# FEDERAL RESERVE BANK OF RICHMOND
# ANNUAL REPORT
# 1965

# *Federal Reserve Bank of Richmond*
# *FIFTY-FIRST ANNUAL REPORT*

## *Contents*


*GOVERNMENT AND BANKING* ........ 4

*Some Legal and Constitutional Aspects* ........ 6

*The Philosophy of Bank Regulation and Supervision* ........ 8

*Structure of Regulatory and Supervisory Agencies* ........ 10

*Areas and Types of Regulation* ........ 16

*The Administration of Banking Laws and Regulations* ........ 20

*The Application of Antitrust Laws to Banking* ........ 24

*Recent Developments and Problems Affecting Regulation* ........ 30

*Conclusion* ........ 37

*SIGNIFICANT EVENTS OF 1965* ........ 39

*Summary of Operations* ........ 41

*COMPARATIVE STATEMENTS* ........ 42

*FEDERAL RESERVE BANK OF RICHMOND—Directors and Officers* ........ 44

*BALTIMORE BRANCH—Directors and Officers* ........ 46

*CHARLOTTE BRANCH—Directors and Officers* ........ 47

*TO OUR MEMBER BANKS:*

*It is a pleasure to present the 1965 Annual Report of the Federal Reserve Bank of Richmond. Featured is a study of the regulation and supervision of commercial banking in the United States. Also included in the Report are comparative financial statements, a brief summary of our operations, and a current list of officers and directors of our Richmond, Baltimore, and Charlotte offices.*

*On behalf of our directors and staff, we wish to thank you for the splendid cooperation and support you have extended to us throughout the past year.*

*Sincerely yours,*

*Chairman of the Board.* *President.*

# GOVERNMENT AND BANKING

## The Regulation and

Commercial banking is a highly regulated, closely supervised operation. This is true in all countries but especially in the United States. From conception to liquidation, from cradle to grave, commercial banks live and operate under special and complex codes of law, interpreted and applied by regulatory agencies. The codes provide for control of entry since they prescribe how and under what conditions a bank may be organized and begin business. During the bank's active life, laws and regulations specify the kinds of business in which it may engage, limit the kinds and amounts of many of its assets and liabilities, and provide guidelines for many of its operating policies. If and when it goes out of business, the law prescribes how it shall be liquidated and how the proceeds shall be distributed.

In the United States the subject of banking regulation and supervision is diverse, complex, and often detailed and technical. In many respects its limits

# *Supervision of Commercial Banking in the United States*

are vague and poorly defined. It is marked by considerable overlapping and some duplication on the part of state and Federal agencies and occasionally by conflict of authority. In large part this situation is caused by three conditions: (a) a very large number of banks, amounting to nearly 14,000 at present; (b) a dual banking system, state and Federal; and (c) 53 major regulatory agencies, one in each of the states and three at the Federal level. In addition, the Department of Justice intervenes from time to time with antitrust actions.

The control and supervision of commercial banking has had a turbulent and controversial history in the United States. In this area attitudes are deeply rooted and so sensitive that usually basic revisions and improvements have been attempted only under pressure of major emergencies. Changes made at such times were designed to correct current defects and were added to the existing structure of laws and regulations with little adaptation or integration. There has been no policy of periodic study, review, and revision of the whole system. As a result, the supervisory system has not had a smooth or logical development in keeping with the needs of the economy but rather has moved ahead by fits and starts as dictated by acute necessity.

Popular interest in the subject has fluctuated widely, usually reaching a climax in periods of banking crisis or panic. Recently, however, there has been a general revival of interest in the topic at a time when the banking system is strong and prosperous and when no threat of crisis is apparent on the horizon. This has probably been due to the ever-widening scope of commercial bank activities and the corresponding spread in supervisory rules and regulations. Banks are competing more keenly with each other and with nonbank financial institutions. This takes them into new types and forms of activity, some of which raise questions as to whether banks can participate in them and, if so, how. These extensions have increased the numerous areas of overlap and possible conflict already existing among the regulatory agencies. Points of friction between different regulatory systems and agencies and between underlying philosophies and policies of the agencies have stimulated much of the current discussion of bank supervision.

The discussion in this report is confined to the impact of governmental control, regulation, and supervision on the structure and operations of the commercial banking system. It does not deal with the effects of central bank monetary policy on commercial bank policies or operations. Both state and Federal activities are considered, but the principal emphasis is on Federal activities. Available resources do not permit any comprehensive study of the fifty state regulatory systems.

# *Some Legal and Constitutional Aspects*

A brief consideration of the legal and constitutional bases of governmental control of banking may be helpful in understanding the problem. This aspect is especially significant because of our country's dual banking system, under which banks may be chartered and regulated by either state or Federal authorities.

## STATE POWERS

States have very wide powers in the banking field. The courts have consistently held that banks are businesses "affected with a public interest" and as such have some of the characteristics of public utilities. They are subject to regulation by the states in the public interest under the police power, which is one of the broadest of governmental powers. One authority has stated: "The police power of a state extends to prohibiting the banking business except under such conditions and regulations as the state may prescribe." The courts have held that state legislatures may impose any regulation, control, or limitation which is reasonable in view of the circumstances and that the legislatures are the best judges of what is reasonable. Very few acts of banking legislation have ever been held invalid for lack of constitutional power.

States may exercise their regulatory powers by providing that only corporations may conduct a banking business, and then controlling the granting of charters. In most cases banking corporations are chartered under a special code which imposes the obligation to abide by state regulations. For about the first fifty years of our national life there was "special charter" banking under which the charter for each bank was issued as a special act of the legislature. The powers and limitations often varied from one charter to another and the obligations imposed by the charters constituted the principal element of bank supervision since there were few administrative agencies to enforce compliance.

## FEDERAL POWERS

The Federal Government also has the power to charter and regulate commercial banks. This power is entirely separate from and independent of the state chartering power. It is full and complete, not subject to limitation by the states. The banks created under that power are instrumentalities of the Federal Government and are protected from interference and discrimination by the states.

In theory, the Federal Government is one of designated or specified powers. This means that it can exercise only those powers conferred by the Constitution or which may reasonably be inferred therefrom. But Congress does have the power ". . . To make all laws which shall be necessary and proper for carrying into execution the foregoing powers. . . ." The Constitution makes no mention of chartering or regulating banks, but it does give Congress power ". . . To coin money, [and] regulate the value thereof . . ." and to regulate interstate commerce. But on three different occasions when the Supreme Court considered the actions of Congress in establishing the First and Second Banks of the United States and the National Banking System it upheld the legislation under the "implied powers" to ". . . make all laws . . . necessary and proper . . ." rather than under the monetary or commerce powers. The implied powers are broad and indefinite and, in effect, are determined by court interpretation. In passing on Federal banking legislation, the courts have allowed the legislation wide leeway and have rarely held legislative provisions unconstitutional.

The constitutional positions of the states and the Federal Government in this country means that in each of the fifty states there are two separate and independent governments with practically complete power to charter and regulate banks operating in the same geographical area. In such a situation the possibilities of conflict and friction are numerous. One danger in particular has loomed large in American thinking. Generally speaking, and barring interstate agreements, a state-chartered bank is limited to the boundaries of its own state. But the Federal Government could give national banks the power to operate nationwide systems of branches. Such a development would probably alter drastically the balance between state and national banking systems. To preclude such an occurrence the Federal Government subordinated its power to that of the states by providing that national banks in any state shall be governed by the branching powers of state banks in that state. Similar action has been taken in giving states power to regulate interstate commerce in insurance and alcoholic beverages but it is extremely rare.

National banks, of course, are subject to state authority in several respects. They must carry on business under state laws and regulations governing contracts, negotiable instruments, legal holidays, and the like. In late 1932 and early 1933, the power of state governors to proclaim special banking holidays and to impose restrictions on the withdrawal of bank deposits played a vital role in quickening the spread of state holidays and making the nationwide closing of banks inevitable. Currently, the applications of one type of state law to national banks is uncertain and is the subject of considerable interest and concern. A New York law prohibits commercial banks from issuing short-term negotiable promissory notes. Are national banks subject to that law? It would appear that Congress *could* give national banks permission to issue such notes irrespective of state law. But for the present Federal law is silent on the matter and the position of national banks remains unclear.

## CHARACTERISTICS OF REGULATION

As a result of the dual banking system, the banking business in this country has the privilege of choosing its own supervisory authority. If a business organization wishes to conduct a banking business, it may choose to obtain a state charter and subject itself to exclusive state control. Or it may elect to carry on the same business under a Federal charter and Federal control. Further, having chosen one authority it may reverse that choice and select the other. Finally, if it is a state bank it may place itself under concurrent Federal-state jurisdiction by joining the Federal Deposit Insurance Corporation (FDIC) or the Federal Reserve System. Such freedom of choice is rare indeed.

Transfers from one banking jurisdiction to another are not uncommon; in the past few years a considerable number of banks, including several large ones, have switched from state to national charters. At other times the movement has been in the opposite direction. When such a movement gains momentum there is a revival of suggestions that either the state or national banking system must become more "competitive" in order to prevent a collapse of the dual banking system.

Another important characteristic of bank regulation is the wide discretion given to administrative regulatory agencies. In the granting of charters, authorizing the establishment of branches, prescribing rules for bank operation, conducting examinations, and, finally, in the closing of banks, supervisory authorities have wide powers, usually limited or guided only by broad and general provisions in the law. Further, the methods and procedures through which these powers are exercised are usually prescribed by the administrators themselves. Finally, as one study has noted, with respect to the Comptroller, these actions are "accompanied by a remarkable degree of judicial finality. In the absence of fraud, caprice, or *ultra vires,* the decisions of the comptroller are usually regarded by the courts as binding and conclusive." Perhaps it should be noted that this was written before the Department of Justice became active in enforcing antitrust laws against banks.

# *The Philosophy of Bank Regulation and Supervision*

As is true of most of our major legal and economic institutions, our system of bank regulation does not rest upon any neat, coherent, and consistent philosophy or theory. This is true because it has not been built up continuously and systematically according to recognized guidelines. Nevertheless, it is possible to mention a few general considerations which have motivated most of the policies and actions in this field.

## NECESSITY FOR REGULATION

In the earliest phases of bank regulation the dominant purpose apparently was to protect the individual depositor or, more precisely, noteholder, since notes constituted the principal liability of banks in those days. It has long been recognized that in dealing with financial institutions such as banks and insurance companies, most individuals are not able to protect themselves adequately. Therefore, it is regarded as proper and perhaps necessary for governments to prescribe minimum standards for such institutions in an effort to prevent losses. In earlier days the country was predominantly agricultural; self-sufficiency and barter were more prevalent than they are today; money was correspondingly less important; and there were comparatively few banks. Under those conditions, bank supervision in most states was very rudimentary and in many cases took the form primarily of writing restrictions, limitations, and requirements into bank charters, with very little machinery for insuring compliance.

As the economy developed it became more dependent on commerce and industry which, in turn, were heavily dependent on a reliable and smooth-functioning banking system. Deposits supplanted notes as the principal bank liability and became *a* form of money though perhaps not the most important form. When one bank in a community failed others were affected through both financial and psychological channels. Wide-spread bank failures in an area could paralyze that area. So gradually it became apparent that bank supervision was necessary not only to protect the individual from loss but also to protect the business community from recurring paralysis.

In the most recent phase—perhaps the past fifty or sixty years—both the economic and banking systems have become much more interdependent, and the money economy has become almost universal. Improved communications and transportation spread the effects of bank disturbances further and faster. Demand deposits have become not only the largest but the *dominant* form of money. So now governments must regulate banks, not only to protect individuals and the business community, but also to safeguard the whole economy and to insure the stability and integrity of the monetary standard. Monetary policy has a part to play in this, too, but effective banking supervision is a necessary accompaniment.

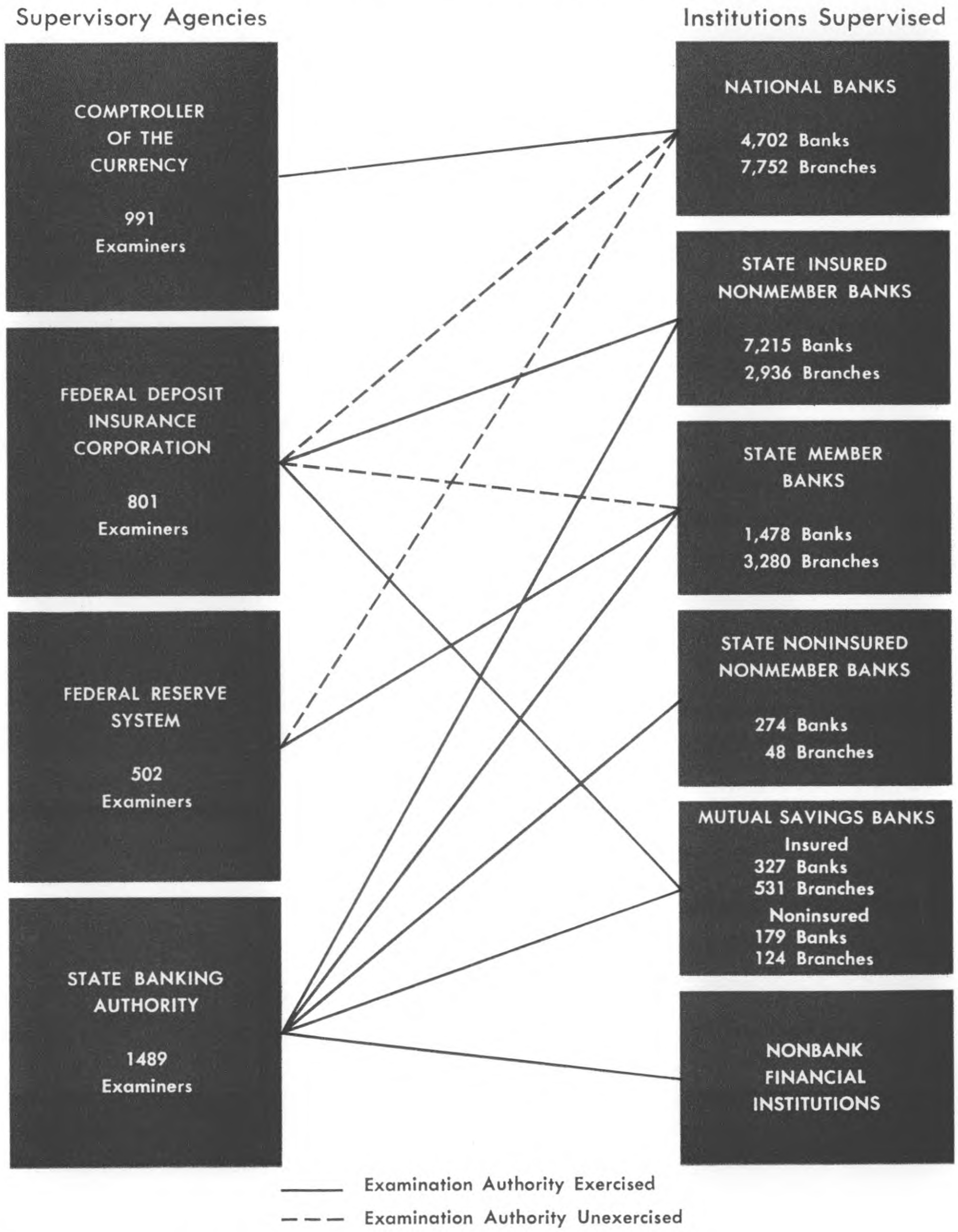
So over the years there has been a widening and deepening of the scope of bank regulation and supervision as recurring troubles have demonstrated the need for it. This has accompanied the ever-wider role played by money, and especially bank-created money, in our economy. Today the money flow constitutes the bloodstream of the economy.

It is the responsibility of the central bank to see that there is an adequate supply of the vital fluid. Bank supervision has the task of preventing the flow from becoming obstructed or polluted along the circulatory system.

Along with and overlapping the above motives for bank regulation has been another—the fear of monopoly. From the earliest days the American people have shown a fear of monopoly generally and of financial monopoly in particular. This may be because it is more difficult to understand financial operations and people are inclined to be suspicious of that which they do not understand. Since banking includes some elements which look like black magic to the average person, the fear of banking monopoly has been strongest of all. This deep-rooted fear has been a major cause of the strong preference for unit banking which prevails in many parts of the country.

Americans have placed much faith and confidence in bank regulation, perhaps for lack of a preferable alternative. It should be noted, however, that at best regulation and supervision cannot in themselves produce a sound, efficient, or dynamic banking system. They cannot create good bankers or good banks. They are essentially negative in character, although good supervision does include considerable help and guidance to responsive bankers. Mainly regulation and supervision set boundaries to bank activity and tell bankers what they may *not* do. Within those limits it is the responsibility of the bankers to develop and maintain a sound, flexible, and progressive banking system to serve the needs of a growing economy.

DIAGRAM OF BANK SUPERVISORY RESPONSIBILITY




Note: Data as of mid-1964

Source: American Bankers Association, Board of Governors of the Federal Reserve System; and National Association of Supervisors of State Banks.

# *Structure of Regulatory and Supervisory Agencies*

## EARLY HISTORY

Until the Civil War period, the Federal Government played only a limited role in bank regulation and supervision, leaving the field primarily to the state governments. There was no national banking code, and no body of Federal laws pertaining to banking in general. But in two periods—1791-1811 and 1816-1836—the First and Second Banks of the United States played a vital role in the country's banking system. As fiscal agent for the United States Treasury, each regularly came into possession of large amounts of state bank notes. By presenting these notes to the issuing banks for redemption, the large Federal institutions could, and occasionally did, exercise an effective restraint on the note-issue activity, and hence on the lending and investing, of state-chartered banks. Between 1846 and 1861 the Independent Treasury System, operated by the Federal Government, exercised much the same type of influence on state banks.

**Early State Regulation** State governments entered the area of bank regulation soon after adoption of the Constitution. Generally, individual state regulatory systems grew slowly and erratically. The period was one of experimentation and state banking laws were changed frequently to correct real or fancied deficiencies revealed by experience.

Individual state regulatory systems were heavily influenced by popular notions respecting the proper functions of banks and the economic effects of banking operations, which differed considerably from state to state. Moreover, individual states differed sharply in economic and demographic characteristics and the problem of providing effective banking facilities varied accordingly. Because of an acute shortage of metallic money and an unsatisfactory system of coinage, there was an urgent need for a sound system of circulating bank notes. After the demise of the Second Bank of the United States, the various systems of state banks provided bank notes which circulated, but often they were lacking in soundness.

By 1820, state banking in New England, the Middle Atlantic, and the South Atlantic states was confined to institutions operating under special corporate charters issued on a limited basis by state legislatures. These charters imposed a variety of restrictions on such things as capital, note-issue, types of loans and investments, activities and borrowing of directors, interest rates, and exchange charges on domestic bills. In general, these restrictions were designed to protect the public, and especially noteholders, from losses resulting from mismanagement or abuses. Several states required periodic reports, at first usually to legislative committees but later to state auditors or comptrollers and, especially after 1830, to state banking commissions. Increasingly after 1820, many also provided for official visitation and examination.

Because of an economic environment unfavorable to banking and a shortage of capital, some of the new states in the South and Middle West took action to encourage the establishment of banks. In some cases, they established and operated banks directly; in others they were part owners and appointed some of the directors. In still others, governments pledged their credit to support bonds issued to provide capital for banks.

These state-sponsored banks were under close legislative surveillance and generally made periodic reports to legislative committees. Supervisory and regulatory practices differed in some important respects from those in the East. Unit banking was the rule in the East, but most Southern and Western states allowed statewide branching in order to accommodate a widely dispersed population. Often regulatory authorities in the South and the West took a more liberal view of what constituted appropriate bank lending and investing, since banks were popularly regarded in those areas as "creators" of badly needed capital and were expected to lend liberally. In particular, state governments often insisted that they invest heavily in state and local bonds issued to finance internal improvements.

"FREE BANKING" A few states reacted to the severe banking panics of the period 1837-1843 by prohibiting banking entirely; others turned toward a system of more banks and increased competition in banking. The latter group replaced systems of special-charter banks by the so-called "Free Banking" system, first adopted by Michigan and New York in the late 1830's and copied by many other states between 1849 and 1860.

The free banking laws of this period prescribed broad general rules within which the banking business was open to all comers. A central feature of the system dealt with the issue of circulating notes, and provided that banks could issue notes only on the basis of specified collateral deposited with a state official. In the event of bank failure, the state authority was empowered to pay off the failed bank's circulating notes from the proceeds of the sale of its collateral. Thus, the principal aim of the free banking laws was to provide a competitive system of banking and protection for the holders of bank notes.

The free banking principle spread rapidly after 1849, especially in the South and West. By the early 1850's, many states which had earlier prohibited banking found this prohibition inconvenient and turned to free banking as a solution. Even in New England, where special-charter banking had proved more satisfactory, free banking laws were adopted and in some of these states special-charter and "free" banking existed side by side.

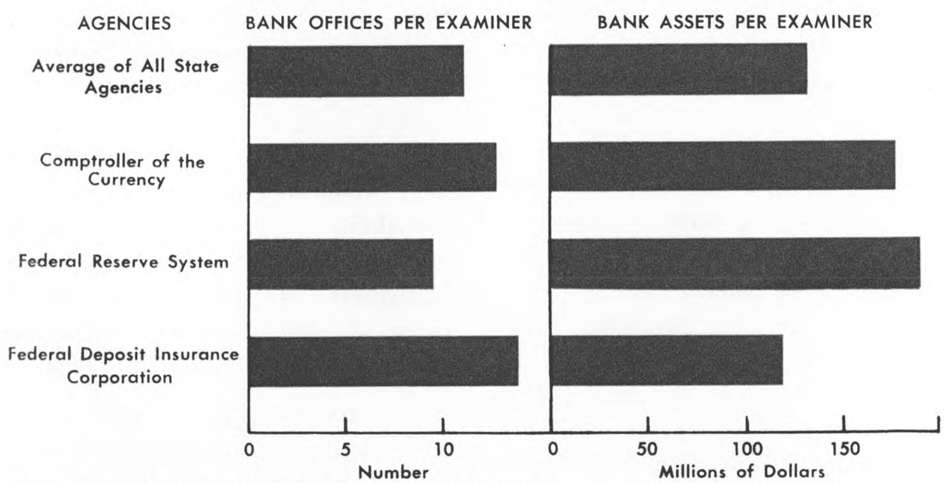
Yet many of the early free banking laws were hastily and loosely drawn and early experience under them was marked by many abuses. In 1854, extensive failures of the so-called "free banks" occurred in the West and the South and as a result many state laws were redrawn. Collateral requirements were tightened and, in many states, banking departments were established to administer the new laws. This movement toward closer state surveillance was accelerated by the nationwide banking crisis of 1857.

By the time of the Civil War many states had banking departments, with regular visitations, examinations, and reporting programs to supplement the collateral requirements for bank notes. Some had even added a requirement of a specie reserve against note liabilities. While many states operated under free banking laws, entry into the field was far from unlimited. Practical limitations were imposed by the restricted availability of qualified collateral for notes and, in some states, by specie requirements. In addition, the surveillance of state regulatory authorities served to limit entry into the field.

## ENTRANCE OF THE FEDERAL GOVERNMENT

The Federal Government entered the field of bank regulation in a comprehensive way and on a permanent basis with the enactment of the National Bank Act of 1863. The Office of the Comptroller of the Currency, created at that time, was the first major Federal agency established to regulate a form of business activity. That office grew and expanded over the years under competent management. For many years a major part of its activities was supervision of the issue of national bank notes. That activity came to an end in 1935.

WORKLOAD PER EXAMINER IN THE VARIOUS SUPERVISORY AGENCIES
June, 1964




Note: Some June figures estimated from year-end data.
Source: National Association of Supervisors of State Banks; Board of Governors of the Federal Reserve System.

After the imposition of a Federal tax on state bank notes in 1865, the number of state banks dropped sharply, almost to the vanishing point, because banking was not profitable without the power to issue notes. Gradually, however, banks found that they could do a profitable business with deposit banking alone, and state banks began to come back. By the 1890's they outnumbered national banks. Naturally, activity in the field of state bank regulation was not great in the 1870's but it revived and expanded near the end of the century.

Now, after more than a century and a half of development, bank regulation and supervision have assumed wide proportions in both state and Federal areas. Today the major responsibilities of supervisory authorities include: (1) granting charters; (2) approving the opening and closing of branches and changes in capitalization; (3) approving mergers and holding company acquisitions; (4) interpreting banking laws and issuing and interpreting regulations and instructions; (5) examining banks periodically to verify compliance with laws and regulations and to ascertain their financial condition; (6) prescribing and enforcing corrective action in cases requiring it; (7) giving counsel and advice when requested; (8) receiving, reviewing, and analyzing periodic reports; and (9) presiding over the liquidation of insolvent banks.

The execution of these duties is divided among many agencies, and consequently most banks are responsible to more than one authority. National banks, for example, are subject primarily to the Comptroller but also to the Federal Reserve and the FDIC. State banks come under the primary jurisdiction of the chartering state but may also be subject to one or more Federal authorities. State member banks are subject to the regulation of both the Federal Reserve and the FDIC. Insured nonmember banks come within the jurisdiction of the FDIC. Only in the case of noninsured, nonmember banks is the line of supervisory responsibility clear-cut and simple. Encompassing all types of banks is the authority of the Department of Justice, which has responsibility for the maintenance of competition under the antitrust laws.

## PRESENT STRUCTURE—STATE

Bank supervisory agencies are separate units of state governments in thirty of the fifty states. Although they fall within some larger subdivision of government in the other twenty, separate status is widely regarded as very appropriate because bank supervision is a highly specialized responsibility. Separate status helps attract capable administrators, which is essential if regulation is to be effective. Also important is the adequacy of funds for hiring and maintaining an adequate and competent staff.

Scope of Supervision State banking departments supervise all state-chartered banks in their respective states and that supervision includes practically the whole range of activities listed above. In most states, however, a majority of the time and effort of supervisors is devoted to granting charters, acting on applications for branches and mergers, and conducting examinations. In a majority of the states, banking departments also have the responsibility for supervising a variety of other financial institutions such as mutual savings banks, industrial banks, trust companies, savings and loan associations, sales finance companies, small loan companies, and credit unions. These activities are often substantial and have the effect of requiring supervisory authorities to divide their attention and efforts at the expense of commercial bank supervision.

The Supervisor Qualifications for the position of state supervisor are sometimes spelled out in detail, but in nearly half of the states the appointing authorities exercise their own judgment with little or no legislative restriction. Supervisors' salaries are scaled roughly according to the amount of banking resources in the various states and range from around $9,000 to $20,000 or more. Their terms of office vary from state to state but generally fall between two and six years. A check of the actual record revealed that in 33 states one or more changes in the position of supervisor occurred during a recent five-year period.

Financing In 45 states examination fees or assessments are the principal source of funds. The money collected, however, is directly available to the supervisory agency in only 13 states. The other 32 require legislative appropriations which generally follow one of the following three patterns: (1) examination fees are earmarked for the banking department and are routinely appropriated for the purpose; (2) examination fees are mingled with other state funds and have little bearing on the amounts appropriated to support the banking department; and (3) budgeted needs of the banking department are covered by an appropriation and fees are set subsequently at levels calculated to reimburse the general treasury. In the five states which do not collect examination fees, funds are provided entirely by the appropriation of general revenues.

Concerning the adequacy of funds provided for the support of state banking departments, *State Banking*, a compendium prepared by the American Bankers Association, had this to say:

> In 1954 only 17 of the State Bank supervisors felt that their budgets were adequate to assure efficient operation of their departments. By the time of our 1959 Survey, the number with adequate budgets had grown to 24 . . . . But in 1964 the number of supervisors who believed that their department budgets were adequate had dropped back to 19.

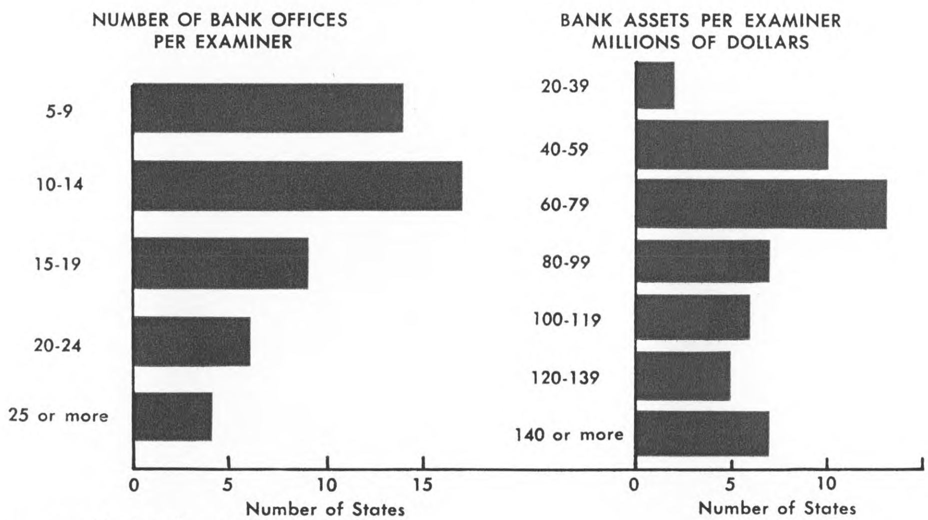
The National Association of Supervisors of State Banks is of the opinion that "weakness of many banking departments appears linked to low salaries and small staffs."

Bank Examination State bank examiners are under civil service in 26 states. In nearly all of the other 24 states supervisors have the sole authority to select and appoint examiners. In a few cases appointments must be approved by the governor or by some other state official. Minimum salaries of state bank examiners range from about $5,000 to around $12,000, with most in the $6,000-$7,000 range. Maximum salaries range between $7,000 and $18,000, with an average somewhat in excess of $9,000.

The number of examiners per state varies greatly, even when related to the work load. Available measures of work load are only approximations because of overlapping jurisdictions and cooperative examining procedures. One measure is the number of bank offices per examiner; this ranges from as few as six to as many as 32. Another measure, the value of bank assets per examiner, has recently ranged from a low of $34 million to a high of over $280 million. The average work load per examiner is 14 banking offices and about $100 million of assets in state banking departments, compared to 11 offices and $148 million in the Office of the Comptroller of the Currency, ten offices and $47 million in the FDIC, and under ten offices but over $190 million of assets in the Federal Reserve System.

All state laws call for regular examinations of the institutions supervised. One examination per year is specified in about two thirds of the states, and two per year are required in most of the others, but the number and timing is left to the supervisor's discretion in two states.

VARIATION IN EXAMINING WORKLOAD AMONG STATE BANKING DEPARTMENTS




Source: The American Bankers Association.

## PRESENT STRUCTURE—FEDERAL

COMPTROLLER OF THE CURRENCY The Office of the Comptroller of the Currency is a division of the Treasury Department. The chief administrator is the Comptroller of the Currency who is appointed by the President with the advice and consent of the Senate for a term of five years. While he conducts the affairs of his Office under the general direction of the Secretary of the Treasury and in accordance with the broad guidelines laid down by Congress, the Comptroller in practice has a great deal of freedom in formulating policies and determining procedures. Since the authority of the Office is vested in a single man, and not in a board as is true of the other Federal supervisory authorities, the effectiveness and the efficiency of the agency hinge to a large extent on the ability and drive of the incumbent. In order to discharge his supervisory responsibilities, the Comptroller has developed a regional structure consisting of 14 districts, each under the direction of a Regional Comptroller.

Broadly, the Comptroller is the principal supervisory authority in matters pertaining to the opening, operations, and closing of national banks. His principal activities are in the area of chartering, acting on branch and merger applications, issuing interpretations and rulings under the National Bank Act, and conducting examinations. He exercises some control over state member banks since his Investment Securities Regulation applies to both national and state member banks. In addition, the Comptroller supervises *all* bank and trust companies operating in the District of Columbia, even those chartered by states, and supervises most savings and loan associations and credit unions in the District.

FEDERAL RESERVE SYSTEM The Federal Reserve's supervisory framework is similar to the Comptroller's in its regional structure and its direction from a central office. Ultimate authority, however, resides not in a single individual but in the seven members of the Board of Governors who are appointed by the President with the advice and consent of the Senate for terms of 14 years. Unlike the other supervisory agencies, the Board's primary responsibility lies outside the regulatory field; it is the formulation and administration of monetary policy. In the supervisory area, the Board's principal activities are acting on applications for acquisitions by bank holding companies, passing on certain branch and merger proposals, interpreting the Federal Reserve Act and related statutes, supervising the examining activities of the Federal Reserve Banks, and collecting and analyzing banking data, partly for regulatory purposes but perhaps predominantly to serve as the basis for monetary policy. In most cases, contacts with member banks and the application of general supervisory policies are carried out by the Reserve Banks under general policies established by the Board.

FEDERAL DEPOSIT INSURANCE CORPORATION The FDIC, created by the Banking Act of 1933, has an obvious stake in effective supervision stemming from its contingent liability for all insured deposits. The FDIC is managed by a bipartisan Board of Directors composed of three members. The Comptroller of the Currency serves as an *ex officio* member and the other two are appointed by the President with the advice and consent of the Senate for terms of six years. One of these serves as chairman. The FDIC has a regional structure consisting of 12 regions, each under the direction of a Supervising Examiner.

While the FDIC is concerned for the soundness of all insured banks, its supervisory attention is focused on nonmember state banks, since other insured banks are supervised by either the Federal Reserve or the Comptroller. The activities of the FDIC are heavily concentrated in the examining field. In connection with this, it not infrequently works closely with banks in distress to avert failure, either by providing direct financial assistance or by arranging to have the threatened banks absorbed by other banks. It may underwrite the rescue operations to insure the assisting banks against loss. The FDIC acts as receiver for national banks which fail and for insured state banks if requested by the appropriate state authority.

## ARRANGEMENTS FOR COORDINATING REGULATORY ACTIVITIES

Because of overlapping jurisdictions, arrangements for coordinating the activities of the various supervisory authorities are necessary in order to achieve efficiency and reduce confusion. Some of these arrangements have been provided for by law, but the majority have grown up over time in response to the obvious need to cooperate to accomplish a common objective. These arrangements are many and varied and cover matters as detailed as day-to-day working relationships. Some of the more important areas of cooperation involve bank examinations, uniformity of reports, and consistency of supervisory rulings and regulations.

In the area of bank examination, arrangements have evolved which are workable, though not ideal. State banking authorities cooperate with the FDIC in examining insured nonmember banks and with the Federal Reserve in examining state member banks. The arrangements vary somewhat from state to state, but frequently the state and Federal authorities conduct joint examinations. At the Federal level, duplication of effort is minimized by exchanging copies of examination reports.

In 1938 a very important agreement was reached by the Federal supervisory agencies with respect to procedures in examinations. The agencies agreed to follow uniform policies in the classification of loans and the appraisal of investment securities. They also agreed that until a bank had written off losses and established adequate reserves, it would be required to use any profits from the sale of securities for those purposes.

In collecting economic information from commercial banks, the Federal authorities have generally been able to agree on the kinds of data needed, the form in which they should be reported, and the timing of reports. In the past few years, however, there has been considerable difficulty on this score. Since the information obtained in this way is vital to the conduct of proper supervision and to the formulation of monetary policy, it is highly important that agreement be reached so as not to burden the banking industry with duplicate and unnecessary reporting.

# *Areas and Types of Regulation*

## BANKING STRUCTURE

One of the most important forms of regulation is control over the structure of the banking system. Supervisory authorities influence the banking structure through control over the chartering of new banks, bank mergers, the opening and closing of branches, and over the formation and growth of bank holding companies. In some of these areas Federal law is paramount, in others state law governs, and in yet others the authority is divided.

CHARTERING OF NEW BANKS The chartering of new banks is one area in which authority is divided. For many years there was little effective control over the creation of new banks and charters were issued almost automatically to any group of men which met certain limited requirements. In the quarter century before 1920 this policy resulted in a phenomenal increase in the number of banks, raising the total to about 30,000. In the next 14 years more than half of these banks disappeared, most of them by failure.

A departure from this policy was made by Comptroller of the Currency Murray (1908-1913) who decided to exercise greater restraint in chartering banks, taking into consideration public needs and convenience. Also, authorities in some states had been directed by law to consider the public interest in chartering banks. Federal legislation in the 1930's specifically directed the Comptroller to consider such things as the bank's future earnings prospects, the character of its management, and the convenience and needs of the community. Today, the laws of most states require the chartering authority to consider similar factors.

BRANCH BANKING The right of a bank to do business at more than one place is restricted by both Federal and state laws. For many years the National Bank Act was interpreted so as virtually to prohibit the operation of branches by national banks. These restrictions were gradually eased, and today Federal legislation gives national banks the same branching powers as are enjoyed by state banks in the states in which they are located. With respect to statewide branching, the law specifies that national banks can establish branches "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."

State laws on branch banking vary greatly. Some twenty states and the District of Columbia permit statewide branch banking, although one of these (Virginia) limits *de novo* branching but permits statewide branching by merger. Fourteen states permit branch banking within limited areas, and another ten prohibit branch banking but permit "offices," "agencies," or "stations." Five states prohibit branch banking, and one state has no legislation on it.

Although state law determines the basic right of banks to branch, national banks and state member banks must, in establishing branches, obtain the approval of the Comptroller or the Board of Governors. Branches of insured nonmember banks must be approved by the FDIC.

Banking authorities affect the banking structure also by controlling bank mergers and consolidations. The period since World War II has been marked by numerous mergers, most of which resulted in the acquired banks being operated as branches. The rate at which banks were being absorbed became so great in the early 1950's as to cause concern over the effects on competition.

Control over bank mergers has long been divided between state and Federal authorities, and this division of responsibility has caused some confusion. During the 1950's, Federal supervisory authorities complained that they lacked power to control the absorption of banks by merger and Congress responded by enacting the Bank Merger Act of 1960. That Act is discussed below.

Bank Holding Companies The decade of the 1920's was marked by a rapid growth in holding companies and by numerous abuses of the holding company device. Banks affiliated with holding companies are subject to the same laws and regulations as other banks, but the holding company itself is not a bank and is not subject to the general banking laws of either the states or the Federal Government. Thus, except for Section 7 of the Clayton Act, there were few legal restrictions on bank holding companies at that time.

The Banking Acts of 1933 and 1935 require holding companies which control member banks to obtain voting permits from the Board of Governors in order to vote the stock of member bank subsidiaries. Before granting a permit, the Board must consider the financial condition of the applicant, the general character of its management, and the probable effects of granting the permit upon each of its subsidiary member banks. The holding company must agree to open its books and those of its subsidiaries to examination by the Federal Reserve and to comply with certain other requirements of the law.

This legislation gave the Federal Reserve System some authority over bank holding companies, but not enough to control their formation and operation. The law did not apply to all holding companies and was aimed more at protecting the safety of the holding companies than at their control. In an attempt to correct these deficiencies, Congress enacted the Bank Holding Company Act of 1956.

This Act defines a holding company as one which owns or controls 25 per cent or more of the voting stock of each of two or more banks, or that controls the election of a majority of the directors of two or more banks. The Board of Governors administers the Act, and all bank holding companies (as defined by the Act) are required to register with the Board. Prior approval is required before a company becomes a bank holding company, and for most acquisitions of bank stock thereafter. Approval is also required for the acquisition of all, or substantially all, the assets of a bank or merger with another bank holding company.

A bank holding company may not acquire any voting shares of, or all the assets of, any bank located outside its home state unless such acquisition is specifically authorized by the laws of the state in which the bank is located, nor, with certain exceptions, may it hold voting shares of any nonbank company. The Federal Act does not prevent any state from exercising powers or jurisdiction over banks, bank holding companies, and subsidiaries. A bank controlled by a holding company may not invest in the securities of the holding company or its subsidiaries, make loans to such companies, or accept their obligations as collateral for loans.

## CAPITAL REQUIREMENTS

An important objective of bank regulation is the protection of the bank and its customers against failure, and this purpose is perhaps responsible for more laws and regulations than any other. But a bank may fail because of insolvency or because of a lack of liquidity, and regulations designed to protect banks against these two types of failure are necessarily quite different.

Protection Against Insolvency Insolvency means that the value of a bank's assets falls below its liabilities. On this basis, a bank becomes insolvent only after the owners' equity has been eliminated through losses. Protection against insolvency, therefore, may be achieved in two ways: (1) through requirement of a minimum ratio between capital accounts and total assets, and (2) through regulations aimed at minimizing losses in asset values.

*Capital Adequacy* Both Federal and state laws have long specified minimum capital requirements for new banks and for the establishment of branches, but these requirements have little significance today. They usually are related to the population of the city in which the bank is located (not the best basis for determining capital adequacy), and they are seldom revised to take account of changing conditions. Moreover, even if a bank's capital equals or exceeds the legal minimum initially, it may become grossly inadequate if the bank has a large growth since the amount, structure, and nature of its assets and liabilities provide the chief guides to its capital needs. Thus, the adequacy of a bank's capital has become largely a matter of administrative judgment, determined by the supervisory authority.

## REGULATION OF ASSETS

SAFETY In the acquisition of assets, all commercial banks are subject to numerous legal restrictions, most of which are designed to protect the safety of the bank. Space does not permit a full discussion, so the following is intended to indicate only the general nature of such restrictions.

Federal and state laws severely restrict the power of banks to own real property, usually by specifying the purposes for which it may be held. Banks may, of course, own real estate which is necessary to the conduct of business. Beyond that, investment in such property is generally prohibited. Even the investment in bank premises is restricted. A national bank or state member bank may not invest in the bank's premises an amount in excess of the bank's capital stock, except with the approval of the appropriate authority. Many state laws impose similar limitations on state nonmember banks. Banks also may acquire real property which is mortgaged to them as security for debts or which they acquire in order to protect themselves from loss on debts. Usually property so acquired must be sold within a specified time period.

As a general rule, national banks and state member banks are prohibited from investing in corporate stock. Exceptions to this rule include ownership of the stock of Federal Reserve Banks and of subsidiaries which own the bank premises, provide safe deposit facilities, or perform other specified functions. In addition, a recent decision of the Comptroller permits the purchase of stock in other corporations under certain conditions. National banks (and state member banks unless prohibited by state law) may invest limited amounts in stock of small business investment companies. Restrictions on stock ownership by state nonmember banks vary greatly, but a number of states permit banks to hold corporate stocks.

Commercial banks are subject to many other restrictions on loans and investments. The aggregate amount of real estate loans a national bank may make is limited in relation to capital funds and its time and savings deposits. Individual real estate loans are limited as to maturity and in relation to appraised value. As a general rule, these limitations do not apply to loans insured and/or guaranteed by the Federal Housing Administration or the Veterans Administration. Some state laws restrict real estate loans in much the same way, but in many states they are limited, if at all, only by supervisory action.

National and state member banks may not make loans to "executive officers" in an amount exceeding $2,500, and a majority of the board of directors must approve all loans to executive officers. The laws of most states limit, and a few prohibit, loans by banks to their officers, directors, or employees, but the limits are far from uniform. Generally, a bank may not make a loan to a bank examiner who might be assigned to examine that bank, nor may it make a loan with its own stock as collateral.

Perhaps even more important than restrictions on particular types of loans are those that limit the amount a bank may lend to a single borrower. The general rule is that national banks may not lend to any one borrower an amount in excess of "10 per centum of the . . . capital stock . . . paid in and unimpaired and 10 per centum of . . . unimpaired surplus funds." The Comptroller recently ruled, however, that in the case of national banks subordinated notes and debentures may be added to the capital stock and surplus to determine the loan limit.

The primary purpose of the loan limit is to reduce risk, so there are no limitations on loans secured by certain types of collateral, while loans secured by other types are limited to various proportions of capital stock and surplus. Excepted loans include those secured by United States Government obligations, obligations in the form of drafts or bills of exchange drawn against actually existing values, and a number of others. State laws limiting loans to one borrower are similar to those pertaining to national banks. Some states have the same basic limit of 10 per cent of capital and surplus, but others have higher limits. State laws also provide numerous exceptions to the basic limit.

LIMITATIONS ON INVESTMENTS Investments of commercial banks also are closely regulated. As noted above, the power of national banks to invest in common stock and real estate is severely limited, and a rule similar to the "10 per cent rule" relating to loans to a single borrower applies to investments as well.

Prior to the 1930's, commercial banks freely engaged in underwriting securities, both public and private. The Banking Act of 1933 severely restricted such activities, and today member banks are prohibited from underwriting the securities of private corporations. Officers, directors, partners, and employees of firms dealing in securities may not serve as directors, officers, or employees of member banks. But member banks may underwrite securities of the Federal Government, Federal agency obligations, and general obligations of state and local governments.

National banks and state member banks may invest in debt obligations classified as investment securities under regulations set forth by the Comptroller, who has defined investment securities so as to exclude securities that are "predominantly speculative." Obligations of the United States, general obligations of states and political subdivisions, and the obligations of a number of Federal agencies are specifically exempted from the restrictions pertaining to investment securities.

**Reserves and Liquidity** Because most bank liabilities are payable on demand or on short notice, maintenance of liquidity has always been a matter of the greatest importance for commercial banks. Both Federal and state governments have attempted, through legislation and supervision, to insure liquidity by requiring that specified types of assets be held in some minimum ratio to deposits.

Early state laws usually specified that reserves be held in the form of specie or deposits in other banks, and their purpose was to insure the convertibility of bank liabilities. Originally, national banks were required to hold reserves in the form of vault cash and/or deposits in other banks. Under the Federal Reserve System, national and state member banks are required to hold legal reserves in the form of vault cash or deposits in a Federal Reserve Bank.

All states except one have statutory requirements for reserves, but these vary widely from state to state. Few states have different requirements based on location, but most have higher requirements against demand than against time and savings deposits. Legal reserves usually may be held in vault cash or in demand balances due from banks, but almost a third of the states permit some part of required reserves to be held in the form of United States Government obligations. In about half of the states reserve requirements are fixed by statute, but in the others bank supervisory agencies may change them within limits.

Legal reserve requirements originally were adopted to protect the safety of banks, but in recent years they have become primarily an instrument for carrying out monetary policy, particularly for Federal Reserve member banks. Required reserves are not a major source of liquidity in time of need, and most banks look upon their secondary reserves as the real measure of their liquidity. Nevertheless, there are no legal requirements governing secondary reserves. The size and composition of such reserves are determined by bank management, although the bank's liquidity is a matter of concern to Federal and state supervisory authorities.

## REGULATION OF LIABILITIES

Regulation of commercial bank liabilities includes the prohibition of certain types of liabilities, limiting the size of others, and regulating interest rates and other terms relating to deposits and borrowing.

**Prohibition of Circulating Notes** Prior to the establishment of the National Banking System, banks in the United States typically made loans by issuing their own bank notes. Soon after the National Banking System was established, however, a tax was imposed on state bank notes which made their issuance impractical, and they disappeared from circulation. From that time until 1914, the only bank notes in circulation were those of national banks. Although the introduction of Federal Reserve currency removed the need for national bank notes, it was not until 1935 that their issue was stopped. This action marked the end of commercial bank notes in the United States.

**Limits on Indebtedness** National banks may not incur debts to an amount greater than their capital stock plus 50 per cent of unimpaired surplus. There are several exceptions to this limitation, including deposits, unpaid dividends, borrowings from Federal Reserve Banks, and certain others. In addition, the Comptroller recently ruled that in the case of national banks borrowings through the sale of short-term notes as well as through the "purchase" of Federal funds from other banks are not subject to the limitation on indebtedness.

**Payment of Interest on Deposits** In the 1930's, Congress authorized the Board of Governors and the FDIC to limit the interest paid on deposits by member banks and by insured nonmember banks, respectively. Interest on demand deposits is prohibited by statute and maximum rates may be prescribed for time and savings deposits. A few states also prescribe maximum rates for deposits.

**Receivership and Liquidation** Supervision plays as important a role at the end of a bank's life as it does at the beginning. Whether a bank ceases operations voluntarily or involuntarily, the law sets forth in considerable detail the procedure to be followed. The Comptroller supervises the voluntary liquidation of national banks. He may appoint a receiver either because the bank is insolvent or because it has violated certain laws, but receiverships for any cause other than insolvency are extremely rare. The FDIC must be appointed as receiver for national banks, but it performs some of its functions in this capacity under the direction of the Comptroller. The laws of 41 states require that either the supervisor of banking or the FDIC be appointed receiver of insolvent state banks; nine of these states specify that only the FDIC may be appointed.

The rarely used arrangement known as bank conservator is an interim measure short of receivership. If a bank's solvency is uncertain and if it is threatened with failure, a conservator may be appointed to take charge of the bank, conserve its assets, and try to work out a solution to its difficulties. The conservator may attempt a reorganization of the bank's finances, and if solvency is restored, the bank is returned to the management of its directors. The Emergency Banking Act of 1933 authorized the Comptroller to appoint conservators for national banks and the laws of a majority of the states contain similar provisions applying to state banks.

# The Administration of Banking Laws and Regulations

## ADMINISTRATIVE PROCEDURES

Supervisory agencies rely heavily on two major procedures—reports submitted by the banks and examinations carried out by staff examiners. If either of these procedures reveals irregularities or questionable practices or conditions, they may be followed by investigations, conferences, and, if necessary, the invocation of sanctions.

**Reports** Banks submit many reports to supervisory agencies. These serve both as a means of surveillance and as the source of data which are vitally important for the formulation and administration of monetary policy and for the analysis of financial and economic developments. Supervisory authorities have considerable discretion in prescribing the form, content, and frequency of reports.

*Call or Condition Reports* The most frequently used report is the "Call Report" of condition as of a specified date. In this the bank submits a fairly complete breakdown of its assets and liabilities. Most supervisory agencies now require four such reports per year. The dates for two of them are fairly well fixed, and fall at or near the end of June and December. The principal purpose of the fixed date is to provide comparable data from year to year. The disadvantage is that bankers know in advance when it is coming and may resort to "window dressing," or an artificial increase in certain items to make the bank's condition appear more favorable than it really is.

The dates for the other two call reports vary from year to year, with one coming in the first half of the year and the other in the second. To prevent window dressing on these calls, banks usually are required to give a statement of their condition "as of" a date a few days before the call is announced. In order to obtain comparable and additive data for the whole country, the many supervisory agencies specify the same call dates and use approximately the same report form.

In addition to the regular condition reports, supervisory agencies may require special reports. If an individual bank warrants special attention or if it is under instructions to make prescribed changes in its practices or to readjust its assets, the supervising agency may require it to make periodic reports to show the progress it is making in improving its condition or in carrying out the instructions.

*Reports on Income and Dividends* The condition reports give a still picture of principal assets and liabilities as of a given date. Banks also submit, annually or semiannually, moving pictures in the form of reports on income and dividends. These reports are broken down to show the principal sources of revenue, the main items of expense, and the dividends paid. The condition reports alone give little indication of the profitability of the bank's operations. But the condition reports and the earnings reports combined make a very useful tool for analyzing the state of the bank's financial health.

*Reserve Reports* Member banks of the Federal Reserve System submit weekly (reserve city banks) or bi-weekly (country banks) reports on their deposits, the reserves required to be held against them, and the reserves actually held. These reports are the principal reliance for checking compliance with reserve requirements. They are also of major importance in the formulation and administration of monetary policy and in providing a reliable indication of the level of tightness or ease of reserves in the banking system of the whole country. Little information is available on reserve reports required by state authorities but it appears that those reports are much less frequent than those of the Federal Reserve.

Supervisory authorities maintain a file for each bank under their jurisdictions. In this file are posted the principal items from recent condition and income reports, and summary items from the latest examination reports noted below. Subtotals are run for key assets and liabilities and significant ratios are computed. These files thus are case histories and provide supervisory authorities some perspective on the banks' condition if and when trouble develops.

EXAMINATIONS In the case histories just mentioned, the anchor or bench-mark items are the reports of examination, which are the principal reliance of supervision in maintaining surveillance of banks and checking their compliance with laws and regulations. Usually each bank is examined, without advance notice, at least once, and sometimes twice, per year.

*Major Examination Procedures* Several major procedures are performed in each examination. It should be emphasized, however, that an examination is not an audit of all the bank's transactions. A complete audit of each bank examined would require much larger staffs than are now available. Further, the audit is a management prerogative and there is serious question whether the supervisory official should usurp that prerogative.

An evaluation of principal assets and a verification of liabilities is a major part of an examination. The first imposes a heavy responsibility on the examiner. He must appraise loans on the basis of data from the bank's files, information supplied by the bank management and any other available source, and the borrower's performance on the current and previous loans. The examiner must apply this information with a broad knowledge of general business principles and conditions as well as an understanding of special conditions and practices prevailing locally. In one sense he is permitted to "second guess" the banker since he appraises the loan on the basis of current conditions and not those prevailing when the loan was made. The examiner must also appraise the bank's investments, but here he may receive substantial assistance from security ratings and market quotations. Local or other unrated securities, however, may present very difficult problems. In all appraisals the aim is to determine intrinsic values which may be realized at maturity and not values based on any abnormal current quotations or on a forced liquidation.

On the basis of his appraisal, the examiner may "classify" certain of the bank's assets which are below acceptable standards. Depending on how far below such standards the asset falls, the bank may be required to write off varying portions or all of the asset's value. Until such losses have been written off or adequate reserves established, the bank is restricted in the use of certain of its profits.

Another and very difficult part of a bank examination is an appraisal of the bank's management. There is no yardstick for such an appraisal and the examiner must rely upon his ability to judge human nature and the information he has about the banker's age, training, experience, ability, and character. In so far as possible, this appraisal should, of course, be impersonal and impartial and should be based upon a careful distinction between the responsibilities of the directors and officers of the bank to set policies and the responsibility of the examiner to offer counsel and advice. The appraisal of the management should be helpful to the examiner in indicating what kind of advice to offer and to all supervising agencies in deciding when and how to intervene if trouble should develop.

Examiners also appraise the adequacy of the bank's capital. Due to the lag in revising legal standards and the rapid growth in the size of banks, minimum capital requirements have lost most of their significance. In recent years, supervisors have rarely permitted banks to start operations with the minimum legal requirement. Before World War II, a rule of thumb frequently used to determine adequacy of capital was that capital funds should be about 10 per cent of deposits. The sharp expansion of bank assets and deposits during the war, with most of the increase in assets represented by risk-free Governments, quickly made that standard obsolete. For a time there was a tendency to eliminate Governments and measure capital against "risk assets." This ratio declined from about 25 per cent in 1945 to around 12 per cent at the end of 1964, but there is no general agreement on what is a satisfactory or adequate ratio. More recently, a practice has developed of allocating certain amounts of capital against various types of assets plus additional amounts for liquidity, trust operations, and other similar factors. No generally accepted standards have evolved and supervisors must depend heavily on their judgment reinforced by such ratios as they consider pertinent.

Bank examinations are not conducted primarily to uncover embezzlements or other irregularities, but the examiner would be remiss if he did not give attention to the bank's system of internal safeguards. This includes good basic records, prompt and efficient handling of all transactions, all practicable internal checks and safeguards, and some system of auditing, dependent on the size and organization of the bank. These things are the responsibility of the bank's management, but if they are clearly inadequate the examiner should call them to the attention of the management and the supervisory authorities. To a considerable extent, also, they will determine the extent and amount of the examiner's work, since in the absence of a sound system of internal safeguards he must dig deeper and harder to find the facts. An open question is whether supervisory agencies should have authority to require banks to establish and maintain systems of internal safeguards which meet minimum standards.

Finally, the examination procedure includes a comprehensive report by the examiner in charge. Much of the effectiveness of the report and of the whole examination will depend on the logical arrangement of the report, the clarity with which it is presented, and the cogency of its conclusions. The report should be built around, and should highlight, the principal conclusions indicated by the examination. Naturally, before he can write such a report, the examiner must prepare a detailed analysis of the favorable and unfavorable features revealed by the examination with respect to the bank's asset distribution, quality of assets, capital adequacy, management, earnings, compliance with statutory provisions, and other pertinent factors. The report serves a dual purpose. First, it gives the supervising agency the examiner's appraisal of the bank's condition, together with his recommendations for any needed remedial action. Second, it informs the bank directors of the bank's condition as seen by the examiner, and calls attention to any matters which might require action by the directors. In special situations the report may be the basis for a special meeting of the directors at which a representative of the supervising agency will discuss major findings and explain the reasons for recommended changes.

The Comptroller is empowered, under specified conditions and after ninety days notice, to publish the report on a national bank. The threat of publication is meant to be a disciplinary action to induce compliance by the bank's officers and directors with instructions contained in the report. It is rarely, if ever, used.

## SANCTIONS

All laws and regulations must have sanctions if they are to be effective, and banking laws and regulations are no exception. Of course, banks, unless specifically exempted, are subject to all general civil and criminal statutes. In addition, banking codes prescribe civil and criminal penalties for a number of offenses peculiar to banking such as false representation in reports, making loans to examiners, accepting deposits when the bank is known to be insolvent, and, generally, violating banking laws and regulations. The discussion here is restricted to sanctions which may be imposed by supervisory agencies.

*Fines* As a general rule, bank supervisors do not have the authority to levy fines to enforce their instructions and rulings. There are a few exceptions. The Comptroller may fine a national bank $100 per day (no variation allowed) for failure to render reports. The Board of Governors may levy a fine of up to $1,000 per day on a bank for failure to sever its connections with a securities company. There may be a few other instances where fines may be used, but they are not a common sanction.

*Removal of Officers or Directors* A comparatively new sanction, added in the Banking Act of 1933 but very rarely used, is the power to remove from office an officer or director of a commercial bank. The Comptroller or a Federal Reserve agent may cite to the Board of Governors any director or officer of a national or state member bank believed to be guilty of continued violation of any banking law or of continuing unsafe and unsound practices. If the Board, after granting the accused "a reasonable opportunity to be heard," finds the charge to be true, it may order the officer or director removed from office. Such action is, of course, subject to judicial review.

*Expulsion and Termination of Insurance* The Board of Governors may expel a member bank from the System for any one of several offenses. These include false certification of checks by an officer of a state member bank, continued affiliation with a securities company, failure of an affiliated company to allow an examination, failure to keep the number of directors within specified limits, and, generally, violations of banking laws and regulations. The Board has the authority, after a hearing, to order explusion, but, again, its action is subject to judicial review.

If any bank insured by the FDIC continues unsafe and unsound banking practices or permits officers to violate banking laws and regulations, the FDIC may bring action to terminate the bank's insurance. The FDIC must notify the bank and other affected regulatory agencies, and hold a hearing. If the bank is found guilty, its insurance may be terminated. During the years 1936 through 1964, the FDIC started 189 actions to terminate insurance. In 72 cases corrections were made and proceedings closed. In 68 cases the affected banks were absorbed or succeeded by other banks, and 34 other banks suspended before a date was set for termination. Three cases were pending at the end of 1964. This left 12 cases in which termination dates were set; of these, nine suspended before the termination date and three continued in operation after insurance was terminated, but one of them closed four months later.

*Forfeiture of Charter* The forfeiture of a bank's charter is a drastic penalty, very rarely used. The Comptroller is authorized to forfeit the charter of a national bank if it refuses to allow an examination or to give information in connection therewith, or if it violates banking laws. Of historical interest is the provision requiring all national banks to join the Federal Reserve System within one year after the enactment of the Federal Reserve Act. A very few banks did fail to join and surrendered their charters at that time. The forfeiture of charter is not automatic. When an offense is committed, the Comptroller must bring action in an appropriate court which makes the decision.

## CONCLUSION

A frequently voiced criticism of sanctions in the banking field is that they are too harsh and drastic for use except on rare occasions. As someone has expressed it, the offense may be comparable to the violation of a traffic law but the penalty is that for murder. There seems to be a need for more flexible and more appropriate penalties. Two suggestions along this line are that supervisory officials be given the power to issue "cease and desist" orders, and that more use be made of monetary fines.

# *The Application of Antitrust Laws to Banking*

Time was when it was felt that antitrust laws did not apply to banks. There were two reasons for this. First, banking, unlike industry and commerce generally, is a regulated business, and this was supposed to exempt it from most provisions of the antitrust laws. Second, the Federal antitrust laws were adopted under the "Commerce Clause" of the Constitution, which gives Congress power to regulate commerce among the states. It was long assumed that banking was not interstate commerce and therefore not subject to Federal legislation on this point.

The idea that banking is not interstate commerce within the meaning of the Sherman and Clayton Acts came from two old cases. These cases held: (1) that a state could regulate the insurance business, since writing an insurance contract was not interstate commerce; and (2) that a state tax on money or exchange brokers was constitutional because the banking business was not interstate commerce. Later, however, Federal power under the Commerce Clause came to be applied to financial institutions in specific situations. The National Labor Relations Act was held applicable to banks in 1942, and in 1944 the Supreme Court reversed itself and held that the insurance business is in interstate commerce and therefore subject to the antitrust laws. In 1946, the Department of Justice filed its first suit against banks under the Sherman Act. In 1953, a Federal appellate court said banking is "commerce" within the meaning of the antitrust laws. In 1963, in the *Philadelphia* case, the Supreme Court laid the question to rest when it said that: "No argument is made in the case that banking is not [interstate] commerce, and therefore that Section 7 [of the Clayton Act] is inapplicable; plainly, such an argument would have no merit." Thus, the old argument that banking is not interstate commerce is of only historical interest, important solely because it accounts for the late entry of the Justice Department into this field.

The first argument—that since it is a regulated industry, banking should be exempt from the antitrust laws—remains with us today. The landmark decision in the *Philadelphia* case settles the question only temporarily; the ruling of that case is the subject of intensive study by Congress. Special interest centers on the peculiar problems relating to bank mergers and holding company acquisitions, including the formidable unscrambling process that would have to be ordered in some cases.

## THE ANTITRUST LAWS

Section 1 of the Sherman Act, adopted in 1890, declares illegal "every contract, combination . . . or conspiracy, in restraint of trade or commerce among the several states. . . ." Section 2 makes it a crime to "monopolize, or attempt to monopolize, or combine or conspire . . . to monopolize any part of the trade or commerce among the several states. . . ." "Restraint of trade" is an elastic concept. Not all restraints are illegal; only unreasonable ones. In antitrust cases, the courts apply the so-called "rule of reason": the reasonableness of a concentration of economic power is determined by its effect in restraining competition.

It was soon felt that the Sherman Act provided inadequate protection against concentration in industry; effective action could be taken under the Act only after a monopoly had been achieved. Consequently, in 1914 Congress adopted the Clayton Antitrust Act, designed to forestall monopoly in its inception. The key provision of the Act is Section 7, which originally provided that no corporation engaged in interstate commerce "shall acquire, directly or indirectly, the whole or any part of the *stock or other share capital* of another corporation engaged also in [interstate] commerce, where the effect of such acquisition *may be* to substantially lessen competition between" such corporations "or to restrain such commerce *in any section or community* or *tend to* create a monopoly of any line of commerce." (Italics supplied.)

The Federal Reserve Board was given power to enforce Section 7 and certain other sections of the Act "where applicable to banks, banking associations, and trust companies."

Generally, except for certain "per se" violations, like division-of-territory or price-fixing agreements, illegal without regard to their actual effect on competition, a Sherman Act violation requires actual realization of monopoly. This means the power to set prices or exclude competition, or at least some overt attempt to achieve such an end with reasonable probability of accomplishment. A lesser degree of proof is required under Section 7 of the Clayton Act, which is designed to prevent monopoly in its inception. The Clayton Act language is broad and sweeping: the conduct spelled out in the Act is illegal if its effect *may be* substantially to lessen competition or to *tend to* create a monopoly.

## SUITS AGAINST THE BANKING INDUSTRY

Once it appeared that the old "banking is not interstate commerce" concept no longer sheltered banks from antitrust assault, a variety of proceedings was instituted. They fall into two broad categories: suits against trade practices and suits against mergers and holding company acquisitions.

TRADE PRACTICE CASES In 1946, the Government brought suit under the Sherman Act against a New York trade association and 38 lending institutions, including one commercial bank and 17 savings banks, charging they had used their association to eliminate competition among themselves through various practices, including fixing minimum amortization rates and terms; establishing standard appraisal procedures and valuations, and withholding mortgage financing from builders, thus preventing new construction in areas where the defendants already had substantial mortgage interests. A consent decree required the trade association to be dissolved and put an end to the challenged practices. A similar Sherman Act suit, charging a Chicago bankers' association, 12 commercial banks, and other corporations with fixing minimum commissions, service fees, and interest rates, was dismissed because most of these practices had ended.

The year 1963 brought something new: the first criminal prosecutions of banks under the antitrust laws. Price fixing was charged in each case. In a Minnesota case, seven banks and a bank holding company were indicted under Section 1 of the Sherman Act for agreeing to fix service charges for checking accounts and other bank services. All defendants pleaded no contest, and were fined. In another Minnesota case, 11 banks were charged in a Sherman Act indictment with agreeing to fix rates of interest, terms, and conditions of loans, and to refrain from absorbing certain losses and providing free supplies to correspondent banks. Ten defendants pleaded no contest and were fined.

A civil action in New Jersey charged three banks with fixing and maintaining a uniform schedule of charges for checking accounts and other services. A consent decree halted these practices. In Utah, competing banks filed a Sherman Act suit charging that a one-check payroll plan offered by the defendant was an attempt to monopolize the local checking account business. The trial court in 1965 found no violation, saying ". . . progress and the utilization of new instrumentalities and procedures are not prohibited . . ." by the antitrust laws.

MERGER AND ACQUISITION CASES

*Holding Company Acquisition Cases*
Until the Bank Holding Company Act of 1956, no Federal statute specifically governed the acquisition of shares of bank stock by a corporation, although there were, and are, some similar *state* bank holding company acts.

Before the Holding Company Act was adopted, however, there was one important proceeding to compel divestiture of a holding company's holdings of bank stocks. This was the *Transamerica* case, a proceeding instituted by the Board of Governors charging violation of the original Section 7 of the Clayton Act, and the only proceeding the Board has ever instituted to enforce the Clayton Act.

The Board, after a hearing, found Transamerica and its affiliates controlled 645 banking offices, 40.9 per cent of the total, in the states of California, Washington, Oregon, Nevada, and Arizona. The Board found that this constituted a violation of Section 7 of the Clayton Act and ordered Transamerica to divest itself of all its bank stocks except those in the Bank of America. However, an appellate court set aside the Board's order and the Supreme Court refused to review the case.

Another attack on a holding company acquisition, this time made *after* enactment of the Bank Holding Company Act of 1956, was the *Firstamerica* case, filed in 1959. This case was settled by a consent decree under which Firstamerica, now called Western Bancorporation, was required to divest itself of its interest in 65 banking offices in California.

*Merger Cases* The original prohibition in Section 7 against acquisition of *stock* was expanded in 1950 to provide: ". . . and no corporation *subject to the jurisdiction of the Federal Trade Commission* shall acquire the whole or any part of the *assets* of another corporation . . ." where the effect of the acquisition "may be substantially to lessen competition, or to tend to create a monopoly." (Italics supplied.) Banks, of course, are not subject to the jurisdiction of the Federal Trade Commission, and therefore it was generally assumed that the 1950 (*assets* acquisition) amendment of the Clayton Act did not directly affect them. It was assumed also that a *stock* acquisition (covered by the original Section 7) meant not a merger but the purchase by one corporation of shares of another, with neither losing its corporate identity. Thus, it could be reasonably argued that a bank could run afoul of Section 7 of the Clayton Act only by purchasing enough shares of the stock of another bank to produce an anti-competitive effect.

This assumption was laid to rest in 1963 in the *Philadelphia* case, in which the Supreme Court said mergers fit perfectly neither the stock acquisition nor the assets acquisition technique, "but lie somewhere between the two ends of the spectrum." Thus, the court said, the only transactions excluded from the coverage of Section 7 were assets acquisitions by corporations not subject to FTC jurisdiction "*when not accomplished by merger.*" (Italics supplied.)

Between the 1950 amendment of Section 7 of the Clayton Act, and the *Philadelphia* case in 1963 came two acts specifically dealing with the concentration of economic power in banks—the Bank Holding Company Act of 1956 and the Bank Merger Act of 1960. The former required approval of the Board of Governors: (1) before a company could become a "bank holding company," i.e., a company owning or controlling 25 per cent of the shares of two or more banks, or controlling election of the majority of the directors of two or more banks; and also (2) for any such holding company to acquire ownership or control of more than 5 per cent of a bank's voting shares. Before approving "any acquisition or merger or consolidation" the Board was required to consider: the financial history, prospects, and management of the companies and banks involved; the convenience, needs, and welfare of the communities and the area concerned, and "whether or not the effect of such acquisition or merger or consolidation would be to expand the size or extent of the bank holding company system involved beyond limits consistent with adequate and sound banking, the public interest, and *the preservation of competition in the field of banking*." (Italics supplied.)

The 1950 and 1956 legislation was assumed by most observers to indicate that bank expansion, as such, was exempt from the antitrust laws, and also that straight stock acquisitions by banks were intended to be treated somewhat differently from acquisitions by nonbanking corporations. This view was buttressed by adoption of the Bank Merger Act in 1960, which provided that the appropriate regulatory agency —the Comptroller, Board of Governors, or FDIC—must give its consent before an insured bank could merge or consolidate with, acquire the assets of, or assume liability to pay deposits in, any other insured bank. In deciding whether to give its consent, the appropriate Federal banking agency was required to consider substantially the same factors as the Board of Governors must consider in passing on Holding Company Act applications. The transaction should not be approved "unless, after considering *all of such factors*," the agency "finds the transaction to be *in the public interest*." (Italics supplied.) The Act further required, ". . . in the interest of uniform standards, . . ." that the appropriate agency, before acting, should request reports on the competitive factors involved from the Attorney General and from the other two Federal regulatory agencies.

In the *Philadelphia* case, however, the Supreme Court majority rejected the argument that the 1960 legislation conferred an implied immunity from the Clayton Act on bank mergers, saying: "When Congress enacted the Bank Merger Act, the applicability of Section 7 to bank mergers was still to be authoritatively determined; it was a subject of speculation. . . . The design fashioned in the Bank Merger Act was predicated upon uncertainty as to the scope of Section 7, and we do no violence to that design by dispelling the uncertainty." The opinion was based entirely on Section 7 of the Clayton Act, and the Court expressly declined to discuss whether or not the merger, as charged by the Government, violated Section 1 of the Sherman Act as well.

However, a Sherman Act violation was found in the Supreme Court's next major banking decision—the *Lexington* case, decided in 1964. When this suit was filed, the *Philadelphia* case had not yet been decided, and apparently because the Justice Department doubted the applicability of Section 7 of the Clayton Act to banks, it elected to proceed only under Sections 1 and 2 of the Sherman Act. The merger of First National Bank and Trust Company and Security Trust Company of Lexington, Kentucky, had been approved by the Comptroller. The bank argued that the Bank Merger Act, under which the Comptroller acted, rendered such transactions immune from attack under the antitrust laws. The District Court rejected this contention but went on to hold that violation of the Sherman Act had not been shown. The Supreme Court reversed, and sent the case back to order the merged bank broken up.

The largest bank merger yet attacked by the Department of Justice occurred in 1961, when the Hanover Bank of New York City merged with Manufacturers Trust Company to form Manufacturers-Hanover Trust Company. Decision in the suit was withheld pending the Supreme Court's decision in the *Philadelphia* case. Finally, the United States District Court for the Southern District of New York handed down an exhaustive opinion in the spring of 1965.

The feature which marked this case particularly was that it involved a merger which directly affected two banking markets—a "wholesale" or national market and a "retail" or local market. The task of defining these two markets in this particular case presented the court with a very difficult problem. After exhaustive analysis and the consideration of great masses of statistics, the court could find no violation of the Sherman or Clayton Acts based "solely on the factor of the market share foreclosed by defendant in either market as a result of the merger." This sounded like a prelude to a ruling that no antitrust law violation had been shown. But the court went on to say: "Whether a given merger increases the market share of the resulting firm to forbidden proportions or threatens a 'significant' rise in concentration depends on the setting."

The "setting" which finally decided the case was the demonstrated trend toward concentration in the New York area. The court noted that in 1950 there had been 70 independent commercial banks in New York City, but in the following ten years 27 were absorbed by mergers, and only three new banks had entered the market. This "factual setting," the court said, "admits no conclusion other than that this merger . . .

tends to create a monopoly by significantly increasing concentration and accelerating a trend toward oligopoly. The case more than satisfied the rule that when concentration is already great, even slight increases must be prevented." Thus, the court found, the merger "substantially lessens competition and restrains trade by the permanent elimination of significant competition formerly existing between major competitors," and that in itself constitutes a violation of Section 1 of the Sherman Act and of Section 7 of the Clayton Act. No final divestiture order had been entered as of this writing.

Five other merger cases may be mentioned briefly. In the *Calumet* case, begun in 1963, the Department of Justice brought action to forestall an Indiana merger which had been approved by the Comptroller. Because of threatened costs and delays the two banks dropped their plans and, at their request, the Comptroller rescinded his approval.

The *Crocker-Anglo* case, also begun in 1963, is a suit to dissolve a California merger and is pending at this writing. It involves one bank with 124 offices, largely in the northern part of the state, and another with 78 offices, mostly in the southern part; there was relatively little competition between them. The Government was unsuccessful in an attempt to obtain a preliminary injunction to stop the merger.

The *Continental-Illinois* case, begun in 1961, is also still pending. If the court should order a dissolution here it would present an especially difficult problem since the merged bank has been operated as a unit bank due to the Illinois no-branching law.

The *Third National* case, filed in 1964, sought to block a merger in Tennessee. The court denied application for a preliminary injunction, relying heavily on the findings of the Comptroller in approving the merger. The court denied the Comptroller permission to intervene in the suit.

One of the most recent actions is the *Mercantile Trust* case, started in 1965, which attempts to dissolve the merger of two St. Louis banks. It has two unusual aspects. It has been called a "cash merger" because the stockholders of the bank being absorbed received cash instead of stock in the surviving bank. Conceivably, this may affect the applicability of Section 7 of the Clayton Act. The other unusual feature is that the Comptroller received permission to intervene as a defendant in the suit. This case also is still pending.

*State Antitrust Laws* Many states have antimonopoly statutes which may apply to banking. In what appears to be the only decision involving enforcement of a state antitrust law against banks, a Michigan court in the *People's Saving Bank* case, decided in 1960, disapproved a plan to dissolve a competing bank. The court relied on the Michigan antimonopoly statute, which provided in part: "All combinations of persons ... entered into for the purpose and with the intent of establishing ... or of attempting to establish ... a monopoly of any trade ... or business, are ... illegal and void." A commercial bank in Lansing had a branch in Port Huron, where the People's Saving Bank was the only other bank. The Lansing bank, through its employees' profit-sharing trust, acquired a majority of the stock in the savings bank and announced its intention to vote these shares to dissolve it. Action was brought to stop the transaction. The court, in rejecting the defendants' argument that the state antimonopoly law did not apply to banking and that Federal antitrust and banking laws had pre-empted the entire field, held that "... banking is not generally exempted from the antimonopoly laws, . . . ." It also rejected the defense argument that "banking is not a business in which monopoly is ever possible. . . ."

## PROPOSED LEGISLATION

THE ROBERTSON-PROXMIRE BILL In April 1965, Senator Robertson, Chairman of the Senate Committee on Banking and Currency, introduced a bill to amend the Bank Merger Act. It provided that the authority of the Federal regulatory agencies to approve mergers and acquisitions involving banks "shall be exclusive and plenary," and that any merger or acquisition approved under the Bank Merger Act would be exempt from the operation of the antitrust laws. The bill also exempted any insured bank with respect to any approved merger or acquisition consummated before May 13, 1960.

Opposition developed to the complete exemption of bank mergers and the Senate Committee ultimately reported a bill containing an amendment offered by Senator Proxmire. The amended bill would leave bank mergers and acquisitions subject to the antitrust laws, but would create a thirty-day waiting period after approval by the appropriate banking agency. This would serve the double purpose of delaying consummation and imposing on the Department of Justice a short statute of limitations. Unless suit were filed within thirty days after the Attorney General was notified of a merger approval, the transaction would thereafter be immune from antitrust attack. If suit were filed within thirty days, the merger could not take effect until final determination of the antitrust suit. The Proxmire amendment also contained a controversial provision exempting from the antitrust laws any approved merger or acquisition consummated before adoption of the amendment if the resulting bank had not been dissolved or divided pursuant to a final judgment. This, of course, would have exempted from divestiture the banks involved in the pending cases discussed above. While the proposal for retroactive exemption of the banks involved in pending suits encountered strong opposition on the Senate floor, the bill passed the Senate with this provision intact.

In the final week of the 1965 session of Congress, the House Banking Committee reported a much-revised and controversial version of the Robertson-Proxmire bill. As amended, the bill provides that the responsible Federal banking agency, and also any court reviewing the legality of a merger, should "take into account the effect on the public interest and the community" of the banking factors specified in the Bank Merger Act. If this version of the bill is approved during the 1966 session of Congress, the rule of the *Philadelphia*, *Lexington*, and *Manufacturers-Hanover* cases—that a merger is illegal if it has substantial anticompetitive effect, even though it is beneficial to the public—will be changed. However, the question whether the bill was actually reported out by the House Committee was in dispute as Congress adjourned.

Thus, while changes in the application of antitrust laws to banks may be accomplished during the 1966 session of Congress, the form such changes will take and the effect they will have on the six cases now pending in the courts remain to be seen.

# *Recent Developments and Problems Affecting Regulation*

The Justice Department's suits to apply the antitrust laws to banks as discussed in the previous section have perhaps been the most striking development in bank regulation in recent years. But there have been other developments in bank regulation which, though of less immediate interest to the general public, may have consequences just as far-reaching as the court decisions which have made headlines.

## METHODS OF ACQUIRING FUNDS

The acquisition of reserves by commercial banks has always been regulated to some extent. Reserves are derived traditionally from three sources: capital, Federal Reserve credit, and deposits. Capital requirements have always been specified by the banking authorities to some extent and the use of capital funds has been regulated. Additions to bank reserves from Federal Reserve credit are closely regulated, but the creation of reserves through primary deposits has attracted less attention until recently. Individual savings deposits are usually solicited on a local basis, and larger corporate and correspondent bank deposits typically are negotiated, at least to some extent. Until recently, only very limited use was made of the impersonal instruments of the money market to acquire deposits.

Certificates of Deposit During the past five years, banks have raised large sums through the sale of three types of instruments: negotiable certificates of deposit (CD's), subordinated debentures, and negotiable unsecured short-term notes. The active solicitation of corporate time deposits represented a substantial departure from previous policy for most banks. Banks have usually welcomed savings deposits, which are the deposits of individuals, having no specific maturity but which, in practice, may be withdrawn on demand. Such deposits usually represent true savings and are in the aggregate relatively stable. A time deposit, which may be evidenced either by an open account or by a certificate of deposit, may not be withdrawn in less than thirty days after the deposit.

In contrast with savings deposits, most time deposits are highly volatile. They consist mainly of corporate funds which are temporarily idle, but which must be available on specific dates for working balances or payments purposes. Until the advent of the CD, the great volatility of corporate time deposits discouraged banks from seeking them. Banks apparently felt that the CD minimized the shortcomings of corporate time deposits. Once a CD market was developed, the volatility of any single corporation's deposit became less important. Also, the wider market presented the possibility of increasing time deposits by drawing down corporate demand deposits at some bank other than the issuing bank. Because the market for CD's is very impersonal, the issuing bank may easily reduce the amount outstanding if it no longer needs the funds.

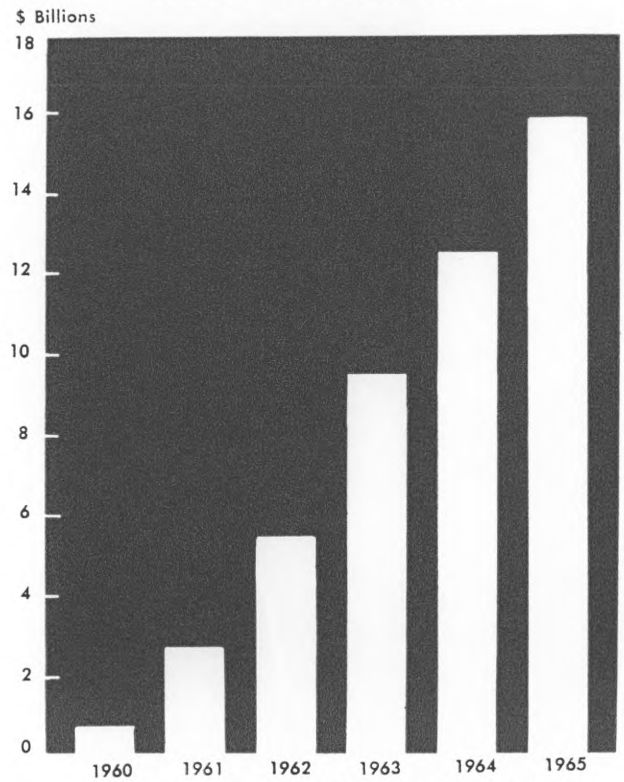
Since 1933, the Board of Governors has regulated the interest rates member banks may pay on time and savings deposits by changes in Regulation Q. These interest rate ceilings have become especially significant since banks have issued CD's on a large scale. With some $16 billion of CD's outstanding in late 1965, the Board must consider not only the prevention of unhealthy competition between banks for deposits, but also the ability of banks to compete with other financial intermediaries for deposits. A rate ceiling low enough to impair the ability of banks to attract and retain deposits may have far-reaching effects.

SUBORDINATED DEBENTURES Since 1962, banks have issued approximately $1 billion in capital notes and debentures. In a sharp break with previously accepted banking practices, banks of all sizes have entered the market with a variety of long-term debt instruments. Traditionally, the issuance of debt instruments to provide capital was considered inappropriate and unsound. It was generally believed that a major function of bank capital was to afford protection for depositors, and that protection could best be provided with equity capital.

In almost half the states, the sale of capital notes or debentures by state banks was illegal or limited to special circumstances, and until recently national banks had no authority to raise capital in this manner. These restrictions, together with the unfavorable connotations involved in such issues, were sufficient virtually to prohibit the use of senior securities.

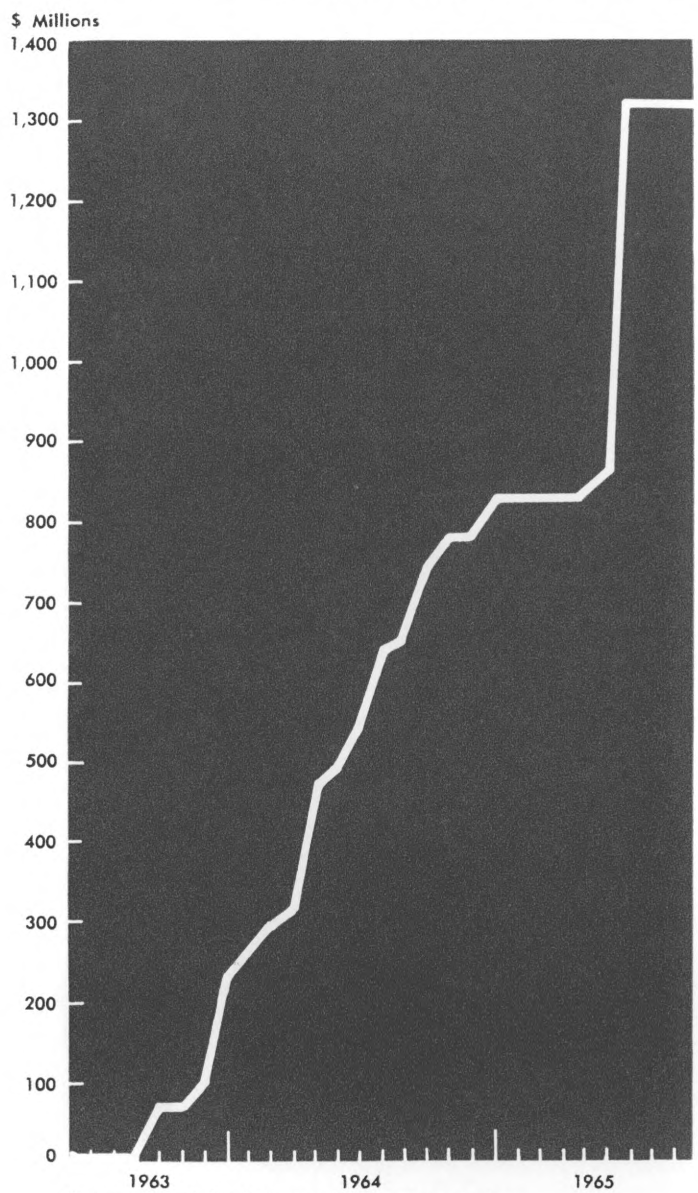
The situation changed quickly when, in December 1962, the Comptroller issued a ruling permitting the issuance of either convertible or nonconvertible capital debentures by national banks. Another ruling, permitting the proceeds of

NEGOTIABLE TIME CERTIFICATES OF DEPOSIT OUTSTANDING




Source: Board of Governors of the Federal Reserve System.

CAPITAL NOTES AND DEBENTURES OUTSTANDING




Source: Bank Stock Quarterly; American Banker.

all subordinated capital notes or debentures to be included as part of bank capital for the purpose of computing the legal limit on loans to a single borrower further enhanced the use of such securities. Almost immediately after the Comptroller's first ruling, a number of banks issued debentures, and many others soon followed their lead. Today many of the largest banks have sizable issues of capital notes or debentures outstanding, and the number is increasing.

Supervisory authorities are not in agreement on the use of debt capital. The Comptroller has encouraged its use; the Board of Governors has not favored it. Some states freely permit capital security issues, while others forbid them completely. The Comptroller considers subordinated notes and debentures as part of a bank's capital. For purposes of determining capital adequacy, the Board of Governors considers such issues to be a part of capital but it has ruled that ". . . capital notes or debentures do not constitute 'capital', 'capital stock', or 'surplus' for the purposes of the provisions of the Federal Reserve Act."

Some states which prohibited the use of debt capital by banks before 1962 have recently liberalized their laws. Under the dual banking system, a state bank may escape most state regulations by applying for a Federal charter and becoming a national bank, and many banks have done so. The Comptroller's ruling on debentures is one of several rulings which have induced state legislatures to alter state banking laws in order to preserve the state banking system.

**Negotiable Unsecured Short-Term Notes** Another recently developed method of raising additional funds, but thus far a minor one, is the negotiable unsecured short-term note. This represents a further departure from the traditional reliance on equity capital and deposits by commercial banks. Until recently, commercial banks had generally used the money market only for buying and selling investments, but the short-term note, like the CD, represents an attempt to tap that market as a source of loanable funds. Since funds secured through the sale of notes are not at present considered to be deposits, they are not subject to Regulation Q nor to the reserve requirement against time deposits, nor is it necessary to pay FDIC insurance premiums on them.

Prospects for the further growth of note issues are still in doubt. Some state banks still are faced with legal barriers. But probably the major reason for lack of expansion is that the CD is working satisfactorily. It appears likely that unsecured notes will be issued on a significantly larger scale only if CD's prove to be inadequate.

## FEDERAL FUNDS

The term "Federal funds" means reserve balances of member banks at a Federal Reserve Bank. If a member bank has an excess of such funds above requirements, that excess produces no income since no interest is paid on its deposits at the Federal Reserve. If another member bank is deficient in reserves, it may buy (borrow) funds from the bank with an excess, as an alternative to discounting or raising funds by other means. There is an active market for these funds and trading has increased greatly in recent years.

The Comptroller has issued a number of rulings on the purchase and sale of Federal funds by national banks. Between 1956 and 1958, in several rulings on purchases and sales in connection with repurchase agreements, he relaxed the restrictions somewhat while still holding to the concept that they involved the lending and borrowing of funds. In 1963, however, he reversed his position by ruling that they are purchases and sales of funds rather than borrowing and lending and specifically exempted them from all limitations as to amounts.

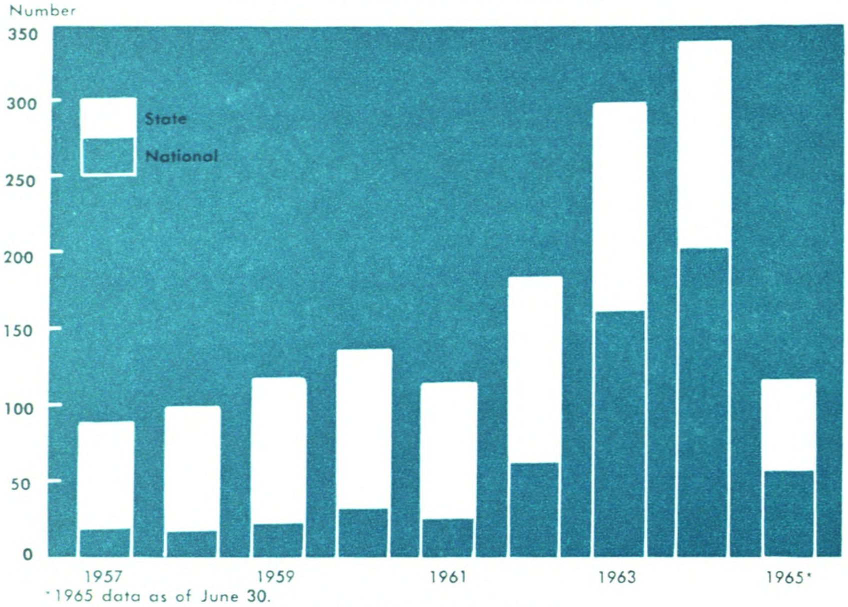
The Board of Governors, in September 1963, made it clear that under the laws administered by the Board, a transaction in Federal funds constituted a loan on the part of the selling bank and a borrowing on the part of the purchasing bank. It also reaffirmed the 1959 ruling that a sale of Federal funds by a bank to another bank in the same holding company system would be considered a criminal violation of the Bank Holding Company Act.

Since 1963, there has been a substantial increase in Federal funds trading, but it is impossible to say how much of the increase is due to the Comptroller's ruling. Because that ruling applies only to national banks, some state banks feel that they have been put in an unfair competitive position. This is one of the more glaring, even if minor, conflicts between supervisory authorities.

## UNDERWRITING REVENUE BONDS

The banking legislation of 1933 restricted the right of commercial banks to underwrite bond issues. In particular, it permitted banks to underwrite bonds issued by state and local governments only if they were "general obligations" of such units. By direct implication this

NEW BANK CHARTERS ISSUED



*1965 data as of June 30.
Source: Board of Governors of the Federal Reserve System.

excluded "revenue" or limited obligation bonds. Thus the distinction between the two types of securities is of considerable importance both to commercial banks and to issuers of this type of security.

For a long time there was no disagreement over the definition of general obligation bonds, but in October 1962, the Comptroller ruled that the revenue bonds of certain Georgia state authorities were general obligations. Since then he has ruled that revenue bond issues of various public authorities in Virginia, Illinois, Pennsylvania, and elsewhere are general obligations. In late 1965 he accomplished the same purpose by holding that revenue bonds of the Port of New York Authority were "general obligations of a state or political subdivision thereof."

The Board of Governors continues to use the older definition, and has specifically forbidden state member banks to engage in the underwriting of rental revenue bonds, despite the fact that the rental collections were totally dependent upon the tax income of local governments. Thus, at present, there is a conflict; national banks are permitted to engage in certain underwriting operations which are forbidden to state member banks. There have been legislative proposals to clarify the issue either by specifically defining general obligation bonds or by permitting all member banks to underwrite revenue bonds, but as of now, the matter remains unsettled.

## BANK OWNERSHIP OF LEASED EQUIPMENT

In March 1963, the Comptroller ruled that the leasing of personal property, acquired for that specific purpose, was "a lawful exercise of the powers of a national bank and necessary to the business of banking." The ruling came as a shock to other regulatory agencies, and as a great surprise to the banking and legal communities. It was a direct reversal of a ruling of the previous Comptroller who had concluded that a leasing arrangement would qualify only if it required the lessee to pay the total amount of the "rents" even if he were deprived of the use of the property. This would give the bank an unconditional promise to pay, and would make the so-called "lease" in actual fact a promissory note. The Comptroller's ruling apparently has not yet been tested in the courts.

## RENEWED COMPETITION BETWEEN STATE AND NATIONAL SYSTEMS

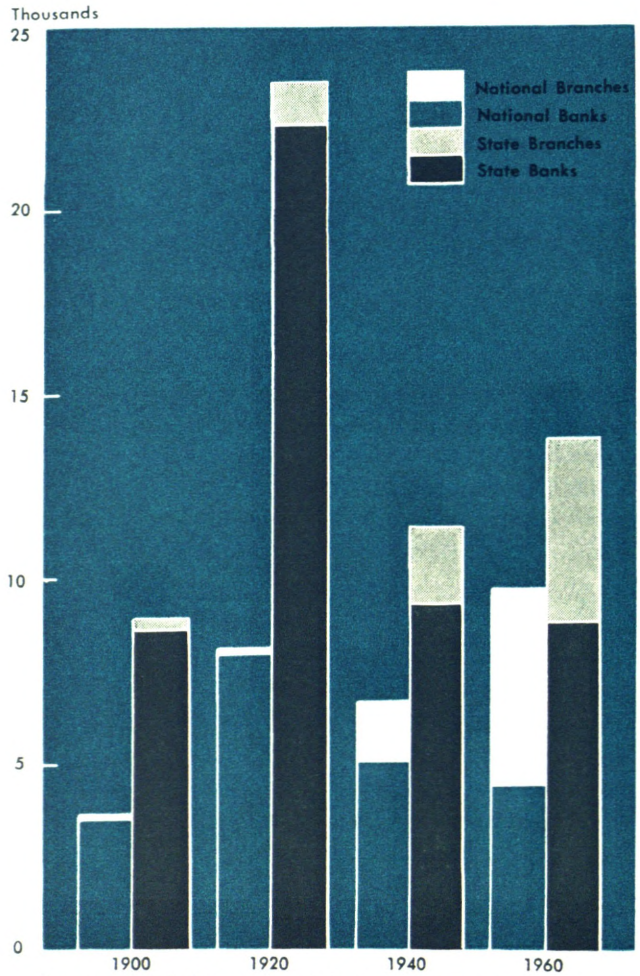
From the early 1930's, when the American banking system underwent massive changes, until 1961, the number of banks in the United States declined slowly but steadily. A few banks closed their doors involuntarily, but a great many more were eliminated through mergers. Meanwhile, the number of new banks chartered each year remained fairly stable. In 1946, 136 new banks were chartered; in 1960, 134. In the years between, new bank charters ranged from a low of 55 in 1953 to a high of 120 in 1956. Then, in 1961, the picture suddenly changed. A series of rulings from the Office of the Comptroller apparently stimulated great interest in national bank charters. From 26 in 1961, the number more than doubled in both 1962 and 1963. A record of 202 was set in 1964 before the rate dropped sharply to 57 in the first half of 1965. For many years prior to 1961, the states issued about two thirds of all bank charters, but in 1964 their share dropped to only a little more than one third.

While state charters did not increase as rapidly as Federal charters, there was a substantial increase in the number issued after 1961. Further, the competition between state and national regulatory agencies has not been limited to the issuance of charters. In an atmosphere reminiscent of the competitive laxity before 1930, the Comptroller has issued numerous rulings liberalizing banking practices, and placing national banks in a stronger competitive position vis-a-vis state banks.

The Comptroller has permitted for the first time: (1) the sale of preferred stock, capital notes, and debentures on the open market, and the issuance of short-term negotiable promissory notes; (2) ownership of leased equipment; (3) ownership of mortgage-servicing corporations; (4) the sale of data processing services; (5) travel services for customers; (6) extensions of foreign operations through direct acquisition rather than stock purchase of foreign banks; (7) purchase of "key man" life insurance for the benefit of the bank; and (8) the acceptance of corporate savings accounts (prohibited by the Federal Reserve).

The Comptroller has also liberalized the rules governing: (1) underwriting of municipal securities; (2) certain trust operations; (3) investment of a national bank in its own premises; (4) loans to a single borrower; (5) sale of insurance by banks; and (6) the issuance of stock dividends, and stock options and purchase plans. The Comptroller also liberalized numerous practices regarding real estate lending, and removed several

## COMMERCIAL BANKS AND BRANCHES



Source: Board of Governors of the Federal Reserve System.

types of loans involving real estate from the category of "real estate loans" with their various limitations.

Probably in response to the more liberal attitude of the Comptroller, at least 37 states have appreciably liberalized their bank regulations. Meanwhile, state banks have switched to national charters in unprecedented numbers. From the beginning of 1962, when the Comptroller's more liberal policies first appeared, through September 1965, 88 state banks switched to national charters. In the 12 preceding years, only 77 had switched. Included among those switching in recent months is the Chase-Manhattan Bank, one of the largest in the nation.

The American Bankers Association, the National Association of Supervisors of State Banks, and other trade groups have voiced concern about the future of dual banking, and have launched efforts to prevent its erosion. Attempts are being made to speed up the revision of state banking codes, improve the training of state bank examiners, and to awaken state banks and banking authorities to the need for preserving a dual banking system. Thus, the conflict between state and national supervisors is contributing to the constant and rapid changes taking place in bank regulations.

# Conclusion

Bank regulation in the United States is vast and complex. It is carried out by many agencies whose jurisdictions overlap at many points. The potential for jurisdictional friction and conflict is large. In recent years, as the banking industry has moved vigorously to adapt its services to the changing environment, numerous disagreements and conflicts between regulatory authorities have developed and have caused deep concern in banking circles. The problems raised by those conflicts threaten the base of the unique banking system of this country and affect both the structure and operations of the system.

Numerous efforts have been made, and are being made, with some limited success, to restore the previous balance between state and national banking systems by making state charters more attractive. Many proposals have been advanced to consolidate or unify regulatory activities at the Federal level. At this writing no appreciable progress has been made in that direction. Perhaps one useful by-product of the current ferment has been to focus attention and study on the nature, structure, and procedure of bank regulation. It may be hoped that, regardless of other consequences, this will produce some simplification and clarification in our complex system of bank regulation and supervision.

# SIGNIFICANT EVENTS OF 1965

## EARNINGS AND CAPITAL ACCOUNTS

Net earnings before payments to the United States Treasury rose to a record $89,186,576.09 in 1965 from the 1964 level of $77,534,187.61. Six per cent statutory dividends totaling $1,629,632.11 were paid to Fifth District member banks, and $85,603,893.98 was paid to the Treasury as interest on Federal Reserve notes.

Capital stock increased $1,953,050.00 to $28,092,450.00 as member banks added to their stockholdings by three per cent of the rise in their own capital and surplus. The surplus account was increased $1,953,050.00 to $28,092,450.00, the level of paid-in capital.

## CHECK COLLECTION

During the current year all three offices updated check handling programs and equipment. Richmond now has three Burroughs B-275 systems with additional core memory and two six-tape listers for each system. Baltimore is planning to replace two IBM 1421 systems and two third generation IBM 360's early in 1966. Charlotte has two IBM 1421 systems and has placed an order for two of the new IBM 1979 systems as replacements.

At Richmond 81 per cent of city checks and 91 per cent of country checks were processed on computers. Baltimore handled 91 per cent of city checks and 92 per cent of country checks on high-speed equipment, and 52 per cent of the city checks and 86 per cent of the country checks at Charlotte were processed on electronic equipment.

Check volume increased 11 per cent over the previous year, but it was possible to improve service by extending closing hours at all three offices for computerized country checks, Government card checks, and postal money orders.

## CHANGE IN DISCOUNT RATE

On December 10 the Richmond Reserve Bank, with the approval of the Board of Governors, raised its discount rate from 4 per cent to 4½ per cent. The action was part of a package policy move initiated December 6 when the Board of Governors raised the maximum interest rate payable on member bank time deposits to 5½ per cent and approved discount rate increases for the New York and Chicago Reserve Banks. By December 13, similar increases had been approved at all twelve Reserve Banks.

The actions were undertaken for three reasons: (1) to bolster the Government's efforts to prevent inflationary excesses from damaging an economy already carrying the added burden of military operations in Viet Nam, (2) to support the Government's programs to overcome persistent deficits in the U. S. balance of payments, and (3) to demonstrate anew United States determination to maintain the international strength of the dollar. The change was the first since November 1964 when the rate was increased from $3\frac{1}{2}$ per cent to 4 per cent.

## THE COIN SITUATION

The persistent coin shortage began to show signs of improvement by mid-year. As a part of the Treasury's crash program, the San Francisco Mint was reopened for preparing metal strip for pennies and nickels and for striking the new clad quarters. The Treasury continued the purchase of metal strip from private industry for nearly all denominations. This enabled the Mints to add additional striking presses and step up the volume of production.

In late August the Bureau of the Mint began production of the new type quarters, which consist of a covering of 25 per cent nickel and 75 per cent copper on a pure copper core. On November 1, Federal Reserve Banks began distributing the new quarters to commercial banks throughout the country.

During the last two months of 1965 coins were circulating more freely. At year end it appeared that the coin shortage was substantially broken, with only half dollars in short supply. The Treasury's current production schedules, coupled with circulation of existing coins, suggest that the crisis has passed its peak.

## NEW MEMBER BANKS

Four new national banks were organized in the Fifth District during 1965, and were welcomed into the Federal Reserve System. These banks, and the dates of their openings, are:

First National Bank of Norfolk,
Norfolk, Virginia,
January 5, 1965

The Old Line National Bank,
Rockville, Maryland,
April 9, 1965

Metropolitan National Bank,
Richmond, Virginia,
July 15, 1965

Williamsburg National Bank,
Williamsburg, Virginia,
December 8, 1965

In addition, two former nonmember banks converted to System membership during the year. Southwest Virginia Bank, Pocahontas, Virginia, adopted a national charter under the name of Southwest Virginia National Bank on March 10. Blackville State Bank, Blackville, South Carolina, converted to a national charter under the name of County National Bank on November 22.

## CHANGES IN DIRECTORS

Fifth District member banks elected one Class A and one Class B director to three-year terms on the Board of Directors at the Head Office. William A. Davis, President, Peoples Bank of Mullens, Mullens, West Virginia, was elected a Class A director. Mr. Davis succeeds David K. Cushwa, Jr., President, Washington County National Savings Bank, Williamsport, Maryland. Elected as Class B director was Charles D. Lyon, President, The Potomac Edison Company, Hagerstown, Maryland, who succeeds Raymond E. Salvati, Consultant, Island Creek Coal Company, Huntington, West Virginia.

The Board of Governors appointed Arnold J. Kleff, Jr., Manager, American Smelting & Refining Company, Baltimore, Maryland, to fill a vacancy on the Board of the Baltimore Branch occasioned by the resignation of Harry B. Cummings, Vice President and General Manager, Metal Products Division, Koppers Company, Inc., Baltimore, Maryland. John L. Fraley, Executive Vice President, Carolina Freight Carriers Corporation, Cherryville, North Carolina, was appointed by the Board of Governors to a three-year term at the Charlotte Branch. Mr. Fraley succeeds J. C. Cowan, Jr., Vice Chairman of the Board, Burlington Industries, Inc., Greensboro, North Carolina.

## CHANGES IN OFFICIAL STAFF

The year 1965 brought about several changes in the Bank's official staff. James Parthemos and Joseph F. Viverette, formerly Assistant Vice Presidents, were elected Vice Presidents in July and September, respectively. Mr. Parthemos is the senior administrative officer in the Research Department, and Mr. Viverette is senior officer in charge of Data Processing, Fiscal Agency, Planning, and Securities.

Stanhope A. Ligon, Cashier of the Charlotte Branch, retired in September and Stuart P. Fishburne, formerly an Assistant Vice President at the Richmond Office, was named Vice President and Cashier of the Charlotte Branch. In December, Clifford B. Beavers, junior officer in charge of the Transit Department, was promoted from Assistant Cashier to Assistant Vice President.

Appointed to the official staff at the Richmond Office were Jimmie R. Monhollon and William C. Glover. Mr. Monhollon was named Assistant Vice President in Research and Mr. Glover was named Assistant Vice President in Planning and Data Processing. Gerald L. Wilson was appointed Assistant Cashier at the Baltimore Branch, succeeding A. C. Wienert, who retired at the end of November.

# *Summary of Operations*

| | 1965 | 1964 |
|---|---|---|
| CHECK CLEARING & COLLECTION | | |
| Dollar amount | | |
| Commercial bank checks* | 108,683,006,000 | 98,095,365,000 |
| Government checks** | 9,468,158,000 | 9,421,817,000 |
| Other items | 701,191,000 | 987,180,000 |
| Number of items | | |
| Commercial bank checks* | 339,698,000 | 302,129,000 |
| Government checks** | 59,423,000 | 58,193,000 |
| Other items | 4,312,000 | 3,870,000 |
| CURRENCY & COIN | | |
| Currency disbursed—Dollar amount | 2,293,759,320 | 2,158,384,872 |
| Coin disbursed—Dollar amount | 69,121,605 | 46,345,858 |
| Dollar amount of currency withdrawn for destruction | 834,771,400 | 820,864,500 |
| Dollar amount of currency burned | 59,948,400 | 111,139,000 |
| Daily average of currency burned | | |
| Dollar amount | 236,017 | 434,137 |
| Number | 180,667 | 378,801 |
| DISCOUNT & CREDIT | | |
| Dollar amount | | |
| Total loans made during year | 9,113,929,315 | 5,512,538,400 |
| Daily average loans outstanding | 24,969,669 | 15,061,580 |
| Number of banks borrowing during the year | 95 | 102 |
| FISCAL AGENCY ACTIVITIES | | |
| Marketable securities delivered or redeemed | | |
| Dollar amount | 8,286,880,667 | 6,694,596,621 |
| Number | 174,593 | 176,243 |
| Coupons redeemed | | |
| Dollar amount | 100,109,860 | 98,601,038 |
| Number | 371,763 | 383,406 |
| Savings bond issues (including reissue) | | |
| Dollar amount | 348,910,372 | 349,361,605 |
| Number | 8,418,449 | 7,923,289 |
| Savings bond redemptions | | |
| Dollar amount | 418,478,236 | 384,416,970 |
| Number | 8,726,857 | 7,954,864 |
| Withheld tax depositary receipts processed | | |
| Dollar amount | 2,501,017,121 | 2,355,519,585 |
| Number | 859,108 | 837,886 |
| Transfers of Funds | | |
| Dollar amount | 159,039,470,295 | 161,866,483,638 |
| Number | 283,619 | 264,614 |

*Excluding checks on this Bank
**Includes postal money orders

# COMPARATIVE Condition

| ASSETS: | December 31, 1965 | December 31, 1964 |
|---|---|---|
| Gold certificate account | $1,012,486,436.66 | $ 895,509,335.08 |
| Redemption fund for Federal Reserve notes | 142,512,550.00 | 133,364,850.00 |
| TOTAL GOLD CERTIFICATE RESERVES | 1,154,998,986.66 | 1,028,874,185.08 |
| Federal Reserve notes of other Federal Reserve Banks | 102,010,149.00 | 56,420,180.00 |
| Other cash | 8,773,823.52 | 8,661,450.13 |
| Discount and advances | 2,650,000.00 | 13,855,000.00 |
| U. S. Government securities: | | |
| Bills | 643,686,000.00 | 438,268,000.00 |
| Certificates | ---------- | ---------- |
| Notes | 1,756,015,000.00 | 1,826,322,000.00 |
| Bonds | 463,254,000.00 | 382,449,000.00 |
| TOTAL U. S. GOVERNMENT SECURITIES | 2,862,955,000.00 | 2,647,039,000.00 |
| TOTAL LOANS AND SECURITIES | 2,865,605,000.00 | 2,660,894,000.00 |
| Cash items in process of collection | 699,625,048.59 | 666,004,788.33 |
| Bank premises | 4,736,309.27 | 4,884,719.71 |
| Other assets | 53,520,673.80 | 33,238,793.10 |
| TOTAL ASSETS | $4,889,269,990.84 | $4,458,978,116.35 |
| **LIABILITIES:** | | |
| Federal Reserve notes | $3,388,300,616.00 | $3,010,111,595.00 |
| Deposits: | | |
| Member bank—reserve accounts | 824,915,070.66 | 780,280,497.01 |
| U. S. Treasurer—general account | 68,830,632.64 | 56,781,775.78 |
| Foreign | 7,500,000.00 | 11,000,000.00 |
| Other | 12,749,807.26 | 10,075,861.15 |
| TOTAL DEPOSITS | 913,995,510.56 | 858,138,133.94 |
| Deferred availability cash items | 518,052,215.27 | 504,148,407.28 |
| Other liabilities | 12,736,749.01 | 34,301,180.13 |
| TOTAL LIABILITIES | 4,833,085,090.84 | 4,406,699,316.35 |
| **CAPITAL ACCOUNTS:** | | |
| Capital paid in | 28,092,450.00 | 26,139,400.00 |
| Surplus | 28,092,450.00 | 26,139,400.00 |
| TOTAL LIABILITIES AND CAPITAL ACCOUNTS | $4,889,269,990.84 | $4,458,978,116.35 |

| | | |
|---|---|---|
| Contingent liability on acceptances purchased for foreign correspondents | $ 7,180,000.00 | $ 6,140,000.00 |

# STATEMENTS

## Earnings and Expenses

| | 1965 | 1964 |
|---|---|---|
| EARNINGS: | | |
| Discounts and advances | $ 1,048,591.04 | $ 542,502.38 |
| Interest on U. S. Government securities | 103,120,760.22 | 90,899,833.80 |
| Foreign currencies | 699,210.82 | 317,400.76 |
| Other earnings | 20,538.04 | 21,022.49 |
| TOTAL CURRENT EARNINGS | 104,889,100.12 | 91,780,759.43 |
| EXPENSES: | | |
| Operating expenses (including depreciation on bank premises) after deducting reimbursements received for certain Fiscal Agency and other expenses | 12,844,811.25 | 12,399,415.31 |
| Assessments for expenses of Board of Governors | 428,900.00 | 429,500.00 |
| Cost of Federal Reserve currency | 2,521,522.65 | 1,469,254.02 |
| NET EXPENSES | 15,795,233.90 | 14,298,169.33 |
| CURRENT NET EARNINGS | 89,093,866.22 | 77,482,590.10 |
| ADDITIONS TO CURRENT NET EARNINGS: | | |
| Profit on sales of U. S. Government securities (net) | ........... | 42,609.98 |
| All other | 97,860.47 | 11,306.13 |
| TOTAL ADDITIONS | 97,860.47 | 53,916.11 |
| DEDUCTIONS FROM CURRENT NET EARNINGS: | | |
| Loss on sales of U. S. Government securities (net) | 840.27 | ........... |
| All other | 4,310.33 | 2,318.60 |
| TOTAL DEDUCTIONS | 5,150.60 | 2,318.60 |
| NET ADDITIONS | 92,709.87 | 51,597.51 |
| NET EARNINGS BEFORE PAYMENTS TO U. S. TREASURY | $ 89,186,576.09 | $ 77,534,187.61 |
| Dividends paid | $ 1,629,632.11 | $ 1,528,499.41 |
| Payments to U. S. Treasury (interest on Federal Reserve notes) | 85,603,893.98 | 99,005,588.20 |
| Transferred to surplus | 1,953,050.00 | −22,999,900.00 |
| TOTAL | $ 89,186,576.09 | $ 77,534,187.61 |

### SURPLUS ACCOUNT

| | 1965 | 1964 |
|---|---|---|
| Balance at close of previous year | $ 26,139,400.00 | $ 49,139,300.00 |
| Payments to U. S. Treasury (interest on Federal Reserve notes) | ........... | 22,999,900.00 |
| Addition account of profits for year | 1,953,050.00 | ........... |
| BALANCE AT CLOSE OF CURRENT YEAR | $ 28,092,450.00 | $ 26,139,400.00 |

### CAPITAL STOCK ACCOUNT

(Representing amount paid in, which is 50% of amount subscribed)

| | 1965 | 1964 |
|---|---|---|
| Balance at close of previous year | $ 26,139,400.00 | $ 24,569,650.00 |
| Issued during the year | 1,978,200.00 | 1,619,650.00 |
| | 28,117,600.00 | 26,189,300.00 |
| Cancelled during the year | 25,150.00 | 49,900.00 |
| BALANCE AT CLOSE OF CURRENT YEAR | $ 28,092,450.00 | $ 26,139,400.00 |

# Directors (December 31, 1965)

| | |
|---|---|
| Edwin Hyde | *Chairman of the Board and Federal Reserve Agent* |
| William H. Grier | *Deputy Chairman of the Board* |

Class A

| | |
|---|---|
| George Blanton, Jr. | *President, First National Bank*<br>*Shelby, North Carolina*<br>*(Term expires December 31, 1967)* |
| David K. Cushwa, Jr. | *President, The Washington County National Savings Bank*<br>*Williamsport, Maryland*<br>*(Term expired December 31, 1965)*<br>*Succeeded by: William A. Davis*<br>*President, Peoples Bank of Mullens*<br>*Mullens, West Virginia*<br>*(Term expires December 31, 1968)* |
| Robert T. Marsh, Jr. | *Chairman of the Board, First & Merchants National Bank*<br>*Richmond, Virginia*<br>*(Term expires December 31, 1966)* |

Class B

| | |
|---|---|
| Robert Richardson Coker | *President, Coker's Pedigreed Seed Company*<br>*Hartsville, South Carolina*<br>*(Term expires December 31, 1967)* |
| Robert E. L. Johnson | *Former Chairman of the Board (Retired), Woodward & Lothrop, Inc.*<br>*Washington, D. C.*<br>*(Term expires December 31, 1966)* |
| Raymond E. Salvati | *Consultant, Island Creek Coal Company*<br>*Huntington, West Virginia*<br>*(Term expired December 31, 1965)*<br>*Succeeded by: Charles D. Lyon*<br>*President, The Potomac Edison Company*<br>*Hagerstown, Maryland*<br>*(Term expires December 31, 1968)* |

Class C

| | |
|---|---|
| Wilson H. Elkins | *President, University of Maryland*<br>*College Park, Maryland*<br>*(Term expires December 31, 1968)* |
| William H. Grier | *President, Rock Hill Printing & Finishing Company*<br>*Rock Hill, South Carolina*<br>*(Term expires December 31, 1966)* |
| Edwin Hyde | *President, Miller & Rhoads, Inc.*<br>*Richmond, Virginia*<br>*(Term expires December 31, 1967)* |

Member Federal Advisory Council

| | |
|---|---|
| John F. Watlington, Jr. | *President, Wachovia Bank and Trust Company*<br>*Winston-Salem, North Carolina*<br>*(Term expires December 31, 1966)* |

# BANK OF RICHMOND

## *Officers*

Edward A. Wayne, *President*

Aubrey N. Heflin, *First Vice President*

Robert P. Black, *Vice President*

J. Gordon Dickerson, Jr., *Vice President*

Welford S. Farmer, *Vice President and General Counsel*

Donald F. Hagner, *Vice President*

Edmund F. Mac Donald, *Vice President*

Upton S. Martin, *Vice President*

John L. Nosker, *Vice President*

Joseph M. Nowlan, *Vice President and Cashier*

James Parthemos, *Vice President*

B. U. Ratchford, *Vice President and Senior Adviser*

Raymond E. Sanders, *Vice President*

Joseph F. Viverette, *Vice President*

Clifford B. Beavers, *Assistant Vice President*

John G. Deitrick, *Assistant Vice President*

H. Ernest Ford, *Assistant Vice President*

William C. Glover, *Assistant Vice President*

William B. Harrison, III, *Assistant Vice President*

John C. Horigan, *Chief Examiner*

Jimmie R. Monhollon, *Assistant Vice President*

Arthur V. Myers, Jr., *Assistant Vice President*

Victor E. Pregeant, III, *Assistant Vice President and Secretary*

J. Lander Allin, Jr., *Assistant Cashier*

Edward L. Bennett, *Examining Officer*

John E. Friend, *Assistant Cashier*

Robert L. Miller, *Assistant Cashier*

Chester D. Porter, Jr., *Examining Officer*

R. Henry Smart, *Examining Officer*

Jack H. Wyatt, *Assistant Cashier*

G. Harold Snead, *General Auditor*

Roger P. Schad, *Assistant General Auditor*

# BALTIMORE BRANCH

## Directors (December 31, 1965)

| | |
|---|---|
| Joseph B. Browne | *President, Union Trust Company of Maryland*<br>*Baltimore, Maryland*<br>*(Term expires December 31, 1968)* |
| E. Wayne Corrin | *President, Consolidated Gas Supply Corporation*<br>*Clarksburg, West Virginia*<br>*(Term expires December 31, 1968)* |
| Leonard C. Crewe, Jr. | *Chairman of the Board, Maryland Specialty Wire, Inc.*<br>*Cockeysville, Maryland*<br>*(Term expires December 31, 1967)* |
| Harry B. Cummings | *Vice President and General Manager, Metal Products Division, Koppers Co., Inc.*<br>*Baltimore, Maryland*<br>*(Resigned December 31, 1965)*<br>*Succeeded by: Arnold J. Kleff, Jr.*<br>*Manager, American Smelting and Refining Company*<br>*Baltimore, Maryland*<br>*(Term expires December 31, 1966)* |
| Adrian L. McCardell | *President, First National Bank of Maryland*<br>*Baltimore, Maryland*<br>*(Term expires December 31, 1967)* |
| Martin Piribek | *Executive Vice President, The First National Bank of Morgantown*<br>*Morgantown, West Virginia*<br>*(Term expires December 31, 1967)* |
| John P. Sippel | *President, The Citizens National Bank*<br>*Laurel, Maryland*<br>*(Term expires December 31, 1966)* |

## Officers

Donald F. Hagner, *Vice President*

A. A. Stewart, Jr., *Cashier*

B. F. Armstrong, *Assistant Cashier*

E. Riggs Jones, Jr., *Assistant Cashier*

Gerald L. Wilson, *Assistant Cashier*

# CHARLOTTE BRANCH

## (December 31, 1965) Directors

| | |
|---|---|
| Wallace W. Brawley | *Senior Executive Vice President, The First National Bank of South Carolina*<br>*Spartanburg, South Carolina*<br>*(Term expires December 31, 1967)* |
| J. C. Cowan, Jr. | *Vice Chairman of the Board, Burlington Industries, Inc.*<br>*Greensboro, North Carolina*<br>*(Term expired December 31, 1965)*<br>*Succeeded by: John L. Fraley*<br>*Executive Vice President, Carolina Freight Carriers Corporation*<br>*Cherryville, North Carolina*<br>*(Term expires December 31, 1968)* |
| Carl G. McCraw | *President, First Union National Bank of North Carolina*<br>*Charlotte, North Carolina*<br>*(Term expires December 31, 1967)* |
| W. W. McEachern | *Chairman and Chief Executive Officer, The South Carolina National Bank*<br>*Greenville, South Carolina*<br>*(Term expires December 31, 1966)* |
| William B. McGuire | *President, Duke Power Company*<br>*Charlotte, North Carolina*<br>*(Term expires December 31, 1967)* |
| James A. Morris | *Dean, School of Business Administration, University of South Carolina*<br>*Columbia, South Carolina*<br>*(Term expires December 31, 1966)* |
| G. Harold Myrick | *Executive Vice President and Trust Officer, First National Bank*<br>*Lincolnton, North Carolina*<br>*(Term expires December 31, 1968)* |

## Officers

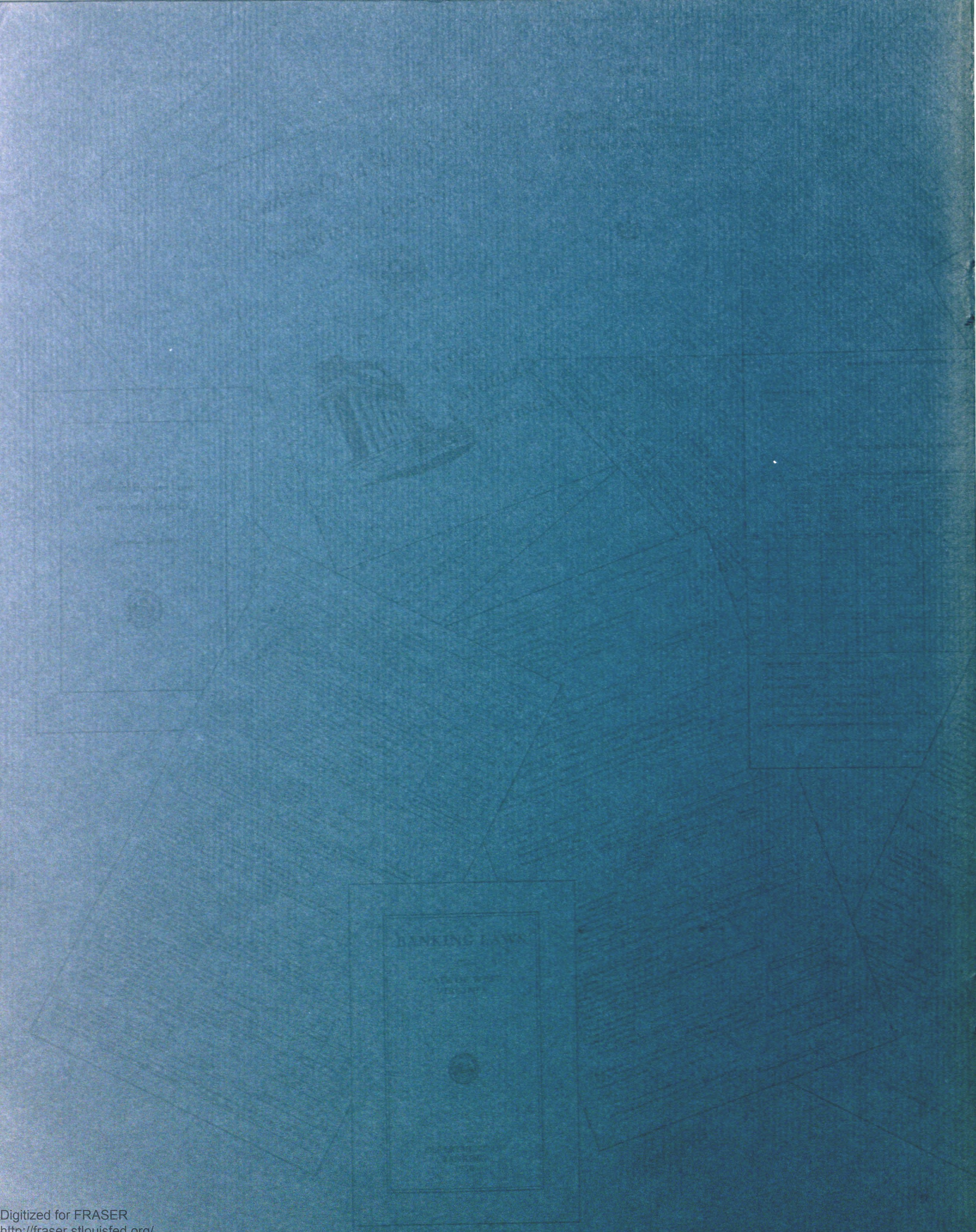
Edmund F. Mac Donald, *Vice President*

Stuart P. Fishburne, *Vice President and Cashier*

Winfred W. Keller, *Assistant Cashier*

Fred C. Krueger, Jr., *Assistant Cashier*

E. Clinton Mondy, *Assistant Cashier*


BANKING LAWS