MEMORANDUM RECOMMENDING A REGULATION PROVIDING THAT NATIONAL BANKS MUST HAVE A MINIMUM CAPITAL OF $50,000 AS A CONDITION PRECEDENT TO THE GRANTING OF TRUST POWERS

By Mr. Platt.

Subsection k of Section 11 of the Federal Reserve Act - the subsection relating to the granting of trust powers to National banks - was as originally enacted very short - only four lines. It authorized the Federal Reserve Board "to grant by special permit to National banks applying therefor when not in contravention of State or local law, the right to act as trustee, executor, administrator, or registrar of stocks and bonds under such rules and regulations as the said board may prescribe."

I need not go into the difficulties of the administration of this broad power, or into the litigation which followed. It is sufficient to say that there was controversy over the meaning of the words "when not in contravention of State or local law." The Board at first issued permits for the exercise of trust powers to banks with a capital smaller than that required by State laws in some States, and, as our records show, a few such national banks are still exercising, or are authorized to exercise, the powers then granted.

As a result of the opposition of the State authorities and as a result of the litigation and the Board's own difficulties with regulations and administration, the Act of September 26, 1918 greatly enlarged subsection k of Section 11 and both clarified and limited the Board's powers. The amendment provided among other things "that no permit shall be issued to any national banking association having a capital and surplus less than the capital and surplus required by State law of State banks, trust companies and corporations exercising such powers," and in addition provided that "in passing upon applications for permission to exercise the powers enumerated

in this subsection the Federal Reserve Board may take into consideration the amount of capital and surplus of the applying bank, whether or not such capital and surplus is sufficient under the circumstances of the case, the needs of the community to be served, and any other facts and circumstances that seem to it proper."

The Board was prohibited from granting trust powers to banks with a smaller capital than the State laws prescribed for State banks or trust companies competing, and the paragraph distinctly authorized the Board to require a larger capitalization than State laws required if thought advisable.

This at once raises the question whether the limitations of State laws are in all cases adequate, and also raises the question whether there is good reason for the high capitalization required for trust powers in some states, by comparison with others.

Twelve states require a minimum capitalization of at least $100,000, three of them requiring $125,000. Fourteen other states require at least $50,000, one of them $60,000. It should be added that in a few states where the minimum requirement is much lower it is generally impossible for banks with the minimum requirement of capital to exercise trust powers because of a high requirement of deposit of securities with the State Treasurer. For instance, Illinois allows banks with a capital of $25,000 to exercise trust powers in cities of less than 5,000 but its minimum requirement for deposit of securities is $50,000. We have given trust powers to one $25,000 bank in Illinois, but it is naturally not exercising them.

The following states require $100,000 or more as a minimum:

California	$125,000	New York	$100,000
Kansas	100,000	North Dakota	100,000
Maryland	100,000	Ohio	125,000
Michigan (for all powers)	150,000	Pennsylvania	125,000
Montana	100,000	West Virginia	100,000
New Jersey	100,000		

The following require $50,000, or between $50,000 and $100,000:

Arkansas	$60,000	Massachusetts	$50,000
Colorado	50,000	Missouri	50,000
Connecticut	50,000	Minnesota	50,000
Florida	50,000	Texas	50,000
Georgia (trust Cos.)	50,000	Washington	50,000
Idaho	50,000	Wisconsin	50,000
Louisiana	50,000	Virginia	50,000

It will be noted that the states with comparitively high requirements are by no means all eastern states: California, Montana, North Dakota and Kansas are among the states requiring $100,000 or more. Furthermore some eastern states have low requirements, and one of them, Rhode Island, none at all. In spite of the absence of any capital requirement for trust companies Rhode Island has no National bank with a capital less than $200,000 exercising trust powers and according to the Bankers' Directory has only four state trust companies with a capital smaller than $200,000, the smallest of which has a capital of $75,000. We have granted one permit to a national bank with a capital between $50,000 and $100,000 but it is not yet administering trusts. There is obviously no reason, so far as the public convenience is concerned for small trust companies in Rhode Island.

New Hampshire and Vermont each allow $25,000 institutions to administer trusts but in New Hampshire the National banks at present actively in trust business have a capital larger than $50,000, with one exception. In Vermont two national banks of $50,000 capital and one of $25,000 are exercising trust powers. The 16 others are all capitalized above $50,000. There is obviously little demand for small trust companies in either of these states and the same is true of Maine, which has no National banks of $25,000 with trust powers and only 3 with a capitalization of $50,000.

In view of the high requirements of such western states as Montana, and North Dakota - $100,000 - states which are sparsely settled by comparison

with the New England states, it can hardly be maintained that the states generally believe that public convenience requires that every community should have an institution authorized to administer trusts, and the fact that a majority of the states require a capital of $50,000 or greater indicates that they believe small banks are not as a rule so managed or officered as to be able to administer trusts safely and successfully.

I have dealt with minimum requirements only and have not included the surplus requirements of State laws, because they seem as a rule unimportant - not adding greatly to the minimum capital requirements. In a few states they nevertheless do much towards keeping the small banks from trust business. Seventeen states require banks exercising trust powers to deposit security with State authorities. The effect of these requirements might be given further consideration, but it seems unnecessary to devote more space to them in the present memorandum.

State banking superintendents, as in California, have frequently expressed the opinion that small banks cannot "maintain proper trust standards." There is of course difference of opinion as to what constitute "proper trust standards" and a disposition in some states to insist that the bank should be large enough, or that there should be sufficient trust business in the community to justify "the employment of a staff of experts in trust business." Without subscribing fully to this view it is evident that the clerical force in the average small bank rarely contains men who could qualify by any stretch of imagination as "experts" either in trust business or in banking. It is the view of the directors of the Federal Reserve Bank of New York that a group of men may be well enough qualified to conduct a local bank, but may not be qualified to conduct trust business. The test they apply is the question whether they

would be willing to entrust the management of an estate or a trust fund in which they were interested to the group. Certainly something more in ability, in character and in financial standing should be required for conducting fiduciary business than for local banking.

That the small banks are much more liable to failure than large banks has been amply demonstrated. Of the 5,004 bank failures from 1921 - 1928 inclusive, 4434, or 90.7 per cent were banks with a capital of less than $100,000. A bank may fail without loss to the trusts administered by it, and so far it does not appear that there have been any losses of trust funds due to National bank failures, but this may be attributed in part to good luck and part to the fact that the banks having trust powers which have so far failed (61 in all) have been comparatively few in number, and had not yet accumulated much trust business. More than 75 per cent of them were in fact not administering any trusts at the time of failure. Lack of actual loss is furthermore a negative argument and gives little indication as to whether the trusts have been properly managed. I have been informed that not much is yet known as to the securities in which the trust funds of failed banks were invested, beyond the fact that there have been no complaints to the receivers. About all that is known is that uninvested funds were not lost. Such uninvested funds might easily be lost if they were not properly segregated from the general funds of the bank, and small banks, where trust business and commercial business must be handled by the same persons are less likely to be careful about segregation than banks large enough to afford a staff engaged solely in the trust business. This is one of the chief concerns of our Reserve Board trust department, and banks are constantly admonished and required to maintain proper segregation. An Iowa national bank that failed in February was found to have an uninvested

unsecured fund in its banking department only two weeks before it closed.

To sum up: a majority of the states evidently regard a capitalization higher than the minimum capitalization required for commerical banking necessary for trust corporations "as a guarantee that trusts will be faithfully administered," and the states which maintain this position are as a rule the states with the best banking standards. Should not the Federal Reserve Board seek to raise the standard for trust powers in states where it is now low, instead of granting trust powers solely with reference to the question whether similar powers would be granted by the state banking authorities? By following the latter course the Board undoubtedly runs the risk of furnishing an argument towards the lowering of state standards. The advocates of a lowering of the standard in a state where it is now high can point to the fact that in an adjoining State the Federal Reserve Board endorses a lower standard by granting trust powers to banks with a small capitalization.

It would appear that bankers generally, as well as many of the State superintendents of banking, are of the opinion that small banks ought not to be permitted, or ought not to attempt, to administer trusts. By comparison with the large number of small banks in existence, only a few have applied for trust powers and although nearly all that have applied have been given permission to act, a large majority of them remain inactive. Of 76 $25,000 banks with trust power 56 were inactive at last reports.

Section 11-k, as amended in 1918 authorized the Board to consider "the needs of the community to be served." Without going so far as to say, as the Superintendent of Banking in California says, that public officials charged with the duty of passing upon applications for trust powers "should satisfy themselves that there is sufficient business in the community to

justify the employment of a staff of experts in trust business," the memorandum submitted by Governor Young on November 8, 1928 goes much too far in the other direction by saying that "outside of a few isolated and cross-road communities in the United States, the need exists in every community." Evidently a majority of the states disagree with this view, as I have indicated above, and it seems clear that the public will be better served if trust business can continue to be administered by the larger, well equipped institutions instead of being scattered among many small institutions. There is probably some saving of expense in the administration of an estate if the administrator or executor is a resident of the county of the decedent, but there is nothing to be gained by having the administrator or executor a small town bank when there is a larger, better equipped bank only a few miles away. In the administration of trust funds generally, apart from court trusts, and estates in process of settlement, the location of the trustee bank is generally unimportant to the beneficiaries. Certainly the difficulties of supervision will be greatly increased if the small banks generally are permitted to administer trusts.

In the California case submitted, and in every case where the Board finds a superintendent of banks administering the law so as to enforce a standard higher than the minimum legal requirements, I believe the Board should adopt the same higher standards. To do otherwise is obviously to force the state banking authorities to lower their standards in order to meet the competition of the lower National bank or Federal Reserve standards.

Finally I believe we should adopt the policy of the majority of the states and should provide by regulation that no national bank with a capital less than $50,000 be granted permission to administer trusts, and further that no national bank with a capital less than $100,000 be granted full trust powers unless an exceptional showing is made as to the bank's condition and management, and as to the need of an institution exercising trust powers in the community.