, Hearings on S. 3316 and H.R. 8887, <u>Consolidation of National Banking Associations</u>, Senate Committee on Banking and Currency, January 30, 1925, pp. 85-86.

profitable to operate independent unit banks.

Since 1929 changes in the laws of several States have been in the direction of liberalizing branch banking provisions. By May 1932, the right to engage in some form of branch banking had been authorized, or powers already existing had been broadened in Vermont, Georgia, Montana, Indiana, Iowa, Ohio, and Wisconsin. In Vermont a bank may now have agencies in any part of the State. In the other States the branch privileges are much more restricted, the banks being allowed to operate under certain conditions additional offices or branches in the same city or in the same county or, in some States, in contiguous counties.

In most of these States the reversal of practice appears to have come about as a result of bank failures. In Iowa and Wisconsin this was especially evident. The purpose in these two cases appears to have been in part to save weak banks by consolidating them with sound banks and converting them into "offices" of the latter, and in part to supply banking facilities where they were otherwise no longer available. The changes in these two States were especially striking since both States still avowed their opposition to branch banking. In both of them branches were still expressly prohibited, but at the same time they were in fact allowed under other names--"offices," "receiving and disbursing stations," "locations"--with restricted powers and functions. When failures had gone so far as to deprive communities of banking facilities, a need was felt which, in spite of the hostility to branch banking, was supplied by relaxing restrictions.

Bank failures and the growth of group and chain banking likewise caused Congress and Federal banking authorities to continue actively interested in the problems of the banking structure. Group and chain banking became especially important in territory where there was no branch banking and where sentiment seemed strongly antagonistic to it. Furthermore it was found possible, where state-wide branch banking was permitted, as in California, for a member bank, which itself could not establish branches outside its home city, to control through affiliation a nonmember bank which could establish them.

The increased importance of these two developments, rural bank failures and affiliations, was manifested in the hearings on the subject of branch, chain, and group banking which were held by the House Committee on Banking and Currency in 1930. These hearings were authorized by House Resolution 141,(1) "for the purpose of obtaining information necessary as a basis for legislation." In contrast to previous hearings, the majority of the witnesses who appeared before the committee were in favor of branch banking in some form, and the case for branch banking was presented more fully than ever before. Among others, the Comptroller of the Currency, Mr. J. W. Pole, and the Governor of the Federal Reserve Board, Mr. Roy A. Young, were heard, and both recommended that the power of national banks to have branches be extended.

Mr. Pole, who was the first incumbent of his office in thirty years or so to give emphatic endorsement to branch banking, embodied in his testimony the recommendations he had already made to Congress in his annual report. The distinctive feature of his recommendations was that branches be authorized for national banks "within the trade areas of the

(1) Ibid., 71st, 2nd Session.

cities in which such banks may be situated."[1] Trade area branch banking, he believed, would make it possible for the larger and stronger banks to serve outlying communities through branches. These trade areas might in some cases be coextensive with Federal reserve district lines, he thought, but in other cases they would be of a more limited extent.

In its emphasis upon branches as a means of serving rural communities, the recommendation of the comptroller took the issue back where it had been thirty years before, when the earlier advocates of branch banking had urged it for the same reason.

The Glass Bill. - The Senate also continued to manifest interest in branch banking. The Glass bill, as reported by a subcommittee early in 1932, embodied provisions for branch banking on a more extensive scale than the McFadden Act permits. It proposed to give national banks state-wide branch banking privileges wherever State banks have the same privileges. At hearings held by the Senate Committee in March 1932,[2] a number of witnesses criticized the bill because its provisions made national bank privileges dependent on State laws. They said that state-wide branches should be allowed for national banks, regardless of the State laws. Mr. J. W. Pole, the Comptroller of the Currency, again recommended trade area branch banking and expressed dissatisfaction with the principle of making the privileges of national banks depend on the privileges of State banks.

Following these hearings, in which other matters than branch banking occupied most of the attention, the bill was altered in a number of provisions. Its branch banking provisions as reported from the Banking and Cur-

(1) United States Congress, 71st, 2nd Session, Hearings under H. Res. 141, Branch, Chain, and Group Banking, House Committee on Banking and Currency, 1930, Vol. I, Part 1, p. 6.
(2) United States Congress, 72nd, 1st Session, Hearings on S. 4115, Operation of the National and Federal Reserve Banking Systems.

rency Committee to the Senate on April 18, 1932, authorized state-wide branch banking for national banks upon the approval of the Federal Reserve Board regardless of State laws.[1] This draft of the bill also contained a provision authorizing branches across State lines under certain circumstances. In order to establish a branch outside of the head office city a national bank would be required to have a paid-up capital of $500,000. The bill provided further that:

> "The aggregate capital of every national banking association and its branches shall at no time be less than the aggregate minimum capital required by law for the establishment of an equal number of national banking associations situated in the various places where such association and its branches are situated."

<u>Opposition to the Glass Bill</u>. - The report of the Economic Policy Commission of the American Bankers Association in May 1932, as approved by the Executive Council of the association, opposed some of the branch banking provisions of the Glass bill.[2] It opposed interstate branch banking as well as the principle of giving national banks broader branch banking powers than those accorded to State banks in a particular State. The report, however, approved the suggestion that banks in stronger centers should be able to extend adequate facilities to communities which have been deprived of banking services, or where such extension is economically justified.

At the same time individual bankers, banking commissioners, and State banking associations attacked the branch banking provisions of the Glass bill. The Association of Independent Unit Banks of America, organized to fight the proposals for state-wide branch banking, expressed the belief "that the laws of the respective States should regulate branch banking within

(1) <u>Ibid.</u>, S. 4412, Section 19.
(2) <u>The Commercial and Financial Chronicle</u>, May 7, 1932, p. 3377.

their borders"; that branch banking threatens to "wipe out our present dual banking system"; and that "the autonomy of State laws" should be a "cardinal principle in Federal branch banking legislation."(1) Substantially the same point of view is expressed in the resolutions of the Illinois Bankers Association, May, 1932.(2)

As finally enacted June 16, 1933, the Glass-Steagall Act, "The Banking Act of 1933," provides that:

> "A national banking association may, with the approval of the Comptroller of the Currency, establish and operate new branches: (1) Within the limits of the city, town or village in which said association is situated, if such establishment and operation are at the time expressly authorized to State banks by the law of the State in question; and (2) at any point within the State in which said association is situated, if such establishment and operation are at the time authorized to State banks by the statute law of the State in question by language specifically granting such authority affirmatively and not merely by implication or recognition, and subject to the restrictions as to location imposed by the law of the State on State banks."

The act also stipulates minimum capital requirements for national banks, which operate branches.

(1) American Banker, June 8, 1932, p. 8.
(2) The Commercial and Financial Chronicle, May 28, 1932, pp. 1-2.

Branch Banking in Canada

Since the banking system in the United States has exhibited serious defects under the test of adverse conditions, a study of other banking systems operating under similar conditions has been considered pertinent to the Committee's inquiry. Consequently, a study has been made of the branch banking systems in two other English speaking countries, Canada and England, to determine their records of safety and service during the past twelve years. The commercial banking requirements of Canada and the United States are essentially similar in nature, owing to similarities in the economic structure of the two countries. Canada, furthermore, has faced the same agricultural problems in her Western or Prairie Provinces as those with which our Western Grain States have been struggling.

Safety Record. - The Canadian banking system, composed of 10 banks with about 4,000 branches and operating under charters granted by the Dominion Government, has provided a notable degree of safety for its depositors. Since 1923 there have been no suspensions of Canadian banks. In the eleven year period 1921-1931, during which nearly 9,000 State and national banks suspended in the United States, only one institution suspended in Canada, the Home Bank of Canada which failed on August 17, 1923, with 68 branches.

At the time of suspension the Home Bank reported paid-up capital of $1,960,591, and liabilities to the public of $18,356,000. Losses to depositors have been estimated at $6,400,000, after a donation of about $3,425,000 by the Dominion Government for the benefit of creditors with claims of less than $500, as well as of those with claims of over $500 if found to be in special need. Subsequent investigations by a Royal Commission showed mismanagement in the head office of the bank extending over a period of several years. The failure of the institution led to the inauguration in 1924 of a system of governmental inspection of Canadian banks, designed to reveal to the authorities the development of unsound conditions in time to permit remedial measures.

The ratio of total assets of banks suspending during 1921-1931 to average total yearly assets of active banks during the same period was less than one-twentieth as great in Canada as in the United States. Even during the years 1901 to 1920 inclusive, before the present large number of suspensions in the United States began, the ratio of the assets of suspended banks to the average yearly assets of active banks was about seven times as great in the United States as in Canada.

Post-war agricultural conditions have proved a severe test for Canadian banks. The story of rising agricultural prices, rising land values, expansion of credit, and the overdevelopment of banking facilities prior to 1920 was much the same in the Prairie Provinces of Canada as in the Northwestern States across the border. The number of branches in the three Prairie Provinces increased over 50 per cent from 1916 to 1920. After 1920 both sections likewise experienced declining prices, declining land values, frozen bank loans, and profitless banking offices. In 1923 the president of the Canadian Bankers' Association testified before a committee of the House of Commons that ". . . out of the 1,219 banks(1) operating in Western Canada 419 are operating under an actual loss, an operating loss." As a result of these conditions many branches were discontinued. From 1920 to 1926 nearly one-third of the branches

(1) Banking offices.

in the Prairie Provinces were closed, but the losses incurred were absorbed by the banks, that is by the proprietors or stockholders. Except for the branches and subagencies of the Home Bank, the reduction in the number of branches was accomplished without suspension of payments to depositors. The accounts of the closed offices were transferred to neighboring branches of the same or other banks.

The structure of the Canadian banking system is an important factor in its record of safety. The Canadian banks are powerful institutions having: (a) a wide diversification of assets; (b) large reserve funds for the absorption of special and regional losses; (c) adequate facilities for formulating and pursuing effective credit and investment policies; (d) ample resources for providing managerial ability; and (e) wide facilities for training the personnel in the traditional principles and practices of commercial banking. In Canada the facilities of large institutions have been made available to the smaller communities through the development of branch banking.

A further factor in connection with the safety record is the degree of adherence to commercial banking principles and the tendency to resist the practice of using deposits to supply capital funds. This is due in some measure to legal restrictions but in large part to management.

Service Record. - Safety to depositors does not appear to have been attained at the cost of adequate service to the community. Facilities for banking service are provided for all the settled regions of Canada, often in frontier towns and other communities too small to support independent banking institutions. There are more than twice as many banking offices in Canada as in the United States in proportion to the population, and nearly four times as many in proportion to the commercial banking resources of the country. While loans are generally made on business principles rather than on a personal basis, no evidence has been obtained that either communities or individuals have suffered from the withholding of credit warranted on the basis of sound banking practice. Banking funds in Canada have a high degree of mobility through the network of branches, and are readily shifted to communities where they are most needed. The evidence available shows that the loans of the branches in the great agricultural areas of the Dominion exceed their deposits, whereas for the country as a whole deposits exceed loans. This indicates that the newer regions of the country are financed in part through the loan of the surplus funds accumulated in the older and more thickly settled regions.

Effective Competition. - While the banking resources of the country have been gradually concentrated in a few large institutions, there is no evidence that competition between these institutions has been diminished. On the contrary competition is keen, both in the establishment of branches and in the development of business. In fact competition in the establishment of branches has resulted in what many observers have described as an overbanked condition. Towns of under 2,000 inhabitants all over the Dominion frequently are served by the branches of as many as three banks. Many villages of less than 1,000 have two or more banking offices. In the cities the multiplication of banking offices is equally apparent. In Montreal, for example, with a population of about 1,000,000, there were about 230 banking offices in 1931, compared with about 660 commercial banking offices in New York City, which has a population more than seven times as great as Montreal. Toronto, a city of about 700,000 inhabitants, had about 300 banking offices, more than four times as many in proportion to its population as New York, two and a half times as many as San Francisco, and twice as many as Detroit.

The costliness of competition in the number of banking offices is recognized by the general managers of the Canadian banks. There appears to be a conviction, however, that if one institution refrains from opening a branch wherever a profit can eventually be made some other bank would be sure to do so. At the same time it is believed by bank officials that a concerted attempt on the part of the banks to limit the number of branches in a given city or community would be likely to meet with public criticism as a monopolistic practice.

Costs to the Community. - In view of the differences in banking practice in Canada and the United States and the difficulties of securing comprehensive data on earnings and expenses of banks, it is not possible to draw definite conclusions as to the relative costs of the two banking systems. The evidence available, however, does not indicate that the total cost per unit of business is higher for the Canadian system than for the American system, although the former maintains a much larger number of banking offices and personnel in proportion to the volume of business than the latter. On the contrary, the average gross earnings and the average operating costs (including net losses) of Canadian banks, in percentage of loans and investments, appear to be nearly the same as the averages for all member banks of the Federal reserve system. Taking into consideration the thousands of small high-cost nonmember banks in this country, there is reason to believe that the cost to the economic community of the unit banking system of the United States per unit of banking accommodation is at least as large as the cost of the branch banking system of Canada. In addition, the public in the United States has had to bear a much larger cost resulting from bank failures.

Branch Banking in England

Since 1920 England has suffered even greater economic and financial difficulties than the United States. Industry as well as agriculture has been in a state of depression a large part of that time. Problems of public debt and taxation have been far more serious than in this country. Yet there have been practically no losses to depositors or serious upsets to business in England as a result of commercial bank failures in recent years.

Safety Record. - Losses to depositors because of bank failures have been negligible in England since the rise of the great branch banking organizations in recent decades. There were less than ten failures among commercial joint stock banks from 1900 to 1925, and since that date there have been none.

The existing banking structure in England, where about 80 per cent of both commercial banking deposits and offices are concentrated in five large branch systems, is the outcome of a long period of competition between small local banks and joint stock branch banking companies. A century ago there were scores of local banks operating as small partnerships, many of which failed during the course of the nineteenth century. After the law of 1826 gave joint stock companies the right to operate in the commercial banking field, they began to develop branch office systems and their growth was rapid, especially after the Act of 1862 definitely permitted banks to operate as modern corporations with limited liability.

The large branch systems of England, in contrast to small local banks of earlier periods, serve a wide geographical area and are in contact with a variety of business interests. Therefore, they have a wide diversification in their portfolios. Management in England has endeavored to operate along traditional commercial banking lines, keeping funds liquid in the form of short-term loans and investments. Careful attention to the problems of internal audit and supervision of large and small banking offices alike has been essential to the stability of these large organizations.

Many of the branch banking offices in England that have proved unsuccessful have been liquidated but this liquidation has not caused losses to depositors. Assets of the discontinued offices have been transferred to other offices and losses sustained by the operation of these offices have been absorbed by the banks. About 4,000 offices were closed in England between 1876 and 1914, as compared with about 9,000 that were opened during the same period.(1) The number closed was almost half as large as the number opened. In 1915, 154 new branches were opened and 53 were closed,(2) but during 1916, when the war made the banking situation very difficult, more offices were closed than opened.(3) This indicates that adjustments to changing economic conditions and expansions into new fields have been made in England as in other countries, but these adjustments have not caused losses to depositors because forced liquidation of assets was avoided and operating losses have been absorbed by the banks.

(1) Bankers' Almanac and Year Book.
(2) Ibid., 1917, pp. 26-27..
(3) Ibid., 1918, p. 25.

Availability of Credit. - Government commissions in England charged with investigating the problem have concluded that all classes of borrowers at the commercial banks, including farmers, are well served by existing facilities there. It is recognized, however, that the large banking institutions extend their accommodations on a less personal basis than small local concerns. Since this has served to bring fewer undesirable assets into the banks, it has been generally regarded as more of a gain than a loss to the community.

Available data indicate that a substantial proportion of the loans of the great branch banking organizations are in small units, and that the small man in England who represents a reasonable commercial banking risk receives adequate consideration and accommodation. Although the widely diffused branch banking systems are channels for the mobilization and distribution of funds, the investigating commissions have concluded that this does not result in draining deposits from the outlying communities to the industrial and financial centers. Comparisons which have been made between the rates of interest charged for short-term accommodation in England and elsewhere indicate that English borrowers are in a favorable position.

On the other hand, a body of opinion for years has been critical of the attitude of the banks, holding that they should make longer term commitments to industry and agriculture. Bank management has resisted these suggestions on the ground that it is not sound banking to lock up for long periods deposits payable on demand or short notice. Responsible investigating commissions have concurred in this view. They report, however, that England needs more adequate investment banking machinery to handle capital financing.

Effective Competition. - After the emergence of the "Big Five" more than a decade ago public policy set its face against further uncontrolled concentration of banking resources. It was felt at that time that continued reduction in the number of banking units might lead to joint agreements among the remaining banks resulting in a "money trust." The Government has been an advisor and adjudicator in connection with all subsequent moves toward concentration.

Government commissions have concluded, however, that "up to the present there has been little or no attempt on the part of the amalgamated banks to exercise any monopoly powers, or to suppress competition by districting or other working agreements."(1) Indeed, many believe that concentration so far has been accompanied by increased competition, which has found expression among other ways in the spread of banking facilities through new offices.

The large banks have branches and sub-branches spread over practically all of England and Wales in competition with each other. Usually a town which needs banking facilities has two or more banking offices (branches or sub-branches) representing two or more of the joint stock banks. It has often happened that a bank has opened a new office in a locality where a competitor was operating when there was not enough business to justify the outlet. In some cases these redundant offices have been put on a paying basis after a period of several years. On the other hand, such overbanked situations have affected earnings substantially and have frequently led to the closing of unprofitable banking offices. Nevertheless, the number of banking offices has increased during nineteen out of the last twenty years.

(1) Committee on Industry and Trade, Final Report, 1929, pp. 52-53.

The increase in the banking offices in England has been much more rapid than the increase in population. The population per banking office declined from about 6,800 in 1901 to about 5,000 in 1921 and to about 3,900 in 1930, compared with 4,800 in the United States. Liverpool had a commercial banking office for every 5,500 persons; Birmingham had one for every 6,200 persons. Because of the peculiar boundaries of the City of London, the number of banking offices there is difficult to determine. The best evidence, however, appears to indicate an office per 5,000 to 6,000 persons. As of a comparable date New York City had a commercial banking office for every 10,500 persons; Chicago, one for 17,100 persons; Detroit, one for 5,000; Baltimore, one for 9,800; and San Francisco, one for 5,800 persons.

There was one banking office in England for each six square miles, while in this country there was one national or State banking office for about one hundred and twenty square miles. In the densely populated States of New York, New Jersey, and Pennsylvania, there was a banking office for each twenty-five square miles.

These figures illustrate the relative accessibility of banking offices in England. The responsible heads of English banks have on occasion commented on the problem of excess offices. In 1924 one of them spoke of "fresh branches which take a long time before they can pay their way, and in some cases, one may fear, are not likely ever to pay at all."(1) Some evidence that steps are being taken by the banks to protect themselves

(1) Chairman of the Westminster Bank, Statist, May 10, 1924, quoted by Patrick Fitzgerald, Industrial Combination in England, p. 181.

against excessive competition among branches is found in an address to the shareholders of Lloyds Bank early in 1932 by the chairman, Mr. J. Beaumont Pease, who said:(1)

> "Banks have sometimes been criticized for opening new offices in places where banking facilities were redundant. The multiplicity of branches has been to the advantage of the public, but, undoubtedly, there are places where the business is not sufficient to ensure satisfactory results to all the banks represented there, and, with this in mind, and by mutual arrangement with other banks, we have closed down a good many sub-offices, with a consequent saving in expense."

Costs to the Community. - Data available with respect to the earnings and expenses of the joint stock branch banks of England are so meager that it is difficult to draw conclusions in respect to the relative cost of banking services to the public. Although the English banks make smaller charges for their services than do small unit banks in this country, their advantage over large banks here is not clear. It is clear, however, that the costs of the great British branch systems are the result of averaging low cost large offices with high-cost small ones. The competition for new branch outlets has been reflected in the costs and profits of English banks. Although there has been a reduction in the margin of profit per unit of business among English banks during the past two decades, a commensurate reduction in the rate of profit on book invested capital has not occurred, owing to a large increase in operations per unit of capital.

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(1) Address to shareholders quoted in American Banker, February 24, 1932, p.4.