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FEDERAL RESERVE BANK

OF SAN FRANCISCO

March 1, 1929

Walter Wyatt, Esq.,
General Counsel,
Federal Reserve Board,
Washington, D. C.

Dear Mr. Wyatt:

On February 13 and 14 last a general conference of the directors of this bank covering both the head office and all the branches was held at San Francisco. The meeting was a very interesting one and I believe great benefit was derived by all who attended.

One of the subjects placed upon the program at the suggestion of some of the directors of our Portland Branch was the question of stockholders' liability as applied to banks owned by holding companies. As you know, in many states where branch banking is prohibited by statute attempts have been and are being made to accomplish approximately the same object through the formation of holding corporations which, in turn, purchase all the capital stock of a number of banks. This is familiarly known as "chain banking," the difference between this method and branch banking being that each unit in the chain operates as a separate corporate entity, with more or less control on matters of policy and procedure coming from those who constitute the holding company. In the opinion of many, chain banking possesses all the weaknesses and very few, if any, of the virtues of branch banking. Some of the directors present evidenced considerable concern over the effect of this somewhat recent development in their states.

The question was propounded to me as to what, if any, legislation had been enacted seeking to impose upon the shareholders of the parent organization liability for the debts of the separate units constituting the chain. I was also asked what, if any, legislation had been enacted seeking to restrict the formation of corporations organized for the sole purpose of holding stock in banks and whether or not any regulation or control could be exercised through state laws or through amendments to the Federal Reserve Act. I was not able to give any very positive response to these inquiries. A suggestion was made that through you we seek information from Counsel to the other Federal reserve banks as to what legislation, if any, of this character had been enacted in their respective districts. I believe that in New Jersey there is a law prohibiting a corporation from holding more than ten per cent. of the

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capital stock of any bank. I am also informed that in the State of Washington a bill is now pending seeking to prohibit the formation of corporations organized for the sole purpose of holding stocks in banking institutions and another bill seeking to impose upon the stockholders in the holding corporation the same liability as that imposed upon individual holders of bank stocks.

The question is chiefly important in those states which prohibit branch banking. For instance, in the State of Oregon branch banking is prohibited but stockholders in banks organized since 1912 are liable for the benefit of depositors to the extent of 100% of the par value of stock held. In other states double liability is imposed upon the holders of bank stocks and branch banking is now allowed. Let us suppose that in such a state a corporation organized under the laws of a foreign state in which no double liability exists seeks to own a number of state banks through the purchase of the entire capital stock. In the event of the insolvency of one or more of the banks so held what recourse have the creditors and depositors? Is it not true that by such device the double liability sought to be imposed may be entirely defeated?

Another problem is presented in this situation:

A corporation is organized for the sole purpose of acquiring the entire capital stock of a number of banks. The stockholders of the holding company are not bankers and under the existing law in most jurisdictions are not subject to the restrictions imposed upon banks. Each bank acquired by the holding corporation is officered by men having no proprietary interest in the institution which they operate, being merely employees of the holding company. If the holding corporation is well managed and exercises close and direct control over the units composing the system or chain, all may be well, but if the holding corporation is organized solely as a money-making proposition and if no well directed efforts are used to control or supervise the manner in which the unit banks constituting the chain are conducted, it may be seen that a very serious situation may be created. The elements of local pride and local identity are lacking, the banks scattered throughout the state becoming merely money-making agencies of an absentee corporation.

These problems and others which naturally occur to one in connection with the situation thus created are those which were disturbing our directors and upon which they desired information as to restrictive or regulatory legislation.

Mr. James, who was present at the conference, stated that he thought you would be willing to seek information from

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Counsel to the other Federal reserve banks as to what, if any, legislation had been enacted or proposed seeking to reach these problems.

I am addressing letters of inquiry to the superintendents of banks in the states comprising the Twelfth Reserve District, asking for the necessary information, and I wonder if you will ask Counsel to the other Federal reserve banks to do likewise. The information thus acquired could be compiled either through your office or by me and would, I believe, make a very interesting study.

Thanking you in advance for your assistance in this matter, and with kindest personal regards, I am

Yours very truly,

(S) Albert C. Agnew,
Counsel.

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