

X-3796

July 31, 1923.

To: Federal Reserve Board
From: Mr. Wyatt, General Counsel
C O N F I D E N T I A L

Subject: Past policy of Board in acting upon applications of State member banks for additional branches.

I have been requested to make a study of the Board's records and to report as to what has been its policy in the past in acting upon applications of State member banks for its permission to establish additional branches. This information I have had to seek from the minutes of the Board (which frequently state merely the Board's action without giving any reasons therefor) and in the correspondence on this subject, (which is filed in several different places, is incomplete, and is not analyzed or indexed in any way). I have made as thorough an investigation as is possible under these circumstances and in the limited time allowed me; and, so far as I have been able to ascertain, the Board has never had any definite, comprehensive policy on this subject, though from time to time it has adopted or approved policies covering certain specific points.

It has been suggested that a comprehensive policy should be developed gradually like the common law^{by} deciding each case on its merits as it arises; but if such a method is to result in a definite policy it is necessary (as in the development of the common law) to decide each case in accordance with precedents previously established, if there are any precedents in point and in the absence of precedents in point to decide each case in accordance with the general principles that have been announced in connection with previous cases. So far as I have been able to ascertain, no well defined comprehensive policy has yet been developed in this way.

Numerous different considerations of policy have been suggested or acted upon, however, from time to time as a basis for the Board's decisions

in various cases, and it is believed that a statement of these various considerations will throw considerable light upon this subject and will be of some assistance in formulating a policy for the future. After a careful investigation of all the Board's records on this subject, I have prepared the following statement which I believe describes most, if not all of the various considerations of policy which have influenced the Board at different times in acting upon applications for permission to establish additional branches or which have been suggested as possible bases for such action.

POLICIES FAIRLY WELL ESTABLISHED.

Assimilation of Banks Taken Over:-

The Board seems to have adopted the principle that a bank should not be permitted to establish additional branches through the absorption of existing banks at a rate out of proportion to its power to assimilate the business taken over by the banks absorbed. (Letter, Harding to Perrin, Sept. 24, 1921, Bank of Italy File No. 22). Thus, in acting upon the application of the Bank of Italy for permission to take over and operate as branches the eight banks in the so-called "Bakersfield" and "Marysville" Groups, the Board permitted it to take over only four of such banks at a time, with the understanding that the other four should not be admitted until after the Board was satisfied that the first group had been properly organized and was properly functioning as branches of the Bank of Italy. (Letter, Harding to Perrin, January 18, 1922.)

Branches in Same City as Head Office:-

The Board apparently has been disposed to grant any California State member bank in good condition authority to establish additional branches

or agencies in the same city as the head office whenever the public convenience would be served. In the case of the Pacific Southwest Trust & Savings Bank of Los Angeles, and the Mercantile Trust Company of San Francisco, these additional offices have been for the most part so-called "receiving and paying stations". (Letter, Perrin to Board, February 21, 1922, re establishment of additional branches in Los Angeles by the Bank of Italy).

Receiving and Paying Stations Distinguished from Branches:-

The Board has taken the position that there is quite a distinction between the establishment of a branch bank and the establishment of a mere office or receiving station at which no discounting of any consequence is carried on and the funds of which are sent to the main office each day, and it has expressed the opinion that it is not a matter of primary concern with the Federal Reserve Board how many such stations member banks establish, unless the expense threatens the impairment of their working capital. The Board, however, has expressly reserved the right to interfere if such stations should develop into full fledged branches and has notified the banks concerned that if they desire to operate full fledged branches they must obtain the Board's approval. The Board has not issued a general ruling on this subject giving blanket to all member banks, but has adopted the policy of making its approval of such receiving stations under such circumstances and conditions as those which obtain in the City of Los Angeles a more or less proforma matter. (Letter to Perrin, May 15, 1922). In this connection, it is to be noted that the Board gave the Southwest Trust & Savings Bank of Los Angeles blanket permission to establish twenty-five such additional offices in Los Angeles and gave the Mercantile Trust

Company of San Francisco blanket authority to establish thirty such offices in and about San Francisco. The Board has also taken the position that the mere fact that such stations make loans in amounts not exceeding \$500 does not bring them within the designation of "branches" and that, so long as the managers are not vested with discretionary power to make larger loans, the Board is not disposed to consider them as actual branches. (Letter, Platt to Perrin, January 4, 1923.)

Effect on Examination Problem:-

In a number of cases the Board has expressed concern about the extension of branches in so far as such extension tends to make it impossible to have simultaneous examinations of the head office and all branches. (Letter Platt to Perrin, March 14, 1923). After a careful study of the situation in California and numerous conferences with the various parties concerned Messrs. Miller and Mitchell also reached the conclusion that the ability to supervise and examine banks having a large number of branches should govern the number of branches to be permitted. (Report to Board April, 1922, page 12). And in this connection the Board has taken the position that, for examination purposes and general administrative purposes, there is no difference between a full fledged branch and a mere additional office or receiving station. (Telegram, Hoxton to Perrin, March 10, 1923). The Board has also expressed the belief that the inability of the State authorities to make proper examinations is a vital matter and the difficulty of conducting an examination of a bank with a large number of branches offers adequate justification for limiting branch expansion. The Board, of course, is reluctant to have the Federal Reserve Bank assume the responsibility in such case which should be borne primarily by the State authorities. (Telegram, Hoxton to Perrin, March 10, 1923). In a report

submitted to the Board as early as December 22, 1921, by a Committee composed of Messrs. Crissinger and Mitchell, the conclusion was reached that the Bank of Italy already had more branches than the Federal Reserve Bank had machinery to properly supervise and examine and that any request for additional branches should be refused.

Considerations Influencing Board's Decision in Particular Cases:-

The following is a statement of the various considerations which have influenced the Board's action on applications of member banks to establish branches in particular cases and which it is believed contain suggestions which may be of assistance in formulating a general policy:

Understanding with Giannini re Admission of Bank of Italy:-

In the letter addressed by Dr. Miller to Mr. Giannini, President of the Bank of Italy, under date of September 26, 1917, and ratified by the Board in a telegram addressed by Governor Harding to Mr. Perrin, under date of October 20, 1917, it is stated that on the question of the Bank of Italy taking on additional branches the sole concern of the Federal Reserve Board would be to satisfy itself that any proposed extension will not impair the general safety and strength of the institution. Since that statement was made, however, the method of the Bank of Italy in acquiring additional branches has changed materially, and the entire problem has taken on new aspects which would justify the Board in taking other matters into consideration. Furthermore, the Bank of Italy did not join the Federal Reserve System upon receiving these letters but waited until 1919, over two years later, and at the time of its admission its method of developing branch banks was under serious criticism by the Superintendent of Banks, and the Board admitted it only after it promised to comply with all the

requirements of the Superintendent of Banks and agreed specifically that it would not establish any additional branches without first securing the approval of the Federal Reserve Board. (Letter, Supt. of Banks to Perrin December 15, 1919, Bank of Italy File 13). This would seem to supersede completely any understanding based on Dr. Miller's letter of September 26, 1917. At the time of the admission of the Bank of Italy, the Superintendent of Banks and Mr. Perrin agreed that the Bank of Italy should not go forward with the expansion of its branch system unless and until its organization, policy, management, both practical and theoretical, could demonstrate a full control abreast of its problems. (See also letter Perrin to Board, December 18, 1919, Bank of Italy file 14).

Condition, Organization, and Management of Parent Bank:-

It is obvious that the condition, organization and management of the parent bank necessarily must be given important consideration in determining whether the establishment of additional branches will affect its soundness, liquidity or solvency. This element has always been considered in acting upon applications of the Bank of Italy for permission to establish branches, and the Board clearly has been influenced by the criticisms of Mr. Perrin and the State Superintendent of Banks on the ground that it is expanding too fast, is suffering from lack of proper coordination between the branches and the head office, from lack of head office control and supervision, from lack of trained bankers among the senior officers of the head office, and from lack of independence on the part of the directors of the home office, and also on the ground that its affiliation with other corporations such as the Bancitaly Corporation of New York, The Stockholders' Auxiliary Corporation, the Liberty Bank of San Francisco, and California Joint Stock Land Bank, the East River National Bank of New

York, the Commercial Trust Company of New York, and two banks in Italy, constitute an element of danger.

Criticism of Routine Operations:-

In approving certain applications of the Bank of Italy for permission to establish branches the Board did so on condition that the Bank submit "evidence that the matters criticised by the State Banking Department in connection with the last report of condition of the Bank of Italy had been adjusted to the entire satisfaction of the Superintendent of Banks." (Letter, Governor Harding, June 29, 1922, which is not in file but is quoted in memorandum, Hoxton to Board, December 12, 1922). Mr. McAdoo, Counsel for the Bank of Italy, questioned the propriety of this condition on the ground that "it concerned matters wholly unrelated to the merits of its application for the acquisition of additional branches." (Letter to Harding July 21, 1922). Governor Harding replied under date of July 21, 1922, that the Board had particularly in mind, however, criticism relating to routine operations of a bank and felt that where so large an institution was subject to criticism in respect to its routine operations the matters complained of should be adjusted before the Board should become a party to permitting the bank to still further enlarge the scope of its operations.

Effect on standard Required as Condition to Membership:-

Naturally, the Board must take into consideration the effect which the establishment of additional branches will have on the standard required of such bank as a condition of membership, and quite frequently this question and the question of local convenience have been the only points discussed in Mr. Perrin's recommendations. (See memoranda Inlay to Board September 29, 1920, and February 24, 1921, re applications of

Pacific Southwest Trust & Savings Bank, and correspondence attached).

Ratio of Capital to Deposits:-

In approving the application of the Bank of Italy for permission to take over the eight banks in the so-called Bakersfield and Marysville Groups, as explained above, the Board indicated that its approval was based largely on the fact that the Bank of Italy had recently increased its capital and surplus saying, "The Board places great importance upon the proper relation of capital and surplus of the Bank to its deposit liabilities". (Letter Harding to Perrin, January 18, 1922). This is very important in connection with a rapidly expanding branch system, because the continued absorption of going banks with their existing deposit liabilities will soon reduce the ratio of the capital of the parent bank to the aggregate deposit liabilities, unless the capital is increased correspondingly.

Laxity of Management:-

Mr. Perrin refused to recommend the establishment of a branch at Fresno by the Sacramento-San Joaquin Bank (now United Bank and Trust Company of California), because of the laxity of its management, saying, "If unable to manage acceptably the present complex situation, it was not clear how matters would be improved by increasing the complexity with the addition of another branch." Upon being advised of this fact, the Board said that Mr. Perrin's position was well taken. (Letter Perrin to Harding July 9, 1921, and Harding's reply July 16, 1921).

Monopolistic Tendencies and Bludgeon Methods:-

Another factor which has made the Board hesitate to approve applications of the Bank of Italy for permission to establish additional branches has been the so-called "bludgeon methods" of that bank in acquiring other

branches for the purpose of converting them into branches, and the tendency to compel such banks to sell out rather than face the competition of the Bank of Italy. This, of course, tends to destroy the independent system of banking upon which the Federal Reserve System is based and is in my opinion a perfectly valid legal and moral ground for declining to permit the establishment of additional branches. (See telegram First National Bank of Yuba City to Crissinger, January 16, 1923).

It is especially important to consider the effect of this tendency on the existence of independent national banks, which constitute the real "back bone" of the Federal Reserve System since their membership in the System is compulsory. It has been suggested that a continuation of the present tendencies in California would eventually result in the complete elimination of the national banks from the State. This would place the Federal Reserve Bank of San Francisco largely at the mercy of the large State banks, because they could practically take California out of the Federal Reserve System on six months' written notice. They have already indicated a tendency to attempt to coerce the Federal Reserve Bank and even the Federal Reserve Board by threats of withdrawal from the System.

Branches Outside Home City:-

The board's disapproval of the application of the Bank of Italy for permission to establish a branch de novo at Sacramento was based upon a recommendation of Mr. Perrin and upon the policy of the State Banking Department not to permit more than one branch to be established by any bank in a city or locality other than that in which its principal place of business is located, nor to permit any bank to establish branches de novo in any town or city other than that in which its head office is located, unless the

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Superintendent of Banks in his discretion shall find that the public convenience and advantage require it. (Letter, Crissinger to McAdoo, June 1, 1923).

Local Convenience:-

The Board's disapproval of the establishment by the Bank of Italy of a branch at Yuba City was based primarily upon a finding of fact by Mr. Perrin, its local representative at San Francisco, to the effect that the banking needs of Yuba City were already adequately served and that there was no apparent public demand for additional banking facilities in the community. The Board also had before it a suggestion from Mr. Perrin that, as a matter of general policy, it is not desirable to permit the establishment of branches de novo in towns or cities other than that in which the head office is located, if there already are community banks located in such towns or cities whose existence may be threatened. Furthermore, the Board was advised that the Bank of Italy already had substantial representation in the banking field in that locality. (Letter, Crissinger to McAdoo, June 1, 1923).

In this connection, I consider it my duty to advise the Board that in my opinion it took an unnecessarily weak position when it based its disapproval of the application of the Bank of Italy to establish a branch at Yuba City on the ground that the banking needs of Yuba City were already adequately served and that there was no apparent public demand for additional banking facilities in the community. As a practical matter, it is very difficult for the Board to determine whether or not a small community in California needs or desires additional banking facilities, and it cannot always depend upon its local representative to decide such

questions. This is demonstrated by the fact that Mr. Perrin first advised the Board that no additional banking facilities were needed in Yuba City and has since reversed that finding. Furthermore, for the Board to undertake to determine local questions of this character contrary to the findings of the local authorities would be likely to have a very bad effect on public opinion if the matter should be made the subject of a test case or public controversy, because it is apparently inconsistent with one of the fundamental principles of our Government, namely, that local questions should be decided by the local authorities rather than by the Federal Government. If Mr. McAdoo chooses to make a test case of the Board's action in the Yuba City case, he undoubtedly will make a lot of capital of this point, which will have its effect on the public mind. It may even have its effect (subconsciously at least) on the court, just as the idea that the Federal Reserve Banks were oppressing the small State banks recently influenced the Supreme Court of the United States to make a decision in the North Carolina par clearance case which was entirely out of line with its decisions for the past fifty years on questions involving State interference with the corporate powers of Federal corporations.

In my opinion, there are many other grounds upon which the Board could have based its refusal to permit the Bank of Italy to establish a branch at Yuba City and which could have been defended much more easily. Thus, it could have placed it squarely on the ground suggested by Mr. Perrin that, as a matter of general policy, it is not desirable to permit the establishment of branches de novo in towns or cities other than that in which the head office is located if there already are community banks located in

such towns or cities whose existence may be threatened; or it could have placed it on the ground that the Bank of Italy already has too many branches, is expanding too rapidly, has not properly coordinated the branches which it has already acquired, or on many of the broad grounds which have been considered in other connections. On any of those grounds, its action could be sustained before a court or before the bar of public opinion with comparatively little trouble, and it is doubtful that the Bank of Italy would dare to make a test case if the Board has based its action on such grounds.

I do not presume or intend to criticise the Board's action in this matter; but I do consider it my duty to point this out, in order to suggest that it would be advisable for the Board to base its action in such cases on broader grounds in order that its position may be as strong as possible if it is ever drawn into a test case or into a public controversy. In this connection, it should be remembered that if a test case is brought it probably will be brought by the Bank of Italy, and the attorneys for that Bank naturally will select the case in which they think the Board has taken the weakest position.

POLICIES SUGGESTED BUT APPARENTLY NOT ADOPTED.

The following are several suggestions that have been made from time to time but apparently have not been adopted by the Board. It is believed that a statement of them will be helpful in connection with the formulation of a general policy on this subject;-

Liquidity of Parent Bank and Coordination of Branches.

At a conference held in San Francisco, April 11, 1922, attended by Messrs. Mitchell and Miller of the Federal Reserve Board, the Superintendent of Banks of California, Mr. Oliver, his attorney, and by Mr. Perrin, Governor Calkins and other officers of the Federal Reserve Bank of San Francisco, the following was agreed to as a basis upon which the State Banking Department and the Federal Reserve Board should treat branch banking problems:

1. That a bank should not add a branch or branches unless examination discloses that it has in cash, due from nonaffiliated banks, United States Government bonds and paper eligible and acceptable for rediscount by the Federal Reserve Bank, a total of not less than fifty per cent of its demand deposits and fifteen per cent of its time and savings deposits.

2. And in the case of a bank already operating branches that it should not establish an additional branch or branches unless a survey discloses in addition that its existing branches are well coordinated under Head Office control and direction both in accounting and in extension of credit.

These conclusions were approved unanimously by the directors of the San Francisco Federal Reserve Bank, but the State bankers were unwilling to accept such a basis. (Report of Messrs. Miller and Mitchell

to Federal Reserve Board, April 1922, pages 5 to 8). The Board apparently took no formal action on this suggestion, but at times has followed a policy somewhat similar to the second point stated above.

Branches within Reasonable Radius of Parent Bank:-

The national banks in San Francisco have generally taken the position that branch banking should be confined to districts within a reasonable radius of the parent bank and that it is impractical to attempt to cover the entire State with a system of branch banking. (Report of Messrs. Miller and Mitchell, April, 1922, page 5). The Board apparently took no action on this suggestion.

State Policy re Branches De Novo:-

It has been suggested that the Board adopt as its policy in acting upon applications of California State member banks for permission to establish additional branches, the following policies adopted by the State Bank Superintendent, and promulgated as rulings effective March 8, 1923, after a conference with the Legislative Committee of the California Bankers' Association and the Executive Committee of the California League of Independent Bankers; but the Board apparently has not adopted this suggestion:-

"From and after this date no branch office shall be established by any bank in a city or locality other than that in which its principal place of business is located by the purchase of or consolidation or merger with another bank unless both banks shall have been open for business for at least three years prior to said sale, consolidation or merger unless the superintendent of banks in his discretion shall find that the public convenience and advantage require it; in the case of a national bank that has been converted into a state bank the time required herein shall be considered as running from the date of the original organization of said national bank.

"From and after this date no more than one branch office shall be established by any bank in a city or locality other than

that in which its principal place of business is located, unless the superintendent of banks in his discretion shall find that the public convenience and advantage require it. In the event, however, of sale, consolidation or merger, all branches that have been maintained for a period of three years prior to such sale, consolidation, or merger by the respective institutions or banks concerned may be thereafter continued as branches of the consolidated banks. The three-year requirement herein provided shall not be construed as applying to branch offices in existence as of this date.

"From and after this date no branch shall be created in any locality other than the city or locality in which is located the principal place of business except by purchase of or consolidation or merger with an existing bank in said city or locality unless the superintendent of banks in his discretion shall find that the public convenience and advantage require it."

(It should be noted that the practical effect of these policies is greatly diminished if not entirely nullified by the exception stated in the words, "unless the superintendent of banks in his discretion shall find that the public convenience and advantage require it," especially when it is well known that most California ex-Superintendents of Banks obtain lucrative positions with the large California banks operating branch systems.)

Distinction between Establishing Branches De Novo and Taking Over Existing Banks:-

Attention has been called to the fact that there is quite a difference between granting permission to establish new branches and acquiring the business of banks already established and converting them into new branches. In the case of new branches there is no immediate assumption of additional liabilities, and the machinery of the parent bank is gradually developed with the growth of the business of the new branch. With the acquisition of established banks, however, the volume of business is immediately greatly increased, and, unless the organization is equipped with the highest quality of efficiency, a proper control cannot be had over the business acquired. (Letter, Jan. 17, 1922, proposed by Mr. Mitchell disapproving application of Bank of Italy to establish eight branches; but not adopted by the Board.)

Mr. Hamlin's Pending Resolution:-

At the Board meeting on May 22, 1923, Mr. Hamlin stated that he had on April 10, 1923, presented certain resolutions setting forth the terms of a general policy covering the Federal Reserve Board's attitude towards applications for branches by State member banks, and requested that his resolutions be recorded upon the minutes of that date, but laid aside for the present as unfinished business. Mr. Hamlin further stated that he now desired to amend the resolutions aforesaid, and to have them recorded upon the minutes as follows, with the request that the amended resolutions be treated at this time as were the original, and laid aside for the present as unfinished business:-

"Resolved:-

That, in passing upon the establishment of Branches by Member State Banks and Trust Companies, whether de novo or through voluntary purchase of existing Banks, the Board will take into consideration the need of the community for additional or improved facilities and the effect of the establishment of the proposed Branch on the condition of the Parent Bank.

"Resolved:-

That, the Board will accept the decision of the State Banking Department as to the need of the community for additional or improved banking facilities.

"Resolved:-

That, the Board will not undertake to lay down any general policy as to territorial limitations or spheres of influence, but will accept the policy of the State with regard thereto, as determined by the State authorities."

(Minutes May 22, 1923)

It appears that these resolutions are still pending and that no action has been taken on them.

SUMMARY

The following is a brief summary of the various points heretofore considered or suggested and which might be given consideration in connection with the formulation of a general policy on this subject:-

1. Rapidity of expansion and assimilation of going banks taken over and operated as branches;
2. Distinction between branches in same city as head office and branches scattered over the entire State;
3. Distinction between branches and mere receiving and paying stations;
4. Effect of establishment of further branches on the problem of proper supervision and examination;
5. Effect of establishing additional branches on general safety and strength of parent institution;
6. Condition, organization and management of parent bank;
7. Ratio of capital to deposits;
8. Monopolistic tendencies and bludgeon methods in obtaining branches;
9. Establishment of de novo branches in competition with existing banks in cities other than that in which the head office of parent bank is located;
10. Geographic location of branch with reference to parent bank, especially as it affects economic relation and ability of parent bank to properly control and supervise branch;
11. Policy of State re branches de novo;
12. Distinction between establishing branches de novo and taking over existing banks;
13. Mr. Hamlin's resolutions which are now pending before the Board.

CONCLUSION

It is believed that a historical discussion of the Board's attitude toward the development of the present branch system of five or six of the

California State member banks having large numbers of branches will throw more light on this problem, but I have been unable to prepare such a statement in the short time allowed me. This office will cheerfully undertake the task if the Board so desires; but it is not a legal problem and the Board may prefer to have it prepared by some other department of its organization, especially in view of the fact that this office already has all it can do while some of the other offices are not so busy.

In conclusion, I respectfully suggest the importance of having the Board's files on this subject put in such shape that they can be more easily consulted and that correspondence on any particular point can be more readily located. To this end, it is respectfully suggested that all the files on this subject should be consolidated in one place; all missing papers should be found and restored as far as possible, even if it is necessary to write to the Federal Reserve Bank of San Francisco for duplicates; and the entire file should be analyzed, subdivided and indexed. In their present state, it is very discouraging to attempt to make a study of these files, and it is often difficult and sometimes impossible to locate a particular letter when it is needed. This is not intended as a criticism of any one, but merely as a constructive suggestion.

Respectfully,

WALTER WYATT,
General Counsel