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July 30, 1923.

MEMORANDUM on opinion of General Counsel:

Power of the Federal Reserve Board to impose conditions of admission of State banks.

1- I agree that the Board has power to impose, as a condition of membership, that no new branches shall be established without the consent of the Board.

2- The only question of difference is as to the reasons upon which such consent or refusal should be based.

3- The opinion of Counsel seems to rest upon the belief that the Board has a dispensing power wholly apart from the express provisions of the Federal Reserve Act, and limited only by what it believes to be the so-called "spirit" of the Act.

4- For example, Counsel claims that the Board could refuse its consent on the ground that branches are inconsistent with the independent system of banking which was the basis upon which the Federal Reserve System was founded.

5- In my opinion, no condition can lawfully be imposed, and no reason for refusing consent would be valid, which did not rest upon some provision, express or necessarily implied, of the Federal Reserve Act.

6- It is clear to my mind that the Board could justify its refusal upon the ground that the taking over of a particular branch would injure the parent bank, or that the general character of its management was such that the Board felt that it could not properly maintain such a branch.

7- I differ decidedly with Counsel in his statement that the Federal Reserve System is based upon an independent system of banking. On the contrary, I believe that the System rests upon a double base, (1) national banks,- an independent system; (2) state banks and trust companies, which in many states consist of banks with numerous branches.

8- By the Act of June 21, 1917, it is provided that when a state bank becomes a member of the System it shall retain its full charter and statutory rights, and may continue to exercise all corporate powers granted it by the state in which it was created. It would seem clear that the above language can only mean that where the corporate powers of a state bank include the right to establish branches, such a bank has that right during its membership in the System, unless it affects the soundness of the parent bank. If this were not so, the Board, apparently, would have the power to refuse to admit any state bank having branches, irrespective of its financial condition, which I cannot believe would be claimed by anyone.

9- There are other questions which the Board has, from time to time, taken into consideration in determining whether to give or refuse consent, which I believe to be not within its province.

For example, in my opinion, the question whether or not the community needs a new branch, or whether it will be benefitted by the purchase by the state member bank of an existing bank, is one to be determined by the authorities of the state, and that the Board should accept such determination. In this connection, we should remember that if the state authorities refuse permission to establish a branch or buy an additional bank, the matter is settled, as the consent of the Board would give no

power to the applicant to establish such a branch or buy such a bank. So, conversely, I believe that where the state authorities have certified their approval the Board should accept this decision as a finality as to this question.

10- Some members of the Board, apparently, believe that, even though there is an admitted necessity for a new branch from the point of view of the public, and even though the parent bank is amply able to maintain such a branch,- the Board should still decline to give its consent if the parent bank seeking to establish such a new branch is seeking to invade territory which the Board believes to be within the sphere of influence of other banking centers, and it has even been suggested that the Board establish a zone or sphere of influence with this end in view.

To my mind this would be an extension of the "dispensing power" fraught with peril to the Federal Reserve System. Such a limitation and spheres of influence should surely rest and remain upon the sound discretion of the individual states. For the Board to interfere would seem to be a taking away from the states of their police powers,- which I can not believe Congress ever intended even to attempt to bring about.

11- I believe that the legislature of California has acted for the best interests of its people in establishing its branch system of banks; that this system, on the whole, is demonstrating its usefulness; that in many instances it is giving the agriculturists the benefit of lower discount rates; that it has enabled them to borrow larger amounts than they could borrow from many of the individual unit banks,- such larger amounts being necessary to the proper development of said agricultural interests; and, furthermore, that the branch bank system is of

special value because of the different peaks of borrowing within the state, thus enabling the banks having branches to move their loanable funds quickly wherever they may be needed, in order to serve the needs of the respective communities.

C. S. HAMLIN.