

FEDERAL RESERVE BOARD

WASHINGTON

May 18, 1927.

My dear Congressman:

The Federal Reserve Board has considered your letter of May 2nd enclosing a copy of a letter addressed by you to the Comptroller of the Currency with reference to chain banking in the United States through the purchase by holding companies or investment trusts of the controlling stock interests of banks. You suggest that the Federal Reserve Board adopt administrative measures calculated to control or prevent the growth of this form of banking control among State bank members of the Federal Reserve System.

The Federal Reserve Board is powerless under the law to take the action which you suggest. There is no provision of statute which confers upon the Board any authority to regulate or prohibit the holding of the stock of State member banks by any group or corporation. In this connection you will recall that in a letter addressed to you under date of January 8, 1926, (a copy of which is enclosed herewith - see pages 8 to 10) the Federal Reserve Board took occasion to recommend as amendments to your bill H.R. 2, then pending in Congress, provisions designed to secure adequate information regarding national banks and State member banks which are closely related in management, operation or interests to other banking institutions, and in particular to afford some check upon the abuses frequently occurring in chain banking. The suggestion of the Federal Reserve Board on this subject was not adopted.

The Board has attempted in prescribing conditions upon which State banks may be admitted to the Federal Reserve System to effect some degree of control over chain banking. Among the conditions of membership with which State banks entering the Federal Reserve System are required to comply is the following:

"Such bank or trust company, except after applying for and receiving the permission of the Federal Reserve Board, shall not consolidate with or absorb or purchase the assets of any other bank or branch bank for the purpose of operating such bank or branch bank as a branch of the applying bank; nor directly or indirectly, through affiliated corporations or otherwise, acquire an interest in another bank in excess of 20 per cent of the capital stock of such other bank; nor directly or indirectly promote the establishment of any new bank for the purpose of acquiring such an interest in it; nor make any ar-

rangement to acquire such an interest."

This condition of membership was incorporated in the Board's Regulations of 1924 and has been prescribed for every State bank admitted to membership since that time. Under the provisions of the recently enacted McFadden Act, however, the Board appears to be without authority to continue to impose a condition of membership of this kind. Section 9 of the Federal Reserve Act, as amended by the McFadden Act, provides that the Federal Reserve Board may permit State banks to become members of the Federal Reserve System, subject to the provisions of the Federal Reserve Act "and to such conditions as it may prescribe pursuant thereto." As there is no provision in the Federal Reserve Act which seems expressly or by necessary implication to authorize the imposition of a condition of membership designed to control or prohibit chain banking among State member banks, the Federal Reserve Board will be unable in the future to prescribe such a condition.

Inasmuch as the existing law contains no provision designed to check or control chain banking, the remedy lies with Congress. The Board will be very glad to do anything in its power to assist your Committee in making a study of chain banking.

By direction of the Board.

Very truly yours,

D. R. Crissinger,
Governor.

Honorable Louis T. McFadden,
House of Representatives,
Washington, D. C.

(Enclosure)

Excerpt from Board's letter of January 8, 1926, to Honorable Louis T. McFadden, Chairman of the Committee on Banking and Currency of the House of Representatives (pages 8-10), referred to in the Board's letter of May 18, 1927, to Congressman McFadden.

"2. That Section 5240 of the Revised Statutes of the United States, as amended, be further amended by adding at the end thereof a new paragraph reading as follows:

"Whenever in the judgment of the Comptroller of the Currency any national banking association is so closely related in management, operation or interest to any other bank, banking association, trust company, securities company or investment company that an examination of such national banking association fails to disclose its true condition in the absence of detailed information regarding such other related institution, such national banking association shall (a) obtain from such related institution and furnish to the Comptroller of the Currency a copy of a report of an examination of such related institution made by the State authorities simultaneously with an examination of such national banking association made by examiners appointed by the Comptroller of the Currency, or (b) by such other means as may be deemed satisfactory by the Comptroller of the Currency, furnish to the Comptroller of the Currency detailed information regarding the condition and operation of such related institution. In such cases the Comptroller of the Currency may, upon request, furnish the State Supervisor of Banking, or other similar officers, copies of reports of examination of such related national banking association. If any national banking association shall fail to comply with the requirements of this paragraph after a demand for such compliance has been made by the Comptroller of the Currency, the Comptroller shall report the facts in the case to the Federal Reserve Board, which may, after a hearing, issue an order depriving such national banking association of the privilege of receiving any discounts, advancements or accommodations from the Federal reserve bank of which it is a member until it has complied fully with all demands made by the Comptroller of the Currency pursuant to the provisions of this paragraph. The Federal Reserve Board shall send a copy of such order by registered mail to such national banking association and a copy to the Federal reserve bank of which it is a member; and, after receipt of said order, such Federal reserve bank shall not rediscount any paper for, or make any loan, advancement, or other extension of credit to, such national banking association until said Federal reserve bank has been notified by the Federal Reserve Board that such national banking association has complied fully with the requirements of this paragraph."

"This proposal is designed to secure adequate information regarding national banks which are related to other institutions and in particular to afford some check upon certain abuses frequently engaged in by chains of banks. During the last few years a number of such chains have collapsed,

and investigation shows that when a national bank is in such a chain an examination of it fails to disclose its true condition, due to the shifting of assets back and forth between the various institutions which make up the chain.

"3. That Section 9 of the Federal Reserve Act as amended be further amended by inserting therein, immediately after the sixth paragraph thereof, a new paragraph reading as follows:

"Whenever in the judgment of the Federal Reserve Board any member bank is so closely related in management, operation and interest to any other bank, banking association, trust company, securities company or investment company that an examination of such member bank fails to disclose its true condition in the absence of detailed information regarding such other related institution, such member bank shall (a) obtain from such related institution and furnish to the Federal Reserve Board a copy of a report of an examination of such related institution made by the State authorities simultaneously with an examination of such member bank, or (b) by such other means as may be deemed satisfactory by the Federal Reserve Board, furnish to the Federal Reserve Board detailed information regarding the condition and operations of such related institution. In such cases the Federal Reserve Board may, upon request, furnish the State Supervisor of Banking, or other similar officers, copies of reports of any examination of such related member bank which has been made by the direction of the Federal Reserve Board or of the Federal reserve bank by examiners selected or approved by the Federal Reserve Board. If any member bank shall fail to comply with the requirements of this paragraph after a demand for such compliance has been made by the Federal Reserve Board, said Board may, after a hearing, issue an order depriving such member bank of the privilege of receiving any discounts, advancements or accommodations from the Federal reserve bank of which it is a member until it has complied fully with all demands made by the Federal Reserve Board pursuant to the provisions of this paragraph. The Federal Reserve Board shall send a copy of such order by registered mail to such member bank and a copy to the Federal reserve bank of which it is a member, and, after receipt of said order, such Federal reserve bank shall not rediscount any paper for, or make any loan, advancement, or other extension of credit to, such member bank until said Federal reserve bank has been notified by the Federal Reserve Board that such member bank has complied fully with the requirements of this paragraph."

"This proposal is similar to the preceding and is intended to apply to State banks and trust companies which are members of the Federal Reserve System. At present the only penalty for non-compliance with any provision of the Federal Reserve Act by State member banks is that provided for in the seventh paragraph of Section 9 of the Federal Reserve Act, which authorizes the Federal Reserve Board to expel from the Federal Reserve System any State member bank which fails to comply with the provisions of that Section. The penalty suggested above is less drastic but is nevertheless thought to be sufficient."