

# Operation of the National and Federal Reserve Banking Systems

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## HEARINGS

BEFORE A

SUBCOMMITTEE OF THE  
COMMITTEE ON BANKING AND CURRENCY  
UNITED STATES SENATE  
SEVENTY-FIRST CONGRESS

THIRD SESSION

PURSUANT TO

### S. Res. 71

A RESOLUTION TO MAKE A COMPLETE SURVEY OF THE  
NATIONAL AND FEDERAL RESERVE  
BANKING SYSTEMS

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## CONTENTS

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Statement of—	Page
Mitchell, Charles E.....	285
Robinson, Henry M.....	323
Stephenson, Rome C.....	371
Traylor, Melvin W.....	395
Wells, Oscar.....	415
Young, Owen D.....	553

# OPERATION OF THE NATIONAL AND FEDERAL RESERVE BANKING SYSTEM

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MONDAY, FEBRUARY 2, 1931

UNITED STATES SENATE,  
COMMITTEE ON BANKING AND CURRENCY,  
*Washington, D. C.*

The subcommittee met, pursuant to adjournment, at 10.30 o'clock a. m., Hon. Carter Glass (chairman) presiding.

## STATEMENT OF CHARLES E. MITCHELL, CHAIRMAN OF THE NATIONAL CITY BANK OF NEW YORK

The CHAIRMAN. Mr. Mitchell, this is a subcommittee appointed to make a thorough inquiry into the banking situation, with a view to recommending such modifications in the national bank act and the Federal reserve act as may suggest themselves to the committee as a result of this investigation. We have felt from your varied experience and intimate observation of banking matters in New York that you might be able and willing to give the committee some suggestions as to what should be done, in your opinion, to avert such a situation as we have had recently.

Mr. MITCHELL. Senator Glass, my experience and anything that I might have drawn from it is at the complete disposal of the committee. I think that we have seen, during this past year particularly, the complete merit of the reserve system, and all of us realize it is probably the greatest piece of legislation passed in our day. It obviously must be, because of its comparative youth, a piece of legislation that must develop and adapt itself to circumstances. If the experience which I have had can be of any help to you in your very constructive work in this committee, I shall be delighted to give it to you. I think possibly any suggestions I might have could be drawn out best through inquiry than through any definite statement. I have not come prepared to present any written statement to the committee.

The CHAIRMAN. It would be interesting if you could give us a general statement as to what you think brought about the collapse in 1929, as well as a statement as to what you think is the present situation in banking circles.

Mr. MITCHELL. I think if we are to look to the causes of the particular difficulty of 1929 that we must go back to the war. We must realize the maldistribution of gold and the maladjustment in industry, agriculture, and commerce that resulted from the war. We must realize the corrective processes that started in 1920 and 1921

which were ineffective particularly because of the great demands of Europe to repair the damages of the war.

The CHAIRMAN. Right there, what, in your judgment, contributed most to the maladjustment of the gold supply?

Mr. MITCHELL. The necessity for the creation of debts.

The CHAIRMAN. Do you think that that provision of the Federal reserve act which authorized the exchange of Federal reserve notes for gold contributed to this great accumulation of gold?

Mr. MITCHELL. I would not think so, Senator Glass.

The CHAIRMAN. Then of what use is that provision, if it does not do that?

Mr. MITCHELL. It enables the definite putting to use of idle gold by the segregation thereof, against which the gold certificates are issued in place of the Federal reserve note issues.

The CHAIRMAN. You have to accumulate the gold before you use it, do you not?

Mr. MITCHELL. Quite so. The accumulation of gold is as often accidental as otherwise.

The CHAIRMAN. It is not accidental when you exchange Federal reserve notes for gold.

Mr. MITCHELL. I quite realize that. I do not consider that that has really been an effective factor, in the situation, during the last few years. I would not say that it had brought on any difficulties, nor that it had brought about any great benefits.

The CHAIRMAN. Then, that provision of the act is practically useless?

Mr. MITCHELL. I think it has been more or less useless; yes, sir.

The CHAIRMAN. Well, do you think any one or more policies of the banking community made any material contribution to the situation?

Mr. MITCHELL. Undoubtedly. As a result of all this we had in this country a great inflation. The foreign bankers and economists were certain that it was to take place in commodities and that we would have bad times in the wake. It did start in in commodities, but that was corrected after 1920 and 1921 quite largely. Then the inflation showed itself in real estate and we had some correction of that. Then the inflation developed particularly in securities and the easing of money—that is, the easing of credit to help business—without a quick enough reversal which I think added to the difficulties in 1928 and 1929.

The CHAIRMAN. What comment would you care to make on that rather modern feature of banking in New York briefly described as loans for others?

Mr. MITCHELL. Loans for others were a great contributing factor to the inflation that took place in the security market. It was particularly unfortunate that these lenders, having no responsibility for the credit structure or the money situation, had that important part to play. Personally, I think it was equally unfortunate that in the conduct of the Federal reserve system and the policies established with respect thereto, the greater volume of loans was not, academically at least, considered as a part of the credit structure of the country. I think if it had been so viewed, we would have realized to a greater degree than we did, speaking of the country as a whole, that the inflation of credit was as great as it actually was, and we would

have taken more prompt steps to correct that enormous inflation. It did not enter into the credit structure of the Federal reserve system until the collapse came, and then all of a sudden those loans for the account of others were in no small measure thrown back on the member banks, and a great amount of Federal reserve credit had to be employed to avoid disaster. It is on the point that those loans should have been very definitely considered as a part of the credit structure, as in the ultimate they had to be, that I would stress their importance with respect to Federal reserve policy.

The CHAIRMAN. What measure do you suggest, as a member of the board of directors of the Federal Reserve Bank of New York, and what measures do you think should have been adopted, to restrain credit?

Mr. MITCHELL. Of course, I was not a member of the board in 1928 when this situation began to develop. I became a member of the board in the beginning of 1929 when the roll was well under way. I felt before that and I felt then distinctly that corrective measures should be taken by the reserve system through the operation of the discount rate to control what I regarded as an undue volume of credit.

The CHAIRMAN. You speak of an undue volume of credit. Do you mean an undue volume of credit at the reserve banks?

Mr. MITCHELL. I come back to what I said a moment ago. I think that these loans for the account of others had to be considered as a part of the expansion of the credit system.

The CHAIRMAN. They are not a part of the authorized activities of the Federal reserve banks, are they?

Mr. MITCHELL. Quite right, Senator, but before we finished we found they had to be.

Senator BULKLEY. May I ask a question right there? It is not clear to me what prevented the consideration of the fact of those loans for others. If the facts were apparent, could you not consider them?

Mr. MITCHELL. From the standpoint of the directorate of the New York bank, we were constantly having them in mind. I think the viewpoint of the New York bank was that the corrective for undue inflation of credit should come primarily through the revision of the discount rate. We had a difference of opinion with the reserve board. It would be quite impossible for me to say, if that discount rate had been readjusted with a sharp advance upward, say 1 per cent at a time, that we would have brought about correction. I think it would have been startling to the country and my feeling is there would have been certainly a corrective influence.

Senator BULKLEY. You thought that at the time, and still think, you are right?

Mr. MITCHELL. I do, but I can not prove it.

The CHAIRMAN. Was there any difference of judgment in the board of the New York bank at any time as to whether the rate should or should not be advanced?

Mr. MITCHELL. By and large; no, Senator.

The CHAIRMAN. I should judge you do not consider the sharp advance, you say you advocated, of the reserve rate, as in any degree affecting the rediscount loans of the banks to legitimate commerce?

Mr. MITCHELL. I think it would affect them slightly; but I would hope for a very short period only. After all, commerce, trade, and industry, and the securities of commerce, trade and industry, and the manner in which they are dealt with, make a complete picture, it seems to me, Senator, and it is quite impossible to segregate one class from the other.

The CHAIRMAN. The statute does undertake to do that, does it not?

Mr. MITCHELL. It does, and quite properly, Senator, but I feel that as the years go on, we have found a factor entering into the general situation that we must consider as a part of the picture, and we must give it consideration if we are to look to constructive readjustment of the Federal reserve act.

The CHAIRMAN. Then it is your judgment that the act might be modified?

Mr. MITCHELL. I think it probably should be modified in some ways, and I think it probably will have to be modified over the course of years.

The CHAIRMAN. Do you think its text should be disregarded until it shall have been modified?

Mr. MITCHELL. No, sir; I do not.

The CHAIRMAN. You do not find anything in the act—by conjecture you do not, because I have not been able to find any—which authorizes the Federal reserve bank with the sanction of the Federal Reserve Board, to penalize legitimate commerce for the express purpose of restraining the stock market and for no other purpose?

Mr. MITCHELL. Well, if I had to answer that yes or no, I presume I would have to say no, I see nothing in the act that gives such a power. On the other hand, I conceive the answer to be one that places a heavy responsibility upon those whose business it is to guard the general credit structure of the country. This particular phase—this security and borrowing on security phase—does definitely enter into the general credit picture and the necessity for holding that in adjustment certainly has a reflection upon trade, commerce, and industry, which we are primarily trying to protect and which the Federal reserve act is definitely designed to protect.

The CHAIRMAN. The Federal reserve act was designed to protect the money market for legitimate commerce. It very specifically and textually separated legitimate commerce from the investment market, and the investment market is distinctly precluded, as I understand the act, from making use of the Federal reserve facilities for its purposes.

Mr. MITCHELL. Well, Senator, certainly nobody understands the act better than one who was so prominent in giving it birth, but I believe that one can not paint a picture of credit without at least having the investment market in the picture.

The CHAIRMAN. But we left the security account out of the picture designedly.

Mr. MITCHELL. Yes, sir; you left it out, it seems to me inferentially, completely. In other words, you prohibited security loans from becoming the basis for Federal reserve credit through refusing to permit the banks under the act to borrow against general security collateral or against their collateral loans.

The CHAIRMAN. But we did not take into account the shifting of bankers who were willing indirectly to do a thing that they were directly prohibited from doing.

Mr. MITCHELL. Perhaps I do not get the full purport of your remark or question, if there is a question in connection with it.

The CHAIRMAN. I mean that we textually prohibited investment loans from rediscount at Federal reserve banks.

Mr. MITCHELL. Quite so.

The CHAIRMAN. But a practice has grown up in many banks to use their eligible paper for rediscount purposes at the Federal reserve bank while largely extending their loans for investment purposes. It is an indirect way of making investment rediscounts, which are prohibited.

Mr. MITCHELL. I wonder if it has gone quite that far, Senator? A New York bank, maintaining its liquidity is always necessarily having in its portfolio, for instance, a large volume of so-called call loans—Street call loans—which experience has shown to be the most liquid of all investments and on which even throughout all of this period of uncertainty and panic through which we have passed, so far as I know, there has never been the loss of a dollar. Frankly, in the conduct of our bank I have never felt quite happy unless constantly we have a volume of about \$100,000,000 of demand Street loans. That is the cushion that we have for the day-to-day adjustment of our position. As the requirements of trade and industry come upon us, we can quickly reduce these call loans and as the demands of trade, commerce, and industry decrease we can always enlarge them. It forms a great cushion and adds materially to the liquidity of the bank. Now, there may be times when, with the demands of trade and commerce on us increasing, we might have for a day or a few days, perhaps, an increase in our call loans through maybe an uncertainty existing in the call-money market or through having to take over temporarily the call loans of some correspondent bank or customer. If you would be interested, I have prepared a chart of the call-loan operations of the National City Bank during 1929 and 1930, showing on the same chart the borrowings of our bank at the Federal reserve bank during that period. If it would be instructive or helpful to show how a New York bank does operate with respect to such loans, I will be very glad, indeed, to present it to you.

The CHAIRMAN. I will be very glad to have it.

Mr. MITCHELL. I have it here, if you would like to see it.

Mr. CHAIRMAN. Mr. Mitchell, you say the reserve bank and the board should bring into the credit picture all related elements. I wonder if the banks bring into the picture that very thing. In other words, do they pause to consider what effect a riotous extension of call loans, reaching the unprecedented point of nearly eight billion dollars, will have upon the general business interests of the country?

Mr. MITCHELL. They certainly do, sir.

The CHAIRMAN. Then why did these call loans go to that immense figure?

Mr. MITCHELL. Very largely through the operation of the accounts of others.



The CHAIRMAN. Well, is it not within the province of banks to refuse to loan money on call for others if they have the whole picture in mind and are prepared to determine what effect a brake will have upon the general business interests of the country?

Mr. MITCHELL. Senator, if they did refuse, there would quickly spring up other agencies to perform the same piece of work.

The CHAIRMAN. Do you think a banking unit should endanger the prosperity of the entire country because if they do not do it somebody else will endanger it?

Mr. MITCHELL. Well, if I thought that the banks' refusal to do it would have brought about a stoppage of it, I certainly would agree with you, sir. It is my opinion that that would not stop it, and the banks with their machinery for operation are definitely equipped for that through a very long experience and have become the natural agencies for it.

The CHAIRMAN. There would not be any natural agencies for it.

Mr. MITCHELL. Unfortunately, if we had no banks I fear that it would go on.

The CHAIRMAN. If you had no loans for others, it might not go on.

Mr. MITCHELL. My understanding of the question was as to how it is possible to stop the loans for account of others.

The CHAIRMAN. Can you suggest any way to stop it?

Mr. MITCHELL. I do not think I can, Senator, as much as I wish I could. I certainly can not believe that we can stop the individual from loaning his money as he will. I am not a lawyer, but I have never been able to see why the law could not be invoked to prevent corporations from doing that which any bank has to pay for the right to do.

The CHAIRMAN. I quite agree with you there. I think the law may do it.

Mr. MITCHELL. And a very large percentage, mind you, of those loans made for the account of others were made by corporations.

The CHAIRMAN. Yes; which issued stock for that very purpose?

Mr. MITCHELL. Well, I am not sure I would go quite that length with you.

The CHAIRMAN. Well, that is my information.

Mr. MITCHELL. They issued stock to strengthen their position, the weakness of which was shown during 1920 and 1921, and then, as we found in commerce the way to quicken deliveries and make the necessity for inventory carriage less, and found the way to quicken collections, and so forth, they had surplus funds in very large amounts accumulated in their treasuries, and these became available for the loans for the account of others. I know of no single case, Senator, where securities were issued by a corporation that it might become a lender in the call market.

The CHAIRMAN. Well, I have heard of specific cases. Mr. Mitchell, what relation, in your opinion, has the Federal reserve bank to its credit accommodations and to its ability and willingness to rediscount for member banks?

Mr. MITCHELL. I think, so far as I know, that there has never been any unwillingness on the part of Federal reserve banks to rediscount for members.

The CHAIRMAN. But in rediscounting, what relation has the reserve of the bank to its rate of rediscount?

Mr. MITCHELL. Well, reserves for the last few years have been so high that they have almost ceased to be a factor. They have been so far above the requirement of the law that they have failed to be a factor that had to be taken into consideration when it came to the extension of credit to member banks.

The CHAIRMAN. If the loan facilities of a bank are so abundant, what is the defensible excuse for raising the rediscount rate to legitimate commerce?

Mr. MITCHELL. In order to put a brake upon an undue and what may be regarded not only as an abnormal but possibly a dangerous expansion of the credit structure.

The CHAIRMAN. The stock market?

Mr. MITCHELL. I can not differentiate forms of credit in discussing the credit structure. That seems to be what you may regard as a fundamental difficulty with me, Senator. I view the security loan factor as a part of the credit structure of the country and I am forced in my own mind to look at the whole quantitatively. I find difficulty in differentiating and viewing it qualitatively.

The CHAIRMAN. Do you think the Federal reserve system was set up as a strictly commercial system, or was it designed to control stock-market operations or to be controlled by stock-market operations?

Mr. MITCHELL. I think it was set up definitely to aid commerce, trade, and industry, but again I say I can not myself see how it can go through the operation of helping and controlling it properly unless it takes the security account and what results from that into the picture.

The CHAIRMAN. But if a given bank has 80 per cent reserve, thereby indicating its complete ability to respond to the requirements of commerce in that particular district, what excuse has it for raising its rediscount rate?

Mr. MITCHELL. Because a factor has come into the credit picture that is resulting in a quantity of credit being outstanding that is far in excess of the business requirements of the country, very much larger than the natural business growth of the country justifies. Then we have a red flag set up right away.

The CHAIRMAN. Then, in plain terms, does not that mean, because the bank sees there is a riot of speculation on the exchange and it wants to stop that, they stop it by an increase in the rediscount rate on legitimate business?

Mr. MITCHELL. Well, Senator, I think that they view it as a part of the credit structure and, alarmed at the expansion of total credit, the power of the discount rate is invoked.

The CHAIRMAN. In other words, the stock market is a part of the commercial credit structure of the Federal reserve banking system?

Mr. MITCHELL. It affects the commercial side so directly that it must be taken into consideration.

The CHAIRMAN. Do you think it was ever intended, Mr. Mitchell, that the open-market provision of the Federal reserve act should literally submerge the rediscount provisions of the act?

Mr. MITCHELL. I should judge, Senator, that it was not, but that, as the Federal reserve system gained in experience, it became a very much more important factor than was in the minds of the designers of the act.

The CHAIRMAN. You mean the administrators of the act—not the designers of the act.

Mr. MITCHELL. I think the administrators of the act have found it of more importance than was contemplated by the designers of the act.

The CHAIRMAN. They have made it more important than the designers of the act had ever intended that they should.

Mr. MITCHELL. I do not doubt that.

The CHAIRMAN. As I understand your position, you thought that in this period of unprecedented speculative activity to raise the commercial rediscount rate the Federal Reserve Bank in New York would have a psychological effect on the market?

Mr. MITCHELL. Very marked.

The CHAIRMAN. Did it have when it was raised?

Mr. MITCHELL. It was raised too late to have it. The fire had attained too great a force.

The CHAIRMAN. So the matter remains entirely in the realm of conjecture as to what might have happened?

Mr. MITCHELL. Yes, sir; quite so.

The CHAIRMAN. You are not positive it would have checked it?

Mr. MITCHELL. No, sir.

The CHAIRMAN. I am quite positive that it would not have. Do you think the 15-day provision of the Federal reserve act has been abused at all?

Mr. MITCHELL. I will not say it has not been in particular cases, but I think they are isolated cases, Senator. Speaking broadly, I would say no. In the case of my bank, we very rarely use our eligibles with the reserve bank; it is so much more convenient to use our Government securities; yet at no time—I think I am correct—since I have had any connection with the bank have we borrowed at the Federal reserve bank on governments in excess of the amount of the eligibles we could have taken to them.

The CHAIRMAN. Let me get out of your mind right away, if there has been lodgment of any such suggestion, that I am talking about your bank. I am talking about banks generally.

Mr. MITCHELL. I appreciate the broad, constructive view you are taking and I have not that thought in my mind at all, Senator; but from time to time I have thought that I could best illustrate by speaking of that which I know most about—my own bank. And thus I used that as an illustration directly in answer to your question.

The CHAIRMAN. You will observe by an examination of the act, Mr. Mitchell, that in the set-up of the administrative features of the statute, we undertook to emphasize the importance of that class C directorate, charged with the duty of representing in a special sense the Government, known as the Government agent. The act provides him with quarters in the bank and of all the directors gives him the exclusive right to appoint his own assistants and many kindred privileges and duties.

How did it ever come to pass that the Government agent has been relegated to a rather subordinate position and an officer not con-

templated by the law, known as governor of the bank, has practically superseded him in importance and in most every other way except, as custodian of the notes and eligible paper?

Mr. MITCHELL. I do not know that I can speak of that with any authority, Senator Glass. I presume it is the same kind of thing that has crept into member bank organization in one way or the other and never uniformly. The governor of the reserve bank of New York is the equivalent of the president of a member bank.

The CHAIRMAN. Do you think so?

Mr. MITCHELL. Practically so.

The CHAIRMAN. What is the relative authority and activity of a chairman of the board of directors of a large New York bank and the president of a bank?

Mr. MITCHELL. As I said, there is no uniformity in that respect, Senator Glass.

The CHAIRMAN. Well, there is some uniformity, is there not?

Mr. MITCHELL. It is a gradual development that has occurred. The chairman of our bank, if you will excuse my using this as an illustration again, for many years and up to the time that I left the presidency and took the chairmanship was an honorary position very largely. He was distinctly chairman of the board. I found that the duties of the president were very taxing; that we needed a general manager to handle many of those duties, and so I took the chairmanship and at that time our by-laws were changed so that the chairman became the chief executive officer of the bank.

The CHAIRMAN. Is not that the fact with most of the large banks?

Mr. MITCHELL. The fact? No; I think not.

The CHAIRMAN. I am not saying all of them. I say most of them.

Mr. MITCHELL. It is different in practically every bank, Senator. I could be specific as to that. It is not a uniform proposition.

The CHAIRMAN. Well, evidently you do not know, and I have not found anyone who does, so that you need feel no measure of humiliation on that point, just exactly how this change of administration came about.

Referring specifically to a bill that I introduced in the Senate, do you think it would be wise to put a percentage limitation upon the rediscount activities of banks on their direct loans under the 15-day provision of the act?

Mr. MITCHELL. What paragraph of your bill does that refer to?

The CHAIRMAN. Paragraph 11, I think.

Mr. MITCHELL. Section 11.

The CHAIRMAN. On page 13 of the bill.

Mr. MITCHELL. The important part of that section, as I understand it, is the latter part, Senator, providing that "it shall not increase or enlarge the total of loans upon collateral security while such borrowing exists." I think that is an unnecessarily prohibitive clause and I think it would work a hardship. I again refer to the chart of our own bank operations, if you would be good enough to look at it, as an answer to that particular question.

The CHAIRMAN. As to your particular bank?

Mr. MITCHELL. I can only answer directly as to our particular bank. I have no claim to enforce that our particular bank is run better than any other bank, but I would like to give you an example, and use it purely as an example, of how that paragraph would

operate, our bank being rather typical of a large New York institution, but I do not want to force it upon you.

The CHAIRMAN. If you will leave that chart with us—

Mr. MITCHELL. I will be very glad indeed to.

The CHAIRMAN. It might help us in that respect. The Federal reserve act authorized the Federal reserve bank, with the sanction of the Federal Reserve Board, to establish foreign agencies for the transaction of business with foreign countries. The impression seems to have been produced abroad that we have a central banking system in the United States akin to the European central banking system.

Does the New York bank when it has occasion to confer with the heads of these foreign banks do it of its own initiative or does it have these conferences under regulations prescribed by the Federal Reserve Board, which is the reasonably central supervising authority of the system?

Mr. MITCHELL. It has these conferences sometimes at the request of other central banks and sometimes on its own initiative, but always, I think, with quite a complete understanding on the part of the central reserve board as to the conferences that are taking place and the real reason for them.

The CHAIRMAN. Would it astonish you to learn that when these central banking heads came to this country they came in contact with the Federal Reserve Board, even in a social way, by the courtesy of the governor of the New York Federal Reserve Bank?

Mr. MITCHELL. Possibly not, because the reserve bank of New York is in direct contact with such foreign banks, and I think the reserve board has been quite willing that they should be and that the contact should be so maintained.

The CHAIRMAN. Is the New York Federal Reserve Bank the central bank of the country?

Mr. MITCHELL. No, sir.

The CHAIRMAN. Well, on your numerous trips to Europe, if you would inquire you would get a different answer.

Mr. MITCHELL. We have not a central bank here, have we, Senator?

The CHAIRMAN. I did not think so; but they think so in Europe.

Mr. MITCHELL. Well, our systems are quite different.

The CHAIRMAN. Yes; no advocate of a central bank who came before our committee 17 years ago would advocate for an instant the sort of central bank that they have in Europe, that may deal with individuals, corporations, and concerns.

Mr. MITCHELL. I think that is true.

The CHAIRMAN. They simply wanted a central bank that the bankers could control exclusively without actual Government supervision.

Mr. MITCHELL. Correct.

The CHAIRMAN. Mr. Mitchell, this is exceedingly interesting to me and I wish I might pursue some inquiries further, but I have another very important meeting to attend and I will ask Senator Walcott to preside in my place. I am very much obliged to you personally for coming here and for answering my questions so frankly.

Mr. MITCHELL. Thank you very much.

Senator WALCOTT (presiding). Mr. Mitchell, let us consider the question of new issues during the last three years. Will you describe

briefly what came to be the method of issuing securities when there was such a large amount of them, and when the country or public finally became a little sluggish in taking them, what was the method of digesting them?

Mr. MITCHELL. The machinery for distribution I would not say changed during that three years. Its general structure was the same that had existed in this country for years. I think if there was any general change, it came about through a growing desire on the part of the public to seek investments in equities rather than fixed maturity obligations. That was a development which was very, very marked, and a development to which the investment bankers of the country had to lend themselves. The investment bankers of the country are not the framers of public opinion. They must yield to the will of the investing public. That did bring about very large stock issues as against the old first mortgage and debenture bond issues. It did result in the issuances of a great many convertible bonds. It brought about the issuance of bonds with warrants attached—more or less new types of financing. The change was a trend developed by the public itself toward equity securities.

Senator WALCOTT. Do you think the issue of attached warrants is sound?

Mr. MITCHELL. Yes, sir.

Senator WALCOTT. I should say, detachable warrants.

Mr. MITCHELL. It is perfectly sound, Senator. Investors, however, always are in the danger zone where they try to mix investment in fixed maturity obligation and stock investment at the same time. They are trying to have their cake and eat it too, so to speak, and so many have been successful in that operation that such securities have come into great popularity.

Senator WALCOTT. What do you think of paying dividends with stock? There was a great change in that respect, was there not?

Mr. MITCHELL. Yes, sir. It became fairly prevalent among a number of companies.

Senator WALCOTT. Do you think it is aggravated by the taxing system as affecting personal income?

Mr. MITCHELL. Yes, sir; I think it is.

Senator WALCOTT. What do you think of it as a practice?

Mr. MITCHELL. Personally I do not like it and yet it is a way that seems to satisfy a great public. Of course, it adds nothing to a man's investment. It increases the burden of the issuing company in its dividend requirements. It merely gives a man one piece of paper and, let us say, one-tenth more, for that which he had in the first place, and that one and one-tenth does not represent anything more than he had before; but it is rather pleasing to him. It reduces the value automatically of the outstanding shares of the corporation.

Senator WALCOTT. Well, it is part of a pretty rapid evolution in this whole system; is it not?

Mr. MITCHELL. Yes, sir.

Senator WALCOTT. Now, what were the contributing factors to let us say this increase in public credence or gullibility? Companies with large stock issues began to finance with the junior securities. Something must have happened in the minds of the public to make

that possible. I assume we all agree that that is working toward the edge of the waterfall?

Mr. MITCHELL. Quite so.

Senator WALCOTT. What was it that induced the public to meet the corporation more than half way and swallow up its junior securities as fast as they could be issued?

Mr. MITCHELL. It was the fact that the inflation found its channel, not in the increase in commodity prices, not at that moment in increase in real-estate values, but in the increased price of securities. Seeing this inflation take place, seeing the prices rise, made those securities and securities of that class very popular with the people, and as inflation continued and those prices continued to advance, the inflation being in that particular channel, that interest and enthusiasm increased apace until it became a riot.

Senator WALCOTT. It was a kind of whirlpool of speculation bringing in more and more as the pool widened?

Mr. MITCHELL. Yes, sir. I would rather look upon it as inflation finding its channel in security prices.

Senator WALCOTT. Now, then, what was the chief factor in that? What made it possible? That could not be unless first there were funds available for these securities and public credulity, overconfidence, I will say, and perhaps a gambling spirit. Is it a wise thing to check it in the future? Is it worth studying so that we can place some legislative check on a recurrence of that kind of thing?

Mr. MITCHELL. I do not want your statement of the causes to go by without calling attention to the effect of the capital-gains tax.

Senator WALCOTT. I was coming to that.

Mr. MITCHELL. Which had a marked effect. That any inflation should be curbed seems to me to be an obvious thing.

Senator WALCOTT. That any inflation should be curbed?

Mr. MITCHELL. Yes, sir.

Senator WALCOTT. Obvious in what way?

Mr. MITCHELL. It should be curbed. It showed itself in an inflation of credit constantly and, as I said in answer to a question by Senator Glass, I view that as a part of the total quantity of credit outstanding and I think that the check was necessarily to come through the Federal reserve operations.

Senator WALCOTT. You have suggested two things; one, credit reserve operations and, two, the sale tax or profit tax on the sale of securities. What would you do with that? Would you cut it out or would you reduce it gradually?

Mr. MITCHELL. Eliminate it. Whether it is practical to eliminate it all at once or not I can not say, but it is one of those faults in taxation that operates disastrously, both in an advancing market and in a declining market. The advance of 1929 was very markedly accentuated by the operations of the capital-gains tax in the fact that on the advance there was not a normal supply of stock coming into the market to satisfy the demand, those who had stocks holding them back because of the necessity of paying taxes if they sold. On the other hand, when we came into 1930, we saw the depression in the market again accentuated by the desire of everybody having securities, provided they had an income, to sell in abnormal volume on the decline.

Senator WALCOTT. Taking losses?

Mr. MITCHELL. Taking losses to avoid paying the Government any tax whatever. By and large, I am of the opinion that over a period years the Government would get just as much revenue if you would eliminate that tax altogether.

Senator WALCOTT. That, to my mind, is the essential fact.

Senator NORBECK. I wish the witness would clarify his meaning, where he says "that tax."

Mr. MITCHELL. I mean the capital-gains tax.

Senator WALCOTT. That is the tax that is based upon the profit from the sale of securities. Will you develop that a little more fully. If you are right, then does that not remove the last objection to either removing or graduating downward that tax, provided your statement is true that the Government income might be—of course in time—just as great if you took it all off?

Mr. MITCHELL. I think it does.

Senator WALCOTT. How would that be possible? What would offset the loss from reducing that tax? How would the Government come out as well?

Mr. MITCHELL. You will have to view it over a course of years, certainly.

Senator WALCOTT. I would like to have you develop that idea.

Mr. MITCHELL. Take in any particular year, it would not be so; but when you get your returns from 1930 it is going to be found that the Government revenues are very much cut down by the operation of that tax and while in 1929 the returns were large, possibly owing to the profit that had been made, the returns were lower than they should have been; the actual earnings of people were very much lower than they would have been if the tax had not been there. In other words, if a man can gain his profit without there being a brake upon his so doing or taking his losses in the same way, I am inclined to think that there will be a greater mobility of capital and that through that mobility the Government will, in the ultimate, get certainly as great, if not greater, revenue than it would by the present operation.

Senator WALCOTT. That seems to be an excellent explanation, but let us carry it a little further. By the same method—that is, the encouragement of inflation and the constriction of the number of securities out because of this sales tax, which are hoarded—they are set aside, put on the shelf, because the tax is excessive. The holder does not want to take his profit and pay his tax, which constricts the market. Is that not a big factor in creating a situation of, first, overconfidence on the part of the public; secondly, a desire to speculate; and, thirdly, the natural result that corporations can go into the market and place securities that in normal times or with sound financing would not be possible? In other words, has it not brought on a flood of securities, particularly the junior securities, which rank far down in the matter of investment value to, say, the classes of C, D, and E?

Mr. MITCHELL. Senator, I doubt if the operation of the capital gains tax has had just that effect. I grant that it has held back the normally available securities from coming to the market and thus has advanced the price of those securities that did come on the mar-



ket and because of this unnatural advance in price of those securities it has perhaps unduly popularized shares to the American people. But I doubt very much if it has had the direct effect of bringing about the issuance of second-class stocks. I think that that is stretching the capital-gains tax elimination argument a little too far.

Senator WALCOTT. Have you any idea what the percentage was of undigested securities that had to be carried by the underwriters or the private banking houses or the banks?

Mr. MITCHELL. I should say it was so small as to be negligible.

Senator WALCOTT. The public got it all?

Mr. MITCHELL. Yes, sir.

Senator WALCOTT. To anticipate some questions that may recur a little later on, but which fit in at this point with reference to affiliates, what factor was the new affiliate? How much of a factor is the new affiliate in this movement toward inflation, this speculative period in junior securities? What part does the affiliate play in that? Is not the affiliate rather an encouragement and does it not make large profits as a result?

Mr. MITCHELL. I doubt if that has any appreciable effect. Remember that the affiliate in the investment banking field is not anything new. The rapid growth of the number of affiliates is comparatively new. In the case of our bank the investment affiliate is 20 years old.

Senator WALCOTT. It was for a long time not an affiliate. It was part of your bank for many years, was it not?

Mr. MITCHELL. It has been an affiliate for 20 years.

Senator WALCOTT. As a separate organization?

Mr. MITCHELL. As a separate organization. The development of banking has been toward an increasing distribution of securities through banking affiliates as against distribution through private banking houses. In other words, the development in machinery of distribution that is to be expected as the investment market broadens has occurred rather in the development of the banking affiliate than in the growth of private banking firms?

Senator WALCOTT. Do you think that the affiliate has been a conservative influence in investment securities?

Mr. MITCHELL. It is difficult to generalize. We know of places where the affiliate has been abused. On the other hand, it has become an exceedingly important factor in security distribution. I think, if you were to make a study of the percentage of securities distributed through affiliates to total distribution, you would find that the percentage is very, very much higher than it has ever been in history.

Senator WALCOTT. I think it would be useful for us to know what that percentage is, approximately. Can that be gotten together?

Mr. MITCHELL. There is a good deal of data published on it. The financial papers print regularly, I think each quarter year, a statement of the volume of securities distributed, under what leadership, and by what groups sponsored; and I think you will find very definitely by a study that the percentage of participation has gone up with respect to affiliates as to the total.

Senator WALCOTT. You have one of the most dependable statistical departments of any bank in the country. Would it be imposing upon

you to ask you to see if something can be gotten together on that, and to be sent in later?

Mr. MITCHELL. Yes; I will do that.

Senator WALCOTT. It would be a very valuable thing to see how it looks.

Thereafter the witness submitted a letter to the committee clerk, in explanation of the tabulations attached, all of which were made a part of the record, as follows:

THE NATIONAL CITY BANK,  
New York, February 10, 1931.

Mr. JULIAN W. BLOUNT,  
Clerk United States Senate Committee on Banking and Currency,  
Washington, D. C.

DEAR MR. BLOUNT: In the course of my hearing before the Senate Committee on Banking and Currency on February 2, Senator Walcott requested me to gather some data regarding the increasing importance in recent years of banking affiliates in the investment banking business, and I agreed to do so. As a result of a study made by our people, I am now able to send for your records the attached sheets.

The first is a record of the past four years of the origination of bond issues by all houses who originated \$20,000,000 or more per annum. From this table it will be noted that banking affiliate originations during this period increased from 12.8 per cent of the total in 1927 to 23.3 per cent in 1928, 41.5 per cent in 1929, and 39.2 per cent in 1930.

The second tabulation shows the volume of issues, in addition to their own originations, participated in by the same group as covered in the first tabulation. Of course, the dollar figures represent the sum total of the issues, and not the participations themselves, and in that particular is misleading. But this does not affect the percentage figures showing to what extent various groups participated generally in distribution. From this tabulation, it will be noted that the participations of banking affiliates increased from 20.6 per cent in 1927 to a high of 54.4 per cent in 1930.

Yours very truly,

C. E. MITCHELL.

ORIGINATIONS

[000 omitted]

	1927	Per cent of total	1928	Per cent of total	1929	Per cent of total	1930	Per cent of total
National bank affiliates.....	\$592,075	10.1	\$649,572	15.6	\$714,998	24.6	\$1,279,485	27.6
Other bank affiliates.....	162,714	2.7	320,664	7.7	489,400	16.9	530,779	11.6
Total, bank affiliates.....	754,789	12.8	970,236	23.3	1,204,398	41.5	1,810,264	39.2
Commercial banks and trust companies.....	540,711	9.2	258,803	6.2	115,201	4.0	248,980	5.4
Private bankers.....	4,566,574	78.0	2,923,975	70.5	1,585,933	54.5	2,556,841	55.4
Total.....	5,862,074	100.0	4,153,014	100.0	2,905,532	100.0	4,616,085	100.0

PARTICIPATIONS

(000 omitted)

	1927	Per cent of total	1928	Per cent of total	1929	Per cent of total	1930	Per cent of total
National bank affiliates.....	\$1,661,037	12.6	\$908,968	8.9	\$1,238,306	17.6	\$4,303,183	33.6
Other bank affiliates.....	1,050,690	8.0	1,174,504	11.5	1,905,859	27.2	2,676,056	20.8
Total bank affiliates.....	2,711,727	20.6	2,083,472	20.4	3,144,165	44.8	6,979,239	54.4
Commercial banks and trust companies.....	2,131,368	16.2	1,191,380	11.6	440,509	6.3	877,603	6.8
Private bankers.....	8,310,011	63.2	6,956,949	68.0	3,427,000	48.9	4,992,085	38.8
Total.....	13,153,106	100.0	10,231,801	100.0	7,011,674	100.0	12,848,927	100.0

Mr. WALCOTT. We will leave the affiliates for a moment. I only wanted to get their bearing on the matter of issues. Did such lending on the part of the banks place a severe strain on the bank resources at any time? That is, did the lending for carrying securities—the undigested securities we are talking about, strain them?

Did your bank lend largely for such purposes to your own affiliate or to any other security companies?

Mr. MITCHELL. No.

Senator WALCOTT. Did your bank or affiliate issue new stock of its own or rights thereto? How was such stock financed?

Mr. MITCHELL. The bank issued stock. The stock of our affiliate is trusted for the benefit of our shareholders; so there is no outstanding holding of that stock and no issues that the public is directly interested in, except as through that trusteeship.

Senator WALCOTT. Are you large buyers of affiliate securities? I refer to your bank.

Mr. MITCHELL. We occasionally buy securities from the affiliate and, as a matter of fact, for our portfolio we do buy a substantial portion through the affiliate.

Senator WALCOTT. For investment account?

Mr. MITCHELL. For investment account; very often using the facilities of the buying departments or the trading departments of the affiliate to accumulate blocks for the portfolio of the bank. It is very much easier for us to do so.

Mr. WILLIS. Do you ever buy them for trust accounts?

Mr. MITCHELL. No. For trust accounts we have a definite and fixed rule that we will not buy from the affiliate.

Mr. WILLIS. Nothing that the affiliate has brought out?

Mr. MITCHELL. We do not have any prohibition against the trust company, which in our instance is a separate corporation, from buying securities which the affiliate—

Senator WALCOTT. You can bring out a new issue for any corporation?

Mr. MITCHELL. I am speaking now of the trust affiliate.

Senator WALCOTT. Excuse me.

Mr. MITCHELL. We have no prohibition against our trust affiliate, the City Bank Farmers Trust Co., which is separately organized, separately operated, and separately directed, from buying securities which at some time the National City Co., our investment affiliate, may have had to do with; but we do have a definite prohibition against their buying any securities from or through the National City Co., the investment affiliate, and we go so far as to rule that even where under a specific trust there is a privilege stated for the trustee to buy securities directly from the investment affiliate, it must not be done. It is a fixed policy.

Senator WALCOTT. That would mean that the affiliate would not be a large purchaser of National City Bank new stock?

Mr. MITCHELL. I think perhaps we are mixed in the questions. Doctor Willis's question, as I understood it, had to do with the policy of the bank or the policy of the trust company in purchasing through or from the investment affiliate.

Mr. WILLIS. Quite so.

Senator WALCOTT. Yes. I understand that. My question was a separate question.

Mr. MITCHELL. This is a new question?

Senator WALCOTT. Yes. Is your affiliate a large purchaser of the corporation stock—that is, the National City Bank stock?

Mr. MITCHELL. It always carries an account which is used to take the peaks out of an advancing or a declining market. This operation never affects the trend of the market, but permits the seller of the day or the buyer of the day to sell and buy on a more even market than otherwise. That is a thing that has been done for many, many years, and I have had an agreement with the Comptroller that we would never buy in the affiliate for fixed investment. Generally speaking, the account works itself out usually within 60 or 90 day periods.

Mr. WILLIS. You have an agreement with the comptroller whereby you never buy the stock of the National City Bank through the National City Co.?

Mr. MITCHELL. No; that we will never in the affiliate buy shares of the National City Bank for permanent investment.

Mr. WILLIS. I should have made that proviso—for permanent investment.

Mr. MITCHELL. For permanent investment.

Senator WALCOTT. You do it to take the curves out of your graph?

Mr. MITCHELL. Yes, sir.

Mr. WILLIS. Does the comptroller examine the National City Co. as he does other banks in New York?

Mr. MITCHELL. We have always not only permitted but requested the comptroller to check carefully the cross-transactions between the National City Co. and the National City Bank; but since the privilege has not been given him by law to regularly examine the company we have not extended that privilege to him.

Mr. WILLIS. Has he ever asked for it?

Mr. MITCHELL. I think I could go back a good many years and say this: At the time that Mr. John Skelton Williams was comptroller some 15 years ago, he requested that he be allowed to examine the affiliate. The bank entered into an argument with the comptroller on the legal point, and it was finally determined he had no right to examine and the examination was not made. I think that was perhaps rather unfortunate. It became a very fixed policy that we should not permit the comptroller to examine. There has been a development quite recently that has brought about a rather rapid growth in the number and use of affiliates and we have noted how they can be abused to the detriment of the general banking structure. I am of the opinion that we would better face that situation and provide by law for examination of affiliates. From our standpoint such a law would be quite acceptable.

Mr. WILLIS. You mean to have a regular examination?

Mr. MITCHELL. A regular examination of affiliates.

Mr. WILLIS. And publication of portfolio also?

Mr. MITCHELL. No, sir; not publication of portfolio nor too rapid a publication of the balance sheets. I say that for this reason, Doctor Willis: The commercial-banking business is a business that

is more or less constant and even in its production of profit. The investment banking business is a business which depends upon the state of the market over a period for a profit. I fear it would be misleading to a public to have a rapid publishing of the reports of an investment banking company. The public would get the wrong slant completely as to the earning power. Investment banking earnings are never stable. They are now up and now down. I think the publishing of a statement of the affiliate once a year is in the public interest rather than a more often publication of it. Now, with respect to the portfolios. I can see no more reason for publishing the portfolio of the affiliate than I can for calling upon a commercial bank to make a statement to the public of its portfolio of loans and discounts in detail. It presents to the public to a degree that is totally unjustified, or it seems to me so, the particular operations that it has on at the moment. That would be very disadvantageous to the affiliate as against the private banking firms with whom they are in direct competition.

Senator WALCOTT. Has the stockholder of the affiliate the right to see a list of holdings or to see the portfolio; not a stockholder of the affiliate, but a stockholder of the bank that holds in trust the stock of the affiliate?

Mr. MITCHELL. I think legal counsel would say probably no to that, and I should want to cling very strongly to that legal advice because of the practical phases of the situation; but you will realize that the only shareholders of the affiliate are trustees—in our case, three trustees. They are the shareholders that have under the law the shareholders' rights directly.

Senator WALCOTT. Would you have this examination made by the comptroller? Would you put it in his hands and would you have it coincidentally with the examination of the bank? It would not do very much good unless it was at the same time.

Mr. MITCHELL. It should be made by the comptroller and at the same time that he makes his bank examination.

Senator WALCOTT. You would make that obligatory?

Mr. MITCHELL. I think it would be desirable; yes, sir.

Mr. WILLIS. We have had some witnesses here, Mr. Mitchell, who have said with a great deal of emphasis that any transactions in the stock of the bank should be prohibited to the security affiliate. Do you agree with that or not?

Mr. MITCHELL. No; I do not agree with it, Doctor Willis. I can understand how that privilege might be abused; that is, how the operations of an affiliate in the shares of a bank might be definitely abused. I think that is something that we would best not prohibit by legislation, but something that the comptroller should watch with care in his examination and if he finds at any time that it is operating to the detriment of the shareholders or contrary to the real, fundamental reasoning of the law, then it is something which he can stop.

Mr. WILLIS. Well, the comptroller has complained here he has very little authority except the large authority of closing a bank or something of that kind. Now, suppose he had merely an advisory authority in such a case as that of the Bank of the United States, for example. (I understand, of course, that was a State bank, but I am assuming some similar case might occur in the national system.)

Would he not have been powerless under the plan which you suggested?

Mr. MITCHELL. I have very little sympathy with the views of those who depreciate the authority of the comptroller's office and of the various superintendents of banks. If these authorities have the understanding and if they have the strength of personality within their organizations, they can enforce dictation leading to sound practices, I would rather see those qualities brought into play for the enforcement of proper banking, than I would to see various prohibitions come into the law with respect thereto or the granting of authority that over a period of years and with various men holding such offices, may be used not to the welfare of the shareholders and the public but to the embarrassment of banks and of banking management.

Senator WALCOTT. You would tend toward flexibility rather than legislative restriction?

Mr. MITCHELL. Most decidedly so.

Senator WALCOTT. Does that not lead us into another question altogether as to the matter of branch banking or chain banking? Before I get to that, let me ask you one more question on the affiliates. In the loans of affiliates or by affiliates to brokers and private banking houses, are those included in the Federal reserve statement?

Mr. MITCHELL. Let me get the question. You say the loans of affiliates to private banking houses?

Senator WALCOTT. Yes; for the sale of securities or to brokers? Would that come under the purview of the Federal reserve?

Mr. MITCHELL. I am afraid I do not get the question. You mean the loans made to affiliates?

Senator WALCOTT. For instance, it is fair to assume that some of the credit that the member banks get on commercial loans from the Federal reserve may at times be transferred to brokers' loans and used for brokers' loans.

Mr. MITCHELL. Yes, sir.

Senator WALCOTT. Now, then, would that item be known to the Federal reserve bank? In other words, does the Federal reserve bank know what the member bank is doing with reference to its brokers' loans accounts? The same question might be asked in reference to affiliates.

Mr. MITCHELL. Oh, yes. The Federal Reserve Bank of New York has a weekly record of the loans of all of the member banks in New York City, to brokers. It has not specifically a record of the loans of banks to affiliates from week to week.

Mr. WILLIS. It has no record of loans made by the affiliates to brokers, has it?

Mr. MITCHELL. No.

Senator WALCOTT. That was my first question—loans by affiliates to brokers.

Mr. MITCHELL. I do not think that would ever be a large factor. It certainly has not been a large factor in the last few years and wherever our affiliate has loaned to brokers it has loaned through the bank just as the so-called others make similar loans.

Mr. WILLIS. The bank has never loaned through the affiliate to brokers, has it?

Mr. MITCHELL. No, sir.

Mr. WILLIS. But, as a matter of fact, the loans made by such affiliates would not figure either in the brokers' loan report of the Federal reserve bank or in that of the stock exchange?

Mr. MITCHELL. Well, it would figure in the stock exchange returns.

Mr. WILLIS. Not necessarily, would it?

Mr. MITCHELL. I think Doctor Willis, it would. The stock exchange gets from its members a statement of their complete borrowings and those borrowings would include loans made to them by bank affiliates.

Mr. WILLIS. But corporations are not members of the stock exchange, are they?

Mr. MITCHELL. No, sir.

Mr. WILLIS. And the National City Co. is a corporation?

Mr. MITCHELL. Yes, sir; but the volume of the borrowing if it was by brokers would come into the report of the New York Stock Exchange, regardless of where the loan emanated, whether from an individual or from a corporation.

Mr. WILLIS. So that in one way or the other the loans to brokers are obtained by them, whether they are or are not members of the exchange, would all be reported by the New York Stock Exchange?

Mr. MITCHELL. Yes, sir.

Mr. WILLIS. But not in the Federal reserve portion?

Mr. MITCHELL. No, sir; they are not in the Federal reserve report at all.

Senator WALCOTT. Have you got any question on this subject before we leave it?

Senator NORBECK. I want to ask some questions, but go ahead with whatever you have in mind.

Senator WALCOTT. We were going on to the question of group banking.

Senator NORBECK. Do you believe a bank should be permitted to deal in its own stock?

Mr. MITCHELL. No; not a bank. I think there is reason, as I have tried to state it, for an affiliate to even out the peaks of a market. It never should be permitted to hold the stock of the parent bank as an investment.

Senator NORBECK. You are president of the National City Bank?

Mr. MITCHELL. I am chairman of the National City Bank of New York and chairman of its affiliates.

Senator NORBECK. How many affiliates?

Mr. MITCHELL. Well, we have the National City Co., which is an investment affiliate; we have the City Bank Farmers' Trust Co., which is a trust affiliate. We owned in the bank directly the International Banking Corporation, which is a corporation having to do with foreign banking and controlling certain of our foreign situations that can not be operated directly with branches. I do not know whether you would consider all of these affiliates or not; but certainly the first two would be affiliates.

Senator NORBECK. What is the capital of the bank?

Mr. MITCHELL. The capital of the bank, \$110,000,000.

Senator NORBECK. And the surplus?

Mr. MITCHELL. \$90,000,000.

Senator NORBECK. And the capital and surplus of the other corporations?

Mr. MITCHELL. The capital of the City Co. is \$55,000,000, and its surplus and reserve about \$16,000,000. The capital of the City Bank Farmers Trust Co. is \$10,000,000, and its surplus is \$10,000,000. The capital of the International Banking Corporation is \$2,500,000, and its surplus is \$2,500,000.

Senator NORBECK. And the stock is owned entirely by the bank?

Mr. MITCHELL. The stock of the International Banking Corporation is owned entirely by the bank. The stock of the investment affiliate and the stock of the trust affiliate is separately trusted for the benefit of the shareholders of the bank.

Senator NORBECK. Have they the same shareholders as the bank or have they very much the same shareholders?

Mr. MITCHELL. There are three trustees only in each case.

Senator NORBECK. Whose money is invested in this affiliate? Is it the money of the stockholders of the bank?

Mr. MITCHELL. The stockholders' money, but not the bank's money.

Senator NORBECK. But as far as ownership goes, it is the same as that of the bank? It is owned by the same people?

Mr. MITCHELL. The ownership is identical.

Senator NORBECK. How many stockholders has the bank, about?

Mr. MITCHELL. About 69,000.

Senator NORBECK. You operate how many branches?

Mr. MITCHELL. We operate in New York City I think now, 51 branches. We operate abroad 100 branches in 23 different countries.

Senator NORBECK. Maybe I do not understand, but I do not quite get the difference between the case in which a bank is prohibited from dealing in its own stock and that in which permission is given to create an affiliate that is owned exactly by the same group and controlled by the same group so that parts of the same institution lean on each other.

Mr. MITCHELL. It may be that there is a distinction. I will try to make clear the basis for my argument that such dealing by the affiliate is justified. Suppose all of the shareholders of the bank should say: "Now, ironing out these peaks is a desirable thing. Let us form a pool for this purpose." You would not find objection to that, would you?

Senator NORBECK. I do not know. It may depend upon the circumstances.

Mr. MITCHELL. I doubt if there could be an objection.

Senator NORBECK. I do not know just what you mean by a pool in this case. Do you mean a pool to affect the value of the stock of the bank?

Mr. MITCHELL. No; a pool formed to iron out the heavy day to day fluctuations in prices. In other words, what I am trying to establish is that if the stockholders were to have a separate corporation or a separate association designed for this particular purpose, the very fact that it was owned by those shareholders could not develop an objection to such an operation. If on the other hand this



were to become directly a bank operation, that is, dealing in its own shares, I can readily see how there would be objection. That is prohibited under the law. It might be contended that this plan permits indirectly doing that which is prohibited as a direct operation. But I think there is a very good reason for the dealings by an affiliate company in the shares of a parent bank provided such dealings do not go so far in any case as to involve permanent ownership by the affiliate.

Senator NORBECK. You mean, if the affiliate does not buy the shares as an investment?

Mr. MITCHELL. Not as an investment; no.

Senator NORBECK. You spoke of a pool awhile ago. Is not the effect of a pool such that the members buy on their own account and really own the stock?

Mr. MITCHELL. They may. It would depend upon what kind of a pool it was. It might easily be a pool formed to buy and sell stock without accumulation of any magnitude.

Senator NORBECK. You would consider it a proper function of a bank to go into the market for the purpose of sending this stock up or sending that stock down—forming pools, as you say?

Mr. MITCHELL. No.

Senator NORBECK. But it is done through the affiliate companies, is it not?

Mr. MITCHELL. As a matter of fact, we have no pool operations of this sort. I am merely introducing this as an illustration.

Senator NORBECK. Which would justify it?

Mr. MITCHELL. Which would justify it; yes, sir.

Senator NORBECK. You justify it as a principle?

Mr. MITCHELL. Yes, sir.

Senator NORBECK. Now, then, that means that it would be proper for any bank to do it, in your opinion?

Mr. MITCHELL. Not to do it directly, certainly not; but it seems to me that if you and I owned a bank—let us say the control of a bank—while the law would prohibit that bank dealing in its shares, I do not see that it should prohibit you and me from contributing an amount of money to even up the daily irregularities in the market in that bank's stock.

Senator NORBECK. Suppose our pool got interested to borrow from the bank to steady the stock?

Mr. MITCHELL. No, sir; we can not do that. That is, we can not do it on the shares of a bank.

Senator NORBECK. Does it not in fact put the bank squarely into what we common people call the stock-gambling business?

Mr. MITCHELL. I do not think so.

Senator NORBECK. Does it not put it in the investment business if they form a pool and underwrite or agree to buy a certain amount of stock?

Mr. MITCHELL. Well, if they do that, if they agree to buy and underwrite with the intent of holding or with the intent of definitely establishing a price level for the bank shares, I would agree with you there.

Senator NORBECK. You said that pools are sometimes abused. What do you especially have reference to in that case? Let me change

that question. You said that the affiliates were abused by the parent companies?

Mr. MITCHELL. No. I meant that the development of affiliates as a principle was something that had been abused. We saw it in the case of the Bank of the United States where there was the custom of forming an affiliate to take over any bad loan. I think that the number of their affiliates ran to 50 or 60. They were incorporated under the laws of New York and were in truth affiliates. Those corporations took over faulty assets and immediately borrowed from the bank—a very dangerous practice.

Senator NORBECK. In other words, the affiliate was created by the same group, for the purpose of permitting something that was prohibited by the law for them to perform directly?

Mr. MITCHELL. Not in that case. I think that those affiliates—

Senator NORBECK. At least they did that very thing. The bank itself could not do that kind of business, could it? It could not carry those loans or do that business that the affiliates did?

Mr. MITCHELL. Oh, yes; they could. There was no reason for taking those out. I presume they would contend that those items were taken out of the bank and segregated into separate corporations in order that greater attention could be paid to them and more efficient attention, but—

Senator NORBECK. They turned out to be poor assets, did they not? That is, a great many of them did?

Mr. MITCHELL. Yes, sir. Most of them were poor at the time they were taken over by an affiliate.

Senator NORBECK. Then the bank attempted to loan the affiliates to help them?

Mr. MITCHELL. Yes, sir.

Senator NORBECK. That is one of the causes of the breakdown?

Mr. MITCHELL. Yes, sir; but there was nothing in that operation, Senator, that an affiliate did indirectly for the bank that the bank could not have done directly.

Senator NORBECK. You said a while ago you would not mind questions referring to your own bank and it has been referred to often. I do not want to say anything embarrassing, but I have a few questions I would like to ask. Generally speaking, how are the funds of your security affiliate employed?

Mr. MITCHELL. They are employed in the ownership of securities that are passing through transiently, and also in certain permanent investments.

Senator NORBECK. Are they ever loaned for pool operations in the stock market?

Mr. MITCHELL. No, sir.

Senator NORBECK. Are those of the parent bank ever so loaned?

Mr. MITCHELL. It is pretty hard to trace through a loan to a point where you can say the avails are not used for some particular reason of that sort, but never as far as I know.

Senator NORBECK. I think you stated previously that you felt that a pool for the purpose of bracing the market or controlling the market is a justifiable thing to go into indirectly through your affiliate bank?

Mr. MITCHELL. Let me say this, Senator: So far as our own bank practice is concerned, we make every endeavor to stay away from

substantial loans on a single security. That keeps us rather out of those pool operations which are so frequent in New York.

Senator NORBECK. Your loans were not so employed in 1928 and 1929?

Mr. MITCHELL. No, sir.

Senator NORBECK. Does your affiliate ever accumulate stock in the open market for its own account?

Mr. MITCHELL. Yes, sir.

Senator NORBECK. Did it accumulate a considerable quantity of Anaconda copper on its own account?

Mr. MITCHELL. I would not say a considerable quantity.

Senator NORBECK. How much would you say?

Mr. MITCHELL. I would have to go into the records. I should say that the largest amount that it ever had, perhaps a year and a half ago, ran up to 90,000 shares; something of that sort; ninety or a hundred thousand shares.

Senator NORBECK. It had a market value at that time of what?

Mr. MITCHELL. Slightly in excess of \$100.

Senator NORBECK. What does that make in dollars?

Mr. MITCHELL. \$9,000,000.

Senator NORBECK. What about the Baltimore & Ohio Railroad Co.?

Mr. MITCHELL. I can not give you the exact amount, Senator. Of course, we were contemplating recommending to our investment clientele and selling to them directly shares of the Baltimore & Ohio Railroad. The Baltimore & Ohio Railroad has no opportunity to sell its shares to us. We have been connected with the Baltimore & Ohio Railroad Co. as bankers for a great many years. The only way that we can get shares to sell to our clientele is to accumulate them in the open market and that was done prior to distribution to our clientele—a perfectly natural operation and justified in every way.

Senator NORBECK. Was one of the purposes back of it to bring the value of the stock to a higher level?

Mr. MITCHELL. No.

Senator NORBECK. What was the purpose of it?

Mr. MITCHELL. The purpose is to find a stock which we considered to be out of line as to merit with other similar stock.

Senator NORBECK. And getting them for your customers?

Mr. MITCHELL. And getting them for our customers and giving our customers the benefit of our advice with respect to them.

Senator NORBECK. Then you recommended their purchase of them?

Mr. MITCHELL. Yes, sir.

Senator NORBECK. Would you know in a general way how much of that Baltimore & Ohio Railway stock you had at the most?

Mr. MITCHELL. Yes, sir. I would have to check up on that, but I should say probably fifty or sixty thousand shares.

Senator NORBECK. And the market value at that time was about what per share?

Mr. MITCHELL. Under par.

Senator NORBECK. Just a little under par, was it not? It ran around \$90 a share?

Mr. MITCHELL. I do not remember at that particular time just what that price was, Senator.

Senator NORBECK. It was around there, was it not?

Mr. MITCHELL. Yes, sir; it was around there.

Senator NORBECK. What did you do with the Anaconda copper stock?

Mr. MITCHELL. In the ultimate?

Senator NORBECK. Did you recommend that to your customers?

Mr. MITCHELL. We did.

Senator NORBECK. Sell it?

Mr. MITCHELL. Yes, sir.

Senator NORBECK. When you went into that pool, what was the market price of Anaconda? What was the stock selling at?

Mr. MITCHELL. As I say, we accumulated Anaconda stock at slightly in excess of \$100 a share and when we recommended it, which was some little time after, I presume it had gone to between \$110 and \$120.

Senator NORBECK. Was it not up to \$140 at one time?

Mr. MITCHELL. Oh, yes; but we were not responsible for that operation, nor did we have stock during that time.

Senator NORBECK. You did not have stock at that time?

Mr. MITCHELL. No, sir.

Senator NORBECK. Now, then, at what price did you sell this to your customers? Around 100?

Mr. MITCHELL. Between 110 and 120, if I remember rightly.

Senator NORBECK. What is the present value of that stock?

Mr. MITCHELL. The present value is around 35 or 40. I have not followed it up.

Senator NORBECK. Did the bank lose anything on the loans made in unloading those stocks or in selling those stocks to customers?

Mr. MITCHELL. Loans made?

Senator NORBECK. Yes. In selling the stocks, did you make loans on the stock?

Mr. MITCHELL. No, sir.

Senator NORBECK. Neither you nor the affiliate suffered any losses through the Anaconda deal, did you?

Mr. MITCHELL. Not through that distribution; no sir.

Senator NORBECK. I think that is all, Mr. Chairman.

Senator WALCOTT. Senator Bulkley, have you any questions?

Senator BULKLEY. I wanted to get a little more of Mr. Mitchell's idea about the easy credit, say, going back to what you said about a sharp advance in the Federal reserve rediscount rate. Was credit too easy, in your judgment, during the year 1928?

Mr. MITCHELL. It got far too easy.

Senator BULKLEY. The opinion has been expressed here that the large purchasers of Government securities in the latter part of 1927 by the Federal reserve banks made credit so easy as to make too good a structure for the building up of promotions.

Mr. MITCHELL. I think that is quite true.

Senator BULKLEY. Do you think that was bad judgment for the Federal reserve bank to buy so many Government securities at that time?

Mr. MITCHELL. Well, the after look is always better than the forward look.

Senator BULKLEY. Let us take advantage of the afterlook now.

Mr. MITCHELL. I think, if they could have seen into the future, as it has developed, that the action of the Federal reserve would have been different than it was. I am not sure it would have been different as to the easing of credit, but I think it would have been very much more drastic and very much quicker in return to a tighter money policy.

Senator BULKLEY. What would have been the steps to create that turn?

Mr. MITCHELL. Two. The advance in the rediscount rate, which would carry with it an advance in the bill rate and the sale of Government securities, which always sops up Federal reserve credit in the market. That is a piece of machinery that is most valuable for a quick change in the credit position, you understand. The discount rate operates slowly. Open-market operations operate quickly in their effect.

Senator BULKLEY. Well, the banks did sell a good many Government securities in the early part of 1929?

Mr. MITCHELL. Yes, sir; they sold securities. I have not those figures before me. Of course, it endangers Federal reserve control of credit to lose completely a portfolio of Government securities. That is one thing that they should constantly have for credit flexibility. I think that they ran their portfolio down to the point where it was on the edge of safety.

Senator BULKLEY. Without very much effect on speculative enthusiasm?

Mr. MITCHELL. Remember that the enthusiasm had got under way by that time. I am not sure if their action had been quicker than that would have stopped it. Just at that juncture perhaps a very sharp advance of 1 per cent in rate and perhaps two or three rapid advances, in order to show conclusively to the American public what they felt the situation was and to show that they had some teeth in their views, so to speak, would have corrected a lot of the inflation that subsequently did occur.

Senator BULKLEY. Do you think the rate is too low now?

Mr. MITCHELL. No; I do not think it is too low. I get very discouraged from time to time with the sloppiness of money and credit, but, after all, we know that easy money is one of the factors that usually enters into an improvement in general conditions after a depression and in spite of the fact that a condition where money is almost unlendable on short term in the New York market it is not altogether satisfactory and especially from a member banker's standpoint, nevertheless, I think it is a condition we should accept as in the public good.

Senator BULKLEY. It should be kept low until things get better under way?

Mr. MITCHELL. I think we should see a very definite trend toward better business before that rate is touched.

Senator BULKLEY. On that other subject, now, is there any reasonable limit to the number of affiliates that a bank ought to have?

Mr. MITCHELL. I would not want to see prohibitory legislation with regard to that. I think a bank should have as many affiliates as there is a good, sound reason for.

Senator BULKLEY. Was it a source of weakness in the Bank of the United States to have so many or did that not make any difference?

Mr. MITCHELL. Of course, you are stretching the argument when you even call those affiliates. They were not affiliates in the sense that you gentlemen are considering affiliates. They were totally owned companies, formed to handle particular investment operations. That is, it might have been a real-estate venture they got into where the loan was taken over by an affiliate and that comprised the entire assets of the affiliate and their operation had to do with that.

Senator BULKLEY. In other words, they set up a company just to put over one transaction?

Mr. MITCHELL. Take over a loan they might have in the bank. In other words, they might have a loan on a certain apartment house. It might be a second-mortgage or a third-mortgage loan. The loan would get into trouble. They would simply take that out of the bank and incorporate an affiliate, put it in the affiliate, have officers for that affiliate who could deal particularly with that situation. That affiliate, of course, was borrowing from the bank itself for its operation. It made their whole structure very, very complex.

Senator BULKLEY. Well, that would only have the effect of covering up a bad situation by a bookkeeping entry, would it not?

Mr. MITCHELL. That is all.

Senator WALCOTT. Little more than an investment trust, really?

Mr. MITCHELL. I would not call it an investment trust. It was an investment.

Senator WALCOTT. We will leave the word "trust" out. Have you finished?

Senator BULKLEY. Just one more thought. I think you said that you did not buy for trust account anything from either your bank or your affiliate?

Mr. MITCHELL. Right.

Senator BULKLEY. That is your own rule?

Mr. MITCHELL. That is the policy of the institution and a rule.

Senator BULKLEY. Is that the policy of all the banks in New York generally?

Mr. MITCHELL. I do not know that it is. I think it is quite general and I am not at all sure that the law would permit it anyway. I think any bank that does it is probably in violation of the law.

Senator BULKLEY. You think it would be well to make it more clear that that would be a violation of the law?

Mr. MITCHELL. Well, there can not be any harm in pointing out it is a violation of the law and if you find it is not, I would suggest you make a law so as to make it clear. I think it is a very dangerous practice.

Senator BULKLEY. That is all I have in mind.

Mr. WILLIS. I want to clarify two or three things that came out in this examination. The chairman was asking you about the height of the resources of the reserve bank. I think he remarked on the fact that so large a percentage was carried that it rendered the changes in the discount rate relatively unimportant. Is it not true that the reserve of the reserve bank is misleading as it is now stated and that it is really a reserve against the outstanding liability of all member banks?

Mr. MITCHELL. I think that the word "reserve" both in connection with the reserve bank and in connection with the reserve carried with the reserve bank by its members is very unfortunate.

Mr. WILLIS. Now, am I not right in thinking that your bank in its monthly circulars has estimated, or had estimated, the actual or real reserve at about 6 per cent of all demand deposits?

Mr. MITCHELL. I am sorry I have not got that particular calculation here. It was a calculation that was made for a speech which I made at Columbia University. In that we took total banking liabilities and applied the ratio of the gold against such liabilities and, if I recall rightly, we showed it to be about 6.5 per cent, and showed it generally smaller than the gold reserve to bank liabilities in certain foreign countries.

Mr. WILLIS. Is not that the figure, then, that should be held in mind in discussing the changing of the discount rate in the same way that the Bank of England must consider the condition of the joint-stock banks rather than its own immediate reserve?

Mr. MITCHELL. I think we may be misled in doing so. It is certainly a more understandable figure for the public to have in mind than the reserve ratios that are provided by law in the Federal reserve act.

Mr. WILLIS. One other point. We have had from other witnesses a discussion of the same question that you were asked, sir, about the relations of the president of a bank and the chairman. Now, in your bank the chairman is the chief officer of the bank, is he not?

Mr. MITCHELL. The chief executive officer of the bank.

Mr. WILLIS. Mr. Wiggin has told us the same is true of the Chase Bank; it is also true of a half a dozen of the largest banks in New York, is it not?

Mr. MITCHELL. I doubt that very much. Sometimes the chairmen are the heads and sometimes they are the thirds and fourths. The designation of chairman does not mean he is head, as a rule, in the New York banking situation, any more than it does in the Federal reserve system.

Mr. WILLIS. He may be a king maker. In the case of the larger banks, however, it is generally true that the chairman at the present time is the chief controlling officer?

Mr. MITCHELL. No; I would not say so. The chairman of more than one bank in New York is not the motivating spirit of that bank.

Mr. WILLIS. Mr. Mitchell, Mr. Wiggin, when he was here the other day, proposed that as commercial paper was getting relatively scanty, the discount power or lending power of reserve banks should be augmented by permitting what he called clearing-house certificates as a basis for borrowing. Have you given any thought to that idea?

Mr. MITCHELL. I have been trying to find out through the testimony offered here what Mr. Wiggin meant by "clearing-house certificates." I do not think that the record is clear. If he meant the lodgment of ineligibles or of securities with a clearing house which would issue a certificate evidencing such lodgment, with the suggestion that such certificates be discountable or the basis for borrowing at the Federal reserve bank, I should say possibly as a distinctly emergency measure, only, one could find some justification for it; but if it is not an emergency measure but a form of certificate

constantly to be issued against the deposit of securities, then I judge the equivalent of the Lombard loan such as we see in London, is contemplated and I can not agree that such a certificate would be proper paper for borrowing at the Federal reserve bank, as it is not of a self-liquidating character.

Mr. WILLIS. Now, as it stands, where the Federal reserve bank is allowed to make practically unlimited loans on Government obligations, does that not give the advantage to those who have the Government obligations as against those who can not get them? And would not Mr. Wiggin's suggestion, as I have understood it or set it forth, result in giving a more equal chance to others, if you are going to allow any of them to borrow on bonds?

Mr. MITCHELL. May I divert for a moment on this particular subject? You speak of some banks having Government bonds.

Mr. WILLIS. Or Treasury certificates.

Mr. MITCHELL. While others can not get them. Of course, anybody can get them. They are an investment that is free for the world to buy. In this connection, I would call attention to a statement I made some time back to the effect that in the case of my bank our borrowings on Government bonds have never exceeded the amount of eligibles on hand. But your question prompts a digression, if you will permit. I have a feeling that a great deal of our banking difficulty in this country comes from an absence of liquidity in banks. I spoke a minute ago of the unfortunate word "reserve" that we have in the Federal reserve act. I think there has developed perhaps an idea throughout the public and even with a good many bankers, especially those bankers who operate small banks, that when the law sets up what is called a required reserve—in other words, a legal reserve, which in the case of time deposits is 3 per cent and in the case of demand deposits ranges from 3 to 13 per cent—that this must be a reserve regarded by the reserve system as adequate for the protection of their deposits, and that when they comply with the requirement for legal reserve they are running a good bank. Now, as a matter of fact, there is not a bank in this country that is a good bank if it is operating on a liquid position equivalent only to that reserve. If it were only possible to have a provision that every bank in this country must be, say, 25 per cent liquid, I think we would have comparatively few bank failures.

When I say "liquid" I mean the sum of their till cash, their cash with the Federal reserve bank, their eligibles, their Government securities, and their acceptances of other banks. With such a provision we would have less worry as to how the balance of resources was invested. If we had one banking system and every bank was forced into membership in that system and we could make sound requirements of that sort, we would eliminate a lot of the banking difficulties of the country and we would not have to discuss, perhaps at such great length, the merits of unit, group, and chain banking. The trouble is that if we put in tried and true requirements of sound banking for Federal reserve members to follow, we are likely to face an exodus from the Federal reserve system. A provision regarding liquidity, a provision with regard to the volume of bond



account and limitations as to maturities therein, and perhaps some other provisions, all would make for sound banking. But we unfortunately can not make those requirements because we have no way to date, as I see it, of forcing the banks of this country into membership in the Federal reserve and having them stay there where they do belong.

Mr. WILLIS. On the whole, then, this suggestion of Mr. Wiggin, as we understand it, is one that does not appeal to you as being in harmony with Federal reserve principles?

Mr. MITCHELL. Perhaps if I understood it——

Mr. WILLIS. But as you now understand it, you think not?

Mr. MITCHELL. As I now understand it, it does not appeal to me.

Mr. WILLIS. But you would go on lending on the Government securities?

Mr. MITCHELL. Yes, sir.

Mr. WILLIS. Now, suppose there should be a large issue of bonus bonds of the kind suggested, you would not change on that account; you would lend on those?

Mr. MITCHELL. I do not see how you can change really, not in the middle of that kind of a stream. If that legislation goes through we will have to look to three-fourths of 1 per cent at least, if not 1 full per cent, higher yield value in governments; we will have full tax-exempt governments going to the public probably at  $4\frac{3}{4}$  per cent; municipals which now sell freely at 4 will go at  $4\frac{3}{4}$ ; industrials that go now at  $4\frac{1}{2}$  will be going at  $5\frac{1}{4}$  to  $5\frac{1}{2}$  and all of the portfolios of the banks of the country will have to be readjusted as to value on that basis. There will be hundreds and hundreds of bank failures—small-bank failures—throughout the United States. But, to try to swap horses in midstream, on the proposition of member bank borrowing on governments; no such an issue of governments at this time would lead to a grand and glorious inflation.

Mr. WILLIS. You are a director of the reserve bank?

Mr. MITCHELL. Yes, sir.

Mr. WILLIS. You would go ahead and admit these bonds to the same privileges of loan value and so on that present bonds and certificates have?

Mr. MITCHELL. I do not see how you can differentiate against them. If that operation is to go through, these particular bonds would have to have all of the advantages that any government bond has ever had, plus.

Senator BULKLEY. What operation are you assuming?

Mr. MITCHELL. I am assuming a bond issue equivalent to three and a half billions. I did not intend to get on this subject.

Senator BULKLEY. I do not know but two or three people in Congress that would favor that; probably two or three would favor it.

Mr. MITCHELL. That will be encouraging to the banking fraternity any way.

Senator BULKLEY. There is a good deal of setiment, of course, in favor of redemption at the present computed value of the certificates, which would be a very different thing.

Senator WALCOTT. I want to ask you two or three questions. I would like to get your opinion on the matter of branch banking as opposed, let us say, to group banking; that is, within geographically

restricted areas, branch banking perhaps along the English line, or chain banking. How do you feel on that? Is there anything of that sort that you would recommend, or develop along any one of those lines you would recommend?

Mr. MITCHELL. I would be glad to discuss it. I think I might perhaps save the time of the committee if you would let me read from a previous statement I made with respect to that.

Senator WALCOTT. All right.

Mr. MITCHELL. Would that be agreeable to you?

Senator WALCOTT. Yes.

Mr. MITCHELL. I take no firm position as favoring unit, branch, group, or chain banking. I can not, however, be blind to the fact that while unit banking as a sole system has played a prominent part in the development of our country, and still has its ardent adherents, there is a very definite trend away from it, a trend that is fostered not by individual authorities but by public interest. It is to be expected that as time goes on and the public has tested these various types of banking, the right kind of banking for this country will develop from popular demand.

It is my observation that, while national feeling in the United States is second to none existing anywhere else in the world, local civic and neighborhood pride and desire for autonomy is prevalent throughout the United States to an outstanding and exceptional degree. I feel that this must be taken into consideration as the trend in banking develops, and that, while in the ultimate whatever system best serves the public interest will doubtless be adopted, it is important that no banking trend should be forced by precipitate legislation, either permissive or restrictive. The development should be no more rapid in any direction than is sanctioned by the gradual change of public feeling.

Frankly, it would seem clear that the small unit banks for outlying and rural districts have as a system outrun their exclusive position of popularity.

It always has been claimed for the locally owned unit institution that it was more responsive to the wants of the community than a branch of a larger institution, with headquarters elsewhere, would be. Doubtless there is something in the argument, but it works both ways. The most important of all considerations in valuing the services of a bank to a community is that it shall care for the funds entrusted to its custody in such manner that they shall always be safe and ready for return to the depositors on demand. There is such a thing as a banker being too responsive to local applications and too much under the influence of local and personal appeals. The fact that a local banker is under greater pressure from local borrowers than a branch manager, supervised by an outside authority, may cause the interests of depositors to be imperiled for the accommodation of borrowers; indeed, the record of failures proves this to be frequently the case. Every period of boom times has had many bank failures in its wake, because the local bankers were under the same influences and affected by the same psychology as their customers.

Branch banking where permitted by law, and group banking in part as a substitute where branch banking is not permitted, and a

combination of these developments sometimes working hand in hand, is gradually but assuredly taking hold alongside of the old unit system. The development has come about not by the establishment of new banks to compete with the old nor by aggressive action from large financial centers. It has been largely due to local conditions where the opportunity existed for constructive reorganization. It is well that this movement is gradual, as it is educational to a public that is primarily interested in banking service. It is not a movement to be feared. Banking is not a business which can be monopolized. The idea that local money or capital will be drawn away from the small towns to the large cities and that local needs will go uncared for is unwarranted. It is not at all likely that money will be drawn from a higher to a lower market, and since money is usually cheaper in large centers than in the outlying districts, closer relations between the two are most likely to result. There will be no monopoly.

It should be borne in mind, however, and the importance of it is so vital as to justify repetition that the normal banking development which has occurred in a natural and orderly way in most other countries has been discouraged and restricted in this country, and this fact creates a danger of a hasty, competitive development and one that will be publicly resented in case all restrictions are taken off at once. It is undoubtedly best that we gain experience gradually, with legislation keeping pace therewith. No reasonable objection, however, from the standpoint of public interest can be offered to the extension of the branch banking privilege for State and national banks alike beyond the present restricted areas. If such a development gives to the public a safer and better banking service, the demand for a further extension of power will come from a convinced public and the development will be a normal and accepted one.

How far immediate legislation should go in advantageously extending permissive powers for branch banking is a difficult problem. The trade area suggestion appears to me at present too broad in its scope. The suggestion of extension to county or to State lines seems artificial. The expansion to Federal reserve districts extends the territory to an unwarranted degree under existing circumstances and furthermore is filled with impracticabilities owing to the fact that the districts themselves do not represent either trade areas or spheres of natural banking relationships. My one suggestion would be that legislation should be such that under the carefully given permits of the comptroller's office the limitations of branch banking be extended to a somewhat larger field in the immediate vicinity of our cities, allowing the experience of this extension to be the guide in future legislation.

I feel that group banking is playing a most important rôle in what may be a real trend from unit banking at the one pole to widely practiced branch banking at the other. Where well managed, the groups seem to be satisfying the needs of the public which they serve. That they lack the flexibility, the effectiveness, and the economies of the branch system is obvious. As a measure of prudence, I feel that the holding companies should be under the inspection powers of the office of the Comptroller of the Currency.

Senator WALCOTT. You would rather have a swing toward the branch banking idea than to work out its salvation ultimately

through the group-banking system. You think the natural trend should be toward branch banking?

Mr. MITCHELL. I feel that the trend is likely to be toward branch banking.

Senator WALCOTT. Yet this picture has developed in the last two or three years in the Northwest and Southeast;—that we have had 1,300 bank failures in the last year—we have had 6,000 in 10 years. Most of them have been small banks, practically all have been nonmember banks, but there is something wrong, and we ought to fix it in some way so that those banks can survive in those countries, which are to-day even mostly pioneer fields so they can develop normally with the natural benefit to the country, yet they are not doing so. They are suffering to-day from the banking situation in the Northwest and in the Southeast. Some groups have been put together and are perhaps relieving matters by diversifying loans at the season of special allowances, so it is not either all up or all down—leveling the thing out; but it is not successful, as you know. What have you in mind for that? I take it from what you just read you do not want to start something that will stimulate the buying of small banks, competing for these small banks and putting the price away up out of reason. That would be disastrous, most decidedly. Have you anything in mind on that? We would like your ideas on this situation which is really serious.

Mr. MITCHELL. Of course, we must not let ourselves get confused in the basic principles of banking, which is, to my notion, that the depositor is the man who should first be considered. In this country we are prone to think of the service to the borrower rather than to the safety of the depositor. It has led us into a great deal of trouble. It has led us into perhaps more bank failures than has been experienced in any country on the face of the earth, not only as to the number but as to the liabilities involved. We must keep, therefore, this principle of safety to the depositor foremost in mind. Unless you can tell me that there is a way to bring the banks of the United States into one system and especially into the Federal reserve system, I say that we are likely to have a continuance of bank failures and that is going to bring in its trail disaster to community after community, especially through our country districts.

Senator WALCOTT. You include in that statement, of course, your State banks?

Mr. MITCHELL. Oh, State and national, and trust companies.

Senator NORBECK. By what system would you prevent repetition of what happened to the Bank of the United States in New York?

Mr. MITCHELL. I think that is an isolated case. That is the first big bank failure that we have had in a great many years. That is distinctly a case of bad bank management and there is no way that you can legislate against that.

Senator NORBECK. In other words, even when you get your branch banks with your large units and your set-up, you are still liable to have such a thing happen occasionally, are you not?

Mr. MITCHELL. Yes, sir.

Senator NORBECK. That one failure in New York caused larger losses four times over than all the failures of the banks in South Dakota, and we have had hundreds of failures. It is equal to the bank disasters of four States. Why refer to the four other States?

Why not consider them both? Do we not need all the evidence here on this matter? Why not limit it to the last decade when we deal with the small bank? Why not take 50 years' experience instead of 10?

Mr. MITCHELL. I should judge this is a private fight in your committee, in which I have no right to enter.

Senator NORBECK. I am asking you a question, if it would not be fair to take a 50-year experience instead of a 10-year period when we are trying to work out a rule here?

Mr. MITCHELL. Most decidedly.

Senator NORBECK. I object to the unfairness of the argument; that is all. In other words, I am of the opinion that nothing has happened to the Northwest except an agricultural deflation. When we get a price for our labor, our banking situation will become all right because it always has been right. We have an occasional failure due to the causes such as you have mentioned, anyway.

I want to ask a few further questions regarding copper and kindred matters.

Mr. MITCHELL. May I ask you, Senator, if you would be quite agreeable to consider what I say in regard to Anaconda, and Baltimore & Ohio, and any questions you may ask with regard to the details of this operation as off the record?

(By consent of the committee Mr. Mitchell's request was granted as to subsequent inquiries on the topics indicated.)

Senator WALCOTT. Would you favor restricting the fiduciary functions of the national banks to those banks that are not engaged in the investment business?

Mr. MITCHELL. No; I do not quite see that.

Senator WALCOTT. Well, you have got two functions. Of course, you have your fiduciary functions and you have your investment functions.

Mr. MITCHELL. Yes, sir.

Senator WALCOTT. Would you favor reducing the fiduciary functions to those banks not engaged in the investment business?

Mr. MITCHELL. I do not see any reason for that whatsoever. I think the trend is always toward giving to a clientele a complete banking and investment and trust service. I think that the public are indicating that that is what they want. Now, if those businesses can be done by a single organization it is very much better. When I say a "single" organization, I mean by organizations controlled by the same shareholders. Unless it is done in that way we are constantly going to get the wrong answer for the client on some problem that he brings to us. There is always a time when a commercial banking client has problems that should be solved through application of investment banking practice and principle, and there are times with all individuals, and with corporate customers as well, where their need for fiduciary service is very definite. Those are all functions which are proper banking functions and which the average client likes to conduct under one roof, so to speak, and the profits from which are legitimate to the single institution as an institution. No; I see no reason, whatsoever, for differentiating, as you have suggested.

Senator WALCOTT. Mr. Mitchell, have you any suggestion or recommendation that you would like to offer whereby the Federal reserve

banks would be more attractive to the banks that are not in the system?

Mr. MITCHELL. I doubt very much, Senator, if it can be approached from that angle. Everything you do by Federal reserve legislation to invite sounder banking or to prohibit unsound banking, makes membership in the Federal reserve system less desirable for the very bank that you want to get in, namely, the bank that is not inclined to the best banking practices. I do not know any way that can be found to drive these banks in. What we need in this country is certainly to have all the banks of the country members of the Federal reserve. We need to drive them into one system. That will do more than anything else that can be done.

Senator NORBECK. You would wipe out the State bank systems, if necessary, to bring that about, would you not?

Mr. MITCHELL. I think, from the standpoint of the public good, almost anything is justifiable that will bring about that end.

Senator NORBECK. In speaking of the banking systems, you are again using the 10-year experience instead of the 50 years?

Mr. MITCHELL. I am using the experience of this country from its very beginning.

Senator NORBECK. You will agree these unit banks in the agricultural sections stood up very well until the deflation?

Mr. MITCHELL. They always stand up as long as land values go up. You put a small bank into a farming community at a time when land values are declining and that bank is likely to be in difficulty before long. If the values are increasing, if the territory that it goes into is developing, then success will follow the experience of that bank and the bank will grow with the territory. It will serve properly the territory, and countless of them have done so.

Senator NORBECK. Is it not a fact that the business conditions surrounding a bank have a definite bearing on a bank, no matter where it is located?

Mr. MITCHELL. Oh, yes.

Senator NORBECK. If business in a certain line becomes unprofitable and values shrink, it is likely to catch the bank, no matter where the bank is located.

Mr. MITCHELL. That is very true, of course. Bear in mind that in this past year the average life of the banks that failed—and there were 1,300 of them—was 18 years. Now, let us go back. The farm land values in this country doubled from 1900 to 1910, and they doubled again from 1910 to 1920.

Senator NORBECK. When you say the land values of the United States, do you mean the whole land values of the United States, or what land values do you refer to?

Mr. MITCHELL. I refer to the value of farm lands.

Senator NORBECK. Where?

Mr. MITCHELL. In the United States taken as a whole. I am quoting the statistical figures on this.

Senator NORBECK. Are you quoting the United States census figures on it?

Mr. MITCHELL. I do not know whether the United States census shows that or not, but, roughly speaking—

Senator NORBECK. May I insert here whatever figures the census gives?

Senator WALCOTT. Yes.

(Thereafter Senator Norbeck furnished the following letter of the Director of the Census Bureau for the record:)

DEPARTMENT OF COMMERCE,  
BUREAU OF THE CENSUS,  
Washington, March 11, 1931.

HON. PETER NORBECK,  
*United States Senate, Washington, D. C.*

MY DEAR SENATOR: Replying further to your letter of March 9, I give below the value of farm land, excluding buildings, in the United States as shown by the censuses of 1910 and 1920, together with the per cent of increase:

1920 census.....	\$54, 829, 563, 059
1910 census.....	\$28, 475, 674, 169
Increase, 1910-1920.....	\$26, 353, 888, 890
Per cent of increase.....	92. 5

Please note that in the census enumeration the farmer was asked to give the value of the farm, including farm buildings and improvements, and in another question was asked for the value of the buildings on the farm. The value of the farm land is obtained by deducting the value of the buildings from the total value and, therefore, doubtless includes the value of such improvements as fences, tile drains, and incidental improvements on the land.

Very truly yours,

W. M. STEUART, *Director.*

Mr. MITCHELL. My statement is, generally speaking, that the farm-land values in the United States doubled from 1900 to 1910 and doubled again from 1910 to 1920. Now, that was the period when the banks that were established in the country districts could be expected to go on and successfully develop, but when we came to the end of 1920 and began to get into some decline with the line of values bobbing about but usually with downward trend, and when we come to the period of the past two or three years and see what has happened, we know that these small rural banks that are dependent upon this one line of agricultural endeavor for their welfare are going to suffer. They have had to make loans on land. That has been their principal business, and when the decline became——

Senator NORBECK. Of course, you realize this, that the average bank in an agricultural section does not make loans on real estate, although he is dependent upon the earning of the farmer.

Mr. MITCHELL. He is dependent upon the value of the land.

Senator NORBECK. The earnings.

Mr. MITCHELL. Of the land. That is for this reason: The farmer may have a mortgage on his land. If the values of his products will not support that value, he is in trouble.

Senator NORBECK. Exactly so.

Mr. MITCHELL. So that the farmers' prosperity depends upon land values.

Senator NORBECK. It depends upon his earnings, the same as any business.

Mr. MITCHELL. Yes, sir.

Senator NORBECK. It depends upon his earnings and the values reflect the earnings, of course. In other words, it depends upon his wage. Do you know that he is the poorest wage earner in the United States, the lowest paid?

Mr. MITCHELL. Well, a good many of them are; there is no doubt about that.

Senator NORBECK. Now, you look upon that increase of value from 1910 to 1920 as an inflation, do you?

Mr. MITCHELL. Inflation in land values.

Senator NORBECK. What was the gain in commodity values during that same period?

Mr. MITCHELL. I can not answer that question.

Senator NORBECK. How much more did a suit of clothes cost than 10 years ago or a pair of shoes or a locomotive?

Mr. MITCHELL. These questions all involve availability of a lot of statistics to make answer.

Senator NORBECK. That is true, but unless land values increased faster than other commodities, it was a proper inflation, was it not? Did it increase any faster than the cost of an office building, when they went and doubled their rents because they had doubled their values? The higher replacement cost gave them a chance to double the values on the old as well as the new, and still you say that the farmers should not have been in on this higher value. He should hold to the old values. He should still produce corn at the same price per bushel, though he pays twice as much for a suit of clothes.

Mr. MITCHELL. Of course, I was merely trying to trace through the—

Senator NORBECK. I challenge the statement that the inflation of land value has been greater than the inflation in other things. It has not been as bad as the inflation in the coppers that you recommended to your customers to buy.

Senator WALCOTT. Is that all?

Senator NORBECK. That is all.

Senator WALCOTT. Anything further?

Senator NORBECK. Nothing further.

Senator WALCOTT. We are very much obliged to you for coming down and for the frankness of your replies. This meeting is adjourned until to-morrow morning at 10.30.

Thereafter the witness submitted a letter to the chairman of the subcommittee under date of February 6, 1931, with request that it be recorded as a part of his testimony. Such letter appears, as follows:

FEBRUARY 6, 1931.

MY DEAR SENATOR GLASS: I have just finished reviewing the testimony at my hearing before your committee on February 2, and take the liberty of writing you regarding certain views that I would have been glad to have expressed in the hearing had the opportunity been presented, and which, if you deem proper, I would like to have recorded with my testimony.

1. Member reserves: I regard the differential between the legal reserve requirement for time deposits and for demand deposits as altogether too great. The low reserve requirements for time deposits leads to bad-banking practice, inasmuch as there is afforded thereby an undue temptation to bankers to consider as time deposits those which are truly of a demand character, and the way is too often found to pay such deposits on demand and thus nullify the intent of the law. Low reserves required for time deposits as against reserves for demand deposits may be indicative to bankers as to the proper proportion of liquidity to be maintained as between these two classes of deposits, all to the detriment of sound-banking practice. I hope it will be determined to increase the reserve requirement for time deposits and to lower the reserve requirement for demand deposits, but I make no attempt to prescribe the proper differentiation, realizing that this is a matter of study at the present moment by the reserve board.



2. Thrift deposits: There has been some discussion before your committee as to the propriety of such deposits in a commercial bank, with varying expressions of view. Such deposits are desirable, because of their outstanding constancy in volume, and, not being subject to checking privileges but payable only on presentation of pass book, deserve a higher interest rate than can be afforded to checking accounts. They are customarily made under a provision giving the bank the right to delay payment on notice for periods varying from 30 to 60 days, and, therefore, are classified as time deposits, and carry the legal reserve required for time deposits. At the same time, no commercial bank could afford to invoke the right to delay payment on these deposits without causing a run from checking depositors, and, if this were by chance to occur, such checking depositors would be preferred creditors over the savings depositors as to the best assets of the bank, which are the most liquid. The law should require that these thrift deposits be classified as demand deposits, a reserve rate established accordingly, and the provision for delay in paying on presentation of pass book eliminated. These deposits fluctuate so little, however, that I am of the opinion that a fair reserve requirement thereon should properly be somewhere between the time reserve requirement and the reserve requirement for demand deposits on checking accounts. I notice that the suggestion has been made before your committee that assets should be segregated to protect deposits of this class. Such segregation can only be justified if the provision, giving the right to the bank to delay payment on notice, is retained, but even then I refer to my original proposition that such notice could not be made effective without causing a run by checking depositors, with the result that liquid assets would disappear, leaving for the protection of the thrift depositor only the slower and far less liquid assets segregated for his protection. I regard general bank liquidity as far more important than asset segregation, but, if there be a question in determining the law, I feel that a compromise should be reached in giving to any commercial bank accepting thrift deposits the option of classifying such deposits as demand deposits having all the rights of prompt withdrawal that checking deposits have or classifying such deposits as time deposits and segregating assets for the protection thereof.

3. Publicity: There should be a requirement that published statements of member banks must clearly set forth the amount of assets segregated or pledged for the protection of any special class of general depositors, such as Government, State, and municipal depositors, or for the right to do any particular business, such as the right to administer trusts, which, in the State of New York for instance, calls for a deposit of bonds with the State treasurer to the amount of 10 per cent of the capital; also they should clearly set forth the existence of any deposits preferred by law, such as trust or public moneys. Banks should not be permitted to advertise on windows or otherwise that they are designated depositories for public moneys, such as Postal Savings, United States Treasury, State of New York, or City of New York, where such deposits are made only with segregation of assets, because such advertising is misleading, and is designed only to establish confidence in the public mind that is not justified by the fact. Likewise, I have often been impressed with the freedom with which banks advertise their membership in the Federal reserve system as an obvious invitation for public confidence. Certainly, until requirements that do not now exist upon member banks with regard to the soundness of their banking practices can be established in the reserve act, such advertising misleads a public, and throws a responsibility upon the system that is not justified.

May I take this opportunity to express the gratification which I believe all bankers feel over the very constructive attitude taken by your committee and the obvious desire to obtain a frank expression of the views of reserve and member bankers.

Sincerely yours,

C. E. MITCHELL.

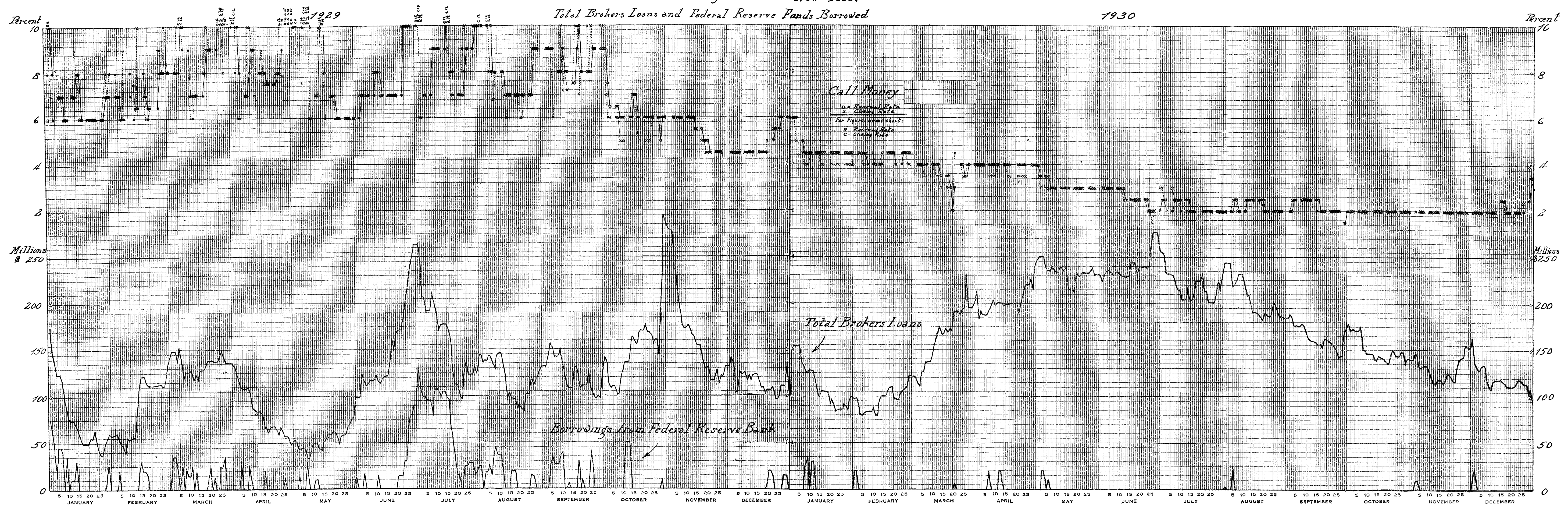
Senator CARTER GLASS,  
*Senate Office Building, Washington, D. C.*

The witness also submitted the following chart, which was ordered to be made a part of the record.

(Whereupon, at 1.30 p. m. the hearing was adjourned until tomorrow, Tuesday, February 3, 1931, at 10.30 o'clock a. m.)

The National City Bank of New York  
 Total Brokers Loans and Federal Reserve Funds Borrowed

1930



# OPERATION OF THE NATIONAL AND FEDERAL RESERVE BANKING SYSTEM

TUESDAY, FEBRUARY 3, 1931

UNITED STATES SENATE,  
COMMITTEE ON BANKING AND CURRENCY,  
*Washington, D. C.*

The subcommittee met, pursuant to adjournment, at 10.30 o'clock a. m., Frederic C. Walcott (chairman) presiding.

## STATEMENT OF HENRY M. ROBINSON, CHAIRMAN OF THE BOARD, SECURITY-FIRST NATIONAL BANK OF LOS ANGELES

Senator WALCOTT. Will you please give us your name and your official title as a banker?

Mr. ROBINSON. Henry M. Robinson, chairman of the board of the Security-First National Bank of Los Angeles.

Senator WALCOTT. Mr. Robinson, there are a few prepared questions here, and I am going to read a group of four questions, and then later you can bunch them in any way you choose in your answers. They are all questions of a general nature. What changes in existing banking law and regulations, if any, do you favor?

Of these, which are of emergency or urgent character, and which do you think represent more or less fundamental changes which might be deferred for further study?

Has the experience of the past two years merely emphasized changes you previously thought desirable, or has it suggested new ones?

Earlier witnesses have expressed the opinion that some thorough measure should be resorted to for the purpose of preventing further competition for members between National and State banking systems; have you any suggestions on this point?

They are all general in nature, and they will perhaps suggest some replies to you.

Mr. ROBINSON. That first question is a fairly large order.

Senator WALCOTT. Yes; that is a large order.

Mr. ROBINSON. Based on our experience, I have been favorably impressed with the comptroller's suggestion of the amplification of the permission to extend branches in areas that might be defined as economic areas with some larger community as the center. That is based largely on our experience. That I think would be a fundamental change.

Senator WALCOTT. You would let that grow slowly?

Mr. ROBINSON. Yes; grow slowly.

Senator WALCOTT. To avoid competing for banks at too high a price?

Mr. ROBINSON. Yes, sir.

Senator WALCOTT. And if it went through it would be more along the English system, where you would actually own the branch?

Mr. ROBINSON. I think it should be a branch instead of what is called a chain or group bank. I believe the control is better. I base that on my own experience where we have tried both.

The possibilities of improper action in group banking are very much greater than they are in branch banking, because in the branch banking the definite information as to transactions between the different branches is more readily obtainable, both by the management and the authorities than in the case of group banking. I think it is safer and finally more economical.

Our experience when we first started in branch banking was that, in giving autonomy to the branches, we ran into a great many different attitudes on the part of the management of the different branches as to what their duties and obligations were to the community and to the bank itself. And it has been a matter of slow growth to get the branch managers to conform to what is considered best banking practice. I can see that that would be accentuated, and I know the reverse accentuated in group banking where the individual banks carry on, either along the lines that have been our experience or new lines, and they may not always be safe or sound. I do not mean to say that necessarily the branch-banking management is always safe and sound, but that it can be more easily controlled as to safety and soundness in a branch-banking system is my belief based on experience.

Senator WALCOTT. You think that the contact between the large controlling bank and the outlying or small district bank is a wholesome thing for the small bank?

Mr. ROBINSON. Yes.

Senator WALCOTT. And do you think the small bank would give fully as good service and perhaps be safer?

Mr. ROBINSON. Our experience in the country is that we have done more for the branches than they could have done for themselves as individual banks. In other words, city funds have gone to our country branches. And that has been true for the last 10 years.

Senator WALCOTT. So that the country districts are better off, you think, under the branch system?

Mr. ROBINSON. Not necessarily. That again would be a question of the administration's view of its obligations to the various communities that it served. But I think in our experience that our branch banks generally have done that.

Senator WALCOTT. And do you get through your branches a kind of diversification?

Mr. ROBINSON. In our particular case; yes, sir. We have almost what the comptroller calls an economic area. We have a great, wide diversity, and that means a better use of our funds than the individual banks could have had.

Senator WALCOTT. You increase your load factor for your loans?

Mr. ROBINSON. Yes; for instance, our crops come on through the various months through the year. So it is almost a revolving fund through the year.

Senator WALCOTT. Yes.

Mr. ROBINSON. So we are rather in a fortunate position in that respect. But we do believe that diversity is good, and that you want to get it through a branch-banking medium that covers a reasonable area.

Senator WALCOTT. Senator Norbeck, have you any questions on this point? These are rather general questions until we get to something more specific.

Senator NORBECK. I was late in attending the committee meeting, so I did not hear the opening remarks of Mr. Robinson, but I am interested in what I did hear.

In speaking of getting the money out into the country in larger quantity than before, is it not a fact that even prior to branch banking that funds from the center or cities went out into the country banks more or less through their correspondents?

Mr. ROBINSON. Yes, Senator.

Senator NORBECK. In other words, in so far as the city banks are concerned they had the outlet before as well as now, did they not?

Mr. ROBINSON. They had an outlet; yes. I do not think it was a satisfactory outlet always.

Senator NORBECK. That is rather a general description. I wish you would go into that further and state as to what you consider satisfactory.

Mr. ROBINSON. The difficulty was to be sure of the use of the funds that were put out through the local banks. In our own branch organization we are able to appraise the value of the loan with greater accuracy, and it was safer for the bank, and really safer for the community through the branch system, than it was where the city bank advanced occasionally and on emergencies to the country banks, the unit bank.

Senator NORBECK. You mean that in the past the local bank could make too liberal loans, which can be avoided under the branch system?

Mr. ROBINSON. At times; yes, sir. Not always. It depended upon the character of the management of the unit bank.

Senator NORBECK. The local bank, of course, has a board of directors who live in the community and are generally familiar with the personal situation as well as the security?

Mr. ROBINSON. Yes.

Senator NORBECK. And under the branch system you have the one man in charge who makes a written report to the centers, and on that information the loan is generally made, is it not?

Mr. ROBINSON. No, sir. We have in the local branches in each case an executive board which corresponds with the board of the unit bank, of the men in the community who are best informed. And they have full authority to make loans up to certain limits without any consultation with the head officers.

Senator NORBECK. And what would the limit usually be?

Mr. ROBINSON. It varies somewhat with the community. It will run as high as \$50,000, and I think in one instance \$100,000.

Senator NORBECK. And as low as what?

Mr. ROBINSON. As low as \$10,000.

Senator NORBECK. You do not maintain that usually that is the way that the ordinary branch-bank system is handled?

Mr. ROBINSON. I can not answer you as to that. In the California branch bank I think that is the usual system.

Senator NORBECK. A few years ago I spent some time in Canada, and I found a farmer who wanted a few hundred dollars for seed grain in the spring, and who had put in an application some time earlier, and it was sent down to the central bank in Montreal or Toronto, and he had to wait a week for a reply, and I know in one case, at least, that the bank changed managers, and when the farmer came in for his money the manager said, "Well, we decided not to make any loans out here."

Mr. ROBINSON. That does not apply to our operation.

Senator NORBECK. Is not that a condition that can easily develop where the authority is so far from the business?

Mr. ROBINSON. I suppose it could, Senator. But it would seem to me that the administration of a bank would be very unwise if it permitted it to develop, because the bank, after all, is dependent upon these various communities for its merchandise and for the sale of its merchandise.

Senator NORBECK. I agree to that, but is not that almost the rule of life, that the unwise things are done?

Mr. ROBINSON. At least occasionally.

Senator NORBECK. Both with bankers and farmers.

Mr. ROBINSON. I think some errors have been made by bankers.

Senator NORBECK. Are not they liable to be made under a branch system, too?

Mr. ROBINSON. The probability is not as great.

Senator WALCOTT. In other words, you give to your district bank or branch almost complete autonomy?

Mr. ROBINSON. No; as I say, not complete autonomy, because we ask them to conform to proper banking practices, as we view them in the head office, and we try, of course, to study banking practices all of the time. And that means that they must conform as to their forms. And when it comes to the matter of loans the local executive board has authority within limits that vary according to the community to make the loans, and they do.

Senator NORBECK. I think you stated before I came in what your connections were.

Mr. ROBINSON. Yes, sir; I am chairman of the board of the Security-First National Bank of Los Angeles.

Senator NORBECK. With how many branches?

Mr. ROBINSON. I can not say exactly, but certainly I think 130. We keep consolidating them.

Senator NORBECK. And when did you first branch out?

Mr. ROBINSON. About 1921.

Senator NORBECK. There is the same old trouble again. We have pretty short experience on a matter which we are asked to legislate upon.

Mr. ROBINSON. Yes, sir; it is only 10 years. But possibly our experience is as old as most of them in the country.

Senator NORBECK. The unit banking system is much older in this country?

Mr. ROBINSON. Yes, sir; and it seems to have had its troubles, too.

Senator NORBECK. Yes; and the troubles have been mainly the last eight or nine years, have they not?

Mr. ROBINSON. I think I can recall some earlier than that.

Senator NORBECK. Yes. But there have been a large number of failures in the agricultural section, and numbers of them have been since the agricultural deflation, have they not?

Mr. ROBINSON. There were a good many in 1920 and 1921, if you remember, but not as many as there have been lately.

Senator NORBECK. Yes. 1920 was when the deflation came on in its fury?

Mr. ROBINSON. Yes, sir.

Senator NORBECK. It started with that.

Mr. ROBINSON. Yes.

Senator NORBECK. Why condemn the banking system because an economic situation becomes so impossible that banks can not survive in certain sections.

Mr. ROBINSON. I think there is a good deal of truth in your statement, Senator. I may venture the opinion, however, that the other is more elastic, and, as we view it, more beneficial to the local community than the unit bank has been in the past.

Senator NORBECK. I must admit that we in the prairie States are deeply appreciative of the great concern that has been shown over our welfare in the past few years. It seems that branch banking has been talked before. We have been hearing it before.

Mr. ROBINSON. Our interest is due to the fact that we hoped these communities would survive and their business survive, because after all, as I stated, our source of supplies in the way of deposits comes from all communities, and we want them to survive very much.

Senator NORBECK. I have no doubt of that.

Mr. ROBINSON. And we do put forth a good deal of effort to try to see that they do.

Senator NORBECK. If you give agriculture a fair price for its product—in other words, a fair price for its labor—do you not think that the agricultural banking situation would take care of itself?

Mr. ROBINSON. Yes; I think that would be a very great help.

Senator NORBECK. If you do not, it will be difficult to make loans out there that will be safe.

Mr. ROBINSON. I agree with that. I wish very much that I could do it, because we have a great many agricultural loans.

Senator WALCOTT. Mr. Robinson, are you familiar with this provision of the proposed law, section 4, on page 4? There is a provision there which amplifies the law regarding branch banking. Will you glance at that and tell us whether it strikes you with favor?

Mr. ROBINSON. I have never thought that we have reached a time yet where it was a large advantage necessarily within the limits of a State. I stated, I believe, that I thought the so-called economic area, if it could be properly established, would be a better measure than this because I do not know that State boundaries really furnish of necessity, a diversification.

Mr. WILLIS. Is there any harm in this one, Mr. Robinson? Do you see any danger in it at all?

Mr. ROBINSON. I do not know that I do.

Senator WALCOTT. That is without limitation to the area, or would you put in a mileage limitation?

Mr. ROBINSON. A mileage limitation would be a very difficult thing.

Mr. WILLIS. How would you fix the area?

Mr. ROBINSON. I understood the suggestion had been made of trade areas.

Senator WALCOTT. That is the comptroller's word, trade areas.

Mr. ROBINSON. Yes, sir.

Senator WALCOTT. But neither he nor we ourselves have ever defined trade areas. It would be different with every section, of course.

Mr. ROBINSON. I tried to study that out myself. But my remembrance is that the suggestion was made that a committee consisting of the Secretary of the Treasury, the comptroller, and the governor of the Federal Reserve Bank act as a committee in trying to define such an area. And I think possibly they could do that.

Mr. WILLIS. You mean you would let them fix the area in every case without having an application and on their own motion?

Mr. ROBINSON. Yes, sir; I believe that would be a method of getting at it.

Mr. WILLIS. Is the California law working out on the whole satisfactorily now? I mean to say is the legislative situation there as to branch banking about as good as you can make it?

Mr. ROBINSON. Of course, they have the law which permits branches anywhere in the State. There is only one bank that has undertaken that. The banks in California—the branch banks in California—could be put into really four groups; first, "state-wide"; what might be called "economic area" as No. 2; and No. 3 "metropolitan area"; and as No. 4 "city branches". There is only one attempt to go state-wide.

Our bank is next in order, and covers what we call the economic area, and we get as our boundary on the north the point where the rail rates break as between San Francisco and Los Angeles.

Mr. WILLIS. Now, the California law has some requirements as to number of branches, hasn't it, in proportion to capital of the bank, or am I wrong about that?

Mr. ROBINSON. I do not recall that. I think not.

Mr. WILLIS. Do you think there should be any such?

Mr. ROBINSON. I do.

Mr. WILLIS. How would you arrange that?

Mr. ROBINSON. There, again, I think it would depend somewhat on the character of the business being done in the area where the branches would be located. I would hesitate to say what ratio that should be.

Mr. WILLIS. You would limit the number of branches in proportion to the capital of the bank?

Mr. ROBINSON. Yes.

Mr. WILLIS. Would not that eliminate a great many objections that have been made to branch banking?

Mr. ROBINSON. I think so. Of course, we have had an area of competition in our particular section for the creation of branches that has created an unwholesome condition, and that would be a step in the right direction, undoubtedly.



Mr. WILLIS. Are there any changes in the California law that are contemplated in the early future?

Mr. ROBINSON. I have heard of none; no.

Senator NORBECK. I am impressed with your using the words "unwholesome condition" with branch banking in California. Might we not also get an unwholesome condition when we get branch banking in South Dakota?

Mr. ROBINSON. If it comes in the immediate future I think there is very little danger. You see ours was a type of competition that came in when the speculation in the banking field was very high.

Senator WALCOTT. The prices of the banks were too high?

Mr. ROBINSON. Yes.

Mr. WILLIS. You do not mean overbanking?

Mr. ROBINSON. No.

Senator NORBECK. You mean the centers misjudged the price of property when they bought?

Mr. ROBINSON. Probably not misjudged it, but paid more because of the competitive situation than they would have otherwise.

Senator NORBECK. Did they charge you more than the fair value?

Mr. ROBINSON. I think in a good many instances they did.

Senator NORBECK. But by doing that they created an unwholesome condition?

Mr. ROBINSON. For the time being, yes.

Senator NORBECK. I am indeed impressed with that statement. It is a remarkable statement. It is a thing that I felt would come in one way or another.

Mr. ROBINSON. That is not true to-day, Senator Norbeck. I am speaking of the time when the competition was on.

Senator NORBECK. If they bought these properties at high values they are still carrying them at high values, are they not?

Mr. ROBINSON. No; that has all been worked out.

Senator NORBECK. How did you work it out?

Mr. ROBINSON. As a rule by the central bank working it out partly through their earnings; in the main through their earnings.

Senator WALCOTT. Writing it off?

Mr. ROBINSON. Writing it off; yes.

Senator NORBECK. And then what happened to the dividends?

Mr. ROBINSON. They were able to pay their dividends, but they did not have as much for undivided profits.

Senator NORBECK. How is the bank stock in these chain banks held? It is held generally to quite an extent by the public, is it not?

Mr. ROBINSON. In our bank it is; yes.

Senator NORBECK. What about the run of prices on your bank stock?

Mr. ROBINSON. It has been as high—our bank stock—as 143, and as low as 78.

Senator NORBECK. And what is it now?

Mr. ROBINSON. About 93.

Senator NORBECK. What did you sell it at when you were putting it out?

Mr. ROBINSON. \$100.

Senator NORBECK. It all sold at \$100. What about some of the other banks in California? Tell us about the Bank of Italy.

Mr. ROBINSON. As to the Bank of Italy I can not give you its range because it is not in the public's hands, as you know, but a holding company holds the shares.

Senator NORBECK. I know, but it is indirectly.

Mr. ROBINSON. Yes, sir.

Senator NORBECK. What about the stock that the public holds?

Mr. ROBINSON. The Trans-America stock is out.

Senator NORBECK. Yes.

Mr. ROBINSON. That is a holding company.

Senator NORBECK. But it holds the Bank of Italy, does it not?

Mr. ROBINSON. Yes.

Senator NORBECK. In other words, how did that stock run?

Mr. ROBINSON. But it holds other assets, and a great many of them.

Senator NORBECK. Yes, sir; I know.

Mr. ROBINSON. I think it has been as high as 72, and as low as 12; I am not sure as to that. I have not followed it very closely.

Senator NORBECK. At what price did the bank put it out at when they sold it to the public?

Mr. ROBINSON. I think I ought not to express an opinion on that, because my remembrance is that the bank did not sell the stock.

Senator NORBECK. I mean the holding company, of course.

Mr. ROBINSON. I think they sold some—I am not sure, but I think they sold some—at 62½.

Senator NORBECK. And at what price is it now?

Mr. ROBINSON. Thirteen.

Senator NORBECK. Then the stockholders have absorbed a lot of those losses, have they not?

Mr. ROBINSON. If that is all of them; yes, sir; but you must remember that they have many other assets, and concerns, that they hold stock in.

Senator NORBECK. Is not the Bank of Italy their main holding?

Mr. ROBINSON. It is now; that is, the Bank of America.

Senator NORBECK. Then if they sold the stock at a higher price and it went low they unloaded it on the public.

Mr. ROBINSON. If that is what influenced the bankers; yes, sir; but—

Senator NORBECK. But it was not the influence of the bankers?

Mr. ROBINSON. May I complete what I started to say?

Senator NORBECK. I beg your pardon.

Mr. ROBINSON. There were a great many factors which entered into the change of the value of those shares, undoubtedly. I think you probably know that the assets of the Trans-America covered a great many other items than the Bank of America.

Senator NORBECK. But the Bank of Italy was the main one.

Mr. ROBINSON. It is to-day, but there was a period when it was not.

Senator WALCOTT. They covered a vast field.

Mr. ROBINSON. A vast field; yes.

Senator NORBECK. Did you have a more serious situation in California in the 10 years preceding the last one in your banking business?

Mr. ROBINSON. You mean from 1914 on?

Senator NORBECK. I mean from 1910 to 1920.

Mr. ROBINSON. I was not actively in the business at the time; I do not recall. Yes, sir, we had our troubles in 1914, of course. But, I think, of course, 1920 was the worst period we had.

Senator NORBECK. Yes, sir; when the deflation came. Is it not a fact that for 30 or 40 years preceding the last decade your banks have been riding along pretty nicely in California as a rule?

Mr. ROBINSON. I do not know as I would say that. We had more or less trouble in southern California. I can not speak for the North.

Senator NORBECK. I notice again we have our branch banking discussion based on the 10-year experience. I would like to have it based on the 50-year experience, which I think would be a better one.

Mr. ROBINSON. I agree that it would be better, but I am afraid that I will not be present at that time.

Senator NORBECK. That is all I have.

Senator WALCOTT. Mr. Robinson, do you find much difference between the California situation to-day following the last two years' development than in the East? Are your banking laws operating more advantageously out there? Are your general conditions better than they are in the East, and if so, for what reason?

Mr. ROBINSON. I would say, if you are speaking about economic conditions, I think maybe they are a little better. As to the banking conditions I do not think my experience with any comparable area in the East would put me in a position to make a comparison.

Senator WALCOTT. They are so closely allied, the economic conditions in a country and the banks that, if you find economic conditions which seem to you better, that would probably account for a better banking situation, would it not?

Mr. ROBINSON. Yes, it might.

Senator WALCOTT. Are there any laws that you know of that are more advantageous to the banking system or more helpful to the banking system in the West than the State laws in the East? Is there anything particularly that you have in mind?

Mr. ROBINSON. No; I do not have any laws at this time in mind. I always thought that the California law was an excellent law. It is a departmental law with which Doctor Willis is quite familiar.

Thereafter Mr. Robinson submitted a letter to Senator Norbeck to be made a part of the record, as follows:

SECURITY-FIRST NATIONAL BANK OF LOS ANGELES,  
*Los Angeles, February 23, 1931.*

The Hon. PETER NORBECK,  
*Senate Office Building.*

MY DEAR SENATOR: In giving my testimony before the Subcommittee of the Committee in Banking and Currency, covering branch banking and more particularly in respect of departmental banking, I felt confident that you will find those who have carried on banking business under the provisions of this act quite, if not entirely, unanimous in the opinion that it is a very great advance over the other systems in vogue.

Certainly it is an advance over the national system, in that, among other things, it gives additional protection to the savings depositor.

I am inclosing—

- (1) Copy of the bank act of the State of California as amended in 1929.
- (2) Copy of pamphlet by Mr. Sartori entitled "Departmental and Branch Banking in California."
- (3) Reprint of newspaper article by Mr. Sartori entitled "Branch Banking and the McFadden Bill."
- (4) Pamphlet, "Branch Banking as Affected by the McFadden-Pepper Bill," issued by the State banking department.

I will see that there are other copies delivered for the use of other members of the committee.

I sincerely hope that the committee will give serious consideration to the departmental plan.

Very respectfully yours,

HENRY M. ROBINSON.

Senator WALCOTT. Is there not a tendency in California to get out from under the Federal reserve or the national banks?

Mr. ROBINSON. No.

Senator WALCOTT. Would you try to equalize the State and national bank requirements so there would be every inducement to bring the banks, as far as possible all of them, under the Federal reserve act?

Mr. ROBINSON. I would. I believe the Federal reserve act is a very great benefit, and I believe that its maintenance depends, of course, upon the certainty that it will have membership. And I believe the tendency in the country generally has been to change to State charters, and I think it has a bad effect upon the whole system.

Senator WALCOTT. It is because the State charter is a little more liberal, or the State laws, rather, are a little more liberal?

Mr. ROBINSON. Yes; I should think so.

Senator WALCOTT. Consequently competition of State banks is pretty keen with the national?

Mr. ROBINSON. Yes.

Senator BULKLEY. What do you suggest we can do to keep the State banks coming into the national system?

Mr. ROBINSON. I think one of the important things is the thing we have been discussing. If we used trade areas in permitting banking (and that could only work out under the national system), that would be helpful, because in many instances you would go over the State boundary, for instance, like Pittsburgh. There would be a great many instances where it would cross State boundaries.

I have sometimes wondered why something could not be done in the national system, where a fund was created, through which the comptroller could promptly take charge of banks that were in difficulty and promptly pay off the stockholders, or depositors, to the point where, on his examination, he felt the assets could be realized. I believe prompt payment desirable because I think it is terrible the way these liquidations drag. It is not fair to depositors nor to anybody.

Mr. WILLIS. That should be done, should it not, regardless of any relations between the State and national systems?

Mr. ROBINSON. Yes, sir. If this was done in the national system it would be helpful.

Mr. WILLIS. It would be more attractive to the depositor than to the banker, would it not?

Mr. ROBINSON. I do not think so.

Mr. WILLIS. Do you mean that would be a way of attracting banks into this national system?

Mr. ROBINSON. I think it might. I think bankers who felt that they did not have to go through the agony of having depositors wait for liquidation might be inclined to the national system.

Mr. WILLIS. A banker is not willing to contemplate failure.

Mr. ROBINSON. I think you are right about that, but for the moment he may be thinking more of it than he did in the past.

Senator WALCOTT. Right on that general point, Mr. Robinson, haven't they 90 days in which to file claims?

Mr. ROBINSON. I have not been through one, so I don't remember what the rules are. I know it is a very long delay, and it is very hard on depositors.

Senator NORBECK. I am more interested in this statement I have heard just now, than anything I have heard for many days here. I think it is constructive. Is it your thought that the treasury should in some way advance the funds in case a bank closes to pay what a bank is liable for?

Mr. ROBINSON. Not a guaranty.

Senator NORBECK. No; not a guaranty.

Mr. ROBINSON. But to pay the amount of the appraisal of the assets.

Senator NORBECK. But to pay a guaranty of the appraisal of the assets.

Mr. ROBINSON. Yes, sir.

Senator NORBECK. And that could be done within two or three months, could it not?

Mr. ROBINSON. It could be done practically immediately; and in addition to that, he should pay to the depositors anything realized on the assets afterwards.

Senator NORBECK. Afterwards; yes.

Mr. ROBINSON. Yes. It does not need to be a large fund.

Senator NORBECK. And a plan like that could have been followed through the last 10 years and have taken away much of the depression.

Mr. ROBINSON. I agree with you.

We had a small bank failure recently which was pathetic in its results. It had one of those fearful rental contracts where the clearing house could not afford to take it over to work it out, and yet the hardship on the depositors was terrible. Now, in another instance the clearing house just agreed to put up the money necessary to liquidate, but there they did not have one of those rental contracts.

Mr. WILLIS. I have just one question, Mr. Robinson, before you leave this general subject. A number of witnesses have spoken before you about this same question as to the competition between the National and State systems. Would you favor any kind of legislation, if such could be found, which was compulsory, designed to bring about a single, uniform chartered system for the whole country and to abolish the distinction between State and National banks?

Mr. ROBINSON. Yes; I think that anything that reduced what seems to me a serious competition between State and National authorities would be good, anything that would modify that.

Mr. WILLIS. Is not that the only way that you will end it—that is, by getting a uniform system?

Mr. ROBINSON. It is the most comprehensive way you can bring it out.

Senator WALCOTT. Your California law provides for some sort of departmentalized banking, does it not?

Mr. ROBINSON. Yes.

Senator WALCOTT. Do you regard that as a success?

Mr. ROBINSON. Yes; I think it was a success.

Senator WALCOTT. You like it?

Mr. ROBINSON. Yes.

Senator WALCOTT. And is it taken advantage of by most of the banks?

Mr. ROBINSON. The State banks?

Senator WALCOTT. Yes; the State banks.

Mr. ROBINSON. They have to.

Senator WALCOTT. It is obligatory?

Mr. ROBINSON. It is obligatory.

Senator WALCOTT. What about the net result in the last two years in the bank failures in California? Have you any figures in mind that would show any percentages there?

Mr. ROBINSON. No; I do not recall. There have not been many.

Senator WALCOTT. Do you think in proportion to the number of banks in California they fared a little better?

Mr. ROBINSON. Yes.

Senator WALCOTT. So far as failures were concerned?

Mr. ROBINSON. Yes.

Senator WALCOTT. That might be partly due to your better commercial situation or economic situation?

Mr. ROBINSON. Yes; it might in part, although I do not think that is the principal reason.

Senator NORBECK. Tell us about these committees of the branch banks that are authorized to make loans without consulting the central bank. I wish you would explain that a little further. I presume there is a fixed limit as to the amount they may loan.

Mr. ROBINSON. Not in any given case.

Senator NORBECK. Nor as a total for the branch?

Mr. ROBINSON. No; not that exactly. But we show them a chart, give them a chart, which indicates what, if they were a unit bank, they would have a right to loan. When they have reached that in their loans they then take up with the head office to find out whether we might be willing for them to go beyond that.

Senator NORBECK. In other words, you determine what you allocate to the community.

Mr. ROBINSON. By its deposits.

Senator NORBECK. By its deposits?

Mr. ROBINSON. Yes.

Senator NORBECK. Are they the actual deposits or theoretical deposits?

Mr. ROBINSON. No; the actual.

Senator NORBECK. The actual deposits?

Mr. ROBINSON. Yes.

Senator NORBECK. And they are permitted to loan what part of those deposits?

Mr. ROBINSON. The same percentage that we would in the head office.

Senator NORBECK. And then if there is anything further they have got to apply to the head office?

Mr. ROBINSON. Yes; to go beyond that.

Senator NORBECK. I can not see they differ much. If they were a unit bank they would be able to loan just the same amount they are loaning now.

Mr. ROBINSON. Yes, sir.

Senator NORBECK. Only in the latter case they would apply to the other bank for additional funds.

Mr. ROBINSON. Yes; additional funds.

Senator NORBECK. I can not see the distinction. I can not get the advantage that comes to the branch with those limitations on it.

Mr. ROBINSON. There is just one other difference, which is that with the unit banking system the city bank might not be as willing to advance excess funds as the central office might be willing to advance to its own branch.

Senator NORBECK. Might it not also work both ways? Does not the city bank advance funds to its correspondent to help it hold its business?

Mr. ROBINSON. Yes; I think that is the primary reason.

Senator NORBECK. And that influence would not enter here, since the branch banks would be the only banks.

Mr. ROBINSON. No. But the other influence I think is stronger, and that is a desire to maintain your community. For instance, these advances are seasonal, and, as I say, in our area they are rather revolving, and one bank at one time flourishes, and at another time another bank, and it enables the funds to go to different districts. They do not fail to employ their funds in that way, and I think it works out better than it would with the unit banking system in that respect.

Senator NORBECK. For instance, here is a correspondent bank getting money from you, getting funds from you rather, for which they pay a certain rate of interest somewhat below the rate at which they loaned; is that right?

Mr. ROBINSON. Yes.

Senator NORBECK. In this case you get the benefit of the whole return on whatever the money is put out at, do you not?

Mr. ROBINSON. Yes.

Senator NORBECK. In other words, where you might be putting money out to a correspondent at 4 per cent, you can in this way put it out at 6 per cent?

Mr. ROBINSON. Yes, you can do that. And, on the other hand, I think—I do not know that I would want to state it positively—it would show during the last eight years that the community has had a lower rate than it would have had from unit banks borrowing from central banks.

Senator NORBECK. But this much you admit, you take more out of the community than the unit bank did.

Mr. ROBINSON. No, I do not. I say we take less, I think.

Senator NORBECK. I mean in the way of interest charge.

Mr. ROBINSON. I mean in the way of interest charge.

Senator NORBECK. Your interest to a correspondent bank might be 4 per cent, and now you get 6.

Mr. ROBINSON. That is correct, but we get it because we maintain an office in the community.

Senator NORBECK. Yes.

Mr. ROBINSON. And furnish the machinery that a unit bank furnishes. And I say the community bank gets it at a lower rate, I believe, than it would where the unit bank in the community borrowed it from the central bank.

Senator NORBECK. Of course there would be less distribution in the community of dividends and salaries than there was formerly.

Mr. ROBINSON. I do not even agree with you on that, because in our case our stock is scattered and owned very largely in the communities where we have branches.

And I would say as to salaries that perhaps we do not pay quite as much in the large, but I do not think it would differ very widely.

Senator NORBECK. As near as I can figure out, as you tell me, you may have a certain greater advantage in dealing with the branch bank than in dealing with the correspondent.

Mr. ROBINSON. Yes.

Senator NORBECK. But I do not see where the community gets any advantage out of it, except the possibility that in case of great need they might be taken care of better.

Mr. ROBINSON. I am sorry you have gotten the impression of possibility, because I have said that in our case that has been our practice.

Senator NORBECK. We are not talking about your practice. We are talking about the banking laws of 48 States.

Mr. ROBINSON. I can tell you that I think that the administration of the branch banking would take the same view that we have. This is my belief. It is only a matter of belief, of course.

Senator NORBECK. Yes; it is possible. It is your belief that they would have such a liberal attitude toward the small communities and that they would furnish them more funds than they are getting now?

Mr. ROBINSON. No; I would not put it on that ground. I think that they would use the funds of their branch banking to the best advantage of the communities, first, in safety, and then to the best advantage of the communities in which a bank is placed.

Senator WALCOTT. By diversification you can revolve and move the funds from one community to another, and in that way you can keep your money working better.

Mr. ROBINSON. Yes.

Senator NORBECK. May I ask if that has not been done for 100 years in banking in America?

Mr. ROBINSON. Yes. Credit moves very fast.

Senator NORBECK. Yes. But this is not an innovation.

Mr. ROBINSON. No; it is not an innovation. It is an improvement, because I think there was a definite lag in the movement of funds where you had a multiplicity of the unit banks, a very definite one. In the first place the management of the small unit bank, we will say, from which the customer is desirous of obtaining funds, has quite a little time making up its mind. Then it goes to the city bank



and they wrangle about security, and this and that, and try to appraise the security value, and at last get the money. Yet, at other times, hardships have come because the city bank felt no responsibility for the community, which the branch bank does, and at times would decline to assist, where the head office of the branch bank would feel that it was its duty to assist.

Senator NORBECK. In allocating funds to a community for loaning purposes, you take into consideration only loans that are made on bonds or stocks that are sold in the community by your branch?

Mr. ROBINSON. I do not know as I understand that, quite.

Senator NORBECK. There has been a tendency in a good many banks now, of course, to go to stocks and bonds rather than to local securities.

Mr. ROBINSON. Yes.

Senator NORBECK. On the argument that a great many of the customers prefer it.

Mr. ROBINSON. You mean using bonds and stocks as collateral instead of commodity loans?

Senator NORBECK. No; I mean do your banks sell stocks and bonds?

Mr. ROBINSON. No.

Senator NORBECK. They do not?

Mr. ROBINSON. No.

Senator NORBECK. I think that is all, Mr. Chairman.

Senator WALCOTT. We want to get to that whole question of investment banking. How far does the law of California encourage investment banking?

Mr. ROBINSON. We have no special limitation on investment banking.

Senator WALCOTT. What is the security situation along the Pacific Coast?

Mr. ROBINSON. There has been some damage done out there. Is that what you mean?

Senator WALCOTT. I assume that you have probably gone through very much the same evolution in that respect there as we have in the Middle East and in the West?

Mr. ROBINSON. Yes.

Senator WALCOTT. That your business has tended towards the general securities. As the confidence of the public increased and would it take them up?

Mr. ROBINSON. As the fashion changed?

Senator WALCOTT. As the fashion changed?

Mr. ROBINSON. Yes.

Senator WALCOTT. And the public have become more venturesome.

Mr. ROBINSON. Yes.

Senator WALCOTT. And the Pacific coast is no exception then?

Mr. ROBINSON. I should say not.

Senator WALCOTT. Now that leads us to the question of security loans. Has the Pacific coast a special local demand for security loans? To what extent do coast banks enter the New York market? Of course, it is a daily thing, I suppose.

Mr. ROBINSON. As banks, I do not know that we have anything to do with the New York market, except to have money on call, if that is what you mean.

Senator WALCOTT. Yes.

Mr. ROBINSON. Yes; I think the Pacific coast banks at times have had a great deal of money on call. We have had money on call for quite a long time.

Mr. WILLIS. To what extent do you have local call money on the Pacific coast?

Mr. ROBINSON. We have none as such.

Mr. WILLIS. You have no call-money loans there practically?

Mr. ROBINSON. None practically. I do not mean that we do not have call money loans in the bank but not in the true sense.

Senator WALCOTT. Have you any exchange?

Mr. ROBINSON. Oh, my, yes.

Senator WALCOTT. Have you any at Los Angeles?

Mr. ROBINSON. Oh, my, yes.

Senator WALCOTT. Is it very active?

Mr. ROBINSON. The building is very handsome.

Mr. WILLIS. Before you leave that may I ask you one question? How many of the larger banks have actual affiliates in California?

Mr. ROBINSON. I think every one of them.

Mr. WILLIS. You think every one of them do, including your own?

Mr. ROBINSON. Wait a minute. Yes, we have one. I do not think the Bank of California National Association nor the Wells-Fargo Bank have any.

Mr. WILLIS. But practically all the others do?

Mr. ROBINSON. But practically all the others do.

Mr. WILLIS. Now, are they provided for under the California departmental banking law?

Mr. ROBINSON. No.

Mr. WILLIS. They have the same sort of indeterminate status that they have here in the East?

Mr. ROBINSON. Exactly.

Mr. WILLIS. Have you given any thought to that? Nearly all of the witnesses have discussed this affiliate securities investment situation, and I should like to hear your views on it, Mr. Robinson.

Mr. ROBINSON. I have rather definite views on it, Mr. Willis.

Mr. WILLIS. Would you give them to us?

Mr. ROBINSON. I have watched it, and I can cite our own experiences. I am inclined to think that it is maybe a necessary adjunct to the banking business. I am inclined to think that maybe in the final analysis as development goes on, it will prove to be the—I am speaking of the affiliate that deals in bonds and securities—best method of dealing in bonds and securities, or putting them out de novo rather; I am not sure it is yet, but I believe it will be. But I also think that it is full of danger, and that if the affiliate is to be conducted as a part, not as a part, but as incidental to the banking system, the authorities should have full power of examination, audit, and in the main control.

Senator WALCOTT. And would you make the examination compulsory?

Mr. ROBINSON. Yes.

Senator WALCOTT. And coincident?

Mr. ROBINSON. Certainly.

Mr. WILLIS. Would you have a publication of portfolio or not?

Mr. ROBINSON. No; I think not. I think that would not be necessary or wise.

Mr. WILLIS. It is desirable in investment trusts, is it not?

Mr. ROBINSON. Yes, sir. But in your security affiliate it is really an intermediary, it is a merchant.

Mr. WILLIS. Yes.

Mr. ROBINSON. The investment trust is a little different.

Mr. WILLIS. How often do you think statements should be published?

Mr. ROBINSON. Of the security affiliate?

Mr. WILLIS. Yes.

Mr. ROBINSON. I never thought much about that.

Mr. WILLIS. Mr. Mitchell was here and discussed the matter and was of the opinion that they should be published not less than once every year for reasons which he gave.

Mr. ROBINSON. I think I would join him, but I do not want to give any reasons. I do not know as I would have any at this time.

Mr. WILLIS. His reasons were briefly, I think, if I followed him correctly, that the earnings of the operation of the security affiliate were variable, and frequent reports might be misleading.

Mr. ROBINSON. I agree with him. They might frequently have on hand things general knowledge of which would be very harmful not only to the affiliate but to other people. You mean halfway bonds or something of that kind?

Mr. WILLIS. Yes, sir.

Mr. ROBINSON. I think that is probably right.

Mr. WILLIS. Now the Comptroller of the Currency has been inclined to the view that the total loans to all affiliates should be limited to 10 per cent of the parent bank's capital and surplus.

Mr. ROBINSON. That is liberal enough.

Mr. WILLIS. That is all of them in the aggregate.

Mr. ROBINSON. Yes.

Mr. WILLIS. Other bankers here have been opposed to that on the ground that it was not sufficiently generous.

Mr. ROBINSON. I am inclined to think the comptroller is liberal enough.

Mr. WILLIS. Would you make that 10 per cent the maximum or would you also allow additional borrowings of the kind that can be made under section 5200 of the Federal Statute.

Mr. ROBINSON. What are they?

Mr. WILLIS. Those are for additional borrowings under special conditions of protection.

Mr. ROBINSON. I do not know as it would be necessary to make it too rigid, but too free use of bank funds through affiliates is dangerous.

Mr. WILLIS. It is dangerous?

Mr. ROBINSON. Very dangerous.

Senator WALCOTT. You permit purchases of the bank stock by the affiliate?

Mr. ROBINSON. Yes.

Senator WALCOTT. And vice versa?

Mr. ROBINSON. Yes.

Senator WALCOTT. A bank can put into its portfolio any of the affiliate company's holdings?

Mr. ROBINSON. You mean buy bonds?

Senator WALCOTT. Yes.

Mr. ROBINSON. The bank can buy bonds but not for the trust department.

Senator WALCOTT. Not for the trust department?

Mr. ROBINSON. We do not permit it.

Mr. WILLIS. Is that forbidden by the law or is it merely your custom?

Mr. ROBINSON. Yes, I think there is no law about it.

Senator BULKLEY. Should there be?

Mr. ROBINSON. I think so.

Mr. WILLIS. Now, does the affiliate on the Pacific coast purchase and operate in shares of the parent bank?

Mr. ROBINSON. Yes, sir.

Mr. WILLIS. It does do so?

Mr. ROBINSON. Yes; I think that is very nearly general.

Mr. WILLIS. Is that a desirable practice or the reverse?

Mr. ROBINSON. In general maybe I think it is not, but I think there are emergency conditions where it is most helpful to the stockholders and to the bank.

Mr. WILLIS. The superintendent of banks of the State of New York has suggested, and is recommending in New York, that the security affiliates be entirely disassociated from the parent bank, and he said here that I believe if they should continue they should be wholly prohibited from dealing in stock of parent banks. What is your comment on that?

Mr. ROBINSON. I think it is worthy of consideration, but I have not studied it definitely enough to say.

Mr. WILLIS. You have no opinion on that point?

Mr. ROBINSON. No. We have done it. I can see how it can be easily abused. And on the other hand, I think it has very great advantages if it is properly handled.

Mr. WILLIS. Now, this abuse of the affiliate system you spoke of, has that been chiefly in San Francisco?

Mr. ROBINSON. I am getting a little beyond my definite knowledge if I should answer that. I do not know that I am in a position to say anything positively in respect to that, Doctor Willis.

Mr. WILLIS. Have there been serious abuses of the system in Los Angeles?

Mr. ROBINSON. I know nothing of that kind.

Mr. WILLIS. No undue inflation or attempt to advance local stock, or anything of that kind?

Mr. ROBINSON. Through the affiliates?

Mr. WILLIS. Yes; through the affiliates with the use of the bank's money.

Mr. ROBINSON. No; I know of no instance. I am surprised it has not happened, but I know of no instance.

Senator WALCOTT. It could easily happen.

Mr. ROBINSON. Yes, sir.

Mr. WILLIS. Even on the Pacific coast?

Mr. ROBINSON. Yes; even in Los Angeles.

Mr. WILLIS. You have a local security market on the Pacific coast?

Mr. ROBINSON. Yes; a very good one.

Mr. WILLIS. That is not dependent on the New York market at all?

Mr. ROBINSON. It is not now. We have a very good market, but it is not now so good.

Mr. WILLIS. Are most of the operations, or are these operations of affiliates, I should say, carried on in local shares, or is there considerable operation in shares originating in New York and elsewhere through participation by New York houses at their Pacific coast branches?

Mr. ROBINSON. Now I can only speak with any knowledge of our own affiliates. We do not participate in share issues.

Mr. WILLIS. You never have?

Mr. ROBINSON. No. The only dealings we have in shares is as a matter of customer accommodation.

Mr. WILLIS. But the other affiliates out there, some of them do?

Mr. ROBINSON. I think perhaps some of them do. I do not know that the affiliates of the Los Angeles banks have been doing that much, but we have not done that. We do participate in bond issues, and we originate bond issues ourselves, and we allow others to participate with us.

Mr. WILLIS. You mean you participate with local houses?

Mr. ROBINSON. Yes; in bond issues.

Mr. WILLIS. Yes.

Mr. ROBINSON. But we do not in share issues.

Mr. WILLIS. Now, where a local house participates in a bond issue, does it undertake then to treat that bond issue in exactly the same way through its affiliate as it would a local issue which it itself has brought out?

Mr. ROBINSON. As a matter of distribution; yes.

Mr. WILLIS. It is exactly the same?

Mr. ROBINSON. As a rule; yes, sir.

Mr. WILLIS. And have you found it necessary to carry unsold any considerable part, either of local or participations in New York issues; in other words, have there been any undigested securities there at all?

Mr. ROBINSON. We do not have any at all.

Mr. WILLIS. Neither in the local or in the other?

Mr. ROBINSON. No.

Mr. WILLIS. So there have never been any considerable amount of bonds on the shelves there that have been carried?

Mr. ROBINSON. Not on ours; I mean not our own.

Mr. WILLIS. Do you think that is a general situation?

Mr. ROBINSON. I do not know. I have heard some gossip, but I know of no facts.

Mr. WILLIS. You know nothing that you would care to mention here?

Mr. ROBINSON. No; because I do not know the facts.

Mr. WILLIS. Some persons in this part of the country are under the impression that there had been inflation of securities so far as local issues were concerned.

Mr. ROBINSON. I think that is quite true, but it has not been in our local affiliate.

Mr. WILLIS. Where did that occur?

Mr. ROBINSON. I do not know. Did you hear it was being carried on with us?

Mr. WILLIS. Yes; in California generally.

Mr. ROBINSON. I would think that some banks may have, and perhaps a good many.

Mr. WILLIS. At any rate, it is not a feature of the affiliate system, so far as you know?

Mr. ROBINSON. So far as I know; no.

Senator WALCOTT. Is a large part of your security business on the Pacific coast made up of Pacific coast securities? Do you think they predominate?

Mr. ROBINSON. Suppose I speak for Los Angeles?

Senator WALCOTT. Yes.

Mr. ROBINSON. During the year up to the fall of 1929—and if you are speaking of security you include both the shares and bonds?

Senator WALCOTT. Yes.

Mr. ROBINSON. I would think, probably, eastern securities would predominate during the 3-year period prior to the fall of 1929. But I should think maybe of late the local securities have predominated. There has been more trading in them.

Senator WALCOTT. Have you ever studied this affiliate situation with the idea of a revision of the law?

Mr. ROBINSON. I have not; no. The statements I have made are merely ideas that I have developed from watching our own operation and hearing of the others, both New York, Chicago, and local.

Senator WALCOTT. We think it would be useful if we could correspond, either with you or your attorney or somebody you might name, with reference to developing a situation there with reference to a little better control of the affiliates, or some regulation of them that would be satisfactory to both the East and the West.

Mr. ROBINSON. Yes.

Senator WALCOTT. There are some bad affiliate situations, of course, as you know.

Mr. ROBINSON. Oh, yes, sir; undoubtedly.

Senator WALCOTT. They have been abused.

Mr. ROBINSON. I believe the authorities should have rather definite control and every right and opportunity to examine them.

Senator WALCOTT. I think we would be glad, when we have got something on that, to submit it to you for your consideration.

Mr. ROBINSON. I will be glad to be of any help, because I think that is a great thing.

Senator WALCOTT. As to this whole matter of security loans I will put two or three questions to you, though I think the first ones you have already covered. To what extent do local borrowers borrow money on New York stocks? In other words, have you any idea as to whether that is a large factor?

Mr. ROBINSON. It is a very considerable factor in our particular bank, and I think in our community, and one that has been increasing for the last six or seven years.

Mr. WILLIS. Is that increase because of the fact that Californians are owning larger amounts of New York listed securities, or what is the reason for that?

Mr. ROBINSON. They had a modification of the tax law that permits a man to hold foreign securities, without a very high tax rate to pay.

Mr. WILLIS. It is largely because of the local taxation situation?

Mr. ROBINSON. It is largely because of the local taxation situation.

Senator WALCOTT. Why is so low a percentage of coast security loans made to brokers and dealers and so large a percentage (relatively) to business men?

Mr. ROBINSON. I did not understand the question.

Senator WALCOTT. Why is so low a percentage of loans made to dealers?

Mr. ROBINSON. You mean percentage of loans as to value?

Mr. WILLIS. I think I can explain that more fully. We sent out a questionnaire, Mr. Robinson, and received answers from all of these banks, and from that we have looked up the amount, the proportion, of total city loans made to brokers and dealers, and the total amount made direct. In general on the Pacific coast the percentage of loans made in that way to brokers and dealers is small, with one exception, in general very small. What is the reason for that?

Mr. ROBINSON. I do not know that I can give you the reason for that.

Senator WALCOTT. Perhaps the next question will suggest the answer. Why is so large a percentage loaned for carrying securities, that is, security loans, compared to other purposes? In other words, if security loans are in a higher ratio than commercial loans, does that mean there has been an unusual amount of stock speculation out there?

Mr. ROBINSON. Stock promotion?

Senator WALCOTT. Stock promotion.

Mr. ROBINSON. I think you all appreciate that when the market absorbs shares very readily a man who had a promotional turn of mind, who had had a dream, we will say, if making a merger of various units in an industry, he will get an opportunity to sell his shares. Take, specifically, in our town, we will say a leader of that kind gets a group of his friends together, and they underwrite the new stock issue, or any security issue that may be on this proposed merger; and they borrow against the securities that they receive. And during that market the values went up and they did not sell. We will say the same promoter again evolves a second idea, because the first did go over so well, and he gets the same group, and they go ahead and underwrite and borrow again. And the general market is rather limited, and no attempt, we will say, is made to scatter these shares. The natural result is that you will find the banks carrying, maybe, a higher percentage of collateral loans to individual business men than you would in most communities. My understanding, however, is that this has obtained in other communities besides Los Angeles.

Mr. WILLIS. There is nothing in the California situation that suggests the growth of the practice there whereby business men use securities to protect their business loans and carry them as a part of their business assets for that purpose, is there?

Mr. ROBINSON. In other words, using securities as collateral, and borrowing the money for the use of their commercial enterprises?

Mr. WILLIS. Yes.

Mr. ROBINSON. No.

Mr. WILLIS. The reason I am asking that is this: We have had quite a good deal of testimony here suggesting that there has been a marked decline in the market of commercial paper in the country.

Mr. ROBINSON. That is quite true.

Mr. WILLIS. And there is a growth of the practice of borrowing on commercial securities at the bank, but not for speculation?

Mr. ROBINSON. Yes.

Mr. WILLIS. That is to say, there has been a development of habitual use of types of business borrowings protected by collateral securities.

Mr. ROBINSON. What did you understand that they do with the proceeds of those borrowings?

Mr. WILLIS. It has been stated here that the proceeds were used in many cases to provide working capital, take discounts, carry on any legitimate business; in other words, the placing of the securities there has nothing whatever to do with the securities themselves, except that they are placed there for the purpose of protecting the loan, and thus saving an investigation as to the credit status of the borrower. Is that true on the Pacific coast, do you think?

Mr. ROBINSON. I have not seen any reason for thinking it was true as to us.

Mr. WILLIS. It would be an unfortunate development, would it not, if it resulted in cutting down the amount of credit inquiry and subsequent examination if those were used for protection.

Mr. ROBINSON. Yes; I do not think that would be a safe trend.

Mr. WILLIS. Is that done in San Francisco, or generally on the Pacific coast?

Mr. ROBINSON. I do not know that I ought to speak for San Francisco, but I would be surprised if it is done.

Senator WALCOTT. Does the California law limit the margin on security loans?

Mr. ROBINSON. No. The California law eliminates certain types of loan.

Mr. WILLIS. Does it not also forbid security loans with less than 15 per cent margin?

Mr. ROBINSON. Maybe it does. You see we are a national bank, and I have always been in a national bank, and I had forgotten that there was that law there.

Mr. WILLIS. Do you think it is a good thing to have such a limitation?

Mr. ROBINSON. I think 15 per cent is pretty modest. At a time when you need it, I think it would be a pretty poor margin.

Mr. WILLIS. Should you have any margin, whether it is wisely chosen or not, do you favor a minimum margin?

Mr. ROBINSON. I rather question it.

Mr. WILLIS. You think it should be purely a matter of banking judgment?

Mr. ROBINSON. Administration; yes.

Senator WALCOTT. Has the progress of bank mergers in California been retarded or furthered by the branch-banking system?

Mr. ROBINSON. I should say it had been retarded, because most of the banks have gotten into branch banking by this time.

Senator WALCOTT. You have very few large mergers in view?



Mr. ROBINSON. I would say not any.

Senator WALCOTT. Other than the branch banks?

Mr. ROBINSON. Of course, it would be possible for mergers in San Francisco of banks who do not have any branches.

Senator WALCOTT. Have banks in San Francisco kept away from branch banking largely?

Mr. ROBINSON. Some of them have city branches. And the American Bank—I have forgotten its name, as it has changed altogether—has branches all about the bay area and as far south as San Jose. And the Bank of Italy has its principal office there, so you have more branches out of San Francisco than out of any other city.

Senator WALCOTT. Do you think restrictions should be placed, or what restrictions do you think should be placed, in the event of bank mergers, on the stock?

Mr. ROBINSON. There ought to be some relationship as to the number of branches to the capital. I think that might answer your question.

Mr. WILLIS. Has there not been a good deal of inflation in connection with bank mergers through changing the basis of stock issue, through revaluation of assets and various ways of that kind? I do not mean in California but generally.

Mr. ROBINSON. I have no doubt of that, but I do not know much about that.

Mr. WILLIS. The law at the present time has very little to say about bank mergers. The superintendent of the State of New York when here, called attention to an amendment which he has proposed in New York, whereby the superintendent of banks should be given the power in case of emergency to compel mergers to occur without reference to the stockholders. The subject is under legal advisement in New York, the thought being that in that way you would get a protection against failure somewhat similar to what you have in Canada—that is to say, instead of having failures you would have the compulsory mergers. Now in that event the question of the stock situation would be very seriously raised, and it has already been very seriously raised in connection with mergers in New York. Has anything of this kind been taken up on the Pacific coast, or have you anything in your law governing the terms on which bank mergers should occur?

Mr. ROBINSON. We have, of course, the laws that define the methods of making a merger, but I know of nothing of the kind that you mention.

Mr. WILLIS. Nothing of the kind?

Mr. ROBINSON. No.

Mr. WILLIS. Is that a desirable field for the legislative power to enter—that is, to take control of bank mergers, and compel them when desirable, and prescribe conditions under which they should take place, or otherwise regulate them?

Mr. ROBINSON. I should think that would be fraught with a good deal of danger.

Mr. WILLIS. What would that danger be?

Mr. ROBINSON. It would depend, of course, on the authority.

Mr. WILLIS. I beg your pardon?

Mr. ROBINSON. It would depend on the character of the official, who exercised the authority.

Mr. WILLIS. Yes.

Mr. ROBINSON. And on a lot of other things.

I recall distinctly where the superintendent of banks brought about a merger in California, not by forcing it in the ordinary sense, but by insisting on the State bank doing certain things. And he was immediately attacked as having forced them against their will, and it was a very nasty situation, and I think it would always be the situation in a twilight zone in which an official of that kind would have very great difficulty in being sure he was right.

Mr. WILLIS. As a matter of fact, both Federal and State authorities are concerned with bank mergers, in trying to bring them about or prevent them, are they not?

Mr. ROBINSON. Yes.

Mr. WILLIS. And apparently there is very little in the national law, and I think in the laws of most of the States, on the subject. Do you think anything should be done so that restrictions would be imposed upon the process of merging institutions?

Mr. ROBINSON. Offhand I would hesitate to say.

Mr. WILLIS. The benefit of it would be less than perhaps the disadvantages?

Mr. ROBINSON. I would hesitate to advocate it. I think if you build up so many laws it is dangerous, and that after all what is really needed, as you go along, is better education and better men to do the work, and men that can do it, which is better than to have any law.

Senator WALCOTT. Good bankers, and then watch them?

Mr. ROBINSON. Yes.

Senator WALCOTT. You would make your laws more flexible, would you, more like the English?

Mr. ROBINSON. No; I do not think we could do that.

Senator WALCOTT. Do you think there is too much restriction now?

Mr. ROBINSON. I dislike adding to restrictions.

Senator WALCOTT. You think there are too many restrictions now?

Mr. ROBINSON. On some things. I do not know as I can specify them now.

Senator WALCOTT. How about the low capital of banks? Would you raise that requirement?

Mr. ROBINSON. You mean the capital for small banks?

Senator WALCOTT. The capital required; yes, sir.

Mr. ROBINSON. I have had that feeling for a good while.

Senator WALCOTT. It is \$25,000 now.

Mr. ROBINSON. It is \$25,000 now. That is where a good many difficulties come. With the small capital it is a difficult job at best without taking chances.

Senator WALCOTT. That seems to be the universal opinion.

Mr. WILLIS. What do you think should be a proper minimum? This \$25,000 was fixed 30 years ago.

Mr. ROBINSON. Taking our ratios I suppose that would make it \$100,000 now.

Senator WALCOTT. Mr. Robinson, with reference to the Federal reserve system, have you ever been officially connected with the system?

Mr. ROBINSON. I have been a director of the branch, the Los Angeles branch of the San Francisco bank, for about 10 years. There has been some question in the minds of the directors of the branches, as to whether they are official connections or not. But we have met once a week.

Senator WALCOTT. That is one of the things we would like to bring out. What effect has the branch-banking system on your relationship. For instance, as a member of the Federal reserve, what connection is there there. Are your branches members per se?

Mr. ROBINSON. No.

Senator WALCOTT. They are not?

Mr. ROBINSON. Only the head office.

Senator WALCOTT. Only the parent bank?

Mr. ROBINSON. Only the parent bank; yes.

Senator WALCOTT. And is that a good thing? What is the effect of that, of having a great many small banks that are getting the benefit of the Federal reserve through the parent that are not in themselves members of the Federal reserve? Of course, you own the stock of those banks?

Mr. ROBINSON. No; we do not.

Senator WALCOTT. You do not own any part of the stocks?

Mr. ROBINSON. They are just part of us.

Senator WALCOTT. You own the bank?

Mr. ROBINSON. Or we are a part of them, whichever way you want to put it. It is just our bank—the central offices were the banks. I can not see how it makes any difference at all in that respect.

Mr. WILLIS. Does it not make a difference in this respect: Where you have a chain banking system as in the Northwest, one or two men may, or are said to, in one district, practically control the policy of the Federal reserve bank, whereas in California the unit banks have far outnumbered city banks, which have one vote each. Am I right?

Mr. ROBINSON. Yes.

Mr. WILLIS. How does that work out? Has it affected you?

Mr. ROBINSON. Up to date not at all.

Mr. WILLIS. No change at all?

Mr. ROBINSON. No.

Mr. WILLIS. Do you think there has been a change in the relation of chain and branch systems?

Mr. ROBINSON. That is another question. I thought it went to branch banks.

Mr. WILLIS. But it is all part of the same?

Mr. ROBINSON. Yes.

Mr. WILLIS. That is to say, if you have a reserve bank in a given district which is controlled by a very small group of men, and a different reserve bank in the next district controlled by a large group of men, while the one reserve bank controlled by a small group of men has its policy dictated by that small group, and the large group, though it has the votes, has practically no voice, there is likely to be a very serious situation.

Mr. ROBINSON. Yes; but you know that the different groups are based on capital, and the smaller banks have one representative and the larger another.

Mr. WILLIS. That is of theoretic value.

Mr. ROBINSON. In California; yes.

Mr. WILLIS. Do you think any change ought to be made in the choice of directors—in the voting for directors? Rules have been changed once or twice you know.

Mr. ROBINSON. I do not have anything to advocate. I think maybe there should be some changes. For instance, we have in our district a situation where most of the directors are from San Francisco or vicinity. It just happens that way. And as I understand the practice in the Cleveland district it is to have nobody on the directorate that lives in Cleveland. Possibly there are some changes there that might benefit both of these two extreme situations.

Mr. WILLIS. Wherever there is a group of banks controlled entirely by a holding company should you limit that company to one vote? Do you think a chain of banks should have only one vote?

Mr. ROBINSON. I think something of that kind possibly would arise. It would depend on how you set it up as to groups.

Senator WALCOTT. Of course, you start out by objecting to chain banks.

Mr. ROBINSON. I do not object to them, because I can understand many places where they can only accomplish what they are trying to do by having chain banks. I do not object to them.

Senator WALCOTT. I understand you did.

Mr. ROBINSON. No. I merely feel, from our experience, that the branch-banking system works better for everybody maybe than chain banks. But I can see where you can't have branch banks, where the State laws do not permit them.

Senator WALCOTT. What is your policy with reference to the discount rates for 1928-1929?

Mr. ROBINSON. You mean on the coast?

Senator WALCOTT. On the coast.

Mr. ROBINSON. Of course, we were in the branch, we did not have any policy. We were the Los Angeles branch.

Mr. WILLIS. What was the policy of the San Francisco bank as to discount rates?

Mr. ROBINSON. As I recall it they conformed reasonably well with the policy of the other banks.

Mr. WILLIS. And did not differ?

Mr. ROBINSON. Not much. There was a lag I think about reducing at times, sometimes a lag about advancing, but that is because they felt that conditions warranted one or the other.

Senator WALCOTT. There was no particular clash of views there in 1927 and 1928?

Mr. ROBINSON. No.

Mr. WILLIS. The testimony here has shown a very sharp difference of opinion between the Board and the Federal Reserve Bank of New York.

Mr. ROBINSON. Yes.

Mr. WILLIS. Did the San Francisco bank have anything to do with that—have any views?

Mr. ROBINSON. No views.

Mr. WILLIS. None definitely registered.

Mr. ROBINSON. No.

Mr. WILLIS. Have you yourself any views that you care to express about that?

Mr. ROBINSON. No; I do not have any I care to express, except this, that I still believe under ordinary circumstances the several district banks should fix their rediscount rate without much interference.

Senator WALCOTT. And would you possibly have had that rediscount rate advanced beyond the point that it was advanced at any time?

Mr. ROBINSON. Yes; I am inclined to think it should have been done.

Senator WALCOTT. You think that if it had gone higher it would have been more effective?

Mr. ROBINSON. It might have been. If done in fractional stages; no.

Senator WALCOTT. It has been suggested by two or three methods.

Mr. ROBINSON. Then I think it might not.

Senator BULKLEY. Can you tell us just what does govern the Federal reserve as to that by some definite description?

Mr. ROBINSON. I do not know that I can be very definite about that. I can imagine a condition where the board was convinced that the economic condition in a certain district was such that they should not maintain the rediscount rate as high as they were maintaining it, and asked them to reduce it. I think it would be a question of fact and judgment. I do not believe it ought to have automatically the right to condemn it.

Senator BULKLEY. You do not think the Federal Reserve Board ought to interfere with the local situation for any such purpose as adjusting an international situation?

Mr. ROBINSON. I think it ought to have the right to; yes, sir.

Mr. WILLIS. What should be the relationship between the Board and the international connections of the reserve banks?

Mr. ROBINSON. I do not think the board ought to be in between them in any way, but I think it should have full knowledge, and that its voice should be listened to.

Mr. WILLIS. But you do not think that it itself should take the function of making those connections?

Mr. ROBINSON. No.

Mr. WILLIS. Or of representing the system as a whole?

Mr. ROBINSON. No.

Senator WALCOTT. Does a western branch of the Federal reserve buy its own acceptances?

Mr. ROBINSON. Yes, sir; I think it does—I know they do; yes, sir.

Senator WALCOTT. Or are they bought in New York?

Mr. ROBINSON. We have sold them to them.

Mr. WILLIS. It does not buy any in New York?

Mr. ROBINSON. I do not know, but we have sold them to them.

Senator WALCOTT. How do you feel about a sales tax on profit of securities? Would that have been an important factor in keeping more stock available? Would it have been an important factor in preventing stock speculation in the last two years?

Mr. ROBINSON. Yes; it would.

Senator WALCOTT. Would it, in your opinion, be a wise thing to cancel that tax?

Mr. ROBINSON. No; I do not know that I feel that way.

Senator WALCOTT. It was brought out yesterday that perhaps over a period of over 6 or 8 or 10 years it did not amount to very much in the net, because when there is a sharp decline, as there was a year and a half ago, everyone takes advantage of that to get out of his taxes, so that in the long run one hand washes the other.

Mr. ROBINSON. You are speaking of capital gains, taxes, and taking of losses?

Senator WALCOTT. Capital gains and losses.

Mr. ROBINSON. I think that the capital gains and taking of losses has had a good deal to do with the variation of values in speculation at times, unquestionably.

Senator WALCOTT. It makes a shortage of stock, does it not, without any question?

Mr. ROBINSON. Yes; I think there is no question of that. I did not understand your question in the first place. And also the taking of losses influenced prices downward.

Senator WALCOTT. In other ways?

Mr. ROBINSON. Yes, sir; there is no question about that.

Senator WALCOTT. So the capital gains and sales for losses built up an artificial peak and artificial depression?

Mr. ROBINSON. Yes.

Senator WALCOTT. That seems to be the universal opinion.

Mr. ROBINSON. Yes.

Senator WALCOTT. You say you do not know whether they buy acceptances locally.

Mr. ROBINSON. The Federal reserve?

Senator WALCOTT. Yes; the Federal reserve.

Mr. ROBINSON. I do not know, because I am not on their board, but we have sold them acceptances.

Mr. WILLIS. That is your own acceptances?

Mr. ROBINSON. Yes; our own acceptances.

Mr. WILLIS. Does your bank carry many acceptances in its portfolio or not?

Mr. ROBINSON. Not lately, but at times we do. I think we have about \$5,000,000.

Mr. WILLIS. You do not habitually carry them as secondary reserve?

Mr. ROBINSON. I think we have always had a percentage of them.

Mr. WILLIS. You have always carried a percentage of them?

Mr. ROBINSON. Yes; generally more than that.

Senator WALCOTT. Do you think the Federal reserve ought to be allowed to lend to or discount for savings banks?

Mr. ROBINSON. You mean with real estate as the basis?

Senator WALCOTT. Yes; on any basis.

Mr. ROBINSON. No, sir. What do you mean by "any basis"?

Senator WALCOTT. Well, a real-estate basis.

Mr. ROBINSON. No; I do not think so.

Mr. WILLIS. How about this basis: The eastern savings banks—I don't know how it is with yourselves in California—have of late carried pretty considerable amounts of liquid assets, including some

acceptances, Government bonds, and so forth, and during the troubles after the panic of 1929 it was found that that liquid material did not always help them very much, because they could not get a market for it. They might have found it in the reserve bank if they had been able to go there direct; but, of course, they were not members. Now, do you think any plan for admitting them under associate membership would help the savings bank situation?

Mr. ROBINSON. It might if it did not go to the extent of loaning on things other than are now loaned on.

Mr. WILLIS. Of course, they would not want to do that, as that would involve a change in the lending basis; but this would merely involve a change in the lending to a customer bank who is not a member.

Mr. ROBINSON. I can see no harm in that.

Senator WALCOTT. Senator Bulkley, have you anything more to ask?

Senator BULKLEY. I would like to ask Mr. Robinson if he subscribes to the view which was expressed to us here a few days ago that the large purchases of Government bonds by the reserve bank during 1927 was the forerunner of the difficulties in stock speculation by making credit too easy?

Mr. ROBINSON. I think so. That is the impression I have had.

Senator BULKLEY. And were the reserve banks too slow in checking the use of credit?

Mr. ROBINSON. I do not know that it is fair to say that they were too slow. I think the reserve bank tried to do its job, and did it fairly and pretty well.

Senator BULKLEY. You think they did have a responsibility in the matter?

Mr. ROBINSON. Yes. And I think they tried to execute that responsibility, but the difficulties were very great, very great.

Senator BULKLEY. You do not think it would have done any good if they had advanced the discount rate sharply sooner?

Mr. ROBINSON. Yes; I think it would have if they had advanced the rate sooner.

Senator BULKLEY. Of course, I do not mean it as any criticism.

Mr. ROBINSON. Yes; I think it would probably have had some effect.

Senator WALCOTT. Mr. Robinson, were you formerly president, at one time president of the United States Chamber of Commerce?

Mr. ROBINSON. No; vice president.

Senator WALCOTT. Vice president?

Mr. ROBINSON. And director.

Senator WALCOTT. Vice president and director. You recall two years ago that the chamber of commerce made quite an extensive inquiry into the banking system in some localities for new legislation. Would you be willing to get a copy of that for us and file it with us?

Mr. ROBINSON. Yes, sir. At Mr. Glass's request I have done so. He asked me to furnish you with two copies.

Senator WALCOTT. You have them here?

Mr. ROBINSON. Yes; of the report, the questionnaire, and the referendum.

In presenting it to you I wish to say that Mr. Harry Wheeler was the chairman of our committee, and he is the individual member who did maybe more than any other one man, and I think that they might like an opportunity for Mr. Wheeler or some one at the chamber of commerce to explain or amplify what is contained here.

Senator WALCOTT. You are referring to Mr. Wheeler in Chicago?

Mr. ROBINSON. Mr. Harry Wheeler of Chicago.

Senator WALCOTT. He has been invited to appear before this committee.

Mr. ROBINSON. And he will explain that to you. I just wanted to explain that.

Senator WALCOTT. I am glad you did. We will write him. We thank you for your courtesy, Mr. Robinson, and appreciate your coming here.

Senator TOWNSEND, have you anything to ask Mr. Robinson?

Senator TOWNSEND. No; I have not.

Senator WALCOTT. Have you anything, Mr. Meyer?

Mr. EUGENE MEYER. Just on the point that Mr. Robinson raised of raising the required capital of national banks to \$100,000 minimum and the question of recruiting a large membership into the Federal reserve system, might it not to the extent that banks of less than \$100,000 capital now, which were unable or unwilling to increase, might not they necessarily become State banks and go out of the system probably?

Mr. ROBINSON. There is that danger.

Mr. EUGENE MEYER. There is that difficulty constantly cropping up of the competition.

Mr. ROBINSON. Of course, I was going to say that the State laws have reduced requirements in many States to \$15,000 capital.

Mr. EUGENE MEYER. But if the bank has \$50,000 capital, a national bank, a member of the Federal reserve system, and can not really afford to have \$100,000 capital because business does not justify it, that would put them out of the national system and probably out of the Federal reserve system.

Mr. ROBINSON. The \$100,000 was merely relative to \$25,000. Fifty thousand dollars would be entirely satisfactory, if in the opinion of the Federal reserve bank the \$50,000 bank can successfully survive. You see your difficulties with your small bank are difficulties they have in the chances to make earnings, in the difficulty they have to make earnings.

Senator BULKLEY. I presume the law could only be made to fit future corporations.

Mr. ROBINSON. Yes; but even the \$50,000 may be insufficient. My suggestion was \$25,000 being required 30 years ago that then \$100,000 is enough now.

Senator BULKLEY. You still think there ought to be some increase above the \$25,000 minimum?

Mr. ROBINSON. I do.

Senator WALCOTT. Mr. Robinson, we appreciate your coming here from California, and we appreciate your frankness in answering the questions.

The meeting is adjourned until to-morrow morning at 10.30 when Mr. Owen D. Young will appear.

(Whereupon, at 12.08 p. m., an adjournment was taken until to-morrow, Wednesday, February 4, 1931, at 10.30 o'clock a. m.)



# OPERATION OF THE NATIONAL AND FEDERAL RESERVE BANKING SYSTEMS

WEDNESDAY, FEBRUARY 4, 1931

UNITED STATES SENATE,  
COMMITTEE ON BANKING AND CURRENCY,  
*Washington, D. C.*

The subcommittee met, pursuant to adjournment, at 10.30 o'clock a. m., Hon. Carter Glass (chairman) presiding.

## STATEMENT OF OWEN D. YOUNG, CHAIRMAN OF THE BOARD, GENERAL ELECTRIC CO.

The CHAIRMAN. Mr. Young, as you very likely know, this is a subcommittee of the Banking and Currency Committee of the Senate charged under resolution with a complete inquiry into the banking situation, with a view to suggesting such modifications of the Federal reserve act and of the national bank act as the committee after its hearings may think are essential. We have thought that you, among certain other gentlemen, of the banking business, and of the community, might be able to make valuable suggestions to us. We would like you this morning, if you will, to make some such general statement as occurs to you about the existing situation and the remedies required and what you would like to suggest in connection with our inquiry.

Mr. YOUNG. I have made a memorandum, Mr. Chairman, without knowing, of course, very clearly just what your committee would like to have me speak of. I have only read the testimony of Governor Harrison before the committee, and I have endeavored to relate this memorandum somewhat to the questions which you put to Governor Harrison in the thought that that might at least in some measure meet the inquiries which would be in your mind.

I want to say, first, Mr. Chairman, if I were speaking in terms of theory—and perhaps it is justifiable to do so in order to test our practical steps—I would say that all commercial deposit banking in the United States should be carried on under one law, that examination of banks and their controls should be under one authority. Their reserves should be mobilized in the Federal reserve system. Then we could develop for the country as a whole a sound banking system, and definitely fix responsibility. That would mean that all banks of deposit, as distinguished from savings, should be national banks.

As it is now, banks are chartered both by the National Government and by each of the 48 States. They are in competition, each

endeavoring to offer the most attractive charters and the most liberal laws, to say nothing of the liberality of administrative officials in interpreting the laws. The national banking act has to compete not only with the most conservative States but the most liberal ones. Consequently, there has been a constant tendency to liberalize banking laws and to weaken their administration. In such cases the argument is always made that it is desirable to liberalize the law so as to enable the banks to be of greater service to borrowers.

The first question always regarding banks doing a demand-deposit business should be the safety of the deposits and the ability of the bank to return them to depositors instantly on request, unless they be time deposits. No thought of service to borrowers should be permitted to impair the safety and security of depositors. Banks of deposit are, after all, primarily custodians of liquid funds. Only such use of such funds should be permitted as may be consistent with the interests of the depositors.

In the early years of our Government, our business was largely done by currency moving from hand to hand. It was felt at that time, and properly so, that we should have a national and uniform currency. Consequently, Congress was given power to coin money and regulate the value thereof. This power was made effective as to paper money by the national bank act. Now our business is carried on mostly by transfers of bank deposits, currency forming only a small part of our money transfers. If control of our currency were necessary in the beginning by the Federal Government, control of our bank deposits by it now would seem desirable. We have transferred, either affirmatively or by acquiescence, many powers to the Federal Government which ought not to be there. I am bitterly opposed to the impairment of the rights of the States in their appropriate field. It does seem strange, however, that in the face of such gravitation toward Federal authority, we should have retained divided rather than unified power over our deposit banking system.

Except for the currency in our pockets, our banks of deposit hold the liquid capital of the people of the United States. The transfer of this capital from one of us to another, promptly and safely, should be facilitated. That means, however, that every bank of deposit is truly engaged in a national business. Its soundness and safety is of concern to our people everywhere. Our business of deposit banks is not local in character; it is, and should be, national. Therefore, in my judgment, it should be governed by the national law.

Now, I realize, Mr. Chairman, that of the 24,000 banks of deposit doing business in the United States only about 7,000 of them are national banks and 17,000 are State banks. Under those circumstances, we probably can not hope, immediately at least, for the surrender by the States of their right to grant banking charters. Nor can we expect reincorporation rapidly of State banks under national charters. The practical question is, therefore, what, if anything, can we or should we do now? I think it would be highly desirable that all banks of deposit holding themselves out to the public to do a national or international business should be required to be members of the Federal reserve system, as national banks now are. This would at once mobilize all of our banking reserves into one central system, which is as it should be. In addition, I

think that the powers of examination by the reserve system of all member banks should be clear, and that it should have certain powers to see that banking practices inimical to the safety of depositors should not be indulged in by member banks.

That would mean that when the words "member of Federal reserve system" were put on a bank's window there would be, in fact, some such responsibility on the Federal reserve system as the public now assumes there is. Then, for the first time, we shall be able to fix responsibility somewhere for a sound banking system. It will not prevent bank failures—no law or system can do that—but it will, in my judgment, minimize them greatly. Even now membership in the Federal reserve system is apparently helpful to banking practice, because of the 7,000 banks which have failed in the last 10 years, 5 out of every 6, I am told, have been State banks not members the Federal reserve system.

I have spoken only of banks of deposit, as distinguished from banks for savings. I believe that banks for savings and for the administration of trusts or other special time funds should be State banks, and that these powers should not be included in national banking charters. The investment of savings deposits, which are withdrawable only after a specified notice, is quite a different kind of business from the handling of demand deposit assets. In my judgment it is undesirable to combine them in the same institution, because any bank having demand deposits can never invoke a time notice on savings. If it does, it stimulates quick withdrawals of demand deposits and postpones the savings deposits, which are the most sacred of all, to the least desirable assets of the bank.

It has been suggested, to meet this difficulty, that the assets of the bank created by savings deposits should be segregated and held for them only. I am of the opinion that any segregation of assets in a bank for a particular class of depositors, or for any individual deposit, is highly undesirable practice. Therefore, I see no way of combining wisely savings deposits and demand deposits in the same bank. This does not mean that national banks can not take deposits either for a specified time, which is a true time deposit, or deposits withdrawals only after a specified time notice. It does mean, however, that when deposits are put into a national bank either on time or upon specified withdrawal notice, neither the depositor should be permitted to withdraw nor the bank permitted to pay any such deposits, except strictly in accordance with its terms. My thought is that even thrift deposits might go into national banks, but they could only go in upon specified withdrawal notice with a definite restraint against withdrawal except in accordance with the notice.

I next want to speak on the right of the Federal reserve to examine and to discipline its member banks.

As a part of such program as I have outlined, the granting of charters for national banks and the examination of all banks should be vested in the Federal Reserve Board. The board, in turn, should function through the reserve banks of the several districts. The Federal Reserve Board should have the right to examine the banks which are members of the system. It would be its duty to examine national banks, and it could supplement and aid the State examiners in the examination of State banks. By this method examina-

tions would tend to become more uniform for all banks, and the Federal reserve bank of the district would have information regarding all banks operating within the district because on my assumption all would be members. It should have the power to limit or refuse rediscount, even of eligible paper, or suspend other privileges of membership, if the banking practices of any particular bank were, in its judgment, unsound, and therefore subjected its depositors to unreasonable risk either as to liquidity or security. In case the reserve bank of the district exercised such power unfairly, in the opinion of the member bank, an appeal might be taken to the Federal Reserve Board. In the event unsound practices were persisted in, the Federal Reserve Board, on complaint of any Federal reserve bank, might expel the bank from membership. That power, I think, they have now.

One of the weaknesses of the banking system at present, in addition to the competition between the governments for charters, is the natural hesitation of the Federal reserve banks, in the absence of clearly expressed powers, to require the correction of undesirable practices within the law, in State banks particularly, lest they withdraw from the system and thereby weaken its resources and general influence. The designation "member of the Federal reserve system" remains, therefore, on the window of such a bank, implying a degree of system supervision which is not authorized, and which in fact does not exist.

Now, on affiliated security companies: The question has also been raised, Mr. Chairman, as to the status of securities companies affiliated with banks. I confess to some doubt as to the propriety of such companies. In any event, I am clear that if they are to exist there must be much more adequate examination and control of them than exists now. I realize well the arguments that a depositor with funds should have the privilege of going to one place and one organization for advice as to the best use to which he can put those funds. Without dealing with that question I am clear that the ownership of the securities company and of the bank should be identical. No other kind of affiliate should be permitted. To do so merely reinstates that divided interest which affiliates were created to avoid. If there is divided interest then I think it would be better to prohibit affiliates altogether.

Second. I think the securities companies should be subject to examination, and I am inclined to think that there should be public statements of their condition as well as that of the bank. I realize that this puts some handicap on them in meeting their competitors in the security market, but on the whole I am inclined to think that it will be necessary for the bank having an affiliate to suffer that discrimination in order to operate in the security field.

Now, about the Federal reserve policies in the years 1927, 1928, and 1929, reviewed in reference to the speculative activities.

I notice, Mr. Chairman, that your committee has been interested in a discussion as to what led to our recent orgy of speculation, especially in the security markets. You have also, quite properly I think, been interested in the steps taken to prevent or retard such an extraordinary speculative market. That the action taken or not taken by the Federal reserve system during this period was at

some point unwise or ineffective now seems clear. We should review the situation for the purpose of learning how to avoid a repetition of these errors.

Let me say at once that I think the low rates of 1927 were justified under the circumstances then existing. I say that because there has been some tendency to attribute all of our difficulties during the speculative period to the low rates of 1927. I think they were justified. At that time the gold standard was being reestablished throughout the world, and it was of major consequence to this country that the gold standard should be reestablished and that it should be made to work. We had such an undue amount of the world's gold that it was most important that some be exported. At the same time the foreign exchanges were weak, which put a severe handicap on the sales of our agricultural products abroad. It was highly desirable that in the summer of 1927 the foreign exchanges be strengthened in order that our cotton and other agricultural and manufactured products might move toward Europe.

It was for the purpose of strengthening such exchanges, even to the point of gold export, that the low rates of 1927 were instituted. They were effective and highly serviceable for the purposes intended. There was a substantial rise in the prices of agricultural commodities during the latter half of 1927 and the early part of 1928. I think this was largely due to the rate policy of the Federal reserve system during that period. It was realized at the time that such rates would, if continued, not only induce speculation, but that if they were too long continued, speculation would get out of hand. The low rates were continued too long. An active, firm, and decisive policy of advancing rates should have been carried out in 1928. If it had been, I am of the opinion that we would not have permitted our speculative markets to absorb such a large amount of credit. Looking backward, I am of the opinion that the Federal Reserve Bank of New York did not make its recommendation for rate increases early enough or advance the rates rapidly enough. I say this without reflection upon my associates in that bank, because I was quite as much to blame for that as anyone. The New York bank did, in February, 1929, endeavor to deal with the situation by rate increase. That story has already been recited here, as to how the New York bank recommended increases week after week, and the Federal Reserve Board disapproved them. The board thought that so-called direct action was better. I confess that while I have never had any sympathy with the so-called direct-action program, and I think its failure was demonstrated, still there was some justification on the board's thinking that the speculative movement could be checked by the suggestion to, and the cooperation of, member banks without putting on commerce the burdens of a rate increase. As a matter of fact, I have a strong feeling that business at that time needed a check as well as speculation. As a matter of fact, the speculative furor was carrying business along with it and it would have been very much better for business had it been checked somewhat in 1928. It checked itself in 1929 and probably enough in advance of the stock-market collapse so that it was the cause of it.

I have spoken in terms of the market because, while under ordinary circumstances I do not think that the reserve policies should

be established with reference to speculative markets, I do think that is always one of the factors involved, and when the security market is absorbing such a very large amount of our total credit it may become almost the prime factor in determining a reserve policy.

I speak now of loans by others, because they are intimately related, in my judgment, to that speculative movement.

Undoubtedly, one reason why the speculative market got out of hand and stayed out of hand for a considerable period, and possibly would have stayed out of hand notwithstanding any of the measures of which I have spoken, is because of the loans by others to that market. The Federal reserve system and all the banks, certainly all the large banks, in the East, were apprehensive of the loans by others to the call market. It was perfectly well understood that if and when those loans were called, the banks and the banking system had in some way to take them over, although they had no voice in granting the original loans.

The CHAIRMAN. Had they not a voice in it? Were they not the medium of extending the loans?

Mr. YOUNG. They were the agents, Senator, of the people having the money, but they were obliged to act upon the instructions of their principal. They had no discretion to withhold the loans. Perhaps that would be a more appropriate way to put it.

The CHAIRMAN. Well, I do not agree with you. However, proceed.

Mr. YOUNG. Such loans were therefore a contingent liability of the banking system but one which it could not control. I know that it has been said by eminent bankers here that it is impossible to control such loans. Personally, I would not wish to concede that without making some experiments in that direction. While it may not be possible to control individuals from loaning direct to the call market, it does seem to me that corporations not engaged in the banking business might be so controlled. After all, the business corporations who perhaps produced a very large part of these funds are not purveyors of credit and they have, I feel, no responsibility about the money market.

The CHAIRMAN. I doubt if one of them paid the required tax under the national banking act on the capital entering into competition with national banks.

Mr. YOUNG. I do not know about that. All I can say about that, and the only company for which I can speak with knowledge and a sense of responsibility, is the General Electric Co., which at that time had very large cash balances and which decided not to put its funds into the call market. That represented substantially less income than might have been gained had it put those funds in the call market.

The CHAIRMAN. Mr. Young, why did you decide not to do it?

Mr. YOUNG. We decided not to do it because we felt that the loans by others, if they were going in the market uncontrolled, would inevitably lead that speculative market to a break with its inevitable repercussion on business.

The CHAIRMAN. Should not all corporations have felt the same way?

Mr. YOUNG. One word more. We felt that perhaps if we were to be one of several to set that example, all corporations would follow.

I think it was the practice of the Steel Corporation. My recollection is that similar practices were adopted by the Telephone Co. Of course, we were getting only the rate then yielded by Government bonds instead of 10, 12, or 15 per cent, which the call market would have paid. Now, corporations engaged or authorized to do business in a certain field, having large liquid funds at their disposal I think should be limited in the matter of making loans to activities which would contribute to their business and that loans to the market entirely unrelated to their business should either be penalized or prohibited. I am not willing to concede what I understand was Mr. Wiggin's view that you can not control that outside market. I think some way can be found and should be found to do so.

Senator BULKLEY. When you say "penalized" do you mean by tax?

Mr. YOUNG. Yes, sir; that would be one way of penalizing it. There may be others. Tax at once arises to your mind.

The CHAIRMAN. Might we not prohibit the practice altogether under heavy penalty?

Mr. YOUNG. Well, that is a question of law, but I would have great sympathy with any measure which prohibited the practice.

Senator BULKLEY. Absolutely prohibited it?

Mr. YOUNG. Or made it very difficult. Now, I do not suppose there is any way we can reach money advanced by individuals. However, I do not believe that the aggregate of the individual advances would have been sufficient during this period to have carried those loans for others to anything like the figures which they ultimately showed. Doctor Willis would know about that very much better than I.

Now, Mr. Chairman, I am going to speak of the use of governments as a basis for Federal reserve credit, or, rather, explain why I would prefer not to speak of that.

I notice, Mr. Chairman, from your examination of Governor Harrison, that you are interested in the use of Government bonds as a basis for Federal reserve credit. I am, too. I am firmly of the belief that the fluctuations of central bank credit above the minimum always required for the country's needs should have a very direct relationship to the business fluctuations in the country and to gold movements. If the volume of this credit is based on the self-liquidating paper of business the control is largely automatic, whereas if it may be based on governments alone control becomes subject to management. The use of governments in our Federal reserve system needs, I think, review and definition. Their use is still somewhat in the experimental stage. It seems to me that we must learn how to use them properly and that to exclude them would be a serious mistake.

In considering this question we can not ignore the long experience of the Bank of England in using governments, nor should we fail to consider their convenience of use in the Federal reserve system. For example, in the field in which eligible paper might be used as collateral, I see no harm in substituting governments so long as they bear an appropriate relationship to the paper which might have been supplied. In other words, if they are distinctly used as a substitute.

The CHAIRMAN. As a convenience?

Mr. YOUNG. As a convenience; and if you still have the yard stick of expansion and contraction in the paper and are not permitted to use governments beyond that, then I think they would be a great convenience. They are perfectly good collateral for the loans, as far as security goes, but they have not within themselves the measuring capacity which self-liquidating paper has.

Mr. WILLIS. Does that not bring you very close to section 11 of the bill before the committee?

Mr. YOUNG. I am sorry, but I am not familiar enough with that bill to answer it offhand, Doctor Willis.

I may say I have some personal views on this whole question of the use of governments in central bank operations, and in that connection I may say that I am opposed to a managed currency and credit. I do not feel that it would be helpful to the committee for me to express these views. We have not reached, in the Federal Reserve Bank of New York, any final views. The officers and directors have frequently discussed it. Now that the question is raised before your committee, it seems to me that it would be much more helpful if the New York bank, through Governor Harrison, could present to you the best considered views we have on this difficult question. With your permission, therefore, I would like to avoid saying more to-day on this particular subject.

It does not seem to me, Mr. Chairman, it would be particularly helpful to exploit my personal views here upon that subject. They differ somewhat, I know, from some of the officers of the bank, and they differ somewhat from other directors, but I do think that you ought to request us, and I am sure that we would respond, to formulate a statement which will represent the consensus of the views of the officers and directors of that bank on the use of governments. That is all I have in the memorandum.

The CHAIRMAN. Mr. Young, that is to me, and I am sure to the other members of the committee, an exceedingly interesting statement. If we were initiating a banking system, we might accept it without question—some of us, at least. How much of that do you think may be done now?

Mr. YOUNG. I should hope, sir, that you might find a way to bring all State banks holding themselves out to do a national business and carrying demand deposits into the Federal reserve system by compulsion.

The CHAIRMAN. Do you think we could do that?

Mr. YOUNG. I have that feeling very strongly.

The CHAIRMAN. You will have noted that a very large percentage of the banks which have failed in the last 10 years, particularly in very recent years, have been banks of very small capital. Would you raise the minimum requirement for the capital of a bank becoming a member of the Federal reserve system?

Mr. YOUNG. I think you would have to, sir. There must be a sufficient volume of business to get the diversity required, which is the safety, of course, of the banking business, and unless you have a basis in your capital for volume large enough to get diversification the business is too risky.

Senator BULKLEY. What do you suggest as a minimum?



Mr. YOUNG. I am not a professional banker, Senator, and I have great hesitation in expressing a view upon that. I notice by the paper that Mr. Robinson suggested a hundred thousand dollars. I have heard that frequently suggested elsewhere, and I should imagine you would find a general agreement among bankers perhaps that that is an appropriate figure.

The CHAIRMAN. Would not the decision on that question perhaps relate to the question of branch banking?

Mr. YOUNG. I think it would certainly do so.

The CHAIRMAN. Do you advocate branch banking?

Mr. YOUNG. I see no escape from it if we are to have the required credit service for the country.

The CHAIRMAN. Would you think that branch banking should be nation-wide? Do you think we should attempt that at this time?

Mr. YOUNG. I should think not.

The CHAIRMAN. Would you confine it to the States?

Mr. YOUNG. Personally, I should experiment with it in limited areas.

The CHAIRMAN. The Comptroller of the Currency suggested trade areas. It occurs to some of us that that is a rather general term, and it would be difficult in a statute to define a trade area.

Mr. YOUNG. Yes, sir. It seems to me as a practical matter you would have to take some well-defined geographical division, either State or, if one wished to make the experiment that large, a Federal reserve district. I should have great doubt whether branch banking ever need be extended beyond the district, but so long as it were confined to the district—

The CHAIRMAN. The Federal reserve districts?

Mr. YOUNG. The Federal reserve districts; and the Federal reserve bank of that district, therefore, being familiar with the home bank and all its branches, there would be then no divided authority, and possibly we might go that far even in an initial experiment.

The CHAIRMAN. You seem so completely to have covered the field of our inquiry that I experience some trouble in asking you any questions that might amplify what you have said. I would like to know, however, if you think the Federal reserve system should be established as a commercial rediscount system and, if so, whether it could ever have been intended that the open-market operations of the system would practically submerge the rediscount feature of it, as seems to have been the case at some time.

Mr. YOUNG. I should hesitate in your presence to express any view as to what was intended when it was created, but personally I think that the function of the Federal reserve system is to serve the business of this country.

The CHAIRMAN. Yes. When you say "business" you do not simply mean the stock-market business, do you?

Mr. YOUNG. When I say "business" I mean primarily the handling of goods and services. As a matter of fact, sir, I start with the basic assumption in my own mind that, broadly speaking, the assets of a central bank should be gold, goods in motion, or services in action. I mean by "goods in motion" this, and I can perhaps illustrate that better than I can define it: Copper in the ground, of course, is real estate. The moment you start your mine operations

and reach it, certainly the moment that it passes from real estate to personal property, then from that time until it finds its ultimate resting place in the hands of the consumer or in the capital accounts of business concerns it is the proper basis for a credit issue by a central bank with all the services which may be accumulated on it. That is what I mean by goods in motion. The real estate at one end is not. The capital investment in which it finally takes its form is not, but all of its activity in between, which represents constantly self-liquidating and turnover material, it seems to me is the proper basis for Federal reserve bank credit and the appropriate yardstick by which to measure it. Such speculations as may go on, using that as the basis for credit and using that as a yardstick, may be entirely helpful economically to the community, but a situation where governments may be used as the basis for Federal reserve credit without relationship to that yardstick merely means that they may be used, if the management of the system so elects, to create pools of speculative funds as well as pools of business funds. That I do not believe in.

The CHAIRMAN. It not only means it may be done, but, as a matter of fact, we know it has been done.

Mr. Young, have you any specific suggestions to make as to the improvement in the examination of the Federal reserve system?

Mr. YOUNG. I do not think I know enough about that, Senator Glass, to answer it. You see, as I said, I am not a professional banker, and the examination of banks comes before the executive officers of the New York bank and seldom reaches the directors.

The CHAIRMAN. You made a very interesting suggestion in the course of your general remarks, which bears on the question. That is to say, you suggested that the banking administration should in some way put an end to what I might call illicit practices which are not strictly forbidden by the text of the act.

Mr. YOUNG. Yes.

The CHAIRMAN. The State superintendent of banks for New York when here suggested that the Comptroller of the Currency in the case of national banks and the Federal reserve management in the case of member banks and the State administrative authority in the case of the State banks, should be given the right to suspend or dismiss bank officials who indulged in unsafe practices. In short, the only real penalty visited upon a national bank under the existing system and practice for maladministration is to close the bank.

Mr. YOUNG. Yes, sir.

The CHAIRMAN. And every Comptroller of the Currency that we have had for many years has hesitated to apply that extreme penalty.

Mr. YOUNG. Yes, sir.

The CHAIRMAN. Do you think we might take the suggestion made by the superintendent of banks of New York?

Mr. YOUNG. Of course, this closing of a bank puts the penalty at the wrong place. It puts the penalty on the depositors.

The CHAIRMAN. But it would be better to have the penalty on the depositors before things had gone to an extreme than to wait until they do so?

Mr. YOUNG. That is quite true. If we did not have this competitive situation, if all banks were in the Federal reserve, if there were no hesitation about dealing with State banks lest they leave the system, then I think power in the Federal reserve to limit the privileges of the member banks and possibly to suspend the right of rediscount—

The CHAIRMAN. It has that power now.

Mr. YOUNG. May I speak of that in just a moment? And possibly suspend the power of rediscount, would be such an impressive thing upon the board of directors of a bank or, if not, upon its stockholders, that they themselves would deal with the officers. I feel that the pressure should come, after all, upon the people who own the institution rather than upon the officers themselves. This business of dismissing the president of a bank whom the stockholders and the directors have selected to run their institution seems rather abhorrent to me, but if the bank is not being run properly I would like to suspend such privileges so that the stockholders and directors would of their own volition either dismiss him, curb him or substitute some one else for him.

The CHAIRMAN. Mr. Young, has not the Federal reserve bank that right now under the law? They are not obliged to rediscount for a member bank, although it may present eligible paper? They are textually given the authority to reject a discount.

Mr. YOUNG. I suppose, Mr. Chairman, if we have had the sections read once we have had them read at least a dozen times in the board of directors' meetings of the New York bank governing that very question of our right with reference to rediscount. We have never been able to agree there that the power was clearly enough expressed to warrant that action by the board. Personally I agree with your view of it, but, obviously, if one is to exercise such an extraordinary power and one which may be fraught with very serious consequences to a body of depositors, the right to do so should be very clear and the obligation to do so should be clear.

The CHAIRMAN. Well. I thought we were making it perfectly clear. It would puzzle me to make it any clearer. But, after all, it is an administrative function?

Mr. YOUNG. Yes, sir.

The CHAIRMAN. We could not go to those who administer the law and tell them just exactly when and why they should avail themselves of the power given.

Mr. YOUNG. Well, the difficulty, as I recall it, and it is some time since it has been before us, is that the act seems to relate the refusal to rediscount to the security of the loan or to the volume of the borrowings or to the period which they have been borrowing, and when you get to the point of refusing to rediscount merely because the judgment of the Federal reserve bank differs as to the appropriate practice from that of the member bank, there I think the doubt has arisen.

The CHAIRMAN. I am sorry it ever has. I think we would have avoided many troubles if the text of the law had been availed of.

Doctor Willis suggests that we would like to have some expression of judgment from you as to whether or not the spirit of the Federal

reserve act is largely or strictly observed in the matter of the constitution of the board of directors of the respective Federal reserve banks. It was intended, as you know, that the business interests, strictly as such, should be represented on these boards of directors by one-third of the membership. It repeatedly has been suggested to some of us that the spirit of the law is not fully observed in some of the districts, and that after all the banks as such control the entire situation. Is that your observation? Is not that the conclusion that you reach?

Mr. YOUNG. Well, Senator Glass, I do not know anything about the boards of any of the banks except the board of the New York bank. In the case of the New York bank there has been for the last eight or nine years since I have been sitting on it certainly ample representation of the business interests as distinguished from the banking interests.

The CHAIRMAN. I would infer so, since you are a member of the board, but I am told that that is not the fact in all the districts.

Mr. YOUNG. I do not know how the directorships are handled in the other districts outside of New York.

Mr. WILLIS. You would see no reason for changing the method of selecting the directors, would you?

Mr. YOUNG. From my experience no; but my experience is too limited.

Mr. WILLIS. Your experience indicates it is satisfactory; is that so?

Mr. YOUNG. Entirely satisfactory, I think, in New York.

The CHAIRMAN. Any questions?

Senator WALCOTT. I feel very much as you do, that Mr. Young has covered this thing so thoroughly and given us so many constructive notions, that I have not any particular questions to ask except this: I would like to get a little more in detail your suggestion of curbing the affiliates. Our previous inquiries have indicated that the affiliates have been abused a great deal; and that they ought to be severely restricted. Some doubt, as you do possibly, whether they ought to be done away with altogether, certainly unless they can be curbed in their operation. I fail to get clearly in my mind what you mean as to their integrity in connection with the bank of origin. How far would you allow that separation? How complete would you have that separation? I am assuming you would insist upon a thorough examination under the comptroller and have it coincident with the examination of the bank. Now, how far would you separate them as to the trustees or the holding of stock or limit them in their operations as to the affiliates dealing in the stock of the parent bank? I would like you to enlarge upon that.

Mr. YOUNG. First, the ownership of the bank and the ownership of the affiliate, in my judgment, should be identical. No other situation should be permitted. Second, I think that the affiliated securities company should be examined and that its statement should be made public.

Senator WALCOTT. Including the portfolio?

Mr. YOUNG. I would not like to answer that question offhand, because no greater disadvantage to the affiliate should be required than is necessary to protect the public interest.

Senator WALCOTT. Of course not.

Mr. YOUNG. Whether disclosure of the portfolio is necessary for the public interest, offhand I would have some doubt. Now, as to the use of the affiliate to buy or support the stock of the bank, I think it should be prohibited. It may even be desirable in the public statement to show the indebtedness of the affiliate to the bank as a separate item. Of course, my whole approach to this business of affiliates is in a sense unfriendly to the affiliate notion. I agree to them now only because they are in existence and my first idea would be to experiment on the matter of their control. If we can control them, well and good; then they stand, because I realize there is some advantage in this department-store business under one roof.

Senator WALCOTT. May I insert a question there? If your previous suggestion could be carried out, and if gradually we could force all of the banks of deposit under the roof of the Federal reserve, it would then eliminate largely this element of competition between the State banks, which are perhaps under a more liberal charter, and the national banks?

Mr. YOUNG. Yes, sir.

Senator WALCOTT. And make it easier not only to control the affiliate but, if it was then abused, to do away with it altogether?

Mr. YOUNG. Very much easier.

The CHAIRMAN. That has been the vice of the whole situation and it has been our insuperable difficulty. Whenever we have been appealed to to liberalize the national banking act, the basis of the plea in every instance has been that they can not compete with the privileges of the State banks; and if we can, as you seem to think, get them all within the jurisdiction of the Federal reserve system, I think it would largely cure the whole situation.

Mr. YOUNG. Well, Senator, it does not seem to me that we will ever have a time soon again where there is such justification for that action and perhaps when the public would so readily accept it. We have seen thousands of banks fail here. It is certainly a great reflection on the American people that they can not get a banking system in hand which will not provide such awful tragedies as we have witnessed in the last 10 years—a period of prosperity—true, a period of disturbed economic conditions resulting from the war, but still, on the whole, a period of prosperity—and during that time throughout this country we have the tragedy of depositors of small amounts handicapped and disabled by the failure of our banking system. If that be true because of divided authority between the States and National Government, I would first like to see the Federal Government undertake to exert what authority it has, and if it be finally decided that the Federal Government has not the authority, there will be no way, in my judgment, to meet that situation but to go for an amendment to the Constitution. I think the situation is serious enough to warrant your taking the first step, and if it does not result in anything, then we shall have to take the second, because we can not go on with the kind of tragedies which the last 10 years have yielded us.

The CHAIRMAN. It took the disaster of 1907 to get us the Federal reserve banking system. It seems to me that the disaster of 1928 and 1929 ought to get us somewhere in an improvement of the system.

Mr. YOUNG. Certainly. Unless we can take some advantage of these disasters to improve our situation, then they certainly are a total loss.

Senator WALCOTT. I have just one more question, Mr. Chairman: then I am through. I would like to ask, Mr. Young, how you feel toward the capital-gains tax. Do you not think that if we could do away with it or cut it down materially that we would prevent both the high peaks of speculation and the drops?

Mr. YOUNG. Yes, sir; I do, Senator Walcott. The capital-gains tax, in so far as the security markets are concerned, does exaggerate the curve both ways. Whether or not there is sufficient justification for its elimination, I do not know, because I have not studied the question of the repercussions elsewhere. We sometimes have to suffer in one field in order to get helpful results elsewhere.

Senator BULKLEY. I want to get one thing more clear. You referred a few minutes ago to forcing into the Federal Reserve System State banks holding themselves out to do a national business. Now, how shall we draw that line as to what constitutes such a holding out?

Mr. YOUNG. Of course, that is really a legal question and I am not very competent to answer it, but what I had in mind was that a bank might well be said to hold itself out to do a national or international business unless, for example, it were to require all of its depositors to put on their checks "This check can not be cashed outside of the State." Of course, you can not reach any bank that merely holds itself out to do business only within the confines of the State, I take it, but if it holds itself out to its customer so that he may send his check anywhere, then it does seem to me it is engaged in a national business.

Senator BULKLEY. I would be disposed to doubt whether the bank holds itself out to do an interstate business by any such operation as that, because all the bank undertakes to do is to pay the check when it is presented there at its own office. I do not mean to involve you in a legal argument. What I am trying to get at is whether you thought there was some line where some State bank could be distinguished from other State banks, or whether you meant to go to the comprehensive extent of covering all banks of deposit.

Mr. YOUNG. I put it in that way because I think the danger in drawing this act is it may go too far to be constitutional and, therefore, I was trying to find some distinguishing limitation.

Senator BULKLEY. I thought you covered that by saying you would go ahead and amend the Constitution if you had to.

Mr. YOUNG. Yes, sir; if we had to.

Senator BULKLEY. You do contemplate the compulsion. You do not have any reasonable hope that this could be worked out by cooperation of the State banks and the State governments?

Mr. YOUNG. Well, we have not had very much success with it, sir. The members are 8,000 out of 24,000 banks at the present time.

Senator BULKLEY. I understood your statement to be that we should go ahead and force it and not rely upon enticement.

Mr. YOUNG. I do not know that it is necessary to limit it to the interstate commerce provisions. Bank deposits have so far taken the place of currency in all interchanges and if you have anything

like a liberal interpretation I do not see how the National Government can really deal with this currency question on a national scale without having some control of these banks of deposits or of these deposits which take the place of currency and move quite as freely in much greater volume.

Senator BULKLEY. So you would really have to cover every bank that accepts demand deposits to carry out your idea?

Mr. YOUNG. I think so, sir.

The CHAIRMAN. Ninety per cent of the business of the country is done by check, is it not?

Mr. YOUNG. Yes, sir.

The CHAIRMAN. And membership in the Federal reserve system inevitably implies an interstate business, does it not?

Mr. YOUNG. Yes, sir.

The CHAIRMAN. With its check clearance provisions, that is inevitable?

Mr. YOUNG. Yes, sir.

Senator BULKLEY. I would like to get a little more clear idea of your view about prohibiting these banks of deposit from accepting savings. I can readily see the argument against doing the two businesses together, but you said you thought segregation of assets was a bad practice. Would you develop that a little further?

Mr. YOUNG. Of course, you are now getting into a field, Senator, where, however little competent I may be to speak on the general situation, I am less competent to speak here, because it is only the professional bankers who should really speak on that. I have less confidence in my suggestion as to the division of savings and general bank deposits for that reason than some of the other things I have referred to in my statement.

Senator BULKLEY. We have permitted national banks to take savings deposits and I suppose if we were going to prohibit that now, we ought to have a good reason for it.

Mr. YOUNG. I should like to think of deposits perhaps as demand, as time, as thrift, and as savings. Now, the last two, thrift and savings, are difficult to distinguish, and yet there is some real difference between them. These banks of deposit, for example, with branches scattered all over the city of New York, into which the small merchant puts his account and where it is quite convenient and, perhaps, where even the laborer or the worker carries a little checking account, it is convenient for him, and I think probably encourages thrift, to be able to establish his thrift account in that bank. Perhaps his little boy 10 years old goes along with him to the bank and puts in 25 cents. It is a very desirable thing to encourage. I would not wish to take the thrift accounts out of the deposit banking system; because the fact they are doing this business enables them to have so many doors open for the convenience of depositors. The thing which I would like to say about this thrift question is that they should not be permitted to be withdrawn except in accordance with the previously specified notice, nor should the bank be permitted to pay them earlier than that notice calls for, because, especially in the city districts frequently, where there may be many foreigners, you get rumors started. Then it is the little thrift and savings customers, who in the first place are the most excitable and most suspicious, who create

the crowd and block the street in a few minutes because they represent such large numbers, as a rule, and then your bank is in trouble. If it were perfectly well understood, both by the depositors and the bank, that they could not be paid except after notice, there would be no point in coming there, and I think you would avoid or diminish the risk of runs in that respect. Of course, once started, then your demand depositors come in and then there is trouble in hand.

I would like to keep the thrift deposits in those institutions, if possible, but with real limitations on time withdrawals. Of course, in reference to savings, while they cover something of the same area, they cover more. That really means where people are going to put their money in for a considerable time, maybe for a long time. The States for the most part in connection with savings banks, as you know, limit the character of securities in which investments can be made, and so forth, and one could not carry them over into the deposit banking system unless you segregate the assets. Well, this business of segregating assets in times of stress is open to suspicion as to how they may be shifted, and if it turns out that one depositor gets more or less than another, it is a very bad situation and, more than that, of course, you destroy at once the diversity, which is one of the greatest securities of your whole group, the moment you begin to segregate. Personally, I would like to see the thrift accounts, if possible, perhaps limited in size, protected as to time of withdrawal, and kept in the commercial deposit bank, and then have all the rest of the savings in the savings banks under State control.

Senator BULKLEY. One other question on another subject. Have you any comment to make on the relations between the boards of the Federal reserve banks and the Federal Reserve Board as to authority to initiate changes in rates and to review motions to change rates?

Mr. YOUNG. I think the initiation of rates should always come, Senator, from the individual banks.

Senator BULKLEY. You think the system is all right as it is?

Mr. YOUNG. Yes, sir.

Senator BULKLEY. Or would you suggest any modification?

Mr. YOUNG. I think it is all right. So far as the system goes, I think it was remarkably well set up. It drew the outlines of a great picture and we are gradually filling in the detail by experience which finally develops into precedent, sometimes by rules from the board, sometimes by well-established customs and practices, and that is the way I think the system should grow.

Senator BULKLEY. Now, you referred to a difference in view between the New York board and the Federal Reserve Board as to advancing the rate in New York. Whatever the merits of that difference of opinion, you still believe it is all right for the Federal Reserve Board to have the review of that?

Mr. YOUNG. I think it is entirely right, Senator. I think it must have the review because the relationship of these different rates through the system, after all, is a matter for consideration and review by a national board. We in New York are dealing with a fairly definite situation, and Chicago the same way. There must be some general supervisory power, I think even to the point of vetoing our recommendations. I believe in that. It is true—I think I may make this observation about the system—looking backward over the



past 10 years the system as a whole has acted wisely. The criticism is not that it did not act wisely, but that it did not act quickly enough. That, I think, has been largely the trouble.

Senator BULKLEY. That is a matter of human judgment of those who are administering the system. We can not learn anything about improving the system?

Mr. YOUNG. No. What I am trying to say is it partly did not act quickly enough because of the constitution of the system—of the machinery.

Senator BULKLEY. What improvement do you suggest there?

Mr. YOUNG. I do not know that we can improve it. I think that we can only improve it by operating experience within rather than by the compulsion of a statute without. That is my present feeling, but I think we will have to learn to act more quickly than we do, because time is just as important in its relationship to the functioning of a central bank as it is to Einstein's theory.

Senator BULKLEY. But that is an experience those charged with administering the system ought to study and take to heart; and so you do not suggest changing the system?

Mr. YOUNG. I do not think a statute can deal with it, sir, justly.

The CHAIRMAN. Well, sir, we are all greatly indebted to you. Some of us may find fault with the fact you covered the ground so thoroughly to start with.

(Whereupon, at 12.15 o'clock p. m., the subcommittee adjourned subject to call of the chairman.)



# OPERATION OF THE NATIONAL AND FEDERAL RESERVE BANKING SYSTEMS

MONDAY, FEBRUARY 16, 1931

UNITED STATES SENATE,  
COMMITTEE ON BANKING AND CURRENCY,  
*Washington, D. C.*

The subcommittee met, pursuant to call of the chairman, at 10.30 o'clock a. m., Hon. Frederic C. Walcott presiding.

## STATEMENT OF ROME C. STEPHENSON, PRESIDENT AMERICAN BANKERS ASSOCIATION, VICE PRESIDENT OF THE ST. JOSEPH COUNTY SAVINGS BANK, AND PRESIDENT OF THE ST. JOSEPH LOAN & TRUST CO., SOUTH BEND, IND.

The ACTING CHAIRMAN. The committee will come to order. Mr. Stephenson, will you give us your name?

Mr. STEPHENSON. Rome C. Stephenson, vice president of the St. Joseph County Savings Bank and president of the St. Joseph Loan & Trust Co., at South Bend, Ind., and I am also president of the American Bankers' Association.

The ACTING CHAIRMAN. Mr. Stephenson, these hearings, as you doubtless know by this time, have been conducted along lines that we hope will prove constructive and be of some benefit. We are looking for suggestions that might possibly, in ten years, or whenever the next time comes, cut off some of the deflation and reduce some of the drop we have had. We have had a great many valuable suggestions, and you as an experienced banker and head of the bankers' association, can probably help us out. Have you a prepared statement to make?

Mr. STEPHENSON. I have not.

The ACTING CHAIRMAN. You have nothing you care to give us, except in response to our questions?

Mr. STEPHENSON. Yes; I shall make a statement.

The ACTING CHAIRMAN. As we ask questions?

Mr. STEPHENSON. No; I shall make it without any questions.

The ACTING CHAIRMAN. Very well; we shall be glad to have you do that.

Mr. STEPHENSON. The American Bankers' Association has a commission that is known as the economic policy commission. That is composed of some of the leading financiers of the country and bankers located in various parts of the United States.

The members of this commission are Rudolf S. Hecht, president Hibernia Bank & Trust Co., New Orleans, La., chairman; George

E. Roberts, vice president, National City Bank, New York, N. Y., vice chairman; Nathan Adams, president, First National Bank, Dallas, Tex.; Leonard P. Ayres, vice president, Cleveland Trust Co., Cleveland, Ohio; Frank Blair, chairman of board, Union Trust Co., Detroit, Mich.; Walter W. Head, president Foreman-State National Bank, Chicago, Ill.; W. D. Longyear, vice president, Security-First National Bank, Los Angeles, Calif.; Walter S. McLucas, chairman of board, Commerce Trust Co., Kansas City, Mo.; Max B. Nahm, vice president, Citizens National Bank, Bowling Green, Ky.; Melvin A. Traylor, president First National Bank, Chicago, Ill.; Paul M. Warburg, chairman of board, International Acceptance Bank, New York, N. Y.; O. Howard Wolfe, cashier, Philadelphia National Bank, Philadelphia, Pa.; Gurdon Edwards, American Bankers' Association, New York, N. Y., secretary.

This commission has been, for some time, making an intensive study of branch, group, chain, and unit banking. They have also under consideration the study of paper that is not now eligible for rediscount with the Federal reserve system, which is known as installment paper, issued by finance companies.

The commission meets twice each year, in the spring at the time of the meeting of the council of the American Bankers Association and also in the fall at the annual meeting of the American Bankers Association in their conventions. It is my belief that the recommendations that are made in behalf of the American Bankers Association should come from the membership of the economic policy commission after they have completed the studies in which they are now engaged on the various phases of banking and for any amendments that they might suggest to be made to the law governing the Federal reserve system.

The ACTING CHAIRMAN. When will that report be ready, Mr. Stephenson? Have you any idea?

Mr. STEPHENSON. Mr. Rudolf Hecht, who is chairman of the committee, in a conversation with me over the telephone last Thursday, said that he expected to be in Washington on Monday morning a week from to-day and he would be very glad to appear before the committee and I rather thought, from what he had said, that he had been asked to appear.

Mr. WILLIS. I have that matter in hand and arrangements have been made to have him appear here.

Mr. STEPHENSON. In the reports made by this commission to the executive council of the American Bankers Association on May 7, 1930, Mr. Hecht said, in behalf of his committee—his report was signed by all members of the committee—

Neither railroad bonds, municipal issues, nor finance company installment paper quite qualify under this theory as classes of credit instruments suitable for eligibility.

As to railroad bonds and municipal bonds, it may be true that as collateral security they are almost as good as Federals, but Federal securities themselves are distinctly an anomaly as a basis for loans at the Federal reserve bank. They were admitted only as a war finance measure. They do not tend to keep member borrowing coordinated with the expansion and contraction of trade.

As to installment paper, it must be remembered that it represents consumer credit that is not based on productive transactions, but is wholly dependent upon extraneous factors for its liquidation, as the ability of the purchaser of

the goods involved to hold his job and make his payments out of wages. The value of the underlying goods themselves rapidly disappears through consumption or depreciation. This is in distinct contrast with the notes covered by the present rules for eligibility which represent producer, not consumer, credit, and are strictly self-liquidating out of the increased value produced by the underlying commodities and transactions.

Our feeling, therefore, in respect to these proposals for admitting certain other types to eligibility is that such action might tend to make our reserve credit structure less liquid, throw its workings out of step with fundamental business changes, and also increase the task of preventing the Federal reserve system from being employed as a facility to inflation. We believe this latter point is especially important. The increase in credit which these added instruments would facilitate would not necessarily reflect and respond to the enlarged productive requirements of commerce and industry for supplies of currency and credit at going price levels. They would rather be liable to tend to create easy money in advance of those requirements and thus stimulate overtrading, rising prices, and finally overproduction. They would tend to create a volume of credit that would not be automatically extinguished after it had served its designated function. We feel that the original impulse for credit expansion should come not from easy money but from actual increased consumer demand, which is the channel along which the present rules tend to guide our credit economy.

We feel, also, that there are important changes developing in credit conditions which will increase the supply of paper eligible under the present rules. For instance, we cited that in September, 1929, the volume of open market commercial paper outstanding in New York had fallen to only \$265,000,000. Since then there has been a steady improvement in the commercial paper market, and in March the supply was reported at \$529,000,000, a gain of \$264,000,000, or virtually 100 per cent in only six months. We find indications also that many corporations are returning to the practice of financing their current operations by means of bank loans instead of by the issue of securities.

We do not mean to minimize the seriousness of this problem nor the disadvantages under which it has placed many banks, especially in the country districts, but we do feel that there are serious disadvantages involved in the proposal to set up an easier basis of access to Federal reserve bank credit. We believe such action at present would be hasty and that time should be allowed to show whether natural forces are not at work which will within a reasonably short period correct the present situation.

We are not prepared to recommend that the council go on record against broadening the rules for rediscount, but we do suggest that the subject be given further study before any stand is taken.

Mr. WILLIS. Was this report adopted by the American Bankers' Association?

Mr. STEPHENSON. No; it was reported.

Mr. WILLIS. Does it or not represent the sentiment of the association?

Mr. STEPHENSON. I believe it represents the sentiment of the association.

Mr. WILLIS. And your own also?

Mr. STEPHENSON. Yes, sir; at this time.

Mr. WILLIS. So that may be fairly taken as an informal expression of the views of the association?

Mr. STEPHENSON. At the time this report came out, but as indicated by the chairman of the committee, it was to be subject to further study and investigation.

Mr. WILLIS. That seems to imply—am I right in thinking—that no broadening of the base of rediscount on the part of the reserve banks is thought wise by the association?

Mr. STEPHENSON. In connection with the admitting of paper of finance companies to eligibility?

Mr. WILLIS. The paper you read speaks in more general terms of the broadening of the base.

Mr. STEPHENSON. Yes; it refers to municipal and railroad bonds.

At the Cleveland, Ohio, convention, held in September and October, 1930, there was a report adopted which was the voice of the association on the subject of branch banking, and it was as follows:

The American system of unit banking, as contrasted with the banking systems of other countries, has been peculiarly adapted to the highly diversified community life of the United States. The future demands the continued growth and service of the unit bank in areas economically able to support sound, independent banking of this type, especially as a protection against undue centralization of banking power. Modern transportation and other economic changes, both in large centers and country districts, make necessary some readjustment of banking facilities.

In view of these facts, this association, while reaffirming its belief in the unit bank, recognized that a modification of its former resolutions condemning branch banking in any form is advisable. The association believes in the economic desirability of community-wide branch banking in metropolitan areas and county-wide branch banking in rural districts where economically justified.

The association supports in every respect the autonomy of the laws of the separate States in respect to banking. No class of banks in the several States should enjoy greater rights in respect to the establishment of branches than banks chartered under the State laws.

Mr. WILLIS. Does that community-wide branch banking that you speak of mean that metropolitan banks should be allowed to spread out into the counties in which they are situated?

Mr. STEPHENSON. I believe it would, because it says "community-wide branch banking."

Mr. WILLIS. That seems as if it were one of those "weasel words" that often appear in resolutions.

Mr. STEPHENSON. In many places, of course, the city covers the entire county, like Chicago, which covers all of Cook County; New York City; and Philadelphia; so I think that would mean that the American Bankers Association was in favor of branch banking in the metropolitan areas, which indicates that it should be community-wide branch banking, and I think that would cover the whole county.

The ACTING CHAIRMAN. And in the rural districts, it would cover several counties?

Mr. STEPHENSON. No; I think county-wide branch banking would limit the bank to having its branches within the same county in which it is located.

The ACTING CHAIRMAN. Does that imply that the bankers association would not favor suppressing or gradually doing away with State banks in order to force all the banks under the Federal reserve system?

Mr. STEPHENSON. I think that this resolution is very strong for the preservation of the present State laws protecting the State banks.

The ACTING CHAIRMAN. Which would mean that they would want to preserve the State banks?

Mr. STEPHENSON. Yes, sir.

The ACTING CHAIRMAN. Now, in the first place, let me ask you if the American Bankers Association has taken any active interest in the legislation that is pending?

Mr. STEPHENSON. Here?

The ACTING CHAIRMAN. Yes. I suppose you have a legislative committee.

Mr. STEPHENSON. The American Bankers Association has a Federal legislative committee.

The ACTING CHAIRMAN. Yes; and they take quite an active interest, do they?

Mr. STEPHENSON. Usually, they do. I do not know that the Federal legislative committee has taken very much activity in connection with the pending legislation for the reason that the American Bankers Association has members from the national banks, the State banks, the mutual saving banks, the trust companies, and private banks, and it also has a great many unit banks, branch banks, chain banks, and group banks, and it makes a very delicate situation for the Federal legislative committee to take any action that might prejudice any of these various groups that belong to the American Bankers Association.

The ACTING CHAIRMAN. Do you know what percentage of your member banks are national banks and that are members of the Federal reserve?

Mr. STEPHENSON. That belong to the association?

The ACTING CHAIRMAN. Yes.

Mr. STEPHENSON. I think Mr. Mountjoy can give that figure.

Mr. MOUNTJOY. About 6,400.

The ACTING CHAIRMAN. Out of a total of how many members?

Mr. MOUNTJOY. Twenty thousand.

The ACTING CHAIRMAN. About a third?

Mr. STEPHENSON. Yes.

The ACTING CHAIRMAN. That means you have a tremendous influence in favor of State banks, naturally?

Mr. STEPHENSON. Yes, sir.

The ACTING CHAIRMAN. Let us discuss that phase of it for a moment. You know, of course, the very bad record of bank failures in past years—about 6,000 for 10 years and about 1,300 last year, and most of them State banks, a large proportion of them outside of the Federal reserve system. How far do you attribute the sore spots in banking, or bad banking, if you please, to the troubles that we have had in the last two years?

Mr. STEPHENSON. I think that a very large majority of the failures and closings of banks that we have had throughout the country during the past 10 years has been attributable to the changes that have been brought about through the building of hard-surfaced roads and the transportation that has come through the automobile, and that many of these closed banks have been in communities that have likewise failed. For instance a bank would be located about 8 miles from the county seat. When they had a hard-surfaced road leading from the smaller town to the county seat it would be possible to drive from that small town to the county seat in 12 to 15 minutes, with the use of the automobile and the hard-surfaced roads, and the farmer patrons of banks in the smaller communities would go to the county seat. They would withdraw their deposits from the small bank and take them to the county seat and that community would fail. It would be absorbed by the larger town.

Mr. WILLIS. How would you account for the failures, for instance, in a State like the State of West Virginia, which has few large towns, and whose roads are—

Mr. STEPHENSON. I just want to complete my statement, Doctor Willis. I have been told there are about 4,000 post offices that have been closed in various small communities of the country, and in many of these places the banks also closed.

Now, what is your question, Doctor Willis?

Mr. WILLIS. How would you account for the high record of failures in rural States like West Virginia where there are few large towns, and where the number of small banks is about as large as ever while the failures, nevertheless, occurred without large transfer of deposits?

Mr. STEPHENSON. In those regions there were possibly other reasons for it.

Mr. WILLIS. Such as—

Mr. STEPHENSON. It might have been excessive loans on real estate that depreciated in value, and it might have been their loans to farmers, but I am not familiar with West Virginia.

Mr. WILLIS. I used that only as an illustration.

Mr. STEPHENSON. But it is remarkable the large number of communities that have failed, and I get that information from a magazine article prepared by John Y. Beatty, the editor of the Bankers Monthly, published by Rand & McNally. He compared the number of communities that failed with the number of failed banks, and in a great many of those communities where the post offices were closed the bank failed also.

Senator NORBECK. Did he say at that time whether there had been an increase in deposits at the centers?

Mr. STEPHENSON. He did not say that.

Senator NORBECK. In other words, he did not indicate or attempt to prove where the money went?

Mr. STEPHENSON. No.

Senator NORBECK. Simply left the small communities?

Mr. STEPHENSON. Yes; left the small communities, and I have observed in the community in which I live a number of banks in those smaller communities, located within 15 or 20 minutes of South Bend, being closed because of the fact a great many of their depositors draw their money out and go to the center where they have the hard-surfaced roads.

Senator NORBECK. Admitting that is a factor, how would you explain, for instance, the failures in North and South Dakota, where it is shown that the shrinkage is in the total deposits rather than due to transfer from the smaller to the large communities?

Mr. STEPHENSON. I think the trouble in South Dakota was on account of the shrinkage there in the value of real estate and the fact that the banks in those two States had made a great many loans on farm lands and to farmers, which loans they were unable to meet by reason of the failure of crops in those two States and the general depression in the price of commodities.

Senator NORBECK. In the price of the commodities produced in those States?

Mr. STEPHENSON. Yes, sir; and I think another contributing cause to the failure of the banks in North and South Dakota was the guarantee of deposits that they had in those States that caused bankers who had been conservative prior to the enactment of the



guarantee of deposits law to become much more liberal in their loans and do things in connection with the banking business that were not conservative, but they felt they should do in order to hold the business.

Senator NORBECK. The proof of that might be gotten at by comparison with States where they did not have the guaranteed deposits, might it not?

Mr. STEPHENSON. Yes.

Senator NORBECK. Has anyone attempted to bring out the figures to prove that?

Mr. STEPHENSON. I think not, but I have talked with bankers in North Dakota who have told me some of their experiences. For instance, a banker had been in business for 25 years and had been quite successful and was conservative. When the guarantee of deposits law was enacted and new banks started in the community, the new banks would go to the depositors of the old banks and offer to make a commitment on loans of double the amount that they had procured at the old banks, and they would reduce the rate of interest on those loans, say, from 8 to 6 per cent, and then they would also offer to pay a higher rate of interest on daily balances of the customer.

Senator NORBECK. Did not exactly the same thing take place on the east side of the river in Minnesota, where they have no guarantee of deposits law?

Mr. STEPHENSON. I do not know.

Senator NORBECK. In other words, there was an increase of values of commodities and the banks in that section began to increase their loans.

Mr. STEPHENSON. I suppose they did. But I talked with a banker at La Moure, N. Dak., and he attributed his failure largely to the guarantee of deposits law.

Senator NORBECK. Did he say who asked for the guaranty of deposits law?

Mr. STEPHENSON. No.

Senator NORBECK. He did not say his group went to the legislature and got it?

Mr. STEPHENSON. No.

Senator NORBECK. And then they inserted a proviso that made it a guaranty in name only, and went out and advertised that the State was guaranteeing the deposits, which it was not really?

Mr. STEPHENSON. Well, after they had the experience, they blamed it on the guaranty of deposits law.

Senator NORBECK. Surely. They always do that.

The ACTING CHAIRMAN. Was there any liability on the part of the State?

Senator NORBECK. It was a trivial guaranty, but many bankers took advantage of the law and advertised that the State was guaranteeing the deposits. In South Dakota they had a much more substantial fund behind the guaranty, but it was not substantial enough.

Mr. STEPHENSON. Senator Norbeck, after the guaranty of deposits law was passed there were a great many more banks established.

Senator NORBECK. But is not that also true of Minnesota where there was no guaranty of deposits law? And in Iowa, also?

Mr. STEPHENSON. I have not been in those States. I just had an opportunity to talk with some bankers in North Dakota.

Senator NORBECK. Well, the records are available. You know there was an inflation in the number of banks that spread out all over the States—not in the States that had a guaranty law only but in all States?

Mr. STEPHENSON. That is correct.

Mr. WILLIS. The farmer goes to the neighboring town, you say, because it is easier for him to do that with automobile transportation. He would not do that unless he thought the bank in the larger town was stronger?

Mr. STEPHENSON. I think this is what happens: The farmer who formerly patronized the small stores in the village, when he got the hard-surface roads and found he could get to the larger town within one-fourth of the time it used to take him to drive by horse, began to do his trading in the larger place and naturally, going there to trade, he would also take his banking business there.

Mr. WILLIS. Did it mean that the bankers in those places were more liberal or considerate?

Mr. STEPHENSON. I do not think so, but it became much more convenient to do his banking business in the larger place.

Mr. WILLIS. I do not see how it would be more convenient.

Mr. STEPHENSON. They enjoy traveling—driving—to the larger places where they could get a larger supply or a larger assortment of goods.

Mr. WILLIS. We have heard that chain stores were very numerous in that part of the country and you have them even in the smaller places.

Mr. STEPHENSON. Not a great many, but you will find on investigation where they have these hard-surfaced roads many of the farmers have abandoned the smaller communities and go to the larger cities, where they have a larger assortment of goods, and in many instances they are slightly more reasonable, and if he does his trading in the larger cities he will naturally take his deposits to the larger cities.

The ACTING CHAIRMAN. Does not that indicate we must put our wits together and find some solution? Is it branch banking, in your opinion, that will solve this problem? Apparently the American Bankers Association has been, until recently, opposed to any extension of branch banking. Now, this committee that you are quoting is apparently in favor of some slight modification toward branch banking. Would not branch banking tend to diversify the loans and increase your load factor; in other words, act as a kind of check or shock absorber in saving some of the small communities?

Mr. STEPHENSON. I believe not. In a great many of these communities where the banks have closed there will never be any demand for banks for those communities again, because the citizens who live in the communities surrounding the smaller places go to the larger places and will not go back.

Mr. WILLIS. That is not the case in Great Britain, because you have the branch banks all over the country in the smaller places, and

the same on the continent, sometimes keeping a branch open only a day in the week. Is not that true?

Mr. STEPHENSON. I could not say from personal observation, because I have never been there.

Mr. WILLIS. It is shown by descriptions that I have read. Why should we have a different situation here than there?

Mr. STEPHENSON. I do not believe that we would need any of the branch banks in those smaller communities to be open a day or two days when they have those hard-surfaced roads and can get into the larger communities in 10 or 15 minutes.

Mr. WILLIS. Well, they have the best roads in the world in England and Scotland.

Mr. STEPHENSON. But I do not believe they have as many automobiles there as here.

Mr. WILLIS. But they have excellent bus systems so that what is true here is equally true there.

Mr. STEPHENSON. From reading, I take it in those rural communities in Great Britain and Europe they have very few autos among the members of the rural communities that would patronize banks.

Mr. WILLIS. But they have excellent bus systems and there is no reason why the situation would not be the same here, is there?

Mr. STEPHENSON. No.

Mr. WILLIS. Is it not a fact that the bank of deposit in the smaller community has often not been well run under our existing banking situation?

Mr. STEPHENSON. They seem to have had no difficulty until about 10 years ago in those communities, which was when the price of commodities was fair and reasonable and before real estate began to depreciate. There were very few banks in the smaller communities comparatively that failed at that time because farmers were enabled to pay their notes when the rural real estate was gradually appreciating in price.

Mr. WILLIS. If you had high prices for farm commodities you think the small banks could have stood up in spite of the hard-surfaced roads?

Mr. STEPHENSON. I do not think so in a great many instances, because I think the business of those communities would be naturally absorbed by the larger communities, and I do not believe the smaller communities would get it back.

Mr. WILLIS. The Northwestern chain banks are keeping the units of their chains open.

Mr. STEPHENSON. But the banks in the Northwest group are in fairly good-sized communities. They are not in the very small communities, where the population is only from three to five hundred.

Senator NORBECK. Mr. Chairman, I think that is developing the very point that will be of interest. In making reference to the small community you do not have reference to the small county seats? You mean the villages around in the counties?

Mr. STEPHENSON. Yes, sir.

The ACTING CHAIRMAN. Why can we not analyze it more closely by getting a set of figures that will show the bank failures by population? If your theory is correct—and it is which has not been presented at former hearings—if your theory is correct, why can not we

analyze it to see what percentage of these bank failures has occurred in towns, we will say, of under 1,500, in towns of 2,000 to 5,000, and in towns from 5,000 to 15,000?

Mr. STEPHENSON. I think Mr. Beatty, the gentleman to whom I have referred a while ago, has made a thorough investigation of it, and I shall be glad to get the data that he has compiled and send it to this committee.

The ACTING CHAIRMAN. We will appreciate that very much.

Mr. STEPHENSON. There was another matter that I wanted to present to the committee before I am through, and that is that I am a member of a committee of the National Association of Mutual Savings Banks and the purpose of the formation of this committee was to take some steps, if possible, to present to the Federal Reserve Board a proposal that some plan be devised whereby the mutual-savings banks could be brought into the Federal reserve system.

The larger savings banks up in your State and all through New England, New York, New Jersey, and Pennsylvania would, I think, be glad to become members of the Federal reserve system and buy stock in the Federal reserve banks, based on the amount of their surplus funds, if some means could be devised whereby, in case of emergency, they might put up as collateral some of their very high grade bonds, such as would be designated by the Federal Reserve Board and whereby loans could be made to them for periods of three to four months upon a safe percentage of the market value of those bonds.

The officers of the various mutual savings banks have discussed the matter and if it could be made advantageous to these mutual savings banks to become members of the system, there would be very little borrowing done and I think it would be a means whereby the system could be very substantially strengthened by reason of the large deposits that would be placed with the Federal reserve banks.

The ACTING CHAIRMAN. You would have to have legislation for that? You would have to modify the Federal reserve act?

Mr. STEPHENSON. Yes; you would have to modify the Federal reserve act and, in your deliberations and in your studies that you make of the matter, I should be glad if you would give that some consideration.

The ACTING CHAIRMAN. We will bear that suggestion in mind. There is a desire on the part of those New England banks to come in?

Mr. STEPHENSON. Yes. Judge Paton, the general counsel of the American Bankers' Association, calls my attention to a report that was made by the economic policy commission at Cleveland, at the Cleveland convention, in September, 1930, which I think will be of considerable interest and may aid the committee to have this report in, upon the subject of failed banks, and if you have no objection, I shall be glad to read this to you.

The ACTING CHAIRMAN. We will be glad to have you do that.

Mr. STEPHENSON (reading):

The problem of bank failures has also been considered by the commission. This problem, unfortunately, has again been brought very much to the fore this year after we thought we had reason to believe there had been a turn for the better.

Official records show that in the year ended June 30, there were 758 bank suspensions with deposit liabilities of \$353,500,000. In point of numbers this

is the highest mortality in any year since the war except 1924, when there were 915 suspensions, and in 1927, when there were 831. In point of liabilities it was the highest, even exceeding the \$297,900,000 total for 1924, and \$266,600,000 for 1927.

Following 1927 there was an encouraging drop in failures, there being but 484 in the year ending June 30, 1928, with liabilities of \$158,700,000, and 551 in the year ending June 30, 1929, with \$182,300,000 liabilities. The monthly record for the year since then, ending June 30 last, shows marked rise both in numbers and deposits, as follows:

	Number	Deposits		Number	Deposits
July, 1929.....	69	\$70,400,000	February.....	85	\$33,200,000
August.....	17	7,900,000	March, 1930.....	75	23,700,000
September.....	39	10,200,000	April.....	95	34,300,000
October.....	43	14,000,000	May.....	52	18,600,000
November.....	69	24,600,000	June.....	67	71,000,000
December.....	50	15,500,000			
January, 1930.....	97	30,100,000	Total.....	758	353,500,000

During the last 10 years about 5,700 banks have suspended, mostly in the agricultural districts, tying up aggregate deposits of almost \$2,000,000,000—or to be more exact, \$1,931,000,000.

Senator NORBECK. During how long a time?

Mr. STEPHENSON. Ten years.

The bank-failure problem is chiefly a small rural bank problem.

Senator NORBECK. Whose report is that you are reading?

Mr. STEPHENSON. This is the report of the Economic Policy Commission.

Senator NORBECK. To the American Bankers' Association?

Mr. STEPHENSON. To the American Bankers' Association; yes, sir.

Senator NORBECK. And that last statement—will you read that again?

Mr. STEPHENSON (reading):

The bank-failure problem is chiefly a small rural bank problem.

Senator NORBECK. Well, that means, at least, it is chiefly a rural problem?

Mr. STEPHENSON. Yes.

Senator NORBECK. And chiefly a problem of the small banks in rural communities, is that what it means?

Mr. STEPHENSON. Yes.

Senator NORBECK. Well, I have no disagreement with that conclusion.

Mr. STEPHENSON (reading):

Official studies covering a recent 8-year period show that more than four-fifths of all the banks in the United States are situated in small towns with average capital of about \$44,000, and it is among these small banks that most of the failures have occurred. Seventy-one per cent of the suspended banks, both National and State, were capitalized below \$50,000 each and 88 per cent under \$100,000, but by far the largest number of failures occurred among banks having capital of \$25,000 or less, these constituting 63 per cent of the failures. Over 40 per cent were situated in places having populations less than 500 persons; 20 per cent failed in towns with between 500 and 1,000 population;—

Senator NORBECK. Are you going to throw any light on why they limit this report to a 10-year period?

Mr. STEPHENSON. That is about the time when they began to have the failures. Before that they did not have the failures so much.

Senator NORBECK. Before that we did not have the failures in the rural communities?

Mr. STEPHENSON. No. [Continues reading:]

Twenty per cent in towns of from 1,000 to 2,500, and 12 per cent occurred in towns from 2,500 to 10,000 population. In short, about 92 per cent of the failures were in places having less than 10,000 population.

The failures in the present period of increases, which are general although most acute in the agricultural States, again emphasizes that the situation presents preponderantly a small-bank and small-town problem.

In 1927 at the Houston convention of the association the economic policy commission presented an exhaustive report on the question of bank failures and their causes in which its main conclusions in summary were as follows:

(1) Adverse conditions precipitated numerous failures of financially weak and unskillfully managed banks.

(2) An excessive number of banks is the most potent single cause of failure.

(3) The situation can be corrected in part by increased capital requirements and more completely by the limitation of new charters to the needs of the community for additional banks.

(4) In view of the heavy legal and moral responsibilities of bank directors, closer supervision by them is desirable in their own interest and would serve to correct much that leads to insolvency.

(5) While additional restrictive legislation covering loans and investments is not favored, the more immediate enforcement of existing statutes is approved.

(6) The clearing-house examination system has been in general highly advantageous and its further growth is to be anticipated.

(7) As a plan feasible for immediate and general adoption, the organization of local regional associations of banks for the purpose of supporting and securing the more effective use of the existing system of examinations is strongly recommended.

We believe those conclusions are still applicable. Moreover, there is another economic factor which aggravates the problems of the small country bank to a greater degree than ever before and therefore calls for special emphasis at this time. That is the constant shift of business from the smaller to the larger centers, thus leaving many country banks without sufficient economic support and making more difficult than ever the struggle of these banks to show sufficient earnings to keep them in a sound and healthy condition.

It is axiomatic that unless a bank is profitable it is not safe for itself and it is not safe for its community. A bank that is making satisfactory earnings can absorb the inevitable losses that occur in normal business. A bank with inadequate earnings can not meet these normal contingencies.

Mr. WILLIS. How many of those local clearing houses have been organized?

Mr. STEPHENSON. I have no record.

Mr. WILLIS. Perhaps Judge Paton can tell you.

Mr. PATON. I did not get that.

Mr. WILLIS. How many of those clearing house groups have been organized?

Mr. PATON. I could not tell you how many. There are some 300 clearing house associations, and I know the bank management commission of our association is advocating an increasing of those local clearing houses constantly.

Mr. WILLIS. Am I right in saying that only one has been created?

Mr. PATON. I think not.

Mr. WILLIS. I have been told that only one has been fully organized and in operation. They are not very numerous, at any rate.

Mr. PATON. I understand they are.

Mr. WILLIS. Will you get the figures on that and file them?

Mr. PATON. Yes.

Mr. WILLIS. Your association has recommended the clearing-house associations and has suggested that there should be organ-

ized local clearing-house examination systems among the rural banks for the purpose of keeping the banks, so to speak, toned up?

Mr. PATON. Yes.

Mr. WILLIS. The question is, how many of those associations have been formed?

Mr. PATON. I will read the report of the bank management commission made at the last convention dealing with that subject:

Supplementing the work of the regional bank management conferences, the commission has been active in stimulating the organization of city, county, and regional clearing-house associations as essential local machinery for setting up and putting in to operation necessary standards and uniformities in banking practices. There are now in operation 452 clearing-house associations of the city and regional type.

Mr. WILLIS. They have been in existence for many years.

Mr. PATON (reading):

We recently prepared and published in pamphlet form a detailed plan for organizing and operating regional clearing-house associations—each association to consist of the banks of several counties, thus availing county bankers of the advantages of a clearing-house facilities. Twenty-six regional and county clearing-house associations have been organized—

Mr. WILLIS. Under that plan?

Mr. PATON. Under the plan.

Mr. WILLIS. Which the association has promulgated? Twenty-six have been organized?

Mr. PATON. Yes;

and are in successful operation, and many more in process of formation. City clearing-house associations have been increased to 426. The regional clearing-house idea carries with it tremendous possibilities for standardizing county banking practices and placing them on a sound, profitable basis.

Mr. WILLIS. So, 26 are actually in operation under the plan which the bankers' association has provided?

Mr. PATON. Yes.

Mr. WILLIS. And not under preceding or general clearing-house principles?

Mr. PATON. Under those.

Mr. WILLIS. How have the failures in those districts compared with failures during an equal period before the organization of such associations?

Mr. PATON. I could not answer that.

Mr. WILLIS. Has there been any opposition among bankers to the organization of such associations—any hesitation on their part?

Mr. PATON. I presume it is a matter of education.

Mr. STEPHENSON. The American Bankers Association has what is known as a bank management commission, and it has been the practice for the past two years to hold these regional-bank management conferences at various parts of the country, and the growth of the regional clearing house is dependent upon the education of the bankers to the benefits that will accrue by reason of the organization of those clearing houses.

They have also instituted what is known as the county credit bureaus, whereby the banks in a county may keep watch and obtain information relative to duplicate borrowing by their customers which we think has been quite beneficial.

Mr. WILLIS. Is that beneficial quality shown by actual statistics of losses or is it a general opinion?

Mr. STEPHENSON. I do not know whether the system has been in effect long enough to tell what the result will be, but I know that it has checked men who were guilty of duplicate borrowings and prevented the banks from making losses by reason of the information they obtained from the county credit bureaus. It has been very helpful to the banks in that respect.

The ACTING CHAIRMAN. Do you consider that mismanagement is largely responsible—I am speaking of the rural banks we are discussing—or a fundamental economic condition?

Mr. STEPHENSON. I think that a fundamental economic condition is largely responsible for the condition which has brought about the closing of a great many banks.

The ACTING CHAIRMAN. What factors enter into that other than the one you described—the hard-surfaced roads and the accessibility of the large communities? There must be very fundamental factors governing that, I should think. You spoke, for instance, of inflated land values being a factor.

Mr. STEPHENSON. I happen to know something about—

The ACTING CHAIRMAN. Would we have had these wholesale failures of rural banks if commodity prices had stayed up? In other words, does not the land value depend largely on commodity values?

Mr. STEPHENSON. I think if the value of real estate had remained up and commodity prices also, we would not have had the serious trouble we did have, but in some communities—take, for instance, Florida—there were a number of banks that failed and the confidence of the public was severely shaken and the result was that in that State a great deal of the money was drawn out of the banks and went into safe-deposit boxes. I talked with a number of bankers in Florida and after their land values went down, they were unable, one season, to ship their fruit out of that State and there was a sort of shaking of confidence and the money was withdrawn, and that was one of the causes of the failure of a great many of the banks there. Of course, it resulted from the depreciation in the value of real estate and depreciation in the prices for which their commodities sold.

The ACTING CHAIRMAN. Is there anything that we can do here? One of the witnesses said that it is the lax laws governing State banks, putting too much of a temptation on the national banks. Take the affiliates, for instance, which have been abused. The abuse largely comes because of the competition of State banks, which can lend money more freely and with insufficient collateral, perhaps. How can we stop that without making the banking system of the United States too rigid? We all agree that it should be kept flexible as in England. How can we, without making it too flexible, prevent the terrific expansions, such as occurred in Florida, and occurred in some parts of the Middle West, following the war? Some, of course, have occurred in New York City, brought on by the expansion of the stock market. How can that be done? If we could check that in some way, would not we materially help prevent the recurrence of a panic?



Mr. STEPHENSON. There are two elements that I think would be helpful; one would be to require banks to have a larger capital and not allow banks to open until they had a fair, adequate capital for the needs of the community.

The ACTING CHAIRMAN. Where would you put that figure, Mr. Stephenson?

Mr. STEPHENSON. It would all depend on the community—the size of the community.

The ACTING CHAIRMAN. What would be your minimum requirement?

Mr. STEPHENSON. Not less than \$50,000; and then to limit the number of banks that could be established, and I think that should be regulated according to the population of the region to be served by the bank.

The ACTING CHAIRMAN. Rather than the business done?

Mr. STEPHENSON. Yes.

The ACTING CHAIRMAN. You do not care so much for the business done as for the population?

Mr. STEPHENSON. It would be very difficult in starting a bank to estimate how much business would be done. But you can tell what the population of a community is, and it has been ridiculous the number of banks that have been started in some communities where there were a very small population that would contribute to that community.

Senator NORBECK. I think Mr. Stephenson has cleared up a great many matters, though with possibly too much emphasis on the changed banking conditions in agricultural communities, but he states that he has reference to villages rather than the county-seat towns. No doubt there has been a tendency to go to the centers. The bank failures in the agricultural communities started when the prices of agricultural commodities dropped, did they not?

Mr. STEPHENSON. Yes; and the depreciation came in the values of the lands.

Senator NORBECK. The depreciation came in the value of the lands as a result of reduced earnings?

Mr. STEPHENSON. Yes; and then another thing, the reduced earnings of the farms came also as the result of the very high taxation of farm lands which were assessed on inflated values, and when those values dropped, the farmers were left to continue paying on a very high value of their land.

Senator NORBECK. Now, as to the inflated value of farm land—I should like to get your idea, so we may know what you mean.

Mr. STEPHENSON. All right.

Senator NORBECK. You have reference to the period, say, between 1910 and 1920?

Mr. STEPHENSON. From 1914 to 1920, I would say, because I do not think—

Senator NORBECK. Our census period is from 1910 to 1920.

Mr. STEPHENSON. All right; then make it from 1910 to 1920.

Senator NORBECK. You feel there was an undue increase in the value of farm lands at that time?

Mr. STEPHENSON. I did not think so at the time, but in the light of events I believe there was. I think a great deal of the land sold for more than it was worth.

Senator NORBECK. Of course, we read of isolated sales of land at many hundreds of dollars per acre, but when we get to tracing it down we find it is a piece of land near to a village or city, and the price is very misleading when it is divided into acres. How much, in Indiana, did your land increase in value, on an average?

Mr. STEPHENSON. It increased in value from 100 to 200 per cent.

Senator NORBECK. May I insert the census figures for Indiana into the record at this point?

Mr. STEPHENSON. Yes.

(Thereafter Senator Norbeck produced the following letter from the Director of the Census, which was made a part of the record, as follows:)

DEPARTMENT OF COMMERCE,  
BUREAU OF THE CENSUS,  
Washington, March 18, 1931.

HON. PETER NORBECK,  
*United States Senate, Washington, D. C.*

MY DEAR SENATOR: Complying with your telephonic request of to-day, I give below the value of farm land, excluding buildings, in the State of Indiana as shown by the censuses of 1910 and 1920, together with the amount and per cent of increase.

1920 census -----	\$2, 202, 566, 336
1910 census -----	1, 328, 196, 545
Increase, 1910-1920-----	874, 369, 791
Per cent of increase-----	65. 8

Please note that in the census enumeration the farmer was asked to give the value of the farm, including farm buildings and improvements, and in another question was asked for the value of the buildings on the farm. The value of the farm land is obtained by deducting the value of the buildings from the total value, and, therefore, includes the value of fences, tile drains, and other incidental improvements on the land.

Very truly yours,

W. M. STEWART, *Director.*

Senator NORBECK. I think in Iowa there was a 100 per cent inflation.

Mr. STEPHENSON. I have in mind the land in Indiana in the very best agricultural districts.

Senator NORBECK. In other words, in a small part of Indiana?

Mr. STEPHENSON. Yes, sir; in the northern part of Indiana. I have in mind a case I heard about last week where, about the year 1918, a man had, in Tippecanoe County, 160 acres he had paid for and had no mortgages against, and he bought the adjoining 80 acres, for which he paid \$300 per acre. and then put a mortgage on the 240 acres.

Senator NORBECK. And lost it all?

Mr. STEPHENSON. Pretty near lost it.

Senator NORBECK. You will agree with me that in getting the facts for a conclusion, you should take the whole area instead of a part of it?

Mr. STEPHENSON. Yes.

Senator NORBECK. I understand the Iowa record shows a 100 per cent increase in land values. Can you tell me anything that did not increase 100 per cent during that period.

Mr. STEPHENSON. Well, I do not believe, taking the State of Indiana all over, that it increased as much as I said, because I do not think we had in Indiana anything like the land boom they had in Illinois and Iowa, but in those counties in Indiana that are known as the finest agricultural districts, land increased from 100 to 200 per cent, because land that formerly sold at \$100 sold at \$200 and as high as \$300 per acre.

Senator NORBECK. What per cent changed hands at those prices?

Mr. STEPHENSON. There was not a great deal of activity.

Senator NORBECK. In other words, some isolated sales?

Mr. STEPHENSON. There was not a great deal of activity in the sales of land—not similar to the activity in Illinois and Iowa.

Senator NORBECK. Is it not a fact that the price of a suit of clothes and a pair of shoes doubled, furniture doubled, and the cost of living doubled, and the price of a railroad locomotive doubled, and the price of an office building doubled? Why single out the farm land as the commodity that was inflated?

Mr. STEPHENSON. Your suggestions are unanswerable. I think everything practically doubled.

The ACTING CHAIRMAN. Of course, the rural community is in a class by itself with reference to banking. That is one thing certain, of course.

Mr. STEPHENSON. Yes.

The ACTING CHAIRMAN. And the rural community is seriously handicapped on that account?

Mr. STEPHENSON. Yes. I want to give an illustration. The county seat of Fulton County, in my State, is Rochester, and 15 miles away is the village of Kewanna. Plymouth is the county seat of Marshall, and Argos is a village about 8 miles away from Plymouth. Before they had the hard-surfaced roads, both of those towns had a fine business. They had two banks in each of them and they had operated for years and made money and paid dividends and the towns were both in very fine agricultural communities. When they got these fine, hard-surfaced roads between Kewanna and Rochester and Argos and Plymouth, the citizens in the locality of Argos transferred their business to Plymouth and the people in and around Kewanna transferred their business to Rochester. The result was that all four banks have been compelled to close, and they have been trying, for the past two years, to get some one to start a banking business in those two towns, but it is believed, with their fine roads and accessibility to the county seats, that banks in those places could not live.

The ACTING CHAIRMAN. Would you give, as an additional reason for it, the decrease in the price of agricultural commodities?

Mr. STEPHENSON. Yes; the farmers who had borrowed money from those banks, on account of the reduction in the prices of their commodities, many of them have not been able to pay their notes and the business of the banks for the last few years has not been profitable.

Mr. WILLIS. How can they own automobiles and operate them if they can not pay their notes at the bank?

Mr. STEPHENSON. Well, a farmer can own and operate an automobile to-day economically. If he has not enough money to buy a new car, he can buy a Ford car for \$50 or \$100.

Mr. WILLIS. That would throw a great deal of light on the discussion of installment paper by your association.

Mr. STEPHENSON. Yes. Practically every farmer to-day has an automobile of some sort.

Mr. WILLIS. But the bank has financed him on installment paper with which to buy it.

Mr. STEPHENSON. He is financed by the finance company and the banks, in turn, handle the paper of the finance companies.

Senator NORBECK. There was an interesting statement in regard to bank failures in 1928 and 1929. I believe you said there were about \$150,000,000 for each of those two years.

Mr. STEPHENSON (reading) :

Following 1927 there was an encouraging drop in failures, there being but 484 in the year ending June 30, 1928, with liabilities of \$158,700,000, and 551 in the year ending June 30, 1929, with \$182,300,000 liabilities.

Senator NORBECK. Then, we have had two bank failures this year that, taken together, brought greater losses than all the bank failures in the United States for the two years you mentioned?

Mr. STEPHENSON. I think so.

Senator NORBECK. The so-called Bank of the United States, with \$200,000,000, and \$450,000,000 in the failure shortly afterwards in Philadelphia.

Mr. STEPHENSON. Yes; the Bankers Trust Co.

Mr. WILLIS. That makes it a city problem as well as a rural problem?

Mr. STEPHENSON. Yes.

The ACTING CHAIRMAN. Has your association—the American Bankers' Association—determined upon any policy with reference to security affiliates or given it any particular study?

Mr. STEPHENSON. It has not. It might be possible that the economic policy commission has been giving a study to this, and when Mr. Hecht appears he can give you the information.

The ACTING CHAIRMAN. What is your feeling toward the security affiliates?

Mr. STEPHENSON. I hesitate to give any response, Senator Walcott, for the reason that the economic policy commission sets the policy of the American Bankers' Association and I should hesitate to make a statement that would be at variance with the conclusions of the economic policy commission, arrived at after they have given careful and thorough study.

The ACTING CHAIRMAN. I hope they are doing that because, in connection with other hearings, we find that is a big factor.

Mr. WILLIS. Are they not hampered by the same sort of divergence among the members which you mentioned a while ago which kept the association from taking a position? Does not that operate on the economic policy commission as well as the larger association itself?

Mr. STEPHENSON. I do not think that would prevent the commission from giving it study and arriving at conclusions.

Mr. WILLIS. And its conclusions would be practically those of the association, even without a vote?

Mr. STEPHENSON. I think on those security companies that the economic policy commission could speak for the association after they have given the matter study to a conclusion, because you can

see, from the list of men who are members of the economic policy commission, that we have endeavored to select men representing all phases of banking in the United States, and they come from various communities of this country and they are all names with which you are familiar, as leading bankers and financiers of the United States.

Mr. WILLIS. But that is on the theory that the members of the association would follow the teachings of logic rather than their own interest, and I think what is needed is information as to whether they would do that—whether they have a definite opinion on the subject.

Mr. STEPHENSON. I have no doubt the American Bankers' Association would follow the conclusions arrived at by the economic policy commission.

The ACTING CHAIRMAN. Will you let us know, at your convenience, if they are going to make a study of these affiliates and, if so, when we will hear from them?

Mr. STEPHENSON. When Mr. Traylor appears before the committee, he being a member of that commission, he can give you that information. I understand he is to appear to-day.

The ACTING CHAIRMAN. How do you look upon the loaning of surplus funds by country banks?

Mr. STEPHENSON. Usually the country banks have, in the past, had very little of their surplus funds to loan outside of their communities. They have usually loaned all their surplus funds in their communities and that is one of the troubles they have had when they have had withdrawals of deposits. They have not had such paper as would enable them to get the city correspondent—

The ACTING CHAIRMAN. Do you think a large part of it is due to money getting into call loans?

Mr. STEPHENSON. I do not think a large number of the country banks would know what call money paper was, if you talked about it. The demand for the money in the community has been so large that they have confined their surplus money to use locally.

Mr. WILLIS. Before this committee a couple of years ago, an expert employed by the Federal Reserve Board carefully to study the situation gave it as his opinion that the country banks employed a considerable part of their surplus funds in call loans, and he thought it was unavoidable. Your opinion is different?

Mr. STEPHENSON. We refer to country banks as banks over the country in cities of ten, fifteen, twenty-five, and fifty thousand.

Mr. WILLIS. Let us take those in your community, in Indiana. Do they send much money to New York?

Mr. STEPHENSON. Very little.

Mr. WILLIS. But they do send some?

Mr. STEPHENSON. No; I think that the banks, for instance, in northern Indiana—I think that the money that they have used on the outside has usually gone into the finance companies, because that sort of paper has been such that they could cash in on it any time they wanted to.

Mr. WILLIS. Installment paper?

Mr. STEPHENSON. Yes. There are a number of very successful finance companies out in that section that have used a great deal of the money of those banks. I do not think there was very much money

on call from the cities in northern Indiana, in the locality where I live, or from southern Michigan.

Mr. WILLIS. Did the people in those districts speculate very much just before the panic of 1929?

Mr. STEPHENSON. Yes; considerably. I would say about 10 per cent of the adult population bought securities.

Mr. WILLIS. That is a pretty high percentage. Where did they get their money from?

Mr. STEPHENSON. They borrowed it from various sources, from banks.

Mr. WILLIS. Local banks?

Mr. STEPHENSON. Yes.

Senator NORBECK. And lost all they invested?

Mr. STEPHENSON. No; they usually had sufficient money to buy their stocks outright, and they would borrow the money from the banks to carry the stocks.

Mr. WILLIS. Using the stocks as collateral at the banks?

Mr. STEPHENSON. Yes.

Mr. WILLIS. What margin were the banks asking?

Mr. STEPHENSON. They would not loan over 50 per cent.

Mr. WILLIS. That is, of the current market value of the stock?

Mr. STEPHENSON. Yes.

Mr. WILLIS. So, as the stock went on up they habitually increased the loaning total?

Mr. STEPHENSON. No; they did not usually do that. They would make a loan and if there was an appreciation in the stock, they would sell it and take their profits.

Mr. WILLIS. The reports of the Federal Reserve Board each week show a very large volume of loans protected by securities. They show that for your part of the country as well as others. That must mean that the banks there went very heavily into loans of this kind.

Mr. STEPHENSON. I do not think so; no.

Mr. WILLIS. And yet the figures seem to show about \$7,500,000,000, for the reporting member banks.

Mr. STEPHENSON. I do not think that came from northern Indiana. It probably came more from the cities.

Mr. WILLIS. More, in proportion?

Mr. STEPHENSON. Yes.

Mr. WILLIS. But, as far as we can get the detailed statistics, they seem to come also from the banks in the smaller places. Your idea is that it was kept within reasonable bound?

Mr. STEPHENSON. Yes.

Mr. WILLIS. Was there heavy loaning on real estate?

Mr. STEPHENSON. There was a great deal of money loaned on real estate for the building of homes in our section.

Mr. WILLIS. Was that before the McFadden Act was adopted?

Mr. STEPHENSON. It was done more by State institutions than by national banks.

Mr. WILLIS. What proportion would you say were loans on real estate in the banks in your community now, roughly speaking?

Mr. STEPHENSON. I would say 35 per cent.

Mr. WILLIS. That is, 35 per cent of their entire assets?

Mr. STEPHENSON. Of their entire deposits.

Mr. WILLIS. Both demand and savings?

Mr. STEPHENSON. Yes.

Mr. WILLIS. Does not that put them into a rather nonliquid position?

Mr. STEPHENSON. Well, a number of large life-insurance companies were also loaning in that way and also a number of building and loan associations, so that the life-insurance companies would, as a rule, make a loan on what the bank had loaned on, and if the bank needed the money, they could usually get it from the life-insurance companies.

Mr. WILLIS. What is the usual depreciation on the property that has been loaned on?

Mr. STEPHENSON. It is difficult to say what the depreciation would be for the reason that very little real estate is changing hands, but it is believed in the community from which I come, that when there is a return to normal business, there will be a very small depreciation in the city real estate.

Mr. WILLIS. If you had to liquidate now—

Mr. STEPHENSON. I would not undertake to say what the depreciation would be because where there is a very poor market, comparatively little real estate changes hands and you can not make an estimate.

Mr. WILLIS. Do the banks out there carry very many foreign bonds?

Mr. STEPHENSON. A very small amount.

Mr. WILLIS. Domestic bonds?

Mr. STEPHENSON. They carry quite a large number of domestic bonds.

Mr. WILLIS. A great many public-utility bonds?

Mr. STEPHENSON. Public-utility bonds, municipal bonds, and Government bonds.

Mr. WILLIS. And on the public-utility bonds there is a serious depreciation now?

Mr. STEPHENSON. Yes.

Mr. WILLIS. Has that been written off or has the practice been to carry them at cost?

Mr. STEPHENSON. I think they write off some depreciation every six months.

Mr. WILLIS. Do they amortize the real-estate loans?

Mr. STEPHENSON. Most of them are amortized.

Mr. WILLIS. By the banks?

Mr. STEPHENSON. Yes. The loans are made on the basis of 50 per cent of what it would cost to reproduce the property—not on an appraised value, but what the real estate is worth and what it would cost to reproduce the building; and then they have required that the loss be paid off in sums of 3 per cent of the principal every six months, besides interest.

Mr. WILLIS. Are the building and loan associations there practically in the savings-deposit business?

Mr. STEPHENSON. Yes, sir.

Mr. WILLIS. Is that a bad thing?

Mr. STEPHENSON. I would not want to make any expression on that subject.

Mr. WILLIS. How far has that gone? What is the relative amount of such deposits?

Mr. STEPHENSON. In the community I think that building and loan associations probably have as large a number of savings as the savings banks, trust companies, and national banks.

Mr. WILLIS. What protection have the savers in those associations?

Mr. STEPHENSON. The only protection they have, of course, are mortgages and loans held by the building and loan associations.

Mr. WILLIS. So, if there is a sudden demand for liquidation, is it difficult to settle with them—difficult on the part of the association?

Mr. STEPHENSON. It would be difficult to get the money out of the mortgages unless they should be taken over by some large life-insurance company.

Mr. WILLIS. Is not the thrift saver in this country in a very much worse condition than for some time, in view of the situation you have described? Is he not in a very much less protected position than ever before?

Mr. STEPHENSON. I would not say that. I think upon return of normal business, real estate will come back into its own.

Mr. WILLIS. But in the meantime?

Mr. STEPHENSON. Well, I think—

Mr. WILLIS. In the meantime, ought not something to be done to take care of the small saver in this country? He has lost very heavily from the bank failures, both large and small. He is in the building and loan associations in the way you speak of. The assets behind the savings, under the McFadden Act, have been largely loaned on real estate. Does not that put him in a position where he needs much greater protection, to say nothing of the fact he has only a very small reserve carried behind his deposits?

Mr. STEPHENSON. I can not conceive of any action that would better the condition the saver has in the building and loan associations by national legislation.

Senator NORBECK. What per cent of the value have the building and loan associations advanced in the form of loans?

Mr. STEPHENSON. I understand that they advance about 65 per cent.

Senator NORBECK. Are there any other loaning agencies that will go as high?

Mr. STEPHENSON. They will go higher than any other loaning agencies, but, by reason of the fact the building and loan associations immediately begin to get their money back in installments, they have always been very successful.

Senator NORBECK. In other words, with an amortization plan, the loaning of the larger amount is safer because it starts to come back immediately.

Mr. STEPHENSON. Yes; and there have been no failures of large building and loan associations in Indiana and, from all the information I have, I think they are in very good financial condition and that they will be enabled to weather the depression from which we are emerging and from which we have been emerging since the month of December.



Mr. WILLIS. Do the banks habitually help them out by lending to them?

Mr. STEPHENSON. I think that many of the building and loan associations have put some of their money into securities that are quickly liquid, but most all of the building and loan associations have deposit accounts with the banks, and when they need the money, they can borrow money from the banks for temporary purposes. The banks help them out.

Mr. MEYER. May I ask a question in this connection?

The ACTING CHAIRMAN. Certainly.

Mr. MEYER. You are talking about real-estate loans and loans on securities. Is there a considerable percentage, in your opinion, of loans on real estate, in the form of securities, like real-estate bonds, serial bonds, and so forth, in your territory?

Mr. STEPHENSON. There has been a great deal of money loaned in our territory on securities like S. W. Straus & Co. put out, and some of the banks in our community have made loans on real estate drawing 7 per cent interest, and sold certificates against those mortgages and notes at a lower rate.

Mr. MEYER. Is there any considerable amount of loans on securities in the banks really represented by real-estate securities?

Mr. STEPHENSON. The banks in our section have not made it a practice to buy that sort of loan.

Mr. MEYER. Or to lend on them?

Mr. STEPHENSON. No. Those bonds have been mostly bought by private investors.

The ACTING CHAIRMAN. Have you found any State legislative code governing banking that is, in your opinion, superior to the national act?

Mr. STEPHENSON. No; I have not.

The ACTING CHAIRMAN. How do you regard the lending on securities by national banks? Should that be curbed within reasonable limits?

Mr. STEPHENSON. I think the national banks are justified in lending money on securities as collateral, if the securities are of high grade?

The ACTING CHAIRMAN. How do you account;—in your section of the country, have you not noticed a considerable decline in commercial paper?

Mr. STEPHENSON. Yes, sir.

The ACTING CHAIRMAN. How do you account for that? Is it because they are financed by selling securities?

Mr. STEPHENSON. I think, in our section of the country, one reason is that the corporations have made considerable money and they have been able to finance themselves.

The ACTING CHAIRMAN. By selling securities?

Mr. STEPHENSON. No; from the profits of their business.

The ACTING CHAIRMAN. From earnings?

Mr. STEPHENSON. Yes, sir.

The ACTING CHAIRMAN. The acceptance business. Is that an important business in your section of the country?

Mr. STEPHENSON. No, sir. We have very little of that sort of business.

Mr. WILLIS. You never buy acceptances for your own portfolio?

Mr. STEPHENSON. I have in the past bought bankers' acceptances when we have had a surplus from the National City Bank—

Mr. WILLIS. Are they generally held in that part of the country?

Mr. STEPHENSON. I think the banks buy them when they can obtain a fair rate of interest and when they have surplus funds that they can not lend otherwise.

Mr. WILLIS. You regard that as good use for surplus funds?

Mr. STEPHENSON. I certainly do.

Mr. WILLIS. Better than lending it on call?

Mr. STEPHENSON. Yes, sir.

Mr. WILLIS. Did the association of which you are president take any position for or against the McFadden Act three years ago?

Mr. STEPHENSON. It took one position and then it shifted.

Mr. WILLIS. And its final position was—

Mr. STEPHENSON. Favorable.

Mr. WILLIS. Have you seen fit to alter that at all, or has experience confirmed the impression?

Mr. STEPHENSON. I think they are well satisfied with the McFadden Act.

Mr. WILLIS. Even with the provision for the lending on real estate against savings? That does not seem to them to go too far?

Mr. STEPHENSON. No, sir.

Mr. WILLIS. Has there been any bad experience in regard to investment banking by national banks—buying and issuing securities?

Mr. STEPHENSON. I have not heard of any complaint about it.

Mr. WILLIS. It is entirely satisfactory to yourself and probably to the association as such?

Mr. STEPHENSON. Yes, sir. We have not taken any action.

Mr. WILLIS. But you would have taken action if there had been occasion for it?

Mr. STEPHENSON. I think so. I also want to state at this time that I think the Federal reserve system, as now in operation in the United States, is the most perfect financial system that has ever been devised by any government, and that I would not want to see any radical changes in the laws governing the system that would injure it in any way; but any laws that would strengthen and make the system more useful would be approved by the bankers of America.

I think that the periods that we have passed through since the system came into being have proven conclusively that under any and all conditions the Federal reserve system has stood the test, and it is extremely fortunate that that law was passed creating the Federal reserve system, and it has shown that the men who were responsible for bringing it into existence had thoroughly considered every phase of the practical workings of it, and it has been a very great and conspicuous success. If we had not had the Federal reserve system in operation in 1914 and 1915, the financial structure of America would have gotten into such shape as would have resulted in the closing of practically all banks in the country.

Mr. WILLIS. The Bankers' Association, however, went on record against the Federal reserve act originally.

Mr. STEPHENSON. And I believe the originators should be congratulated from the fact that we have this system in operation to-day.

The ACTING CHAIRMAN. I am sorry that Senator Glass is not here to hear that statement.

Mr. STEPHENSON. Now I will answer your question, Doctor Willis.

Mr. WILLIS. What was the attitude of the American Bankers' Association toward the Federal reserve act when it was first enacted?

Mr. STEPHENSON. My recollection is that the American Bankers' Association was in favor of the central bank advocated by Senator Aldrich in New Orleans in 1911 when we had our convention there.

Mr. WILLIS. Did not they say that the Federal reserve act would be disastrous to the banking system?

Mr. STEPHENSON. I think the association was in favor of the central banking idea presented by Senator Aldrich.

Mr. WILLIS. But that was not passed.

Mr. STEPHENSON. However, the bankers may have felt about the Federal reserve system when it was finally brought into existence by the passage of the law, yet every thinking banker must to-day admit and realize that the men who were responsible for originating the system built better than we knew and have given us a financial system of which America should well be proud, and it has saved us from financial ruin on several occasions.

The ACTING CHAIRMAN. You have confidence that this economic policy commission that you have will earnestly work on those two reports, or on this report?

Mr. STEPHENSON. Yes; I have great confidence in the ability of this commission and I am quite sure they will be very glad to cooperate with this committee in bringing out any constructive ideas.

The ACTING CHAIRMAN. We are very much indebted to you for your frankness and your instructive talk.

Mr. STEPHENSON. I am glad to be here and to have appeared before your committee.

The ACTING CHAIRMAN. This committee will take a recess now until 2.30 this afternoon.

(Whereupon, at 12.15 o'clock p. m., a recess was taken until 2.30 o'clock p. m.)

#### AFTER RECESS

The hearing was resumed at the conclusion of the recess, at 2.30 o'clock p. m., Hon. Carter Glass (chairman) presiding.

The CHAIRMAN. The committee will come to order.

#### **STATEMENT OF MELVIN W. TRAYLOR, CHAIRMAN OF THE BOARD OF DIRECTORS OF THE FIRST NATIONAL BANK OF CHICAGO**

The CHAIRMAN. Mr. Traylor, as you likely know, this committee is conducting an inquiry, under resolution of the Senate, charging us with the duty of investigating the banking situation with a view to proposing such amendments to the Federal reserve banking act or the national banking act as may seem to be required as the result of our inquiry. We have heard from quite a few eastern bankers,

and we have heard from the Pacific coast, and we felt pretty confident, from your banking connections in Chicago, and your familiarity with the Federal reserve banking processes, that you could make a valuable contribution to our inquiry, and we would be very glad to have you make any general statement that you might care to make and any suggestions that you may have that you think would improve either the Federal reserve system or the national banking system.

Mr. TRAYLOR. Mr. Chairman and gentlemen of the committee, I regret very much that I have not had time since I received your invitation to prepare a written statement, which might be more concise and to the point than will otherwise be the case.

Naturally I followed the brief reports of the hearings before your committee with a great deal of interest, and it would not be fair to say that I have not thought about the entire picture; but in my statement I shall necessarily have, more or less, to ramble along and think out loud with you on the situation which challenges the attention of all of us.

Generally speaking, I am convinced that the difficulties which have overtaken the banking business in the United States in the last 10 years have not been those inherent primarily in the banking business itself, in the supervision of that system, or in its management. I think they go very much deeper and involve the determination of questions much more difficult to settle than the mere question of a system of banking, its supervision, or management.

The conditions under which the banks suffer are not unlike those which have overtaken business in general. In a sense, since the greatest difficulties have occurred with the smaller banks in the rural communities, they encountered these economic changes and social changes very much earlier than general business, and these changes were of a character affecting the rural communities which it has and will require very much longer to correct. Recovery will be very much slower.

It may be admitted that, in the period prior to 1920, for 10 or 15 or 20 years, there had been organized banks in communities with capital structures inadequate to withstand periods of depression, but it was believed by those interested—and I believe myself—that at the time and in the circumstances they served a useful purpose. Had there not been a complete collapse of economic values upon which the credits of these small banks were based—livestock, farm products, and farm land—many of them, in fact, most of them, would be functioning to-day and serving a useful purpose. I am not prepared to admit that incompetency and lack of ability and lack of judgment are responsible for the condition that has overtaken these banks, because, as I observed a moment ago, industry as a whole, the wisest managed of corporations, are suffering from exactly the same kind of trouble that overtook the banks, trouble longer delayed and possibly, because of its character, more quickly healed.

But we have the situation and I take it that the purpose we all desire to serve is public welfare. We may disagree as to our method of approach to the problem; we may even disagree as to the causes, but the effects are pretty real and pretty definitely definable. As to

remedies, we may differ, but in the end we all desire to serve the public good, as expressed in human welfare and economic good.

I have read with interest suggestions that have been made as to methods of strengthening our banking structure, perhaps in its physical make-up, its administration and management. I regret that I can not agree with some of my very good friends who have suggested a national system of banks, one system, for the banking facilities of the country. I believe that such a proposal is fraught with more hazard to our political and economic life than any suggestion seriously proposed in my lifetime.

I recognize the tendency of much modern thinking to-day is toward consolidation and federalization of many of our activities. In certain directions that may be excusable. The public good may be best served in that way, for certain activities, but I can not subscribe to the theory that to put the credit facilities of this country completely under the domination and supervision of the Federal Government would, first of all, effect the cure desired, or, secondly, would not lead us into political and economic difficulties which we would have great difficulty in surmounting.

I believe in the independent unit system of banking which this country has always enjoyed. I believe the thing we have to fear most of all is the extent to which, in supposed emergencies, we modify that system. My conviction is that if we were to nationalize—which politically I think is impossible—our banking structure, that the extension of branch banking would be inevitable and that the inevitable development of that system would be, perhaps not in our lifetime, but in due course, a very small number of large units which would control completely the credit facilities of this country, which I think would be extremely unfortunate.

That all banks should be compelled to belong to the Federal reserve system I feel is equally dangerous from the standpoint of our banking, commercial, and economic life. I personally do not believe that the small banks should belong to the Federal reserve system. I am not clear in my own mind as to what the minimum capitalization should be of banks that belong to the system, but I doubt if a bank of less than two hundred and fifty and possibly five hundred thousand dollars capitalization or capital structure should be a member of the Federal reserve system.

The system, as I vision it, is to furnish facilities for discount, elasticity of currency, and to meet the conditions in the ebb and flow of business. In the first place the smaller institutions produce only a limited amount of paper which, in my opinion, should be eligible for discount, as a basis for currency. They have a very distinct place to fill in our financial structure, and they serve a very useful purpose.

They need, at times, more credit than their available paper offers them and, thinking in purely practical terms of the institution with which I happen to be connected, the very practical result is that we loan to a very large number a very considerable sum, of the type of member banks of which I am speaking whose paper is perfectly good. We are delighted to take care of their credit requirements and assist them, and yet they could not and should not, I think, secure that relief from the Federal reserve banks.

If the Federal reserve banks and the national banking system are to serve their largest usefulness, membership either in the national system or in the Federal reserve system must, in my opinion, mean the maximum of safety and security to the depositors in such institutions. We may theorize as we will about bank examinations, supervisions, and management. We know that at best it is difficult to have these operate satisfactorily and the hazard increases as the size of the institution is decreased. To undertake to put all the banking power in the Federal reserve system and include in it all the small banks will not help. Do what we want, we can not prevent banks here and there, and more frequently than we like, from getting into trouble. But if all banks, large and small, belong to the system, it may result in bringing into disrepute that system which should stand as the acme of banking perfection in the country, namely the Federal reserve system.

Whether that is criticism or constructive thought I do not know, but I have one which I should be perfectly willing to give you.

The CHAIRMAN. Right on that point, Mr. Traylor, then I take it you are against the compulsory clause, so called, of the Federal reserve act, which requires a bank holding a Federal charter to be a member of the system?

Mr. TRAYLOR. I think it should be compulsory; I am not objecting to that at all, because I think the strength of the system is preserved by the compulsory feature; but I should rather have the compulsion come from another source, which would be a public demand so strong on the part of the depositing public that no bank attempting to act as a reserve depository for other banks could stay out of the Federal reserve system.

I do not believe that the right of a State bank to withdraw is an inherent weakness in the Federal reserve system, because if the Federal reserve system is continued even in its present enviable position no substantial State bank can afford to stay out of the system.

The CHAIRMAN. Any bank has an inherent right to withdraw.

Mr. TRAYLOR. Yes; a national bank could denationalize and step out. So I do not think that is of importance.

Mr. WILLIS. How do you think it would be if the Comptroller of the Currency or the reserve board had the right, when passing upon a bank's charter, to prescribe whether a bank could or could not become a member of the Federal reserve system?

Mr. TRAYLOR. Without the right to withdraw?

Mr. WILLIS. I beg your pardon?

Mr. TRAYLOR. You would not assume that such an acceptance would preclude it from withdrawing?

Mr. WILLIS. Not from the national system, no; but it would be a situation in which the comptroller might permit the smaller banks to withdraw and remain national banks.

Mr. TRAYLOR. I should favor that, which would allow some control—

The CHAIRMAN. Then you would have a dual system of national banks, with privileges extended to one bank and withheld from another.

Mr. TRAYLOR. Not withheld. If they wanted to accept them, well and good. I think you must make it flexible, of course.

The CHAIRMAN. If you compelled one bank to remain in the system under penalty of forfeiture of charter and permitted another bank to come into the system and not be a member of the Federal reserve system—another bank to be chartered as a national bank and yet remain outside of the Federal reserve—that would be practically a dual system as far as it applied—

Mr. TRAYLOR. To the national banks, yes; and as a practical matter it might not work. The theory I have is that the interest of the small country bank is primarily, and I think inevitably, in the character of practical bank management. A Federal reserve bank or any bank, semigovernmentally controlled—and it ought to be, because any bank of issue should be responsible to the Government and no government could think for a moment of granting such privileges as our Federal banks hold, without holding a hand over their operations—must follow pretty definite, inflexible rules and regulations, and they can not meet the exigencies of a situation as a correspondent bank meets them. We can sit with the board of directors and lend them lots of money, and do many times that which no central banking system could do. It could not afford to do it. Therefore I think the small banks really have no business in the Federal reserve system.

The CHAIRMAN. Could not that be better managed by very materially raising the minimum capital requirement of a national bank?

Mr. TRAYLOR. I was going to come to that.

The CHAIRMAN. And leave the field otherwise to State banks?

Mr. TRAYLOR. I was coming to that in my day dream of an ideal banking structure in view of conditions as they have developed and the trend of the public mind as I think I see it.

I should like to see a system of uniform State banking laws. I am not thinking of what is going to happen. I am thinking of what—

The CHAIRMAN. You would like to see?

Mr. TRAYLOR. Yes; what I would like to see—uniform State banking laws, which would provide, first of all, a minimum capitalization of substantial size, that would grant, at the moment, state-wide branch banking privileges within that territory, but limited for the first five years, or some reasonable period, to the county in which the bank is located, because I do not think, as a practical matter, we know branch banking in this country. I think most of us have as difficult a job as we need at the moment to handle our present business, and I am not willing to spread out too rapidly into the branch banking field. But I would give branch banking facilities within the county in which a bank is domiciled.

The CHAIRMAN. To be ultimately extended to the State?

Mr. TRAYLOR. Yes. I think that is practically more a matter of development than of prime importance.

I should then hope to see an absolute inhibition against any bank operating in the State whose capital was foreign owned, or the operation of a branch of any such foreign-owned bank.

Senator NORBECK. Just what was that last remark, please?

Mr. TRAYLOR. I should also like to see this uniform system of laws provide that no bank could operate in the State if the capital were owned outside of the State and no outside bank could operate a branch in that State; in other words, I would preserve to my State

institutions, the sole right to conduct branch banking, save on the part of national banks, in my State.

The CHAIRMAN. That would apply also as to group and chain banks?

Mr. TRAYLOR. Yes; if it extended beyond the State in which it was chartered. I think there can be no greater danger in this country than to permit the credit facilities of the country to be controlled, Nation-wide, by any agency, corporation, or individual.

The CHAIRMAN. We have a provision in this bill, Mr. Traylor, intended to remedy what some people regard as that evil, in that we do not permit holders of bank stocks in those circumstances, to vote the stock.

Mr. TRAYLOR. The States can reach it more directly by providing that they can not operate a bank whose stock is owned 25 per cent, at least, outside of the State.

The CHAIRMAN. If they reach it at all.

Mr. TRAYLOR. It is about time that the States assert some of their protective sovereign rights in this banking situation. I would provide immediately that national banks should enjoy such branch-banking privileges as are enjoyed by the State banks.

The CHAIRMAN. But you are estopped right there, are you not, by the almost insuperable difficulty of a dual banking system? Could any State constitution prohibit a national bank in one State from controlling another national bank in another State?

Mr. TRAYLOR. I think so. That is a layman's opinion, but I believe they could, but I should hope that there would be some practical sense used in the operation of our banking system and that no ownership of a national bank would want to go into another State and own and organize a bank in opposition to that State's laws. I think there must be some assumption of respect for ethical conduct in banking management.

Carrying that thought further, I am not prepared to say what the minimum capitalization of a banking institution should be under such conditions.

Let us assume that the State of Illinois had such a bill to-day; I am not sure that we could put the minimum capital of a bank in Illinois to-day at \$250,000. Practically any county-seat bank could support a capital structure of \$250,000, and two of them in the county could bank the county thoroughly. Little banks did not just spring up by accident. They met what the citizenship of the county believed, and had a right to believe, was an absolute economic necessity. However, that condition has changed materially and, in the change, lies the answer to the total collapse of real estate values. Community life has shifted and the people are going to the county seats.

Still, there are requirements for banking facilities in places not large enough to support a banking structure with the capital it should have to protect its integrity. I believe if the State banks in Illinois had authority to operate branch banks in their respective counties, we could take care of the banks in Cook County with larger banks. In the down-State counties, we might have a minimum capitalization of \$250,000, but you might have to drop it to \$100,000. That, in my opinion, would be the most practical and effective remedy to the one human element in the equation which is difficult to



handle, namely, management, because management, after all, in the banking business is no different than management in corporate business or any other. It goes without saying that the larger salaries you can pay in the banking management the greater degree of intelligence you can get. That would be one of the strongest features in such a plan, in my opinion.

The CHAIRMAN. Mr. Traylor, what is the practical difference between correspondent banking and branch banking?

Mr. TRAYLOR. You mean as we practice it to-day, and actual branch banking?

The CHAIRMAN. As the larger banks of the country practice it.

Mr. TRAYLOR. I meant the banking fraternity.

The CHAIRMAN. Your bank has perhaps a larger number of correspondent banks than any other bank in the country.

Mr. TRAYLOR. No; I do not think so. The Continental probably do have more correspondents than we have and so have some of the banks in New York City.

The CHAIRMAN. The Continental is Mr. Reynolds's bank?

Mr. TRAYLOR. Yes.

The CHAIRMAN. Of course I know what is the technical difference, but, in effect, what is the practical difference between correspondent banking and branch banking?

Mr. TRAYLOR. Actual supervision of management, capital responsibility, and practically every difference that you could very well think of, I should say.

The CHAIRMAN. I am trying to find what difference you think there is. I do not think there is a great deal myself.

Mr. TRAYLOR. In the first place we have a bank down at Podunk, we will say, which carries its account with us.

The CHAIRMAN. And you are not confined to the State of Illinois by any means.

Mr. TRAYLOR. Anywhere—wherever it may happen to be. We have absolutely, first of all, no responsibility for the capital structure. We have no responsibility for management; no authority for management; we are concerned only, as a very practical proposition, with seeing that such loans as we make to that bank are properly and safely secured, and that is really as far the management of a depository relationship, such as ours to the country banks, can really have. In periods of trouble, we do go down and actually sit with the board of directors and do everything else we can to help them out and sometimes put up money.

My objection to group and chain banking, as distinguished from direct branch banking, is very much of the same character. I do not think a group of banks can be successfully run unless they are run from the head office.

The CHAIRMAN. I agree with you.

Mr. TRAYLOR. I know they will not be successful unless run from the head office. That can best be done without local boards of directors—

Mr. WILLIS. The California branches have been very successful in having local boards of directors, have they not?

Mr. TRAYLOR. They seem to be.

The CHAIRMAN. Why do you think the proponents of the Federal reserve act provided for a withdrawal of the reserves of the individual banks from their correspondent banks and required that they be impounded in a Federal reserve bank?

Mr. TRAYLOR. Well, I have always assumed that it was probably for a dual purpose; first of all, to insure its liquidity and availability as against the hazards that might be implied in maintaining it with the correspondent bank, and, secondly, as a basis, in so far as it was withdrawn in gold—and a great deal of it was—as a basis for providing a currency which would be flexible and responsive.

The CHAIRMAN. Those are material and related reasons, but there was another reason. It was the desire to avert the apparent necessity of draining the interior banks and sending all of the surplus funds, in times of depression, to the money centers resulting in inability to get it back in time of stress.

Mr. TRAYLOR. That was embodied in my word "liquidity."

The CHAIRMAN. In other words, some of us boasted, at the time, that it was an act of liberation for banks that felt that they were required to have a correspondent bank in the larger cities. I suppose you would concede that when you do your various correspondents favors, which you would call service, they would naturally feel some measure of obligation to you, would they not?

Mr. TRAYLOR. Well, Senator, I would say, as a practical benefit, it is 50-50. Our obligation runs to them for carrying their accounts with us and we discharge it when we lend money. The quid pro quo—

The CHAIRMAN. The primary reason they carry that balance with you is because you will loan them money when needed?

Mr. TRAYLOR. Yes.

The CHAIRMAN. Therefore, they are not subservient to you, but under obligation to you. In other words, I am trying to get, in my mind, the distinction between nation-wide correspondent banking and the moderate suggestion of state-wide branch banking.

Mr. TRAYLOR. Senator, I can not see the analogy. One is a voluntary relationship—

The CHAIRMAN. One is a voluntary relationship which, in certain events, becomes obligatory, does it not?

Mr. TRAYLOR. As a matter of decent practice it would, without any question.

The CHAIRMAN. Yes; I would say so. As a matter of reciprocal interest it becomes obligatory.

Mr. TRAYLOR. Yes; I think it is a matter of mutual interest.

The CHAIRMAN. In other words, when you favor a correspondent bank it puts it under obligation to you to keep its account with you?

Mr. TRAYLOR. It is generally started by the opening of the account with us and it follows naturally that we expect to make some money out of that balance, or we do not want it. We do not make much money out of what we lend them.

The CHAIRMAN. That gets me back to one question that has always bothered me very much. I did not know how to correct it at the time we enacted the Federal reserve act, and I do not know that I know how to correct it now. The point is that the local banker disregards the law of supply and demand and maintains what he calls

his standard rate of discount from one year's end to the other. If he has an abundance of credit facilities or of currency, he deposits them with his correspondent bank in a money center at a nominal rate of 2 per cent interest. He never dreams of giving the merchant in his town or a business man of any description, or an industry, the benefit of that superabundance of credit, does he? In other words, he takes what has always seemed to me the very stupid position that if he once demoralizes his standard rate of rediscount, he could never recover, so that the merchant or the business men of any description or the industry of a community never gets the benefit, under the corresponding banking system, of easy credit.

Mr. TRAYLOR. As a small-town banker, Senator—I have been through that, and I think I am prepared to say that—maybe this should not go into the paper, because it does not do any good. It is all right to go into the committee's record.

The CHAIRMAN. I am quite certain the newspaper reporters will not publish anything you ask them not to.

Mr. TRAYLOR. It is perfectly true, as a practical matter, that the hazard of the average credit in the small towns, measured by the volume of business the small banker does, simply compels him to get a very substantial rate of interest to meet the hazard involved in his business. Now, if that small community were served by the branch of a very substantial bank, those in the community entitled, on their risk as credit risks, to a better rate of interest, would undoubtedly get it. There is no question about that.

That, however, is not the fault of the correspondent banking system because, in a measure, the correspondent bank, when the country correspondent wants to borrow, must meet, very substantially, the market rate for the money or your correspondent, whose good will you want to maintain, will transfer to your neighbor. So, in the larger center, the correspondent bank is forced fairly well to meet the competitive-market rate, but in the local market, where there is only the little fellow with a small volume of deposits, and therefore with a limited amount of funds coupled with the inherent credit risks, he has to get a substantial return, and that situation applied to the exchange business of those small banks. Personally, I was glad to see it abolished, but it paralyzed the earnings of these little banks.

The CHAIRMAN. I ought to canonize you. You are the only banker who has ever seemed to be glad of its abolition. I am glad to know that.

Mr. TRAYLOR. We are simply trying to do the best we can for the economic structure and social welfare—

The CHAIRMAN. I know you are, and I am glad to say that, although we may differ as to methods.

Mr. TRAYLOR. The question of pure selfishness, or whether it hurts my business, I hope I will not let interfere with my opinion at any time.

The CHAIRMAN. Have you any specific comments to make on this Senate bill which has been introduced?

Mr. TRAYLOR. Senator, I must confess I have not. Frankly—

The CHAIRMAN. You did not think we were in earnest about it?

Mr. TRAYLOR. Frankly, I have not seen a copy of it.

The CHAIRMAN. Is Chicago now in favor of branch banking in any measure?

Mr. TRAYLOR. Senator, our friends, who rode us so hard, are now its most noted exponents and champions.

The CHAIRMAN. They are?

Mr. TRAYLOR. Yes. I think I can say that without any fear of contradiction.

The CHAIRMAN. They would have saved me 14 months of hard work if they had felt that way at first.

Mr. TRAYLOR. I have some sympathy with you.

The CHAIRMAN. Everyone in Chicago now is in favor of branch banking as set forth in the McFadden Act?

Mr. TRAYLOR. If I was quoted as saying so, they might deny it, but privately I think they are.

The CHAIRMAN. Mr. Traylor, what suggestions have you, if any at all, with respect to these security companies organized in connection with national banks?

Mr. TRAYLOR. Well, I have read the summary of the testimony which has been given here and, in the main, I think I agree with it. I do not think they are wholly to be condemned or that the practice is entirely reprehensible. Quite the contrary. In these days of competition, when every corporation practically has become a bank and every so-called bank has become a competitor for deposit business, and particularly in recent years because of the methods of financing when your customers have become lenders more often than borrowers—

The CHAIRMAN. Do you think every corporation should become a banker or be permitted to be a banker unless chartered regularly for that?

Mr. TRAYLOR. I am afraid I am selfish on that point. I do not think so.

The CHAIRMAN. It is not so much a question of being selfish; it is a question of being right.

Mr. TRAYLOR. That got me off the line of thought I was trying to develop on the security company, so-called. Commercial banking to-day is a very difficult proposition to make money out of and it has all the hazard it always has had. Unless some institution can make substantial earnings beyond reasonable dividends and build up reserves, it had better get out of the banking business.

In the purely banking business, where you accept deposits and make loans, the pickings, in the language of the street, got short and that led to the development of the trust business and security business either through State chartered institutions in the dual set-up that we happen to have, or has led, since the national banking act has been liberalized in regard to trust business, to the establishment of these companies which were expressive of a real need, in my opinion, to bolster up the well-rounded service that a bank ought to render to a community.

Mr. WILLIS. Nearly all the banks of Chicago have them, have they not?

Mr. TRAYLOR. I think nearly all the loop banks. We have one ourselves that has never done anything. We use it to absorb some of our slow paper, taken in reorganizations, and so forth. We do not use it actively.

Mr. WILLIS. Is that the only one you have?

Mr. TRAYLOR. That is the only affiliate of the First National Bank; yes. I think that those suggestions which have been made, that these institutions should be examined and that they should publish statements of their condition, and they should be sharply restricted in the ownership of their own stock, are all in the right direction. They are things that none of us could complain about, and I think should be enforced.

The CHAIRMAN. What is your view, Mr. Traylor, with respect to the use of the rediscount rate to control the speculative market?

Mr. TRAYLOR. I think it is very difficult to do. Frankly, I should like to talk to the committee privately about that.

The CHAIRMAN. Do you think it has ever been successfully done?

Mr. TRAYLOR. I do not think it can be successfully done.

The CHAIRMAN. What is your attitude, may I ask—it is not especially pertinent, perhaps—with respect to the initiation of a discount rate? Do you think, under the act, it is inherent in the banks or the board here in Washington?

Mr. TRAYLOR. As I have read that act—and I have had some little experience with it in recent years—I think it is the duty, and the local banks have the authority, of initiating suggestions with respect to rates and I am perfectly clear, under the act, the board has veto power.

Mr. WILLIS. But you do not think the board has the power to initiate the rates?

Mr. TRAYLOR. No; I do not think so.

Mr. WILLIS. Not in any particular?

Mr. TRAYLOR. No; I do not think so.

Mr. WILLIS. What do you think of the past practice of the board in requiring the reserve banks to report a rate each week so it can refuse it or approve it?

Mr. TRAYLOR. I think that is an admission on the part of the board that they have not the power to initiate it.

The CHAIRMAN. Mr. Traylor, do you or do you not think that the 15-day provision of the Federal reserve act has been used for stock-speculative purposes?

Mr. TRAYLOR. I think I answered that a moment ago when I said I did not believe there was any way of controlling the flow of credit very specifically, and I have no doubt the credit of the Federal reserve system did flow directly or indirectly into the speculative market. That might have happened in this way: When this \$5,000,000 of outside money was going into the market, our deposits were going down. It may have been we were rediscounting perfectly eligible paper to take care of those withdrawn deposits. That part I do not think you can control. I do not think there is any power of reaching them.

The CHAIRMAN. Maybe not, and maybe there is.

Mr. TRAYLOR. Well, not as at present set-up.

The CHAIRMAN. I infer that you will grant that it was never intended by the proponents of the Federal reserve act to make the open-market provision of the act the predominant feature; in other words, it was never intended that the operations under the open-market provisions of the act should literally submerge the rediscount operations of the system?

Mr. TRAYLOR. Or the rates. I think, perfectly frankly, Senator, that the two should be worked together. I should not want to be thought to feel that the entire control should be through the rate structure or the rediscount operation.

The CHAIRMAN. But you should not work one altogether and neglect the other altogether?

Mr. TRAYLOR. I think they should be used in connection with one another.

Mr. WILLIS. And certainly not in opposition one to another?

Mr. TRAYLOR. That is unthinkable.

Mr. WILLIS. No; it is not unthinkable.

Mr. TRAYLOR. I mean in practical operation.

Senator WALCOTT. Thinking back on it, would you have raised the rediscount rate beyond the point it was raised to in 1929?

Mr. TRAYLOR. Well, Senator, it is so easy to confuse hindsight with good judgment.

Senator WALCOTT. Of course that would be hindsight.

Mr. TRAYLOR. No doubt you can think back and say "I would have done thus and so." To be frank, there were people in the country critical because the rate was not raised.

The CHAIRMAN. There was an element at one time in this country very critical about you people in Chicago—because you did not reduce the rate.

Mr. TRAYLOR. They reduced it for us.

Mr. WILLIS. Has there been very much overbuilding in Chicago?

Mr. TRAYLOR. Very considerable.

Mr. WILLIS. Have the banks financed that extensively?

Mr. TRAYLOR. I do not want this answer to go into any of the newspapers.

The CHAIRMAN. That will be understood.

Mr. TRAYLOR. The real estate operations in the Chicago area are financed largely by the so-called outlying banks and not for their own account. They practically immediately sell all the loans they could make largely over the counter. In some instances they had small insurance accounts to whom they sold.

Senator NORBECK. When you say "outlying banks," you mean the banks outside of the loop?

Mr. TRAYLOR. Outside of the loop. We have two groups of banks in Cook County, some inside of the city limits and the others in the outlying districts.

Senator WALCOTT. They are within the county?

Mr. TRAYLOR. Yes, sir. The operation was helpful and was a source of splendid income to those banks, but the habit of protecting the interest and sinking funds on those mortgages grew up, and the practice was continued, namely, that in the attempt to find a market for the mortgages it resulted in the purchasers bringing them back to the bank. What happened was that the banker was letting his customer withdraw his 3 per cent savings account and putting it into 6 per cent mortgages and agreeing to buy them back at a discount of one point. When the condition changed, the banks probably did not act quickly enough.

Mr. WILLIS. And their assets are frozen to that extent?

Mr. TRAYLOR. Yes.

Mr. WILLIS. About what percentage of their assets are so represented?

Mr. TRAYLOR. There has been some difficulty, but, on the whole, if we can convince people, as I firmly believe, that our banking structure is sound and its supervision has been decent and honest and we can restore their confidence, we can save the banking situation, but if we are going to paralyze with fright every depositor, as is unfortunately taking place, the steady seepage of deposits will bring down the good as well as the bad banks.

Mr. WILLIS. Where are these deposits seeping to?

Mr. TRAYLOR. These figures must not be published in the newspapers.

The CHAIRMAN. I am quite sure the newspaper reporters present will respect your wishes.

Mr. TRAYLOR. Here is what happened in Chicago, in 1930: The outlying banks lost \$78,000,000 of savings and the loop banks gained \$58,000,000. Somewhere in the shuffle \$20,000,000 was lost. The outlying bankers I have talked with, estimated fully half of that was used for living expenses and to pay off mortgages, and the other half went into safety deposit boxes.

Senator WALCOTT. Gold?

Mr. TRAYLOR. A lot of it is Federal reserve currency. But the situation in Chicago requires people to sit quiet and not become alarmed.

Mr. WILLIS. Have the banks loaned a great deal on real estate bonds or securities based on mortgages?

Mr. TRAYLOR. Yes.

Mr. WILLIS. Is there anything that should be done in regard to that—for instance, better protection of bonds of that type?

Mr. TRAYLOR. It is just like the stock market boom. We just did things—everybody did—that seem now so utterly foolish we wonder why we did them.

Mr. WILLIS. Well, the time has come to pay the piper. How can we do it?

Mr. TRAYLOR. There is nothing to do but liquidate and clean-up.

Mr. WILLIS. But for the future what would you suggest?

Mr. TRAYLOR. You can set-up all the regulations you want to. You may say, now, "We will let the national banks lend to the extent of 50 per cent of the fair appraised market value." Another boom occurs and we will get appraisals that will move up as the boom continues, and you will find out then, as is perfectly true now, that what was a 50 per cent loan two years ago is now a 100 per cent loan.

Mr. WILLIS. The McFadden Act, which allowed the resources of national banks to be used in making loans, contains no provision as to the percentage of value required?

Mr. TRAYLOR. No; but the past practice is 50 or 60 per cent.

Mr. WILLIS. Should the national act carry a provision as loose as that? Apparently the comptroller has no power to complain of a loan as high as 100 per cent.

Mr. TRAYLOR. Are you sure that the act does not provide that it shall not be more than 50 per cent of the fair market value?

Mr. WILLIS. I do not have the act before me, but certainly in the cases you spoke of—

Mr. TRAYLOR. In those cases, the 50 per cent loans are now 100 per cent loans.

Mr. WILLIS. In the case of loans on bonds, the comptroller can order a mark-down. He does not do that in real-estate loans.

Mr. TRAYLOR. Many of the bonds have gone down so much the banker can not mark them down.

Mr. WILLIS. Ought not national-bank loans of this kind to be amortized?

Mr. TRAYLOR. The better loan policy now is to make no loan except amortized loans.

Mr. WILLIS. Is that true of all banks?

Mr. TRAYLOR. It is growing to be more and more the practice.

Mr. WILLIS. Then there would not be any harm in having that incorporated into the law?

Mr. TRAYLOR. I would favor it 100 per cent. A fellow who does not pay a little each year on his loan will never get out of debt.

The CHAIRMAN. You seem to be rather more optimistic about the effects of this bank examination than anybody we have had yet, not excepting the Comptroller of the Currency. The fact remains that banks have failed—large banks have failed—notably the Bank of Kentucky, which had been repeatedly examined and reported in good condition.

Then, again, according to the Comptroller of the Currency, there have been banks examined by the comptroller, discovered to be regularly engaged in irregular practices, and unsound banking practices not, however, textually prohibited by law. To deal with a situation of that sort, the comptroller suggests that there should be some flexibility in the penalties prescribed. As a matter of fact, the only penalty prescribed is to close up the bank. The comptroller thinks some lesser penalty should be provided, such as the suspension, by the comptroller, of bank officials who persist in engaging in, if not actually illicit practices, practices that tend to destroy the integrity of the bank and bring about its failure ultimately.

What would you say as to that?

Mr. TRAYLOR. Senator, I should dislike very much to see that arbitrary power of removal lodged with any official. I can envisage circumstances where it might be a salutary remedy, but I am afraid that, inherent in it, is the germ of more evil than good that would be accomplished.

The CHAIRMAN. We can point to circumstances where this thing has gone on from month to month and year to year, eventually involving hundreds and thousands of people in losses by reason of bank failure.

Mr. TRAYLOR. I know that and am fully aware of it.

The CHAIRMAN. What remedy would you propose? Just let it go on?

Mr. TRAYLOR. No, sir. I think, in the first place, there are a lot of remedies other than closing the bank, under the present law.

The CHAIRMAN. Let us have them. What are your suggestions?

Mr. TRAYLOR. I got into the banking business by taking over an insolvent bank in 1907, and certainly the then comptroller found more ways of harassing me and my directors, than I thought existed, and he got plenty of action, fortunately. If here and there



there has been a failure on the part of a supervisory staff to be as forceful as they might have been, I do not think—I am sure you would not want to condemn the system for that reason.

I believe that the right of refusal to certify a national bank as a depositor for public funds, so far as it applies to the Government; that the right of calling the board of directors together and telling them as a practical matter if a certain thing is not done the comptroller is going to slap an assessment on the directors or their stock, and any one of a dozen things that he could do, which I know he did to me, would get results.

The CHAIRMAN. There are hundreds of national banks not certified as depositories of national funds.

Mr. TRAYLOR. It can be if it wants to be and meets all the conditions. I think any bank is eligible if it puts up the collateral.

The CHAIRMAN. To be a fixed depository of public funds?

Mr. TRAYLOR. Yes.

The CHAIRMAN. I do not think so.

Mr. TRAYLOR. Since the sale of Government securities, you know, we have offsetting depository accounts. I am not sure that went down to the very small banks, but I think it did.

The CHAIRMAN. I know perfectly well that I have had as the Secretary of the Treasury to refuse over and over again to designate a given national bank as a depository of national funds.

Mr. WILLIS. It is discretionary with the Secretary of the Treasury.

The CHAIRMAN. It does not necessarily follow that if a bank is not designated as a public depository of funds it is an unsound bank, because there are plenty of national banks not so designated.

Mr. TRAYLOR. Oh, no.

The CHAIRMAN. Now, what other mild punishment would you suggest for a bank that is engaging in irregular practices which might ultimately lead to failure?

Mr. TRAYLOR. Well, of course, it is inconceivable, from my practical experience, if you call a board of directors together and pointed out what was going on, that any one man can dominate the board of directors.

The CHAIRMAN. The Comptroller of the Currency tells us he did point out to the Louisville bank, for instance, over and over again, that it was engaging in unsound banking; and also in this Union National Bank in Tennessee, that it was pursuing a course that would lead it into trouble; yet they went right on.

Mr. TRAYLOR. Have you not now the right to suspend membership in the Federal reserve system?

The CHAIRMAN. Yes. The Federal reserve banking board has the right to do that; yes; but do you know of an instance in which they have done it?

Mr. TRAYLOR. I think the 60 days' notice, "Unless you do reform, your membership in the system will be canceled," would be effective.

The CHAIRMAN. If they would administer the matter; yes. You say there is no fault with the administration. I think there has been grievous fault with the administration.

Mr. TRAYLOR. I did not say there was no fault with the administration, but I think if here and there there has been a fault in ad-

ministration or management, we should not condemn the system as a whole or excite the public mind as a whole, either against the administration of the system or the management.

The CHAIRMAN. If there were a failure here and there, that might be so; but there have been a great many failures.

Mr. TRAYLOR. There has been testimony before the committee, unfavorable or disparaging let us say, toward State banks in connection with the number of bank failures. It happens, of course, there are some four times as many State banks as national banks, and if we take the record of membership failures in the Federal reserve system the figures would be the other way and the predominant number of failures among the member banks has been among the national banks.

The CHAIRMAN. That is because of the predominant number of members are national banks.

Mr. TRAYLOR. Certainly.

The CHAIRMAN. I thought in the very beginning of your testimony you pointed to the weakness of the State system, applying in some measure also to the national system, in this thing of chartering pawnshops and calling them banks; that is to say, the minimum capital is entirely too low to be of any real service.

Mr. TRAYLOR. In view of recent developments, that is true; but had there been no economic setback, those institutions would be functioning without difficulty.

Senator NORBECK. In other words, you think we should take 50 years of experience instead of 10 years in arriving at a conclusion?

Mr. TRAYLOR. Yes; and we should take into consideration the changed economic and social situation. We have simply changed our mode of living. Our community life has disappeared, and we are concentrating in the larger places.

Senator NORBECK. How old is our State banking system?

Mr. TRAYLOR. It has been in existence as long as we have had a banking system, practically. In the early days the profit in the banking business was in the circulation, and when in 1862 the national bank act was passed and there was placed a 10 per cent tax on circulation, the State banking systems lost heavily.

Senator NORBECK. How old is our experience in branch banking? Is it not rather modern?

Mr. TRAYLOR. Not over 8 or 10 years, I should say.

Senator NORBECK. You feel that is not long enough to determine the relative merits of the system?

Mr. TRAYLOR. Well, I think the test that that particular experiment has gone through in the last two years is pretty conclusive evidence that, if properly managed, the system is sound. It gets back to the degree of sanity in management within the system.

Senator WALCOTT. That is true of every system, is it not?

Mr. TRAYLOR. Yes.

Mr. WILLIS. How is the Federal advisory council functioning? Is it going on successfully, or would you change its composition?

Mr. TRAYLOR. It might be embarrassing to answer directly, if I say it is successful, because I have had the pleasure of serving on it.

The CHAIRMAN. They must have taken your advice?

Mr. TRAYLOR. I do think it has served a useful purpose. I do not know of anything we can constructively do. We are free with our

advice and suggestions to the board, which have been received most cordially.

Mr. WILLIS. Has the board followed your opinions pretty generally?

Mr. TRAYLOR. At times we have not felt so. I think the majority of the council opinion has been rather critical of what some feel is an unwarrantably cheap money market. I do not quite subscribe to that. I have doubts if the present money market has been artificially influenced.

Mr. WILLIS. On the whole, you see no reason for making any decided changes in the structure or functions of the advisory council? If you were remaking the act, you would leave it as it is?

Mr. TRAYLOR. I doubt if you could endow it with greater power than it has and yet maintain the integrity of the board.

Mr. WILLIS. Is not that changing the question? Is not the real question whether, if there is a change in the board's power, the council's power should be simultaneously changed?

Mr. TRAYLOR. I doubt if there is any change necessary.

Mr. WILLIS. Have you any official connection with the Bank for International Settlements?

Mr. TRAYLOR. None at all.

Mr. WILLIS. But you have followed its developments?

Mr. TRAYLOR. Yes.

The CHAIRMAN. How could he have any official connection with it when the Secretary of State says he shall not have?

Mr. WILLIS. What do you think of the present relationship between the Federal reserve system and foreign central banks? Is the present way of determining that relationship and dealing with it generally satisfactory?

Mr. TRAYLOR. I think it is sound. As I said a moment ago, none of us can, for a moment, contemplate a central banking structure with the tremendous responsibilities and powers that are inherent in its structure, without thinking of its direct responsiveness to governmental authority. It ought to be.

Mr. WILLIS. It is not, at the present time, very responsive to the board; that is, the relationship between the reserve system and foreign banks is not closely supervised by the board or your council?

Mr. TRAYLOR. While I believe the Government should have the right, at any time, to put pressure on or veto, I think, as a practical matter of operation, it should keep as far away from the detail of management of central banking as possible.

The CHAIRMAN. Do you think Chicago should?

Mr. TRAYLOR. Just let me finish with the answer. Mr. Willis asked me the question, as I understood it, whether the board had proper supervision over the Federal reserve banks and foreign bank relationships.

Mr. WILLIS. Yes.

Mr. TRAYLOR. I do not believe they have had supervision, but, as I understand it, the relationship can not be established in the first instance without approval of the Federal Reserve Board.

Mr. WILLIS. According to the general understanding, and to some extent from evidence offered in inquiries other than this one, arrangements have been made between foreign banks and reserve banks

of which the board knew nothing whatever. Should not all relations be reported to the board, and by it to Congress in its annual report? It has been stated that credits have been opened by some reserve banks in favor of foreign banks before the propriety and legal status of those accounts have been adjusted. It seems to me that those things should be reported to Congress. Should they not be?

Mr. TRAYLOR. I think they should be a matter of knowledge on the part of the board.

The CHAIRMAN. I think they should be reported to the board, but I do not think Congress would understand them if they were reported to Congress.

Mr. TRAYLOR. I was going to say it is a doubtful phrase—I was captivated by the phrase “open covenants, openly arrived at,” but experience has taught me the opposite. There are things in this matter of foreign relationships that should not be withheld from the board, but as a matter of public information should not be published.

Mr. WILLIS. Are not those matters that the board should participate in?

Mr. TRAYLOR. I am not sure, under the act, whether they have the right or not, and I am not sure whether it is always advisable to deal with a board. If you had one individual who was governor of the board and had one deputy, you might be able to do it, but to sit around a table with 6 or 8 men and get the decision on a question of great moment, which is, after all, a pure banking function—

The CHAIRMAN. I am sure, under the act, a bank has no right whatever to indulge in such things without the authority of the board, and the character of the supervision of the bank was reflected in the fact that when the head of a certain foreign bank came over here, the Federal Reserve Board only met him socially by invitation of the governor of the Federal Reserve Bank of New York.

Mr. WILLIS. Will you indicate the procedure that should be followed in establishing relations with foreign banks, with reference to reporting to the board, and so forth, and dealing with it in its larger aspects?

Mr. TRAYLOR. I thought I had answered that substantially by saying that I thought the present practice of requiring the assent of the board to any establishment of relationships with a foreign bank, was sound. Now, as a matter of supervision beyond that point, I frankly have not thought enough about it and am not familiar enough with the law, to express an opinion.

Mr. WILLIS. Some one must take the initiative in starting the relationships. Who does that?

Mr. TRAYLOR. Any Federal reserve bank that wants to establish an account with the bank for international settlements—

Mr. WILLIS. Has anyone done that?

Mr. TRAYLOR. I do not know, but it has been my understanding that they could do so. I think the Chicago bank carries an account with the Bank of England.

Mr. WILLIS. You would not give that power to any one bank above all others, to take the initiative in the establishment of foreign relationships?

Mr. TRAYLOR. I should think, as a matter of efficiency of operation, it would be very much better, in the majority of cases, if the

banks would join in appointing the Federal Reserve Bank of New York as their agent to handle their foreign affairs and participate in the foreign relationships, through one bank.

The CHAIRMAN. Subject, as the law requires, to such rules and regulations as the Federal Reserve Board may make.

Mr. TRAYLOR. I think that would be a practical matter.

Mr. WILLIS. The results of those relationships should be reported to the board?

Mr. TRAYLOR. Yes.

Senator WALCOTT. You are a member of the Economic Policy Commission of the American Bankers' Association that is making some studies?

Mr. TRAYLOR. Yes.

Senator WALCOTT. When do you think that the studies that you are making now will be ready for publication?

Mr. TRAYLOR. I am afraid I am derelict in my attention to those matters. I have a wire from Mr. Hecht calling a meeting in New York very shortly.

The CHAIRMAN. We are very greatly indebted to you, Mr. Traylor. You have been both interesting and enlightening, and notwithstanding you have disagreed with me somewhat.

Mr. TRAYLOR. I am sorry. I am probably wrong.

(Whereupon, at 4 o'clock p. m., the committee adjourned until to-morrow, Tuesday, February 17, 1931, at 10.30 o'clock a. m.)



# OPERATION OF THE NATIONAL AND FEDERAL RESERVE BANKING SYSTEMS

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TUESDAY, FEBRUARY 17, 1931

UNITED STATES SENATE,  
COMMITTEE ON BANKING AND CURRENCY,  
*Washington, D. C.*

The subcommittee met, pursuant to adjournment, at 10.30 o'clock a. m., Hon. Carter Glass (chairman) presiding.

## STATEMENT OF OSCAR WELLS, CHAIRMAN OF THE BOARD, FIRST NATIONAL BANK, BIRMINGHAM, ALA..

The CHAIRMAN. Mr. Wells, we are engaged here, as a subcommittee of the Banking and Currency Committee of the Senate, in making an inquiry into the banking situation of the country from all conceivable aspects, and we have had bankers from the East and Middle West and Pacific coast, and we have felt that you might be willing to make a statement for us and give us some constructive suggestions as to what might be done, if anything be required, to so modify the Federal reserve act and/or the national banking act as to strengthen the two systems and avert a recurrence of the unhappy condition that we have now.

We shall be glad to have you make any general statement you may care to make, after which we may take the privilege of asking you some questions.

First, you are head of the bank at Birmingham.

Mr. WELLS. Yes, sir. I have the title of chairman of the board of the First National Bank. I have no statement to make because I had no idea of the scope of the inquiry. I had supposed that might be developed by the questions. I had expected to get some written communication from the committee indicating the nature of the inquiry more clearly, but I did not get it before I left home. I came in response to a telegraphic invitation. I have no prepared statement.

The CHAIRMAN. We have been discussing here all of the outstanding phases of banking. You were formerly connected with the reserve system itself, were you not?

Mr. WELLS. I was governor of the Federal Reserve Bank of Dallas for a short time; at the beginning of the operation of the bank.

The CHAIRMAN. Well, you have followed the development of the system and its practices, have you not?

Mr. WELLS. Yes; I think so—as fairly well as the average member. I have been on the Federal Advisory Council in the last few

years. I am still a director in the Federal Reserve Bank of Atlanta, the Birmingham branch.

The CHAIRMAN. How has the system operated in the Southern States?

Mr. WELLS. I think it has operated fairly well. We are somewhat remote from many of these operations with which you gentlemen have been dealing, if I may judge from the newspaper reports of the investigation.

The CHAIRMAN. You mean the stock-market operations?

Mr. WELLS. Yes; and the general handling of securities and open-market operations.

The CHAIRMAN. The security affiliates and things of that sort?

Mr. WELLS. We have some security affiliates. A great many banks of the South have a security company, developed in the last few years.

The CHAIRMAN. What is your view of that particular phase of banking in connection with national banks?

Mr. WELLS. You mean as to whether they should be restricted or regulated?

The CHAIRMAN. Or abolished.

Mr. WELLS. I am rather inclined to the opinion that they properly belong in the development of banking. Of course I do not think they should be abused in any way or be made evasive.

The CHAIRMAN. If the system is continued, what do you think should be done with respect to examination and publicity of statements, and so forth?

Mr. WELLS. I should think that they should be subject to examination and periodically should make a statement so that the public may know the kind and character of their assets.

They are little more than distributing companies, as we know them; that is, they sometimes handle original issues and otherwise distribute bonds to customers of the bank and customers of the security company.

The CHAIRMAN. At one time there was a great deal of opposition in some of the Southern States, due, as some of us conceived, to extraordinary misrepresentations of the system, toward the Federal reserve system. Do you discover much opposition now?

Mr. WELLS. You mean particularly growing out of the par collection efforts?

The CHAIRMAN. Yes, the par collection efforts, and out of the stupid misrepresentations of politicians as to the Federal reserve system's having deflated the country, and all that sort of thing.

Mr. WELLS. Well, I think that might be found in any part of the country where we have a great many banks not members of the Federal reserve system. It is probably natural for them to have a prejudice against its operations.

There was considerable prejudice against the Federal reserve system, charging it with deflation methods. Of course I know that was grossly exaggerated and grossly misrepresented. But there was a belief that the agricultural interests suffered most and our country being an agricultural country essentially, I think that feeling did exist.



The CHAIRMAN. Agriculture suffered, but it would have suffered infinitely more than it did suffer if it were not for the Federal reserve system.

Mr. WELLS. I heartily agree with that view, and yet it was perhaps natural for those who were seeking to find an excuse for the deflation or a reason for it, to blame it on whatever cause they thought might be held responsible.

The CHAIRMAN. Do you find still much opposition to the par collection system?

Mr. WELLS. No; I do not think so; although I imagine if any effort was made to coerce the State banks now charging exchange, into handling items at par, we would find the same opposition as existed before. They think that is an encroachment upon their natural rights.

The CHAIRMAN. They do not think charging exchange is an encroachment upon the individual?

Mr. WELLS. I doubt if the bank guilty of that practice would admit that it was encroaching upon the right of the individual.

Senator TOWNSEND. What is your opinion?

Mr. WELLS. Well, I am of the opinion that there is some justification for exchange charges in certain remote sections of the country. There is no doubt that the operations of the Federal reserve system have rendered domestic exchange very much cheaper; made it cheaper and more available, and I think the commerce of the country is entitled to that advantage.

The CHAIRMAN. Has it not saved the commerce of the country approximately \$200,000,000 a year?

Mr. WELLS. I am not familiar with the figures, but undoubtedly through the operation of the gold-settlement fund it has made the transfer of funds from one section of the country to another very much more easy and quicker and therefore at a natural cheapening of the cost. However, par clearances were gradually being worked out of the picture even before the Federal reserve system undertook to carry it a little further.

The CHAIRMAN. A little further? Do you think that is an accurate description?

Mr. WELLS. Of course, the member banks—it was incumbent upon them as soon as the system became operative, and then it undertook to carry it to the State banks or, rather, nonmember banks. I think that was a mistake.

The CHAIRMAN. Well, as we have no suggestion from any source either to abolish or modify that system, perhaps I am taking up time that might better be devoted to some other aspects.

Mr. WILLIS. May I ask whether the present system of deferred debit and credit has been satisfactory—the idea of deferring the time of giving credits under the par collection system?

Mr. WELLS. I do not think you can do anything else unless you load the entire float on the Federal reserve banks, which would be a mistake.

Mr. WILLIS. It has been proposed in certain quarters to have that float carried in that way.

Mr. WELLS. That would certainly be disturbing to any sound handling of reserves.

Mr. WILLIS. Has experience confirmed that view?

Mr. WELLS. Oh, there is no doubt about that in my mind.

The CHAIRMAN. Has there been a disproportionate number of failures among southern banks as contrasted with banks in other sections of the country?

Mr. WELLS. I rather think there has been.

The CHAIRMAN. Why?

Mr. WELLS. I think that is primarily true, due to the fact that a great many southern banks in the agricultural sections especially, had relied solely upon seasonal liquidation for liquidness among their assets; and when that fell down this last year they were not able to go on.

The CHAIRMAN. On account of the drought?

Mr. WELLS. Well, drought and the entire set of circumstances surrounding the production and marketing of cotton, which was sold, of course, very much lower than the amount of money invested in the crop by the producer, plus the carry-over of other years.

The CHAIRMAN. Are many of the southern banks loaded with cotton paper?

Mr. WELLS. Well, you would have to differentiate between cotton paper and paper arising from loans made by banks to cotton farmers. Many are loaded with credits growing out of the production of cotton, and I suppose you might in a sense call it cotton paper—ordinary farm mortgages covering crops and livestock. That is the usual method of extending credit to farmers producing cotton in the South.

The CHAIRMAN. We have been told that there has been excessive speculation in real estate in certain sections of the West and Northwest. Has anything of that sort prevailed in your section of the country?

Mr. WELLS. We are not entirely free from that. I think that always happens during a period of prosperity. I can not say that we have had so much of an excess in speculation, but we have had a condition arise in which there is no market for real estate or real estate paper, or a market for mortgages, and, as a result, we have an inordinate amount of slow paper in the banks.

Under normal conditions, even substantial equities in real estate furnish some basis of credit. But take the market away from real estate and naturally the people who have their substance invested in real estate can not convert it into something with which to pay the bank.

Mr. WILLIS. Are those loans made under the provisions of the McFadden Act?

Mr. WELLS. The national banks make very few loans under the provisions of the McFadden Act. I do not mean actual loans on real estate, because all banks acquire some loans on real estate for debts previously contracted, but credits resting upon real-estate values and not necessarily loans on real estate.

Mr. WILLIS. Direct loans on real estate as permitted by the McFadden bill have not been largely made in the South by national banks?

Mr. WELLS. I do not think so.

Mr. WILLIS. What is the character of the loans?

Mr. WELLS. Why, men interested in real estate borrow money from the banks.

Mr. WILLIS. On their unsecured notes?

Mr. WELLS. Yes.

Mr. WILLIS. And those loans are practically loans made to sustain their operations in real estate?

Mr. WELLS. Oh; yes; or it might be to cover anticipated revenues from other channels which have not materialized.

Mr. WILLIS. Is there a large volume of savings deposits in your banks?

Mr. WELLS. We have a larger volume than most banks because we are located in an industrial community.

Mr. WILLIS. How are those used?

Mr. WELLS. They go into the common pot.

Mr. WILLIS. With the regular commercial funds of the bank?

Mr. WELLS. Yes.

Mr. WILLIS. You have never segregated them?

Mr. WELLS. No, sir.

Mr. WILLIS. You have never loaned any considerable portion of those deposits on real estate?

Mr. WELLS. No.

Mr. WILLIS. Have other banks done so?

Mr. WELLS. I do not think so.

Mr. WILLIS. What is the practice of the State banks?

Mr. WELLS. The same as ours. They simply conduct a department of savings and they lend out the money from a common fund.

Mr. WILLIS. Where is the market for real-estate mortgages in Alabama and adjacent States?

Mr. WELLS. I suspect most of them find their way into insurance companies and mortgage companies outside. Of course, some of them go into local companies. We have a great many building and loan associations which absorb a certain amount of real-estate loans.

Mr. WILLIS. Have your building and loan associations followed the practice of other associations in some other States of becoming practically depositories for savings accounts?

Mr. WELLS. Yes.

Mr. WILLIS. And do the banks finance those building and loan associations extensively?

Mr. WELLS. As a rule they rarely borrow from the commercial banks, but lately they have been financed by the banks, when they began to be called upon to pay against withdrawals. They borrowed for a while, and then they resorted to the law in Alabama which allows them to give notice to the depositor and then let him take his place in line and withdraw out of a portion of the receipts of the building and loan association as his turn comes.

Mr. WILLIS. Does this savings situation in general seem a safe one? I do not mean specifically operations under the McFadden law or the national banking act, but taking the entire situation as to savings. Do you think it calls for any rectification in order to protect savers better?

Mr. WELLS. You mean as to directing the manner in which the savings deposits should be invested?

Mr. WILLIS. Or directing that only certain institutions, well supervised, should carry savings?

Mr. WELLS. Doctor Willis, I do not think there is anything in our section which would indicate that the State and national banks are not qualified to take savings accounts. Of course, if they are not well supervised they are not qualified to take any deposits.

Mr. WILLIS. There have been a great many failures in the last few years.

Mr. WELLS. I do not believe the failures in our section are due to any improper use of savings accounts. The average southern bank in the South has comparatively little in savings accounts. The city banks have taken on more and more.

Mr. WILLIS. But is it not a situation that calls for a much more careful protection of savings depositors than exists at the present time? The savings depositors, at the moment, are very much dissatisfied.

Mr. WELLS. Is not that due to the characteristic of the savings depositor rather than any abuse?

Mr. WILLIS. His characteristics are like those of other people, in that he does not like to lose money.

Mr. WELLS. Of course, he does not, and neither does the commercial depositors, but in many instances savings depositors have become alarmed and have done damage where it was not necessary. A number of banks have closed, due to the unrest in the public mind due to the multiplicity of bank failures. But that is a natural by-product of present-day conditions. I do not believe you can pass a law giving protection against that.

Mr. WILLIS. We have had recommendations from various sources; first, that the savings accounts, and assets behind savings be segregated; second, that the reserve against savings be raised to the same reserve as is required against demand deposits.

Mr. WELLS. Either one of those would either drive the rate down or make the handling of savings by commercial banks unprofitable.

Mr. WILLIS. Would it be any protection to the savings depositors?

Mr. WELLS. I can not help but feel that the need for protection is, as I see conditions in our own section, not sufficient to impose that burden upon the banks, thereby withdrawing from ordinary commercial uses the proceeds of savings deposits.

Mr. WILLIS. You think there is no change needed, then?

Mr. WELLS. There is no change necessary to segregate or give extra protection to savings deposits.

The CHAIRMAN. Is it not a fact that demand deposits have been transferred to the savings accounts, or vice versa, in order to avail of the low reserves behind the savings deposits?

Mr. WELLS. You mean that the bank itself has undertaken to switch from the commercial accounts to savings accounts in order to enjoy the low reserve?

The CHAIRMAN. Yes.

Mr. WELLS. I do not believe so, Senator Glass. I have never been familiar with any practice of that kind because it would be an unprofitable switch for the average commercial bank to ask his demand depositor—in most cases a noninterest-bearing depositor—to put his money into the savings department, where interest is paid, in order to get the advantage of the lower reserve.

The CHAIRMAN. You think there should be no readjustment of the reserve? The general testimony that we have had is that that 3 per cent reserve is inadequate and that there has been considerable testimony here to the effect that there has been a manipulation of the accounts just in the way I have indicated in order to avail of the 3 per cent reserve.

Mr. WELLS. I am not familiar with that, and I have never known of such cases. I have no zeal for trying to prevent some readjustment of the reserve requirements. Of course we are in a reserve city where the requirements are a little higher than outside of the reserve cities, but I doubt if there has been a sufficient abuse of the manipulation of savings accounts to warrant a revision of the reserve requirements which would put a larger burden upon the banks, or, as a consequence, take it away from the depositor who gets interest on his savings accounts.

The CHAIRMAN. Are there many security affiliates in your section of the country?

Mr. WELLS. Oh, I should say there are a half dozen banks in Alabama that have companies handling securities.

The CHAIRMAN. Do you think these should be examined under some general system and publicity given to their statements?

Mr. WELLS. I am inclined to think there should be. I think there is no more reason why the public should not know about a security company's assets, kind and character, than it does about the bank and particularly if there is any likelihood of there being an abuse in the relations between the bank and the securities company or the securities company being used to evade the operations of the bank under the law. In such companies as I am familiar with, the securities company simply handles securities—has a fund with which to purchase and handle local securities, but it has been done advantageously.

Mr. WILLIS. They are used to bring out new securities?

Mr. WELLS. Yes. There have been no abuses, as far as I know of, by the affiliate of a bank.

The CHAIRMAN. Have any large security affiliated companies, outside of Alabama, branches in Alabama?

Mr. WELLS. Yes; there are various concerns in New York which have nation-wide branches, operating in Birmingham. The National City Co. has an office there and has had for years, and I think the Chase Securities Co. has an office there. But they are distributing offices.

The CHAIRMAN. What have you to say about the problem of branch banking? We have had various suggestions along that line—one by the Comptroller of the Currency—to have branch banking for designated trade areas.

Mr. WELLS. Senator Glass, I am rather in favor of the development of independent banks rather than the development of branch banks, but I recognize that that is not an answer to present conditions. The American Bankers Association has also come to that recognition as at the last convention. I realize the conflict of interest that has arisen by the development of branch banking in some States, and by the development of group banking in others.

The CHAIRMAN. Which do you prefer?

Mr. WELLS. I think that most group bankers will admit that they think that branch banking is desirable as against group banking.

The CHAIRMAN. And they engage in group banking because—

Mr. WELLS. Because they have no facilities for developing branch banking, although there have been some instances where group banking has been undertaken on a large scale where branch banking, in part at least, has been in practice, such as in Detroit.

The CHAIRMAN. Should we adopt a system of branch banking, do you think it should be confined to the State; that is, should we have state-wide branch banking?

Mr. WELLS. I am not yet in favor of saying we should have state-wide branch banking, but at any rate I do not think we should go beyond that. In saying that I have particular regard for the status of the State-chartered banks.

The CHAIRMAN. Would you mind saying how many correspondent banks your bank has?

Mr. WELLS. I would not mind saying, but I am quite sure I could not give the number. We have a relatively small trade area. Our business is confined more particularly to the industrial district. But we have several hundred banks in Alabama and on the edge of Mississippi doing business with the banks of Birmingham and with our bank. Our total deposits from banks range from three and a half to six million dollars out of a total of forty-five to fifty-five millions. So, you see, we have not a very large volume of business from the banks.

The CHAIRMAN. Did your section of the country or of the South generally make much of a contribution to the fever of stock speculation in 1928 and 1929?

Mr. WELLS. I hardly know how to compare it. I imagine we compare favorably with other cities of our size.

The CHAIRMAN. Would you not like rather to say "unfavorably"?

Mr. WELLS. I know very few people whose affairs at the bank were greatly affected by their operations in the stock market, but still, I imagine there were a great many small operators who perhaps would be better off if they had not engaged in that speculation.

The CHAIRMAN. You do not think the breakdown of the stock market had much effect on the South?

Mr. WELLS. Oh, yes; I think it had considerable effect. I think any reversal of values, or anything which causes depreciation in values, has its effect upon financial operations of all kinds.

The CHAIRMAN. Would you venture to suggest to us how we could more effectively, than under existing law, prevent the use of the facilities of the Federal reserve banks, for the purpose of speculation?

Mr. WELLS. I seriously doubt, Senator Glass, whether it would be possible to write into the law a provision which would prevent the use of the credit of the Federal reserve banks for speculative purposes. You might properly safeguard the extent of the use of Federal reserve credit by banks supporting speculative credits. Of course, you probably have the machinery for doing that now.

The CHAIRMAN. If the law should be observed.

Mr. WELLS. If it is a matter of observation, then it is not a question of amending the law.

The CHAIRMAN. No. I say if the law should be observed.

Mr. WELLS. I was rather of the opinion that the moral force of the Federal reserve system in 1928 did have a deterrent effect. It did not stop speculation. I grant you that. But I think it made banks more careful about the extent to which they loaned funds for speculative purposes while they were borrowing money at the Federal reserve banks.

Mr. WILLIS. Was there much borrowing of that kind in your district?

Mr. WELLS. Not much.

Mr. WILLIS. There were no banks in your district that went to the reserve bank to borrow for the purpose of relending for use in the stock market?

Mr. WELLS. I do not think any bank that has any proper conception of good banking would do that.

Mr. WILLIS. But there was some of that in New York.

Mr. WELLS. I do not know. I observe that many banks have stated publicly at intervals that they have not been in the reserve bank for many months, referring to a lack of the use of Federal reserve credit for speculation.

The CHAIRMAN. Yes; but some banks openly avowed they intended to go into the reserve bank, even to the extent of \$25,000,000, and lend the proceeds for use in the stock market.

Mr. WELLS. I heard that statement, but I understood it was a regulatory matter intended to be beneficial to the general stock situation. What I had in mind was the case of a bank that might do so for the purpose of making the difference between the cost of the money borrowed and the returns from the money loaned—if they did it selfishly. Conditions may arise that might justify a bank in undertaking to steady credit conditions in its locality, and where it might be justified in using the facilities of the Federal reserve bank.

The CHAIRMAN. You think no such condition as that came up in your Federal reserve district?

Mr. WELLS. As far as I know, there was none.

The CHAIRMAN. There was not much sending of money to New York for use in the call market?

Mr. WELLS. There was not a great deal, but there were banks that did do that. I am not willing to say some Southern banks did not lend money on the call market, but I do not believe they were at the time borrowers at the Federal reserve bank.

The CHAIRMAN. Were they large lenders in New York—the banks that did not discount at the Federal reserve bank?

Mr. WELLS. I think the funds so used were small in proportion to the volume of call loans. I think quite frequently banks have seasonally used their money in call loans.

The CHAIRMAN. It has been my understanding that just before the panic in 1929, when call-money rates were very high, southern banks habitually robbed the local borrowers for the purpose of lending at the high call rates in New York.

Mr. WELLS. I doubt if any sound local borrower was deprived of any credit to which he was properly entitled because of the difference in the rates.

Mr. WILLIS. What is the prevailing rate in your part of the country on good commercial loans?

Mr. WELLS. Six per cent has been the prevailing rate for years.

Mr. WILLIS. During the period of these high call rates in New York, what was the prevailing rate in your part of the country?

Mr. WELLS. It was no different then.

Mr. WILLIS. Just about the same?

Mr. WELLS. Yes; and I feel reasonably sure that no southern banker deliberately chose to send his money to the call-money market for the higher rate, at the same time refusing good borrowers in his locality.

Mr. WILLIS. Of course there is involved the question of what is "good."

Mr. WELLS. I mean desirable borrowers or customers of the bank, entitled to credit from any point of view, whether prime borrowers or not.

Mr. WILLIS. Might not that banker, while sending some money to New York for use in the call market, in those cases supply those customers by rediscounting at the Federal reserve bank with perfectly eligible paper?

Mr. WELLS. I think he might have done so if he had ample paper in his portfolio. If he did that constantly, it would result in what I referred to a moment ago—selfishly using the facilities of the Federal reserve bank for the purpose of getting a difference in the rate.

Mr. WILLIS. That existed, if at all, sporadically only?

Mr. WELLS. Yes.

Mr. WILLIS. Where you have these branches of security affiliates with the head office elsewhere, do they distribute stocks in your district—stocks and bonds?

Mr. WELLS. Yes. There are not many that distribute stocks extensively.

Mr. WILLIS. Do they not distribute the stock of the parent bank at times?

Mr. WELLS. That is true, it has been said, of the National City Co. That is the only one.

Mr. WILLIS. In those cases, do the local banks lend extensively on the stocks and bonds which are distributed there in that way?

Mr. WELLS. I do not think the local banks lend extensively on stocks and bonds of any kind.

Mr. WILLIS. There is no working relationship there between the local banking fraternity and the affiliates?

Mr. WELLS. No.

Mr. WILLIS. Those affiliates being correspondents, we will say, of the parent banks.

Mr. WELLS. We have not been asked by correspondent banks in New York to assist them in the handling of stocks and bonds. In the very nature of things, people who had bought stocks and bonds from them might come to us and borrow.

Mr. WILLIS. What is the cotton situation in the South? Is there a great deal of warehoused cotton being carried on loans from the banks?

Mr. WELLS. I think most of it has been sold or has drifted into the pool.



Mr. WILLIS. You means the Farm Board pool?

Mr. WELLS. Yes.

Mr. WILLIS. How is that being financed? Is the cotton being paid for directly by the Government or financed on loans from the banks?

Mr. WELLS. The pool has borrowed very little money in Alabama. We have always loaned extensively to the Alabama Cooperative Marketing Association, but when the larger corporation was formed under the Federal farm marketing act they have been doing their borrowing elsewhere.

Mr. WILLIS. That is, the Cotton Stabilization Corporation?

Mr. WELLS. The Cotton Stabilization Corporation. They do not call it that, do they?

The CHAIRMAN. What effect has that transfer of the trade to these Farm Board operations had upon the banking situation in the South, in your particular section?

Mr. WELLS. Well, I think, Senator Glass, undoubtedly it has taken away some of the lending from our section of the country.

The CHAIRMAN. Some desirable business?

Mr. WELLS. Yes. Seasonal business is always desirable in a bank. It has not hurt us particularly this last year because we had ample demands on account of conditions, but as a normal operation, it does tend to centralize the credit transactions—the borrowing of these large corporations under the acceptance plan, which goes to the centers at lower rates of interest. They borrow upon acceptances, do they not, entirely?

Mr. WILLIS. Those are acceptances of New York banks, are they not, chiefly?

Mr. WELLS. I do not know that it is confined to New York banks, but they go largely to the centers where the rates are cheaper.

Mr. WILLIS. Do you make any acceptances of that kind in your bank?

Mr. WELLS. We have done that very little. Last year, 1930, we accepted for the Alabama Farm Bureau and for one other cotton concern.

Mr. WILLIS. That was an acceptance made and protected by cotton in warehouse?

Mr. WELLS. Yes.

Mr. WILLIS. You had agreements with them as to the rate at which it was to be sold, so it would be all marketed before the next crop?

Mr. WELLS. No.

Mr. WILLIS. Just a flat acceptance agreement?

Mr. WELLS. The maturity of the acceptance would take care of that, you know.

Mr. WILLIS. A great many of the New York banks have had agreements whereby the cotton was carried for varying periods within a crop year.

Mr. WELLS. Ours were simply acceptances for financing the normal operation of the cotton movement.

Mr. WILLIS. You have no carrying acceptances at all?

Mr. WELLS. No. We have only had two instances, as far as our bank is concerned. Those were for a regular cotton-exporting account and the farm bureau. The farm bureau's plan is to sell off

gradually during the season; in other words, with it it was substituting acceptances for borrowing on notes.

Mr. WILLIS. But there is a great deal of cotton being carried in warehouses on acceptances?

Mr. WELLS. I think the warehouses are pretty well filled with cotton.

Mr. WILLIS. Mostly financed by acceptances?

Mr. WELLS. All that went into the stabilization pool has been financed by acceptances, as I understand it.

Mr. WILLIS. That does not turn over very rapidly?

Mr. WELLS. The very fact it is financed by acceptances does not necessarily retard the turnover.

Mr. WILLIS. One would expect that it would not turn over very rapidly.

Mr. WELLS. One would rather expect the acceptances to be paid by the operation itself and at the time the acceptances fell due, but I imagine the turnover would be a question of the conditions of the market.

Mr. WILLIS. On that basis, then, you would have an immense amount of cotton dumped on the market between this and the next crop.

Mr. WELLS. Yes; but I would not say that you must comply with that requirement if it is disadvantageous. I do not see any objection to refunding those acceptances with other acceptances.

Mr. WILLIS. Then you would have "frozen" acceptances.

Mr. WELLS. You might say that they were frozen if continued to be refunded.

Mr. WILLIS. Is the borrowing situation on the next crop going to be unfavorable?

Mr. WELLS. As far as the producer is concerned, it will be unfavorable, because he will be restricted in his basis of new credit by the credit that is being carried over now.

I want to say this in connection with the number of closed banks in our part of the country: Most of the banks that are now closed, unless irritated by some local condition, are banks that went into last season overextended; by which I mean they were not only carrying very heavily the obligations of their customers, but they themselves were borrowers at the correspondent banks. They went into the season hoping to get a favorable season's break, but it was an unfavorable one, and those banks were therefore not able to continue.

The CHAIRMAN. Were they small banks, in the main?

Mr. WELLS. Yes, sir.

The CHAIRMAN. Do you think the minimum on the capital requirement should be advanced?

Mr. WELLS. I do.

The CHAIRMAN. To what figure?

Mr. WELLS. Well, of course, \$50,000 is the figure most frequently used in an argument on raising the minimum capital requirements of banks in the rural sections, although I know of some banks capitalized at less than \$50,000 well run and good. But that would inject a deterring effect upon organizing too many banks. That has been the difficulty. In times of prosperity we have too many banks, and when hard times come along they can not exist.

The CHAIRMAN. Yet the failure of the small bank has a psychological effect altogether out of proportion to its size.

Mr. WELLS. Yes.

Mr. WILLIS. I want to ask you if you are satisfied with the present system of examinations of banks and whether any change is needed.

Mr. WELLS. I think most of our difficulties come from inadequate management and inadequate supervision.

Mr. WILLIS. Supervision by local officers, you mean, or by the Comptroller of the Currency?

Mr. WELLS. Well, in the first place, the men who are usually appointed to the position of supervisors of banks have not had adequate experience or adequate capacity to actually conduct the business of supervising. They are paid meager salaries.

The CHAIRMAN. The bank examiners?

Mr. WELLS. I was thinking of the bank superintendents. But the same thing applies to the bank examiners, among the State banks. As a rule, I do not think we have as good a system of examination and operation in State banks as has been developed under the national banking system.

Mr. WILLIS. The superintendent of banks in the State of New York has urged—

Mr. WELLS. Yes; I read his statement.

Mr. WILLIS. Has urged, I think, that he should be permitted to compel the merging of banks without the consent of the stockholders.

Mr. WELLS. I would be opposed to giving that power to the superintendent of banks. I am perfectly willing to strengthen his hands and give to him more authority than he now enjoys in most States. He is powerless to prevent the organization of a bank in our State, even if he thinks it should not be organized. I think that power should be given him.

The CHAIRMAN. The Comptroller of the Currency has suggested that some penalty not so drastic as that which requires the closing of a bank should be applied to mismanagement of a bank—that is, to the bank which persistently practices unsound banking, illicit in a sense, and yet not textually unlawful. He suggests that perhaps the comptroller might have authority to suspend an offending bank official. What would you say to that?

Mr. WELLS. I think the comptroller can prevent unsound practices if he recognizes them in the conduct of a bank now.

The CHAIRMAN. But he has not.

Mr. WELLS. That is perhaps because he is human and willing to indulge in the hope that there will be an improvement.

The CHAIRMAN. Well, he says that—

Mr. WELLS. He has the power to institute proceedings against the bank for forfeiture of character if it does not comply with his directions.

The CHAIRMAN. Exactly, and he says that that drastic penalty he hesitates to apply. For example, his attention was called to the fact that two very large bank failures in the South, or in the border States of the South, had occurred after his examiners had repeatedly reported these banks in sound condition, and while they were reported in sound condition, he testified there were innumerable irregularities and unsound practices indulged in by these banks, but that he hesitated to apply the drastic penalty of forfeiture of charter.

Mr. WELLS. I would have no objection to giving him some intermediate authority which he might apply in the manner you indicate.

The CHAIRMAN. Yes.

Mr. WELLS. If a bank official is persistent in carrying on infractions of the rules of good banking, I would have no objection to the comptroller having power to remove him.

The CHAIRMAN. For five years the comptroller's office had been severely criticising the practices of this Louisville bank, and yet the criticisms did not amount to a snap of the fingers. The irregularities went on and finally a catastrophe occurred.

Mr. WELLS. Senator Glass, I wonder if the comptroller would have removed any official of that bank if he felt the bank was sound?

The CHAIRMAN. But the bank was not sound, because it failed.

Mr. WELLS. You stated a while ago there were two banks in the border States—and I do not know whether you meant to include the Louisville bank—where at last examinations the examiners had reported the banks to be sound but irregularities continued. In that case I merely suggest that he could have proceeded with the forfeiture of its charter.

The CHAIRMAN. According to his testimony, he should have proceeded long before.

Mr. WELLS. Well, he saw afterwards that perhaps he should have gone ahead sooner.

The CHAIRMAN. What is the use of an examination if there is no remedy for irregularities? It seems to me in those circumstances, the examination serves no purpose.

Mr. WELLS. Well, I would not go so far as to say the examination serves no purpose, because there have been some flagrant bank failures, but it seems to me if the bank at Louisville was as unsound as it now seems it was, the comptroller is on the defensive if and when he allowed it to continue to run after it got to that point. I do not know how bad it was.

The CHAIRMAN. There enters there what you describe as the human element. He was rather averse to applying the extreme penalty by closing the bank.

Mr. WELLS. Well, after all, we must rely upon the judgment of the public official, but, as I am told, it was a bad failure. I do not know how bad. But it seems to me the comptroller must give consideration to preventing bad failures, and if the assets of the bank are in such condition as to endanger the interest of the depositors, he can not escape taking drastic action.

Mr. WILLIS. In your district does the reserve system do much examination of member banks?

Mr. WELLS. Very little.

Mr. WILLIS. Does it have a representative present at each examination by the State or National authorities?

Mr. WELLS. Oh, no.

Mr. WILLIS. It seldom does?

Mr. WELLS. They take the examination of the State examiners.

Mr. WILLIS. The results?

Mr. WELLS. The papers. They are rather revealing.

Mr. WILLIS. But they do not send their own examiners there?

Mr. WELLS. No.

Mr. WILLIS. Not as a practice?

Mr. WELLS. Do they do it anywhere?

Mr. WILLIS. Yes; the bank of New York says it does so, at least at times.

The CHAIRMAN. They are authorized by law to suspend the membership of any bank in the reserve system if there are irregular practices.

Mr. WELLS. Can not they arrive at a conclusion on the condition of the bank from the State and National bank examiners' reports without anyone from their office being present? I have no objection to their having an examiner present, but it puts a heavy burden on somebody to apply the dual system of examination.

The CHAIRMAN. If the one system is ineffective—indeed, if the two systems are ineffective—there is no reason in the world why the Federal reserve banks should not avail themselves of the permission of the act to make their own examinations.

Mr. WELLS. None whatever.

The CHAIRMAN. And to suspend from membership in the Federal reserve system any bank indulging in irregular practices.

Mr. WELLS. I am wondering, as a practical matter, if they might not take the next step, only after the bank is shown to be in an unsatisfactory condition, because I feel reasonably sure that the weakness of every week bank is revealed in the examiners' report. The Federal reserve banks might at least equip themselves to scrutinize these reports of regular examiners. Even then they might hesitate to take the action of suspending from membership, because that would have the effect of focusing public attention on the weakness of the bank.

The CHAIRMAN. There is a flagrant case in connection with the Bank of the United States. If the Federal reserve was aware of the weakness of that bank, it should have suspended their membership.

Mr. WILLIS. My recollection is that the Reserve Board was represented in the last examination of that bank.

Mr. WELLS. Of course, it is one thing to be prepared to be represented at an examination in a large metropolitan city like New York, during the examination of a particular bank, but in a district like the eleventh district in Texas, it is another matter.

Mr. WILLIS. We had before the committee yesterday some officers of the American Bankers' Association. There was proposed, among other things, a plan which I think the association has ratified; namely, the organization of local clearing-house groups and examining associations in different parts of the country, these groups to operate among country banks purely for the purpose of applying to them the same kind of control that the clearing-house banks exert over members of the association, say, in New York. Is that feasible, and is it being done in your part of the country?

Mr. WELLS. No; but the clearing-house section of the American Bankers' Association has sought to encourage the organization of such local clearing-house bodies as county clearing houses or what not, and they report some excellent results. There is not any doubt but if the banks are large enough and conveniently enough located so that you could organize such associations or such clearing-house

associations, presided over by an examiner, that it can be made as successful as in Chicago or in Cleveland.

Mr. WILLIS. Are the country banks generally willing to abide by that?

Mr. WELLS. Of course, so far it is a matter of their own volition. It is not always a matter of expense. Take, for example, in our community. We gave considerable study to the matter of forming such a clearing-house association. We had at that time three down-town banks, and we had a number of suburban banks.

Mr. WILLIS. Yes.

Mr. WELLS. And we thought it might be well to bring them into some sort of organization of that kind because we realized that if hard times came the great number of suburban banks would be menacing to the entire situation locally, but we abandoned it because we realized if that sort of arrangement was entered into that there would be a certain sponsorship upon the part of the down-town banks in the public mind, and we would have a certain responsibility, and we hesitated about taking it.

Then, the average clearing-house association is run by giving to each member, large or small, the same voting power, and it is easy to see that 12 or 15 suburban banks might have control of such an arrangement.

Mr. WILLIS. Then you do not look forward to this as an effective method of improving the condition among the country banks?

Mr. WELLS. I will not say it could not be used, and in its application become an element of great benefit. I think the principle in it is all right, and I heartily approve of it.

The CHAIRMAN. Do you think there might be some equitable readjustment of the distribution of the earnings of the Federal reserve banks, so as to give the member banks—

Mr. WELLS. Senator Glass, I am one of those who never felt that it was inequitable now. It seems to me that that idea continues to persist because of the heavy earnings of the Federal reserve banks at the time that their facilities were used for the flotation of war securities. I do not believe that the conservative bankers of the country believe that the member banks are entitled to more from the Federal reserve banks than they are getting.

The CHAIRMAN. Some of them are constantly proposing that the Federal reserve banks be required to pay 2 per cent interest on reserves. Well, you know that can not be done.

Mr. WELLS. I know that is wrong aside from the question of the money involved, and I think the economic policy commission of the American Bankers' Association made a rather excellent report on that matter last spring at the council meeting. That commission is drawn from bankers of good standing from various parts of the United States and they reported adversely on any change in the participation in earnings. I think they were perhaps even more definitely opposed to its being done in the form of interest payments.

The CHAIRMAN. What right has the United States Government to a large share in the earnings of the Federal reserve banks?

Mr. WELLS. It sustains the relationship of giving to the Federal reserve notes the power of being circulating notes. I think it is entirely proper for the United States Government to receive a return in the form of a franchise tax.

The CHAIRMAN. Do not the Federal reserve banks transact general business for the Government far beyond any advantage that they get from the notes issued?

Mr. WELLS. I dare say that is true. If there was any way of determining what the normal earning power of the 12 reserve banks might be, some additional payment might be given to the stockholders without interfering with the sound operation of the Federal reserve banks, but certainly they ought not to be allowed to receive interest on the reserve funds impounded there.

The CHAIRMAN. This suggestion of a more equitable distribution of the earnings is made as a substitute for the utterly unsound and ruinous proposal to pay interest on reserve funds.

Mr. WELLS. Absolutely; I agree with you there.

Mr. WILLIS. Have you examined this bill, or have you and judgment about it?

Mr. WELLS. No.

Mr. WILLIS. You have no suggestions to make about legislation?

Mr. WELLS. No, sir.

The CHAIRMAN. We are very much indebted to you, Mr. Wells.

Mr. WELLS. I am afraid I have not made any great contribution, but I have been very glad to answer your questions.

(Whereupon, at 11.45 o'clock a. m., the committee adjourned until tomorrow, Wednesday, February 18, 1931, at 10.30 o'clock a. m.)

