RURAL BANKING REFORM

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RURAL BANKING REFORM

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PREFACE

THE purpose of this work is to make an interpretation of current movements in bank organization and management particularly in their effect upon the rural communities. The gradual disintegration of the type of rural banking which was established prior to the advent of the automobile, the hard road and the economic policy of mass production; the rise of the great city banks with highly specialized departments and expert management; the development of branch banking in most of the large cities, and in some states in the rural communities; the new movement of group banking: these forces have given rise to the need of a new public policy to direct them to the creation of a sounder banking system for the whole country. It is evident that the older forms of banking are in the course of evolution. What direction this process may take will depend very largely upon the banking policy which may be arrived at by the Congress of the United States. The investigations into these questions now in progress in both the House and in the Senate indicate that substantive legislation is in prospect for the near future.

The author has not burdened these pages with footnotes of citations of authorities, but apart from his own experience and observation there have been available to him a wealth of original data. The yearly reports of the Comptroller of the Currency to Congress present all of the questions of banking principle and procedure which have arisen during the course of our economic history. While these reports begin for the year 1863, from time to time they have presented compilations of information upon the earlier history of banking in the United States. They contain the basis for a complete history of banking. The reports and publications of the Federal Reserve Board from the year 1913 to date contain a wealth of data on every aspect of banking since the establishment of the Federal Reserve System. Official investigations initiated from time to time by committees and commissions of Congress are most valuable sources. An invaluable work on the history of banking prior to the Federal Reserve Act is found in William Graham Sumner's "A History of Banking in the United States," published more than thirty years ago by the *Journal of Commerce* of New York. This is a scientific treatise with exhaustive references to original sources. The current investigations of the two standing Committees on Banking of the House and the Senate, respectively, are of particular value to an understanding of present banking facts and opinion.

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CHAPTER I

HISTORICAL BACKGROUND

In the current discussion of our banking system a large place is given to the unit bank, particularly the small unit bank. This term is used to describe a banking corporation carrying on a banking business within the confines of a single banking office in contrast to branch banking under which a banking corporation may conduct its business at several offices. Those who advocate unit banking as the proper system of banking take the position that the local communities should be served solely by unit banks.

The term "unit bank" is of recent origin, having come into usage within the past ten years. It seems to have originated in the State of California some time after the enactment of a state banking law which permitted state-wide branch banking. Under this law large metropolitan banks in San Francisco and Los Angeles began to establish branches in various parts of the State, ordinarily by purchasing an existing bank in a community and converting it into a branch. The small country banks became aroused and carried on for several years an organized opposition to the operation of the branch banking law.

Out of this controversy arose the term "unit bank" as distinguished from banks engaged in branch banking. The term came into national usage when the McFadden Bill was introduced in the House in 1924 authorizing national banks to establish branches in certain cities where state banks had that privilege.

The view is quite generally accepted that the unit bank played a large part in the pioneer settlement and development of the United States as the white man's civilization laboriously made its way from the Atlantic to the Pacific coast. We have painted many glowing pictures of the contribution of the unit bank to the spirit of American independence and to the self-reliant character of our people. Our orators in flights of fancy and romance have depicted the heroism of the pioneer banks in building upon our frontiers the nucleus of community life by furnishing credit largely upon the security of the character of the borrowers. It is often said that the very genius of our theory of local self-government and of private individual initiative is largely indebted to the unit bank. How far we have wandered from the real facts in championing the system of small independent banks historical research will reveal.

In the entire colonial period from the beginning of the settlement of the thirteen colonies and including a considerable settlement of Kentucky, Tennessee, Delaware, Maine and Vermont, covering a period of over one hundred and fifty years, there was not a single bank in North America. Cities like New York, Albany, Boston, Philadelphia, Baltimore, Charleston, Wilmington, N. C., Richmond and Williamsburg grew up and flourished without the aid of banking institutions except an occasional credit from banks in Amsterdam or London but that was not banking as we know it to-day. The individual was thrown upon his own resources to make his way in a new country. He got along without banking credit. He saw little or nothing of hard money and the primitive custom of barter was common. Such commodities as tobacco, corn, rice and furs were used as currency. We find the officials of the Tennessee government being paid in deerskins and raccoon skins. One of our earliest cases of counterfeiting occurred there when the tax collector collected raccoon skins and turned in opossum skins with raccoon tails attached. The colonies had been in course of settlement for about fifty years when the Bank of England was established but that bank did not perform the functions which the unit banks perform to-day and the early Americans received no credit from it.

There were some of wealth and position who came over to the colonies and maintained their standards of living through the importation of manufactured articles from England but the majority of the colonists resorted to household manufacturing for nearly everything which they needed. The products of a virgin soil and virgin forests in the hands of a people of great resourcefulness and purpose were sufficient to lay the basis for community development. The distances between settlements were so great that local independence and local self-sufficiency were economically and socially necessary.

When banking did begin in the United States the emphasis was upon the question of the issue of paper money rather than in its function of receiving deposits or lending money. The laws of England had prohibited the circulation of paper money originating in the colonies and banks of issue could not therefore be operated. After the Revolution and the establishment of the State governments the need for paper money expressed itself in measures for the establishment of banks under State and national authority.

The first bank established in this country was in the nature of a national bank. In 1781 the Congress of the Confederation chartered the Bank of North America with an authorized capital of ten million dollars. This was intended primarily as an instrumentality of the Confederation. It was founded largely upon government funds but it was under private management. It ceased to exist after the establishment of peace in 1784. There was grave doubt as to its constitutionality and furthermore it soon ran into financial difficulties. In order to support the legality of its existence the State of Pennsylvania gave it a charter in 1782. In 1785 the State, after an investigation, repealed the charter. It is interesting to observe that with the establishment or attempted establishment of the first bank in the United States the question of a "money power" was raised and there was considerable fear of political danger from such an institution. However in considering the origin of banks of discount and deposit the Bank of North America may be disregarded.

By 1790 there were three banks in operation in the United States, namely, the Bank of Massachusetts, chartered in 1784, the Bank of New York, founded by Hamilton in 1786, which was in operation without a charter, and the Bank of North America, which was rechartered as a state bank in Philadelphia in 1787. It will be observed that these three banks were situated in the three largest cities in the country. In the meantime, in 1791, Congress created the Bank of the United States to operate as a national bank engaged in the banking business for private profit but acting as a fiscal instrumentality of the Federal government.

Within the next ten years twenty-five additional banks were chartered by the various States, making a total of twenty-eight banks in operation by 1800. These banks were all banks of issue, that is to say, they issued paper money which circulated as a medium of exchange. All of them were of large capitalization as compared with banks to-day, the average capital being nearly a million dollars. This was necessary in order to support their currency obligations. It is because of this currency feature that they were considered to be closely related to the State governments. They were banks of the States—on the theory of the Bank of England and the Bank of the United States.

These banks therefore were not pioneers of credit and were not interested in building up communities on the outposts. On the contrary they were situated solely in the largest centers of population and made their chief profit out of the issue of their own notes. They met with considerable popular distrust and resentment partly because of the mystery of their operations, which could not be understood by the average person, and partly because in the very nature of their operations they introduced for the first time in America the practice of definiteness and punctuality in financial obligations.

Within the next decade, ending with 1810, sixty additional banks were chartered by the State governments, bringing the total up to eighty-eight banks The average capital requirement was around $500,000. All of these were also banks of issue and complications began to arise in the paper currency, there being now more than one bank of issue in a State. Inflation of currency soon followed, then bank failures and an increase in the unpopularity of banks in general.

Perhaps the first establishment of banks in the country districts occurred in New England, in Massachusetts, Maine and New Hampshire. The purpose of these country banks however was far different from what might be expected. At that time Boston was the financial center of New England. Paper money flowed into it. On account of the time element in presenting notes for redemption profit was realized in proportion to the distance of the bank from Boston. As a consequence banks were established in remote places in Maine and New Hampshire in order to realize this profit. In 1808 the Boston merchants raised a redemption fund for the purpose of meeting the country note situation and in the following year the greater number of country banks in New England became insolvent and closed their doors. The losses, especially to the farmers, were very great. In the failure of the Farmers Exchange Bank of Gloucester, Rhode Island, it was estimated that holders of notes in one county alone suffered a loss of one hundred thousand dollars—a large sum in those days.[1]

The failure to renew the charter of the Bank of the United States in 1811 left the field open entirely to the local state banks. Between 1811 and 1816 the number of state banks increased from eighty-eight to two hundred and forty-six. This was a war period and there was no national currency. The principal attraction of bank charters was their power to issue paper money. Many of these banks were organized without proper restrictions and all of them without adequate governmental supervision. It was our first experiment in operating the national finances in dependence upon state chartered banks with the circulation privilege. The stimulus of war created unusual demands for credit and there followed a period of great expansion in the issue of paper money.

It was the bitter and costly experience of the Federal government in leaning upon the state banks for support in its fiscal operations during the War of 1812-14 which led to the general desire throughout the country for the reëstablishment of the Bank of the United States and this was done in 1816. The experience of the local communities with their banks was no less disturbing. Hard money disappeared from the country districts and the great volume and the hundreds of varieties of bank notes, with vague and scattered responsibilities behind them, led to its depreciation in value, its restriction in area of circulation and to great inconvenience and confusion

[1] W. G. Sumner, *History of Banking in the United States*, Volume I, page 38.

in financial transactions between various communities. In 1814 there was a general refusal of the state banks to redeem their paper money in gold or silver.

It was during this period that the local state banks began to flourish in the Mississippi Valley in the frontier states of Kentucky, Tennessee, Indiana, Illinois and Missouri. Although the Bank of the United States was reëstablished in 1816 and set up a system of branch banks throughout the United States, the state banks continued to flourish in numbers and influence. By 1820 there were three hundred and seven state banks in operation with an average capitalization of about $350,000.

The period following the War of 1812-14 was one of great prosperity and expansion for the country. The population was moving rapidly westward taking up public lands with live enthusiasm. Banking became popular although little understood. The state legislatures encouraged the organization of banks by making it easy to obtain charters and in many cases by the subscription of stock on the part of the State.

It is very difficult to discuss the state bank situation as a whole at any given period in the history of the United States prior to the Civil War because there was a constant change in community organization as the frontiers became wider and wider. At the beginning of the century in each State there existed pioneer conditions. This was followed by an increase in the density of population, an intensification of economic development and a more stable civilization. As the population moved westward and southward this situation would in new territory be repeated over and over again. As each new State was added to the Union it reflected the economic and social conditions which many years before the older States had faced. The establishment of banks in the Mississippi Valley States during the period from 1815 to 1825 was prompted by motives similar to those which led to the establishment of banks along the Atlantic seaboard at the beginning of the century. Those who were doing the pioneering in the wilderness and taking possession of the land saw in the local bank primarily a machine for the manufacture of paper money which would create wealth and lead to prosperity for all. From almost the very beginning of banking in the United States we developed two types, city banking in the centers of commerce and trade and country banking in the rural communities. With respect to the latter real estate played a large part.

The Constitution of the United States forbade the States from the issuance of bills of credit. The State itself could not issue paper money upon the faith and credit of the State. This restriction however proved of no avail since the State could charter a corporation, own its stock and empower it to issue paper money. The Supreme Court of the United States held that even when the State was the sole stockholder of a bank the issue of paper money by such a bank did not constitute issue by the State itself and therefore was not unconstitutional.[1] Under this procedure local banking got into state

[1] Brisco vs. Bank of the Commonwealth of Kentucky, 8 Peters 118.

politics and political influence made itself felt in the financial policies of the state banks.

The first disillusionment came in 1819 with the panic which began in that year. The States began to enact relief laws postponing the payment of debts and permitting state banks to refuse to redeem their notes. Banks became unpopular and we begin to find in this period the first restrictive laws against banking. These were however haphazard and unscientific. They usually took the form of some sort of discipline for the future failure to redeem paper money.

There was a marked increase in the number of state banks following the demise of the second Bank of the United States after the withdrawal of the government deposits by President Jackson in 1833. In 1835 there were seven hundred and four state banks and by 1840 the number had increased to nine hundred and one, the average capital being about $400,000. Banks again became very popular and there was a public demand for banks in every large community. The Government of the United States after first using state banks as depositories established its own independent Treasury System, with a system of sub-treasuries for the receipt of public deposits and the disbursement of public monies in gold or silver. There was no national paper money. This field was left entirely to the state banks. From 1831 to 1833, ninety banks were chartered in New England alone and by 1837 there were three hundred and twenty-one banks there, all issuing paper money with Boston as the financial center. In the rest of the country in proportion to the population there was a similar increase in country banks.

The decade ending in 1837 was a period of tremendous prosperity. The population in the Mississippi Valley was increasing by leaps and bounds and those fertile lands were being brought under cultivation. The national revenues had wiped out the public debt and the question of the distribution of surplus money out of the Federal Treasury was being seriously discussed. The reaction came with the panic of 1837.

During this panic there was another general failure of banks to redeem their notes upon demand not only in the frontier States but in New York and Philadelphia as well. There were eleven bank failures in Massachusetts and large numbers throughout the rest of the country, followed again by additional restrictive laws and an unfavorable public reaction against banking in general.

There was another economic depression in 1840-41 which led again to failure to redeem paper money and bank failures. About this time the states began to enact general banking laws, the first being the State of Michigan in 1837, followed by the Free Bank Act of New York the following year. These general banking laws did away with the necessity of special legislative charters but led to a multiplication of the number of banks. In the older States these banking laws not only restricted the operations of the banks, according to sound banking as it was then understood, but also put the banks under some sort of visitorial supervision and required reports of condition to be made to the State.

In many of the newer States where sound banking operations were most needed and where the opportunity to assist in permanent community building existed in the greatest abundance the local state chartered banks came into marked disfavor. As the feeling of enthusiasm had once run high so now the flames of passion were fanned by local politicians against banking in general. In several States a state owned bank was established to the exclusion of local banks but these state banks themselves turned out disastrously. In the year 1852 there were no banks at all in the States of Florida, Texas, Arkansas, Illinois, Wisconsin, Iowa, Minnesota, Oregon and California. The absence of banks in these States proved no solution to the financial situation since the circulation of paper money from the banks in other States continued unabated. The last condition was worse than the first since the States without banks had no control over the institutions which circulated the notes.

By 1860 the number of state banks had increased to 1,562. The Federal government again found itself entering into a war without a fiscal instrumentality but dependent upon state chartered banks with a multitude of varieties of paper money the like of which the world had never seen.

The experience of the people of the United States with banking from its inauguration at the beginning of the nineteenth century to the close of the Civil War was not a happy one. In the earlier period banking was unregulated and uncontrolled. There were no banking laws and no supervising government officials. Special charters from legislatures were fairly easy to obtain although there were occasional resorts to political corruption in some States to block or to obtain the necessary legislative enactment. In the frontier communities particularly, at every period of our development as the frontier moved from east to west, banking fell into the hands of swindlers and speculators without financial standing. Although the capital stock of these early banks was large, ranging from $500,000 to a million dollars, the actually paid in capital was sometimes practically nothing. Bank organizers gave their personal notes for the purchase of stock, had themselves elected directors of the bank, opened up for business, issued paper money and themselves became large borrowers of the bank.

These banks prospered only in times of prosperity and inflation. They freely lent money upon the security of public lands but the notes which the landowner received in many cases turned out to be worthless. Paper money circulated across State lines. Persons with bank charters in their possession, without formally opening the bank for business, would issue paper money in one State and take the notes into other States for circulation. It is strange that such a thing was possible among a people who had for the first century and a half of their existence in this country gotten along without banking facilities. It was the lure of paper money with its promise of quick prosperity. They did not understand the mechanism of finance and the technique of banking and they accepted paper money at its face value.

When charters began to be issued under general banking laws what was known as wild-cat banking became very common in the frontier States. A case in the State of Michigan may be taken as an example. Under the general banking law of 1837 a large number of irresponsible banks were established. After the panic of 1837, bank examiners were appointed to examine the books of the banks. In examining the Jackson County Bank there was found about one thousand dollars in gold in a drawer and about one hundred and fifty dollars in silver. Beneath the counter of the bank there were nine boxes, each said to contain one thousand dollars. Upon inspection however one of them was found to be full of American half-dollars and the other eight were filled with tenpenny nails covered over with silver coin. Three days before the examination the bank had reported that it had $20,000 in specie. In 1839 all of the banks in the State of Michigan were found to be insolvent.

Under the Michigan Bank Law of 1837 we discover a provision for a minimum capital of $50,000 for the establishment of a bank. The bank could begin business on the payment of $15,000 of its capital in cash. So far as size is concerned this is the first resemblance of early banking in the United States to the small unit bank as we know it to-day.

In the history of banking in the United States each State developed its own banking experience and each, for itself, without profiting by the experience of others traveled almost the identical road of high hopes and bitter failure. The fact that New York, Massachusetts and Pennsylvania in their pioneer period had learned certain lessons in dealing with banking institutions was of no avail to Kentucky, Tennessee, Ohio, Illinois, and Indiana, and likewise the riper experience of these latter States was not passed on to the later frontier States of Wisconsin, Iowa, Arkansas, Alabama and Mississippi, and so on until every state had had its experiment in banking. Each series of banking operations and banking failures however brought about certain corrective measures by the state legislatures and although during the entire period from 1800 to the Civil War the pioneer communities still followed the will-o'-the-wisp of prosperity through the manufacture of paper money and looked upon local banking institutions as creators of wealth, there grew up in the cities a banking business founded upon demand deposits and commercial loans. This is why New York, Boston and Philadelphia early took precedence as financial centers. Banks there became primarily institutions to serve our rapidly expanding industry, commerce and trade. They were the prototypes of commercial banking as we know it to-day. It was in the outlying country communities that the emphasis upon paper money in banking was still paramount. These sections of the United States possessed an irresponsible and an unsound system of banking until the enactment by Congress of the National Bank Act of 1863.

CHAPTER II

BANKING SUBSEQUENT TO THE NATIONAL BANK ACT

In 1862 there were in the United States 1,496 local state banks. There was in circulation at this time in the northern States $167,000,000 in paper money. There were about seven thousand different kinds of notes in addition to 5,500 varieties of fraudulent notes. There were only two hundred and fifty-three banks whose notes had not been altered or counterfeited. This currency was issued under bank charters established under the authority of twenty-nine different States, each with different requirements of security for the currency. Some of these currency issues were secured by State bonds, some by bank assets and sometimes there was no security at all.

The principal emphasis in banking as we have seen during the entire banking experience of the country up to this time had been upon the question of currency. As a background for the National Bank Act there had grown up a demand for a national currency which would be uniform and sound. This was the motive which brought into existence the National Banking System. Although first recommended in 1861 it did not finally become a law until 1864 and was not put into practical operation until the Civil War was over.

From the point of view of its immediate proponents the National Bank Act gave to the country for the first time a system of paper money issued by national banks under Federal authority and secured by bonds of the Government of the United States deposited with the United States Treasury. The previously existing currency was elastic but it was both local and unsound; the new national currency was national and sound but it was inelastic. It remained for the Federal Reserve Act finally to give to the people of the United States a system of currency which possessed all three qualifications in that it is national, sound and elastic.

Looking back however over the system of banking which was established under the National Bank Act undoubtedly it can be said that the chief accomplishment of the Act was to give to the country a sound system of commercial banking operating under conservative banking powers authorized by Congress and under the active supervision of an executive official of the Federal government, namely, the Comptroller of the Currency. It took banking out of politics for the first time and gave it a responsible and dignified status in the local community. Emphasis was transferred from the question of paper money to banking as we know it to-day. It is here that we find the first evidence of the type of unit banking as that term is now used.

One of the most important contributions of the National Bank Act to our financial organization was that it gave to the Federal government an instrumentality through which it could direct and control financial policies. Attempts had been made in this direction through the first and the second Banks of the United States but it was under the national banking system that the people of the United States through the central government were put into the possession of a nation-wide system of banking available at all times to serve the financial policies of Congress. The importance of such an agency to the central government cannot be overestimated.

Although the National Bank Act set up a standard of the highest order theretofore known, its very soundness and conservatism and the strictness of the Federal supervision over its affairs prevented its preëmption of the more experimental fields of banking. In the course of the economic development of the country there were offered other opportunities of a banking nature which could not be availed of by national banks. A new type of state chartered banks arose alongside of the national banks. These were now completely divorced from the currency question and were organized solely to operate for such profit as might be derived out of the routine banking business. They were enabled by their charters to make loans upon the security of real estate which national banks could not, to accept savings deposits, to buy and sell securities and in addition to conduct a general banking business.

Although in 1865, when the National Banking System went into effect, all of the leading state banks were forced by Congress to become national banks and the national banks dominated the field of banking, we find in 1875—ten years later—that there were five hundred and fifty-one state banks with aggregate deposits of $166,000,000.

Among these assets were about $24,000,000 in stocks and bonds, and about $5,000,000 of other investments. In this year there were 2,087 national banks with aggregate resources of nearly two billion dollars. In 1875 there were thirty-five trust companies in operation with aggregate resources of $123,000,000.

In 1890, fifteen years later, the number of state banks had increased to 1,804 and the trust companies to 100, with aggregate resources for the two groups of about $1,200,000,000. The number of national banks was 3,340 with aggregate resources of $3,141,000,000.

We are now entering the period in which the local independent unit bank began to be organized in large numbers in the various communities, especially of the South and West. It was in 1900 that Congress amended the National Bank Act to permit national banks to be organized with a capital of $25,000 in towns with a population less than three thousand. In 1899 there were 3,595 national banks but under the impetus of this amendment of 1900 the number increased to 5,336 in 1905. One of the purposes of the organization of these small banks was to increase the circulation of the currency in the rural districts. In other words, the motive was not primarily to provide banking facilities, in the ordinary sense of that term, to the small communities. Between 1900 and 1911 the national currency increased from $254,000,000 to $759,000,000—nearly threefold.

A few years prior to 1900 the State governments had begun to encourage the organization of small country banks. This movement developed with great rapidity, especially in the South and West for the two decades ending with the close of the World War in 1918. The fact that the minimum capital of national banks had been set at $25,000 did not act as a restraint upon the organization of still smaller state banks but seems to have had the contrary effect. Some of the state banking laws put the minimum capital as low as $5,000.

It was in 1898 that the state commercial banks for the first time exceeded the national banks in number, there being in that year 3,965 state banks as compared with 3,594 national banks, although the resources of the national banks more than doubled those of the state banks. In that same year there were two hundred and forty-six trust companies, all except twelve of which were situated in the New England and Eastern States.

In 1905 the state commercial banks numbered 7,794 and the trust companies had increased to 683. Two years later there were 9,967 state banks and 794 trust companies and by 1909 the numbers were 11,292 and 1,079 respectively. In 1912 the state commercial banks had increased in number to 13,381 and the trust companies to 1,410, with total aggregate resources of about nine billion dollars. In the same year there were 7,372 national banks with aggregate resources of about eleven billion dollars.

By 1918 the number of state commercial banks had increased to 16,596 and the trust companies to 1,669, with aggregate resources for both classes of $16,100,000,000, while for the same year the number of national banks was 7,662 with aggregate resources of eighteen billion dollars. The peak of the organization of small community banks in the United States was reached in 1921 when the state commercial banks numbered 18,875 in addition to 1,474 trust companies and the national banks 8,169. It was at this time that the aggregate resources of the state commercial banks and the trust companies equalled that of the national banks, the state chartered institutions and the national banks each having about twenty billion dollars.

Of this number of state commercial banks 5,231 were in the Southern States, 6,894 in the Middle Western States and 4,351 in the Western States. That is to say, out of 18,875 banks, 16,476 were situated in the agricultural States, the rest being in New England, the industrial States of the East and on the Pacific Coast. Of the 8,169 national banks, 2,459 were capitalized at less than $50,000 and 7,800 were classed as country banks.

In concluding this historical summary of the development of banking in the United States it may be said that the system of unit banking in the country districts which this generation has inherited is a development of the twentieth century. In the first and pioneer period of our country, namely, that of the colonial settlement of the thirteen colonies, there were no banks of discount and deposit. Communities grew up and flourished without the aid of banks. The cities of Boston, New York, Philadelphia, Baltimore, Richmond, Charleston and many others attained a high degree of commercial development and acquired the comforts and luxuries of civilization through the initiative of their citizens unsupported by banking facilities.

Later on, shortly after the beginning of the nineteenth century, banks began to be established but they were not the modern type of unit banks. They were banks of large capitalization organized for the purpose of issuing paper money and the experience of our people with them over a period of fifty years was highly unsatisfactory.

The National Bank Act established the first system of sound banking but the immediate motive for that Act was not to establish agencies for community development but rather to give to the people of the United States a sound system of national currency and at the same time to create a wide market for the bonds of the Federal government.

The prohibitive tax placed at that time by Congress upon the issue of paper money by state chartered banks caused all of the principal note issuing state banks to convert themselves into national banks. For a number of years the national banks dominated the field of commercial banking in the United States both as to the number of banks and as to banking resources. The national banking system was recognized and utilized as almost the sole instrumentality of commercial banking.

Due however to the severe standard of commercial banking required by Congress of the national banks and the reluctance of Congress to amend the National Bank Act to permit national banks to take up new and different lines of banking, state chartered institutions began to spring up to enter these fields and by 1898 they exceeded the national banks in number and by 1921 began to exceed them in resources. During this period also trust companies began to enter the field of commercial banking and to put the national banks at a severe operating disadvantage.

It was not until after 1900 that the small state banks and small national banks were chartered in great numbers in the rural communities. It is this rather recent system of banking which is the basis of the type of unit banking now so stoutly defended. A study of the history of banking in the United States however must compel that defense to be shifted to grounds different from that now taken. The current argument which attributes to the unit bank a great contribution to the pioneer, independent community life of America is based upon a myth. It is an allegorical interpretation of what might have taken place—perhaps what should have taken place—but it is unfortunately without foundation in fact. Civilization in America preceded banking and the banks came along after the community life had developed to sufficient proportions to make profitable the investment of capital in a banking enterprise. The establishment of a bank on this basis is economically sound and wherever this economic principle has been abused the community has suffered distress through bank failures.

CHAPTER III

THE STATE BANKING SYSTEMS

IT is hardly accurate to speak of a banking system in the United States. The first banks were state chartered institutions and with the exception of the first and second Bank of the United States all of the banks in operation in the United States from the establishment of the first bank in 1784 to the National Bank Act in 1863 operated under charters granted by the State governments. Banking therefore in this country has a very large background and tradition of State influence. This may be the explanation of the rapid rise of state chartered banking institutions within a few decades after the creation of the national system of banks.

State chartered banks developed along three distinct lines, namely, commercial banks, savings banks and trust companies. The trust company movement and the establishment of the savings banks were confined in the beginning very largely to the New England and the more thickly populated Eastern states. There are to-day only a few States outside of New England where savings banks, as separate institutions, continue to flourish. Savings banks may be stock corporations chartered solely for the purpose of conducting a savings bank business, the stockholders of which are paid dividends in the usual manner, or they may be what are known as mutual savings banks in which there is no stock, the respective savings depositors receiving all of the profits of the institution. This latter type is still strongly intrenched in New England notwithstanding the rapid expansion of other types of banks into all fields of banking.

In the other sections of the United States the conventional form of state banks was the commercial bank with varying charter powers according to the State in which it was situated. They were given the power to do a savings bank business, to engage in commercial banking, to buy and sell securities and to make loans upon the security of real estate. Later on as the trust companies developed the trust business as a phase of banking, state banks in general were also permitted to administer trusts. It is interesting to note that there were three types of business open to the state banks, namely, savings, trust and real estate loans which could not be availed of by national banks until amendments to the National Bank Act were made within the first quarter of the twentieth century. The great bulk of the state chartered banks in the United States are small country banks which engage in such commercial banking as may be available, do a savings business, invest in securities and make real estate loans. The trust business goes very largely to the city bank.

Perhaps the most remarkable development in banking in the United States was the rise of the trust company movement in the last decade of the nineteenth century, its entry into commercial banking and its attainment of a dominating position in the banking world within the short period of thirty years.

DEVELOPMENT OF THE TRUST COMPANY MOVEMENT IN THE UNITED STATES, 1898-1928

Year	*No. of Banks*	*Resources*
1898	246	$ 942,462,179
1899	260	1,071,525,994
1900	290	1,330,160,343
1901	334	1,614,981,605
1902	417	1,983,214,707
1903	531	2,298,554,063
1904	585	2,380,287,747
1905	683	2,865,976,479
1906	742	2,959,230,534
1907	794	3,071,419,360
1908	842	2,865,632,876
1909	1,079	4,068,534,892
1910	1,091	4,216,850,061
1911	1,251	4,665,110,868
1912	1,410	5,107,444,382
1913	1,515	5,123,920,197
1914	1,564	5,489,531,037
1915	1,664	5,873,120,341
1916	1,606	7,028,269,761
1917	1,608	7,899,818,189
1918	1,669	8,317,441,476
1919	1,377	7,959,996,000
1920	1,408	8,320,018,000
1921	1,474	8,181,092,000
1922	1,550	8,533,850,000
1923	1,643	9,499,259,000
1924	1,664	10,323,777,000
1925	1,680	11,565,549,000
1926	1,656	12,205,196,000
1927	1,647	13,994,756,000
1928	1,633	15,230,896,000

The above figures show that from 1898 to 1928 the trust companies increased in number from 246 to

1,633 and in aggregate resources from $942,000,000 to $15,000,000,000. In many large communities it has become the accepted and conventional instrumentality of commercial banking. To such an extent is this true that many metropolitan national banks in order to maintain their position under the national charter have added the words "trust company" to their national title.

On the other hand many of the strongest national banks in the United States have within the past five years given up their national charters in favor of the more attractive charter of a trust company. This condition exists in every important commercial center in the United States. In recent mergers the directors, in deliberating over the advantages of the trust company as compared with the national charter, have chosen the former in spite of the tradition and prestige which national banking had attained in the field of commercial banking.

The explanation lies in the fact that the trust business has become one of the most profitable of banking operations. The early trust companies were corporate agencies for the administration of wills, guardianships and the administration of estates through court appointments. Having built up a profitable business of this type and operating under rather unusually wide charter powers these companies began to engage in the conventional forms of banking including commercial banking. They also entered into new financial fields theretofore unknown to banking and developed them as phases of the banking business. So great a power had the trust companies become, even in the field of commercial banking, in the first decade of the twentieth century that Congress found it necessary to give to national banks the charter power to do whatever manner of trust business state chartered institutions could do. The development of the various forms of corporate trusts incident to the financing and refinancing of corporate enterprises created a new and fertile field for this type of banking—one from which no modern metropolitan bank could afford to be debarred.

We have therefore in this country fifty systems of banking, one for each of the forty-eight states, one for the District of Columbia, and one for the nation as a whole, the system of national banks. Each state has its own banking law which is the act of the state legislature. There is no standardized state code of banking. Each state is the sole judge of the requirements for bank charters, banking powers and bank regulations. Out of the experience however of nearly one hundred years of banking, including that of the national banking system, there has developed a general similarity in all of the state banking codes. There will be found however considerable difference in the amount of capital required to organize a bank and some differences in charter powers. For example, some state banks are permitted to own common stock in other corporations and even in other banks. Many trust companies have this power.

It is not so much the difference in the language of the banking codes which distinguish the banks of one State from another or which distinguish state banks from national banks, but rather the fact that there are necessarily forty-eight separate banking departments—one for each state—charged with the responsibility of enforcing the banking laws and supervising the banks of a State. There are many differences in the organization, powers and responsibilities of these departments. In some States the banks come under the insurance commission while in some others there is a special board or commission. As a general rule however the state banking department is separately organized under a state bank superintendent or commissioner. In many States these officials are political appointees with a very short tenure of office and with no strong organization of a permanent civil service character to perpetuate sound methods of procedure.

The state bank supervisor employs bank examiners to make periodical examinations of the condition of the affairs of the banks under his jurisdiction. In a few States there have been developed types of examination of a high and efficient character but these may be regarded as the exception rather than the rule. The difficulty in maintaining a strong state banking department arises very largely from the lack of a secure tenure of office as well as the failure to appropriate sufficient funds to attract officials of experience and ability or to create an adequate personnel of examiners.

In the early days of our national development commerce within the borders of a single State, unrelated in considerable measure to commerce in other States, was an economic factor. It was possible under these conditions for a state government to have a banking policy in the true sense of the word. Transportation was slow and laborious and goods and commodities moved with a snail-like pace to their destination as compared with present-day conditions. Commerce is now national and interstate. The State governments have little or no control over it. Practically all commerce has now been brought under the commerce clause of the Constitution the authority over which is vested in the national government. The national banks as commercial banks operating under Federal supervision have failed to achieve control over commercial banking. Is it not an anomaly that we witness to-day commercial banking passing predominantly under the control of state chartered institutions notwithstanding the fact that a State government cannot properly be said to have a commercial banking policy?

CHAPTER IV

THE NATIONAL BANKS

It was in response to a great public need that the system of national banks came into being. It was not a movement sponsored by bankers or by citizens engaged in commerce and trade. The National Bank Act was the offspring of a purely national policy and had a wide popular appeal. The primary emphasis in this movement was not that of the establishment of banks for the benefit of those to whom the charters might be granted or for the general good of business enterprise but rather upon the urgent need for a fiscal instrumentality of the Federal government through which it could enforce a national financial policy. That the system of banks thus established did develop into a national system of commercial banking in the aid of interstate and foreign commerce may be regarded historically as a secondary development. This feature however came to be regarded as one of the principal reasons for the existence of these banks.

National financial policy becomes of apparent great public interest only in times of national stress when it becomes necessary to finance a national program or to deal with a nation-wide economic situation. Having begun our career on this continent so far removed from the home government and having achieved a considerable economic development without very much assistance from outside sources we have inherited somewhat of a distrust of central government. National consciousness and the agencies for meeting national needs were of slow development until the more recent rise of the Federal aid programs.

This point of view has been particularly evident with respect to banking under charter powers from the Federal government, for added to the dislike of the exercise of national authority within the territorial domain of state jurisdiction was also the fear of the growth of a money power under the domination of a few men which might control the extension of credit throughout the country. It was only after the most bitter lessons and great national suffering that sufficient popular support has been given from time to time to a national banking policy. With the return however of easy times the feeling of local independence reasserted itself and the national instrumentality was allowed to fall into decay. We have preferred to exercise the democratic prerogative of experimentation with banking and finance without ever coming to the full realization that a successful national financial policy is essential to national existence and that it is based upon immutable economic principles whose delicate adjustments can be disarranged only at the expense of economic confusion.

As we have seen, there were no banks in the country at all until after the War of the Revolution. That war was conducted by the Continental Congress which met as a body of delegates from the sovereign States. There was no central executive government. The actual conduct of the war was under the supervision of a Congressional Committee. Notwithstanding the best of intentions, the inexperience in finance of the members of the Committee and the lack of the adaptation of such an instrumentality to the purpose, resulted in a chaotic financial support of the army and many unnecessary hardships and deprivations. Out of this experience there was chartered in 1781 the first bank in the States, namely, the Bank of North America in Philadelphia. The War of the Revolution was over however before the bank got under way and it never performed the function intended as a national instrumentality.

One of the first undertakings of Alexander Hamilton, when he accepted the portfolio as Secretary of the Treasury, was to formulate plans for the organization of a Bank of the United States. Hamilton had previously assisted in the organization in 1784 of the Bank of New York. Many at that time doubted the constitutional power of Congress to charter a national bank but Hamilton was successful in convincing President Washington and Congressional leaders both as to its necessity and its constitutionality.

In 1791, the President approved the Act for the establishment of the Bank of the United States. The charter was limited to twenty years. The bank opened for business at Philadelphia, and eight branches were established in the principal cities of the United States.

The Bank of the United States rendered invaluable services to the United States Treasury in acting as its fiscal agent, as custodian of public funds, in the collection of customs, in lending funds to the national government in anticipation of taxes, in the transmission of government funds from one place to another and in the performance of such other banking services for the government as was required.

However when the year 1811 arrived and the renewal of the charter of the Bank was urgently recommended by the Secretary of the Treasury the opposition to a national bank was strong enough to prevent the passage of the renewal bill. The charter of the Bank of the United States expired in that year. At that very moment however the government of the United States was on the verge of engaging in war with England and would again be in need of a banking instrumentality to enable it to enforce a sound fiscal policy. As a result the War of 1812-14 was a financial tragedy. The government was forced to borrow money from the state banks at exorbitant rates of interest. In 1830 when the House Committee on Ways and Means investigated the finances of this period it was found that the government received only thirty-four million dollars in money for eighty million dollars of obligations issued.

Immediately after the war there was again strong public support for a national bank and in 1816 Congress enacted a bill, which was approved by the President, chartering the second Bank of the United States. Many of the former opponents of the first Bank of the United States had come to the conclusion that a national bank was essential to the operations of the national treasury.

It was during the life of the second Bank of the

United States that the question of the constitutional power of Congress to create a national bank was definitely and authoritatively settled. In the two cases, McCulloch vs. Maryland (4 Wheat. 316) and Osborne vs. Bank of United States (9 Wheat. 738), Chief Justice Marshall handed down the two opinions which taken together completely vindicate the power of Congress to create a Federal instrumentality in the form of a bank or a system of banks entirely independent of and superior to any power of the respective State governments. For more than a hundred years the fundamental principles of these decisions have been cited with approval from time to time by the Supreme Court of the United States in upholding provisions of the National Bank Act and of the Federal Reserve Act.

The second Bank of the United States, although it performed the services to the Federal government, for which it was designed, became involved in mismanagement from which however it corrected itself. Later it became a political issue, with Andrew Jackson assuming the leadership against its continued existence. His overwhelming political victory in 1832 when he was reëlected to the Presidency was construed as a popular approval of his fight against the Bank and in 1833 he ordered the Secretary of the Treasury to remove the government deposits. The Bank thus ceased to be a national bank in the sense it was originally intended and it became necessary to wind up its affairs. From this time to the National Bank Act of 1863 the Federal government was without a banking instrumentality. Again in 1861 it entered into a war without enjoying the protection which it might have had through demanding the services of a national bank. There was the usual period of inflation and as we have seen the country was filled with paper currency of varying standards from hundreds of banks operating under state charters.

The national banking system to-day numbers a little more than 7,000 banks all operating under a uniform Act of Congress, centrally supervised from Washington. It is the one element of uniformity in our complex operations of banks of discount and deposit, but even this has been somewhat vitiated by many concessions to local state banking practices.

The original motive and interest in these banks as agencies for the establishment of a sound national currency and to furnish a market for government bonds as a basis for such currency completely passed away with the establishment of the Federal Reserve System. The question has been raised whether there is now a need for the national banks. An affirmative answer to this question may be found by shifting the scene from the national currency to another field exclusively within the jurisdiction of the national government, namely, that of commerce between the states and with foreign countries. The fundamental principle however remains the same, that is, that Congress requires an instrumentality through which it may formulate and enforce a national financial policy. This it cannot do through state chartered institutions. Through the system of national banks Congress has prescribed the powers and set forth the limitations in the public interest under which national banks in every section of the country may serve the needs of business and industry. If it could force all state chartered banks doing a commercial business into the Federal Reserve System and thereby control their standards, they would in effect be national banks.

It is necessary in the public interest that there be a national standard of commercial banking. We have become a great commercial nation with intricate processes of trade and industry which could not endure submission to forty-eight separate systems of banking. If the national standard were withdrawn from the field the tendency would be for history to repeat itself in a great variety of independent local banking policies with an effect upon business similar to state regulation of interstate commerce. This consideration alone is sufficient to support the maintenance of a national system of banks.

Although the Federal Reserve banks are instrumentalities of the Federal government and have taken over many fiscal functions in aid of the national government, national banks nevertheless remain as the only creatures of Congress which specifically engage in the banking business. Congress can use them at any time to influence and direct banking policies or to transform them as the public interest may require. In 1913 when it was determined as a national financial policy that the Fed ral Reserve System should be established it was the national banks that Congress used as the basis for that system. Had there been no national banking system at that time and the banking business of the country was done entirely by state chartered institutions, Congress could not have created the Federal

Reserve System. This is evident from the fact that even under the stress of the need for a comprehensive and united national financial policy during the World War the state commercial banks were reluctant to come in. The 7,453 national banks were moved bodily by Congress into the Federal Reserve System without consulting the private wishes of their stockholders. The state banks were naturally under the influence of their respective boards of directors and stockholders and viewed the situation from the standpoint of business profits. They entertained considerable fear that they would have to submit to Federal regulation. Although the original Federal Reserve Act of 1913 permitted state banks to become members, from 1913 to June 21, 1917, only 53 state banks and trust companies had joined the Federal Reserve System. As a war measure Congress amended the Federal Reserve Act on June 21, 1917 offering to state banks membership in the Federal Reserve System upon more favorable terms than those enjoyed by the national banks, and the President of the United States, on October 13, 1917, issued a proclamation calling upon all eligible state banks to join the Federal Reserve System as a "solemn obligation." Out of 8,500 state banks and trust companies eligible for membership at that time only 212 joined the system in 1917 and only 686 in 1918. At the close of the War there were only 936 state member banks in the Federal Reserve System.

CHAPTER V

SOME INDIRECT EFFECTS OF THE FEDERAL RESERVE ACT

THE Federal Reserve Act did not attempt to establish a new system of banks in the United States. It is not a banking system. It created a new Federal instrumentality in the form of twelve Federal Reserve Banks operating under the supervision of a Federal Reserve Board in Washington. The Federal Reserve System is a form of central banking superimposed above the banking systems which were in operation at the time of its creation. The two outstanding features of the Federal Reserve System are the establishment of a sound and elastic national currency, the volume of which is automatically adapted to the current needs of business, and the control over credit policies through its power to fix the discount rate and to engage in open market transactions. It is not the purpose here to enter into a discussion of these questions. After being in operation for sixteen years the Federal Reserve System has commended itself with practical unanimity to all classes of business in the United States.

Nearly all of the large state banks are now members of the Federal Reserve System. The view is prevalent among bankers that these state banks could never afford to exercise their privilege of withdrawal. Such has been the prestige gained by state bank members of the Federal Reserve System that many see no additional advantages of a national charter. The alliance of the state bank with an instrumentality of the Federal government brings to it an element of good will of great value. The Federal Reserve System gives to it not only the direct privilege of discounting commercial paper but also the benefits of the impression which is made upon the public that the state member bank is a part of a great Federal instrumentality. This particular situation has operated to the disadvantage of the national banking system.

A state bank upon becoming a member of the Federal Reserve System must submit to certain conditions laid down in the Federal Reserve Act and supplemented by regulations of the Federal Reserve Board. These conditions of membership are designed to bring into the system only reputable state banks. The state member bank however still remains a state bank. It is not supervised by the Federal government but by the state bank superintendent. Its day by day banking operations are carried on under its state banking laws. It may withdraw from the Federal Reserve System at will.

The statement is frequently made that now that the Federal Reserve System is in force it would be just as well if all banks were state member banks and voluntary members of the Federal Reserve System. This doctrine is economically unsound in that it ignores the public need for Federal control over the policies of commercial banking. If all banks operated under powers granted by the state governments and if the supervision of the exercise of those powers rested solely with the various state officials the Federal Reserve System itself would fail to give to the public a sufficient assurance of protection in a time of national stress where a particular national financial policy ran directly counter to the selfish interests of those who hold the charters of the various state banks.

The larger state banks now regard membership in the Federal Reserve System as of the highest value because it gives them an operating advantage. If the balance of advantage were on the outside of the Federal Reserve System it is not likely that they could be induced upon public grounds to maintain their membership. Even to-day where it is the policy of the national government to restrict branch banking to the limits of the city in which the bank is situated several large state banks are operating outside of the Federal Reserve System because the state banking laws give them wider branch banking privileges. In other words the advantage of profits through greater branch banking privileges overcomes those of membership in the Federal Reserve System.

While the Federal Reserve System has fully accomplished its purpose of preventing the types of panics from which the country suffered from time to time, it has not prevented bank failures nor was it intended to do so. The Federal Reserve Board and the Federal Reserve Banks do not control the local banking policy. The responsibility for the operation of a bank, national or state, must rest upon its own board of directors and upon its officers.

Sound banking laws and a sound system of currency and credit may make possible a sound system of banking but it cannot insure good management for banking enterprises nor provide conditions around a bank to make its business operations automatically successful. The great number of failures of small country banks within recent years has no direct relationship to the Federal Reserve System. The causes for these failures must be found elsewhere.

The most important indirect effect of the establishment of the Federal Reserve System was to contribute to the decline of the national banks in their particular field of commercial banking and thereby to weaken the national banking system as an instrumentality of the Federal government. Conversely, by giving to the great trust companies the prestige of membership in the Federal Reserve System, carrying with it the presumption of a form of Federal supervision and control, they have become further intrenched in their operating advantage. The word "national" in the title of a bank has ceased to have its former meaning and the term "Member of the Federal Reserve System" has come to be considered as an adequate substitute. This anomalous result of the operation of the Federal Reserve Act is diametrically opposed to its original purpose. It was intended to add greater prestige to banking under the national charter and to give to Congress a greater control over banking operations in the United States.

The Act as originally passed, in Section 9, permitted state banks to become members but upon such terms and conditions and under such rules and regulations as might require them to operate practically as national banks under the supervision of the Federal Reserve Board and the Comptroller of the Currency. They were required to submit to such rules and regulations as the Federal Reserve Board might prescribe; to conform to some of the most important provisions of the National Bank Act, including that which limits the lending power, the impairment of capital, the payment of dividends, and to such rules and regulations as the Federal Reserve Board might make in this connection. They were also subject to the penal provisions of the National Bank Act. Furthermore such state member banks were subject to examination by the Comptroller of the Currency and were required to make reports of their condition to him. Violation of any of these provisions subjected the state member bank to expulsion. No provision was made for voluntary withdrawal from the Federal Reserve System.

The above were the provisions of 1913 as originally enacted but as we have seen only 53 out of 8,000 eligible state banks became members under these conditions.

After we had entered the war and it became imperative to marshal the banking reserves of the country behind a program of war finance and it further appearing that the state banks would not enter the Federal Reserve System unless special inducements were offered, Congress in the Act of June 21, 1917, as a war measure, amended Section 9. This amendment modified the power of the Federal Reserve Board to make rules and regulations governing the entrance of state banks in the Federal Reserve System; deprived the Comptroller of the Currency of the right to examine them; required reports of condition to be made not to the Comptroller of the Currency but to the respective Federal Reserve Banks; permitted state banks, upon becoming members, to retain their full charter and statutory rights as state banks or trust companies and to continue to exercise all corporate powers granted them by the States in which they were created; permitted such state banks to enjoy all privileges enjoyed by national banks as members of the Federal Reserve System; repealed the former requirements for specific compliance with a number of sections of the National Bank Act, including that governing the lending power; and it permitted state member banks to withdraw voluntarily from the System.

It was under these amendments, enacted under the stress of war conditions, but which have been retained as permanent provisions of the Federal Reserve Act, that the great trust companies of the United States came into their own, thus marking the final development of the trust company movement in the United States. With all of the advantages of the Federal Reserve System which the national banks enjoy and with charter powers much broader and more elastic than the National Bank Act, they attained a position of operating advantage much beyond the reach of the more conservative commercial banking charter of the national system.

Of the $74,020,124,000 of commercial banking resources in the United States in 1930, $44,903,585,000 were held by state banks and trust companies. Many of the largest commercial banks in the United States are operating under state charters. These banks are situated in the large commercial centers to and from which flow interstate and foreign commerce. One of their chief activities is to offer banking facilities to business engaged in commerce between the states and with foreign countries. Technically these banks are instrumentalities of the state governments from which they hold their charters; practically they are engaged in a field of banking the constitutional responsibility for the policy of which is vested in the Congress of the United States. The question therefore may be fairly presented whether Congress through the enactment of the war amendment of June 21, 1917, did not contribute to the acceleration of a movement which appears destined to remove commercial banking from Federal control and supervision.

CHAPTER VI

THE COMPTROLLER OF THE CURRENCY

THE office of the Comptroller of the Currency was created by the terms of the National Bank Act and has been in continuous operation since 1863. His tenure of office is for a period of five years and he may not be removed during his term by the President except upon laying before the Senate the causes for such removal. It was evidently the design of Congress to remove this office from the field of party patronage.

Technically the Comptroller of the Currency is under the general supervision of the Secretary of the Treasury but as a practical matter his office has operated independently during the entire course of its existence. The National Bank Act confers upon him very wide powers and holds him to a specific responsibility for the enforcement of the terms of that Act. On many important questions his decision is made irrevocable and final. In view of the fact that he is the head of a bureau of the Treasury Department, the Comptroller of the Currency naturally would confer with the Secretary of the Treasury on questions of national financial policy but in the nature of the case the Treasury Department cannot control the exercise of powers specifically vested in him.

Charters of national banks are granted solely by the Comptroller. When an application is made for a charter the Comptroller approves or denies it and it is not necessary for him to hold any hearings or to give any reason for his decision. The Supreme Court of the United States has held that when the Comptroller of the Currency determines that an item in a national bank is a loss that determination is final and no appeal can be had to the courts. When therefore the Comptroller declares a national bank insolvent, he may solely upon his own responsibility close its doors and appoint a receiver. Furthermore if in the opinion of the Comptroller a national bank has violated any provision of the national banking laws, suit may be brought in his name to compel the forfeiture of the bank's charter. The exercise of these great supervisory and regulatory powers over a period of more than sixty years has given to the Comptroller of the Currency a recognized position as a general supervisor over the operations of the national banks. When the Federal Reserve Act was passed and the question of the abolition of the office of the Comptroller of the Currency was discussed, Congress instead increased his powers and gave him an even wider influence in the field of banking. He not only became a member of the Federal Reserve Board but also was charged with the duty of enforcing a number of the provisions of the Federal Reserve Act.

The independence of the office of the Comptroller of the Currency is particularly emphasized by the fact that he alone of bureau chiefs in the Treasury Department is required to make his annual report not to the head of the department but directly to Congress itself. Congress has from time to time enumerated the items which he must cover in this report, one of the most important of which is that he must recommend to the Congress such changes in the banking laws of the country as seem to him necessary or expedient. He is charged with a larger responsibility than the administration of the provisions of statutory enactments but must keep abreast of questions of banking policy in all of its aspects in order that Congress might have before it from time to time the data upon which to consider new banking legislation.

Perhaps the least understood of all questions of banking policy is the relationship of the Comptroller of the Currency to the Federal Reserve Board. It has even been suggested that the establishment of the Federal Reserve Board rendered unnecessary the office of the Comptroller of the Currency. In his annual report to Congress for 1923 Comptroller Henry M. Dawes particularly addressed himself to this question, setting forth at length considerations against the absorption of the functions of the Comptroller by the Federal Reserve Board.

The Federal Reserve Board may be called a deliberative body. Its chief function is to arrive at questions of policy. It acts solely by resolution. Every action of the Board upon any question within its jurisdiction is formal and is preceded by discussion and a vote. The executive agencies of the Federal Reserve System are the twelve Federal Reserve Banks at the head of which is a Governor (a non-statutory office) with executive powers acting directly under a Board of Directors constituted under the terms of the Federal Reserve Act. The Chairman of this Board is the local agent of the Federal Reserve Board. As to policy, the twelve Federal Reserve Banks are under the general supervision of the Federal Reserve Board. The Board has frequently been called the supreme court of finance because it has the final decision upon the rediscount rate and upon other questions of credit of great importance to business.

The Board is not therefore a bank supervising agency since it only supervises the operations of the twelve Federal Reserve Banks. It may order the examination of any member bank for the purpose of determining its asset position with respect to its borrowing from a Federal Reserve Bank but it cannot under the present state of the law enforce the state or national banking laws against a member bank.

The Governor of the Federal Reserve Board is not vested with any executive powers as to banking policy. He can take no position as Governor of the Board upon any question except after formal action by the Board. In the absence of the Secretary of the Treasury, who is Chairman of the Federal Reserve Board, the Governor presides and brings the order of business before the Board. As a member of the Board he has one vote but beyond that his authority extends no further than that of the other members. It can be readily seen therefore that the Board, while admirably constituted for deliberative action upon questions of policy, has no facilities in the nature of an executive staff which may deal promptly and authoritatively with questions affecting bank operations.

The Comptroller of the Currency as a member of the Federal Reserve Board has the same responsibility, theoretically, as every other member of the Board on questions of Federal Reserve policy. He is the only member of the Board in active contact with the day by day operations of the bulk of the membership of the Federal Reserve System. The experience of his office is of great value to the Board. Between the Federal Reserve Board and the Comptroller of the Currency there is a coöperative interchange of information whereby each assists the other. Practically, the Comptroller of the Currency must devote the major portion of his time to the multitudinous affairs of his own office and cannot therefore, as do other members of the Board, devote all of his energy to purely Federal Reserve questions.

The National Bank Act put all of the responsibility for its enforcement upon the Comptroller of the Currency doubtless for the reason that in the supervision of a great system of banks it is often necessary to make instant and final decisions. Many important questions of bank operations which come before the Comptroller admit of no debate. Action must be taken at once in one direction or another. The Comptroller transacts a great amount of business by telegram and telephone. He is called upon to deal with every phase of bank operations. From the moment a national bank is chartered questions may arise of management personnel, of loan policy, of the soundness of particular loans, of the value of securities held and many others. He must use his influence and supervisory authority to keep the bank in a sound condition as far as governmental authority can do it. If, through circumstances beyond his control, the bank meets with failure he must determine its insolvency and appoint a receiver and wind up its affairs. In the administration of a receivership the Comptroller must take the responsibility for his receiver and instruct him day by day in the disposition of the bank's assets. It may be repeated however that the primary responsibility for the operation of a national bank is upon its own board of directors. While the Comptroller is charged with general supervision he is not charged with any responsibility for the operation of the bank. If, in spite of his supervisory efforts, the bank reaches a state of insolvency the local board must take the responsibility.

It will be seen therefore that the duties of the Comptroller of the Currency in the enforcement and application of the banking laws to a nation-wide banking system are primarily executive in character. It is not a deliberative office. The sole responsibility for its maintenance is vested in a single person. In order however to discharge his responsibilities the Comptroller of the Currency has in the course of more than half a century built up an extensive organization, the entire personnel of which is appointed by him and responsible to him. At his Washington headquarters there is a Division of Statistics which analyzes the reports of condition of the national banks as they are made from time to time; a Division of Bookkeeping which keeps the record of the issue of national bank notes, a system of currency which is still in force notwithstanding the Federal Reserve currency; a Division of Organization which receives and records all applications for national bank charters, for increases or decreases in capital stock, for the consolidation of banks, the establishment of branches and such other questions as relate to the organization features of national banks; and a Division of Examinations which receives and analyzes the reports of examination of the condition of national banks as made at least twice a year for each bank by the national bank examiners.

The chief source of information as to the operations of national banks are these reports by the national bank examiners. They are formulated upon schedules based upon years of experience and which bring out the most exhaustive information with respect to every phase of the bank's operations. In this work the Comptroller is assisted by a Chief National Bank Examiner for the whole United States and several Assistant Chief Examiners detailed to Washington from the field. To each Assistant Chief Examiner is assigned the consideration of reports of examination from the national banks in a given Federal Reserve District. Their analyses and recommendations are laid before the Chief National Bank Examiner and the Deputy Comptrollers. The Chief National Bank Examiner, in addition, has direct supervision over the personnel of the field examiners.

There are three Deputy Comptrollers of the Currency, which offices are created by law. They exercise the powers of the Comptroller of the Currency. The official act of a Deputy Comptroller is the act of the Comptroller himself, Congress being particular in the law to permit of no division of responsibility.

The field force of examiners is organized by Federal Reserve Districts, there being twelve district chief examiners with headquarters in the city in which the Federal Reserve Bank is situated. There are several hundred national bank examiners and assistant examiners who operate in all parts of the country under the immediate direction of a district chief. These district headquarters however are not offices of record but of convenience, all original records being kept at Washington.

Due to the large number of bank failures in recent years the Division of Insolvent National Banks has become one of the most active operations of the office of the Comptroller of the Currency. This Division is in immediate charge of a supervising receiver who occupies with respect to the receivers a position similar to that which the Chief National Bank Examiner occupies with respect to the national bank examiners. All receivers are appointed by the Comptroller of the Currency and he must sign their commissions. The equitable distribution of hundreds of millions of dollars of the assets of many insolvent banks places upon the Comptroller a great burden of responsibility. The work of reducing these assets to cash involves many intricate questions of law and fact. All lawsuits to protect the creditors are instituted and prosecuted at the personal direction of the Comptroller.

The employees in the office of the Comptroller of the Currency, from the Comptroller down, whether in the field or in Washington, have never been considered as political appointees and are not regarded as patronage. The requirements for the performance of their duties are so technical, and incompetence or inefficiency would be of such dire consequence to the public and to the standards of banking set up by Congress, that this consideration alone has been sufficient to preserve the operations of this governmental agency for the past sixty years as a professional bureau. Its very nature requires that it operate upon merit.

CHAPTER VII

CITY BANKING

BANKING as carried on in the United States has always been recognized as having two aspects, the one its relation to the public and the other its operation as a business for profit. There is great confusion in the organization of our banking system from the standpoint of public policy due to the forty-nine separate public authorities under which the respective state banking systems and the national system are chartered and supervised. From the operating standpoint, however, although there may be a considerable variation in charter powers as between various state banks and as between the banks of a given state and the national banks, there has developed a marked uniformity in the principles and methods of sound banking as the banking business is carried on for private profit. The exercise of charter powers is inclined to be limited to types of business regarded as sound and profitable and practically there is a marked tendency toward uniform bank operations. Out of this great variety of banking laws, national and state, there are in the United States to-day only two prevailing types of banking operations, city banking and rural banking.

This is a natural economic result of the responsibilities of boards of directors for bank operations.

The stockholders and the directors of a bank are not concerned with the bank in its public relations except to protect the institution as far as may be possible from what they may regard as ill-advised banking legislation or to espouse legislation which will enable them more readily to meet from time to time changing economic developments. The governments alone have a direct interest and responsibility in the broad question of public policy in banking.

Banking in this country must ever be under the influence and direction of these two forces, the one seeking public supervision and regulation, the other seeking to operate according to sound business principles at the highest possible profit. It is under the control of this latter force that banking standards —especially in the large commercial centers—have reached a common ground regardless of the source of public authority for the charter. It can be said to-day that a trust company, a state commercial bank or a national bank, belonging to the class of metropolitan banks, may change from national to state or state to national jurisdiction upon short notice without any disarrangement in their business operations.

A contributing force to this development of uniformity in city bank procedure is the modern clearing house. In every large city there is a local clearing house of which the principal banks are members on an equal footing regardless of whether they are national or state. It is a voluntary organization not created by the act of any legislature but its rules and regulations are binding upon its members. The moral power of the clearing house upon metropolitan banking is a potent influence in the promotion of the accepted principles and practices of banking. It may be said to be the custodian of the local banking code of ethics. Clearing houses may vary in importance with the size of the city but the most modern form of clearing house maintains a clearing house examiner who periodically examines all of its member banks with a view to enforcing the clearing house rules. This being an examination from the standpoint of bank operations rather than from that of government supervision it is often considered of greater value to the bank than that of the state or national bank examiners.

This brings us to a consideration of the highest type of banking we have developed, namely, that of the metropolitan bank of clearing house membership. The modern city bank, with resources in excess of one hundred million dollars is an institution embracing a number of operations directly related to the financial requirements of corporations and individuals. It has grown in size and complexity as the country has grown and is greatly different from the older type of banking where the operations were confined primarily to the receipt of deposits and making loans. The financial organization and activities of our great corporate enterprises to-day require many different types of banking contacts and facilities and the growth of individual wealth has brought to the banks new demands. It is almost impossible to compare the organization and operations of the metropolitan bank of to-day with banks in the same relative status of fifty years ago.

The city bank has become a departmentalized institution, each department under the direct operating supervision of a vice president and operated by personnel specially trained and experienced in that particular field. A brief review of the principal departments of one of these banks will serve to indicate the completeness with which their facilities meet modern financial requirements. There will be found the commercial department, the securities department, the trust department, the savings department, the safe deposit department, the foreign department, the personal loan department, the department of research and statistics, publicity and public relations department, department of audit and control, and occasionally other activities.

Banking in the United States has been maintained independently of business enterprise. Our theory of banking is that a bank should serve commerce and industry in every legitimate manner but should maintain its integrity and freedom from outside domination. This is perhaps the chief distinction between American and European banking. This principle is sound because it maintains the bank in a position of neutrality with reference to its customers. It enables it to take a judicial attitude and to consider upon their merits the financial demands which may be made upon it. This point of view is particularly reflected in the operation of the commercial department where the bank maintains the most intimate contact with its customers for the purpose of having at hand complete information relative to their requirements and their financial condition. It can readily be seen, in this day of complex corporate operations, through means of which every variety of manufactured product is produced and distributed, what a high degree of technical skill there must be to compile and analyze the information and statistics necessary to an intelligent appraisal of an important loan. In many such cases the question of fact becomes of greater importance than the question of policy. The commercial department therefore of a metropolitan bank must not only be conversant with the general principles governing the financial requirements of corporations engaged in production, manufacture, transportation, distribution and communication but must also acquire and keep accurate current statistical data with respect to its particular customers engaged in these lines.

The business of buying and selling securities as a form of banking may for practical purposes be said to be a post-war development. Popular education and experience in the participation by the general public in the purchase of securities were greatly enlarged and accelerated by the Liberty Loan campaigns during the war period. The era of great prosperity following the war, with its financing and refinancing of various types of corporate enterprise, developed a distinct demand that banks should offer facilities in this field to the investing public. The securities department of a metropolitan bank has become one of its most important operations. Here again efficient operation requires a special type of training and experience. This is in many respects the most difficult field of banking.

The trust department of a large city bank embraces the entire field of fiduciary relationships. The earliest forms of trusts were confined largely to the execution of wills, the administration of estates and the discharge of the duty of guardian. These were not banking functions but rested upon faith in selected individuals. It was however from this type of trust relationship that the trust business as a form of banking had its origin.

The trust department of a bank is capable of almost unlimited development. It is a field of banking operation which may be regarded as in its infancy. The very fact that it can bring together a management organization skilled in every phase of fiduciary law and practice, supported by the moral power and integrity of a great banking institution, gives assurance of a perpetual trustee whose administration of a trust estate will not be interrupted or disturbed by the circumstances which necessarily surround an individual. It is for this reason that large banks are rapidly supplanting the older type of personal trustee. The potential field of the trust business is nation-wide and world-wide. The trustee function must come into play in every case where an estate is left at death, where an individual or a corporation desires to create a living trust, where the estates of minors and incompetents must be conserved and administered, and in a multitude of cases where under modern corporation procedure the services of a trustee are necessary.

The living trust has seen a rapid development within the last few years. These are trust funds set aside by a living person for various purposes in which a bank is appointed trustee with discretion to invest according to the terms of the agreement between the trustor and the bank. A person may wish to provide for his retirement; he may wish to protect himself against a business misadventure; he may wish to provide an estate for his children which he could see develop in his own lifetime. Foundation funds for charities, recreation, education or other public purposes come under this category. This is the newest and one of the most fertile fields of trust business. The banks in this connection are doing pioneer work in suggesting various methods for the use of unemployed funds which on the one hand prevent their dissipation through unwise or incompetent management and on the other build up and conserve estates through expert and constructive investment.

In the field however of corporate trusts the trust department engages in perhaps the most technical of banking operations. It enters the field of commercial banking from a new angle. The modern business or industrial corporation requires the constant use of a bank trustee in connection with the operation of its capital stock. The bank also is appointed trustee for corporation mortgages which secure bond issues. Although the bank does not become in any way responsible for the value of the security offered by the mortgages it does put its reputation behind the regularity and the good faith of the entire proceeding and to this extent is a protection to the security holders. Corporate trusts also embrace the function of the bank as fiscal agent for corporations, as registrar of its stock issues, of transfer agent validating the transfer of its stock from one holder to another, acting as manager for under-writing syndicates in financing and refinancing corporations, acting as depositary for stock securities and documents under plans of reorganization, mergers and consolidations, acting as assignee and receiver and acting as agent in various capacities.

The corporation trust business differs somewhat from that of the private or personal trust in that it is more directly related to commercial banking. The bank acts in a confidential capacity for its commercial customers. It is a business which naturally flows to the bank in the day by day operations of commerce and trade. Other trusts are more or less occasional but have a degree of permanency. A single large estate may bring to a bank a great volume of business lasting over a period of many years and out of which may grow much other banking business.

Coming now to the savings department we enter a field of banking which is new in its general integration with the ordinary banking business. Savings banks very early grew up in this country as separate institutions but they did not develop very much beyond New England and the North Atlantic States. In the course of time it became the general practice all over the country for state commercial banks and trust companies to open departments for the receipt of savings deposits. At the time of the passage of the Federal Reserve Act in 1913, national banks were recognized as having the power to accept time deposits upon terms which practically authorized them to have savings departments and in the McFadden Act of 1927 the term "savings deposits" was first used with respect to deposits of national banks. Notwithstanding the fact that separate savings banks still exist in the territory above mentioned, the savings department has now become an established banking operation in nearly all large city banks. This department is particularly effective in those cities which permit branch banking. Many of the outlying branches are practically savings banks. The importance of this banking development has not been fully realized and it can be reasonably predicted that the future will see a great increase in the number of savings depositors in the strong banks.

It would be beyond the purpose here to enter into a description of all of the other departments of a metropolitan bank but mention should be made of the personal loan department which is new in city banking. This department is devoted to making small loans solely upon the security of the borrower's signature, with two supporting endorsements or co-makers. The purpose is to meet the needs of wage earners and small salaried employees. This idea was originated by the Morris Plan Banks and has been developed successfully by them throughout the United States. The adoption therefore of this type of banking by metropolitan banks is another evidence of their adaptability to new conditions. This phase of banking is profitable only if it can be done upon a mass production basis. It has however the indirect beneficial effect of introducing large numbers of persons to the bank. From this mass of small borrowers it is possible for important future customers of the bank to emerge.

It has been attempted in this chapter to present a sketch of a modern large city bank and the description is intended to apply to state banks, trust companies and national banks indiscriminately. This type of institution serves every type of a large city population, reaching the needs not only of the important corporations but also of the man in the street. Its methods are scientific, its operating standards are high and its management represents the best experience and ability that can be obtained.

CHAPTER VIII

RURAL BANKING

We have seen that the prevailing type of banking in the rural districts in the United States, under which each community is served by small, locally organized banks, received its greatest impetus at the beginning of the twentieth century when an amendment to the National Bank Act lowered the standard of capitalization for national banks from a minimum of $50,000 to $25,000 and when, beginning at about the same time, state chartered institutions multiplied with great rapidity for two decades ending with 1919. Although these small banks possess the same charter powers as the type of metropolitan bank above discussed, there is no possible comparison of the one with the other. The metropolitan bank is capable of offering every facility, and with greater effectiveness, which the rural bank offers to its community, but rural banking cannot engage in the various types of modern banking to which our large urban populations have access. It is not impossible for a bank of $25,000 capital or less to operate at a profit, especially if it be situated in a community in which it can acquire a fair amount of small business. It can make loans upon the security of real estate and if they are conservatively made and wisely administered they will prove profitable.

It can make small commercial loans and loans upon collateral or personal security. It can receive savings deposits. Nevertheless it cannot be a metropolitan bank in miniature. The more important commercial business is beyond its reach nor can it attract large individual deposits. It cannot operate a trust department, a securities department or any other of the recognized departments of city banking. This means that it cannot offer to the community in which it is situated the general banking facilities which are becoming customary and necessary.

Prior to 1900, in the days when the rural banks were larger and more widely scattered than they are to-day and when overland communication and transportation between the large cities and the small towns were limited as to time and distance by the speed of horse or oxen drawn vehicles, rural banking was in a stronger position. The economic changes incident to mass production of the automobile and its prevailing use as a means of both passenger and intercommunity commodity transportation; the construction of hard roads with arterial highways radiating from all of the large cities; and the common use of the telephone as a means of quick communication has revolutionized our whole rural civilization. If the great increase in the relative number of rural banks had never occurred they would nevertheless in the twentieth century have felt the effects of these fundamental economic and social changes. That the very time these changes were taking practical effect was also the period of greatest increase in the number of country banks stored up inevitable disaster for this type of banking. The Comptroller of the Currency, a Governor of the Federal Reserve Board and prominent bankers recently laid before the Banking and Currency Committee of the House exhaustive statistics and analyses of the banking situation in the agricultural communities. They have shown that in a period of economic prosperity for the country as a whole and particularly for the city banks, rural banking steadily declined. Failures through insolvency were more than five thousand over a period of ten years ending with the year 1929, and more than one thousand additional for the year 1930.

The plight of the rural bank has been summed up in its inability to meet the requirements of one of the most fundamental principles of banking, namely, that of diversification in its loans. If a bank must make a large proportion of its loans upon a single class of security it is naturally subject to the adverse effects of an economic depression in that class of business. If it is not possible for a bank to spread its loans beyond the reach of a local economic situation it cannot hold its own in a time of adversity. The small country bank must however make its loans in the community in which it is situated. That is its sphere of operation. But when it does serve the local community it runs the risk of failure through lack of diversification. The majority of our small country banks are situated in one-crop or one-industry communities. Banks in the wheat country must depend almost entirely upon wheat; banks in live stock sections must depend almost entirely on live stock; banks in cotton states must depend largely upon cotton, and so on. In times of prosperity in these sections, banks are prosperous, in times of adversity banks fail.

There is another aspect of rural banking which has been subject to very little discussion. The cream of the banking business in every rural community goes to the large city banks. The local community bank does not do all of the banking business which originates in that community. Herein lies the real cause for the failure of rural banking to develop in a manner similar to the city institutions. The automobile, the hard road and the telephone have greatly accelerated the movement of banking business to the city banks. Persons of wealth in the towns and villages may carry a small account with the local bank but their principal account will be with a metropolitan bank. One desirous of creating a trust estate or of appointing an executor of his will goes to the trust department of the city bank and not to the local country bank. Those in the rural communities who are able to purchase securities prefer to deal with city bankers. Independent local commercial enterprises where they have not already been absorbed into larger operating units in the cities also do their most important banking business with a city bank. There they offer their best collateral and secure loans in larger volume and at a lower rate of interest than the small bank can afford.

The theory of autonomous small banks for small communities and large banks for large communities is economically and socially unsound and is contrary to the actual state of facts. The existing system of rural banking while it may serve to make small profits for stockholders in exceptional cases, is driving the best class of banking business in the small towns and country districts to the large city banks, thereby further increasing the urbanization of rural communities.

Looking back over our banking history it can be fairly said that the agricultural sections of the United States have never had a sound and adequate system of banking. In its first period of development from the latter part of the seventeenth century to the first part of the nineteenth century, a period of about one hundred and fifty years, there were no banks at all in the rural communities and no banks in the cities until after 1780. It is questionable whether we should have developed more rapidly had these early pioneers depended upon the type of rural banking facilities which we have to-day.

When the States began to charter local banks shortly after 1800, and for the fifty years preceding the Civil War, the farming classes suffered from bad banking. Much resort was had to new legislation attended with rosy promises of future prosperity, but which only resulted again and again in disillusion and bitter disappointment. In the last decade we have only repeated our early history in banking. We have attempted to give to the farmer specialized types of financial services and have multiplied the number of banks excessively. While we have made it easy for him to borrow money on his land we have not yet offered to him a system of banking which can compare in the least with the strength, safety and variety of facilities offered by the large city banks.

So-called unit banking is often associated with the idea of local self-government and local community autonomy. There is assumed a background of local business activity which is definitely confined to the community in which the bank is situated. The implication seems to be that the local community bank gets all of the banking business arising in that locality. These elements of local independence, especially in their application to business, do not however exist. Business and trade move to and fro across the country with great flexibility and with no regard for the preservation of the independence of community life. This is particularly true with respect to those who do business with the banks. The banking business which originates in a given local community may find its banking contact in various cities. The small town bank will be found to hold only the most unimportant local business. The banks in the nearest city will get the business of the next importance. The metropolitan banks in the large commercial centers will be found to have gained the best type of business which originates in that local community. The most important banking business however, that is to say, that of the first magnitude, has usually found its way to the great banks of Chicago and New York, more particularly the latter.

The local community therefore is not dependent upon the small local bank for banking facilities. The rural bank has never played that part in American development which has been attributed to it. The only way in which the small country bank could assume a position of dominating financial influence in the community in which it is situated would be to compel all banking business originating in that community to flow to the local banks. No such suggestion will be seriously entertained.

One of the clearest evidences of the interdependence of banking in the United States is the relationship of country banks to the city banks in the commercial centers under which each becomes a correspondent of the other. Almost from the very beginning of banking in this country it became necessary for the banks in the outlying rural sections of the country to maintain banking connections in the financial centers. This development has continued with increasing ramifications to the present time. Every country bank has one or more city correspondents and practically all of them have a correspondent in New York City.

The primary reason for a city correspondent lies in the fact that country banks as a rule, particularly those in the agricultural communities, do not have occasion for the constant local employment of their funds in the banking business. There are times when they are in need of all of their funds for crop movements and marketing operations, but at other times they find it to their advantage to shift funds to the large cities for investment in activities wholly apart from the local community in which they may be situated.

When the Federal Reserve System was established many students of banking thought that there would be an end to the correspondent relation between banks in view of the services which would be rendered by the twelve Federal Reserve Banks but this has not turned out to be the case. The smallest banks especially have found it more profitable to continue to the fullest extent the correspondent system. Furthermore outside of the field of loans there has developed as we have seen in the large city banks a great variety of banking business requiring specialized knowledge and skill for successful management. The modern city correspondent is prepared to give the small country bank a contact with all of these departments of banking. Although the rural bank may not itself engage in these various lines it may from time to time, under the direction of its city correspondent, invest its funds or otherwise avail itself of the advantages of modern city banking.

The correspondent relationship is purely a business connection. It is not a system of banking created by law nor is it designed to promote a general banking policy. It is a voluntary agreement which, under our practice of banking, may be regarded as economically necessary.

The chief attractions of the correspondent relation to the city bank are the deposit balances which are carried with them by their country correspondents and the banking business which they may gain in the territory in which the country correspondent is situated. It is expected that such business as cannot readily be transacted by such a country bank would be commended to the city correspondent. Many cases arise in the local districts, as we have seen, where a local company or an individual may require banking facilities of a character beyond the capacity of the local bank. On the other hand, the country bank gains the interest which it receives upon the deposit balances which it carries with its city correspondent, the loans which it may secure, and the advice and assistance which the city correspondent may give with respect to investment securities. The fact that the Federal Reserve Banks pay no interest on reserve balances has been assigned as one of the chief reasons why the mass of rural banks continue to operate as non-members of the Federal Reserve System. They however receive directly the general benefits of that system and indirectly its specific benefits through their city correspondents.

Specifically a metropolitan bank will undertake on behalf of its country correspondents to purchase for them commercial paper, marketable securities and trade and bankers acceptances. These transactions will be consummated upon the judgment of the city bank. Loans made by the city bank to its country correspondent must be secured by collateral acceptable to the former. Country banks will from time to time, when market conditions render it advantageous, place with its New York correspondent money to be loaned upon call on stock exchange collateral. In these particular correspondent transactions the city correspondent gains the employment of the funds deposited and new business originating in the place where its country correspondent is situated, and the country correspondent in turn receives the benefit of the advice and direction of metropolitan bankers.

There is however no actual dependence of the small bank upon its particular city correspondent. It is a voluntary connection which may be changed at will. The country bank may, if it sees fit, change its correspondent at any time and it is therefore in the position of getting the best possible advantage from this source. The large city banks on the other hand are very desirous to have as many country correspondents as is possible. On the whole it may be said that the correspondent relation is of much more importance and advantage to a metropolitan bank than to a country bank. The volume of business which may flow to the metropolitan bank from this source is an item in the aggregate of considerable magnitude.

It has been said that the correspondent relation accomplishes a diversification in the banking business of the small bank by virtue of the loans and investments which are initiated for it by the city bank. Looking at the portfolio of the small country bank we shall find, under this theory, a certain proportion of loans locally made, in which item there is a lack of proper diversification offset by loans and investments made in a commercial center like Chicago or New York which embrace a variety of items of undoubted financial soundness. This interpretation of the term "diversification" leaves out of account the local community in which the bank is operating and is at variance with the general and ordinary conception of that idea. Diversification as a cardinal principle of banking, when applied to a unit bank, has always been held to mean a diversification of the business which comes to it from the community in which it operates. Assuming that the bank was established to serve the community in which it was situated, it having received its charter upon the strength of the local need for banking facilities, it must theoretically at least find in the locally available banking business a sufficient diversification in the character and scope of that business to make its operation safe and profitable. The whole principle of independent community banking breaks down if these conditions do not exist. If the local bank must send local funds to distant commercial centers in order to meet the requirements for diversification it is a confession that the business of the local community cannot support the bank. The normal business of a local bank should be derived from the territory embraced by the community in which its depositors and local borrowers reside, or else the local rural bank system be abandoned.

It has been formally stated by the highest banking authorities of the government that under the economic conditions of the rural communities it is not possible for the rank and file of small country banks to gain diversification in local loans and investments. This is put forth as the fundamental cause for the constant repetition of failures of country banks. In this respect there seems to be no likelihood that there will be in the future a return to economic conditions favorable to these banks.

Each of these failed banks was a correspondent of a metropolitan bank but the latter could no' be expected to take steps toward protecting the local community or saving the local depositor from loss. That is not a feature of the correspondent relation any more than it is the duty of a Federal Reserve Bank to attempt to protect the banking public under similar circumstances. It is true that a correspondent will offer such facilities to save a bank from failure as can be offered without loss but it has not the duty nor responsibility to make any such effort for the benefit of the local public. As a consequence under the correspondent relation small country banks will fail and it will be found that perhaps their best assets are held by a metropolitan bank as security for loans made before the bank became insolvent. The correspondent system no doubt has its proper place under the existing system of rural banking but in any consideration of a plan to give the rural population a safer and stronger system of banking and a direct access to more extensive and convenient banking facilities, the prevailing methods of correspondent banking may have to be disregarded. The history of our banking operations however has convincingly shown that whatever system of banking we may employ, some form of correspondent relation is necessary.

CHAPTER IX

ANALYSIS OF A BANK FAILURE

THE effect of the failure of a local community bank may be considered apart from the causes of bank failures. The immediate effect of a failure is a violent shock. Banks, particularly national banks, are regarded as the most substantial and economically secure institutions in the community. The sudden closing of the doors is a surprise to all but a few insiders. The condition of the bank is known to the governmental authorities responsible for its supervision, to the officers of the bank and presumably to its directors—but never to the general public.

Let us consider first the position of the depositors in a country bank. They fall into two classes, namely, the commercial depositors as represented by the local merchants and business men and the savings depositors composed of men, women and children of thrifty habits. Both of these classes of depositors, while representing the most substan ial element, economically, in the community, nevertheless are persons of small means. In the rural communities and country towns it is well known that money is accumulated with extreme difficulty and savings deposits are built up through years of careful planning and self-denial. These persons know nothing about the technique of banking or about banking laws and banking conditions. If the bank is a national bank many of them rely upon the Federal charter and Federal supervision as a protection. Suddenly the bank closes its doors and goes into the hands of a receiver. It is too late for the depositor to withdraw his account. Instead of dealing with his banker he must now reckon with the receiver who in the course of time will ascertain what percentage, if any, of his deposit will be paid. In some cases nothing is paid, in many others only a small percentage and in all cases all of the deposits are tied up for a period of time.

To the small merchant who has been efficient and thrifty enough to carry a balance on deposit in the bank it may mean bankruptcy and ruin. To the savings depositors, composed in many cases of widows and orphans, it brings despair and blighted hopes.

Consider next the borrower. Country banks lend money to small merchants and farmers who are accustomed to renew these loans when they become due. Most of them are not expected to be paid in full at maturity and among them will be found a considerable body of loans upon the security of real estate. Mortgages on homes and small business houses and mortgages on farms make up a considerable portion of the loan portfolio of a country bank.

Bank failures have not ordinarily been considered a hardship upon borrowers but a closer examination of the situation reveals inevitable embarrassment to this class. When the receiver takes charge of a bank he must wind up its affairs. The bank as a corporation is dead. He must produce for the depositors every cent which he can derive from the bank's assets and these assets are principally the notes owed by local borrowers. He must force the collection of these notes. He cannot extend them or renew them as that would be beyond his authority. The sudden closing of the bank therefore throws every borrower face to face with an immediate demand for settlement of his account at maturity. In a great many cases he is unable to do so. As a consequence every country bank failure is followed by a multitude of lawsuits against borrowers. While it may be said that such a borrower is entitled to the least sympathy since he has had the use of the bank's funds, the suddenness and swiftness of the liquidation often wipes out his entire estate. If such a borrower had theretofore arrived at such a state of prosperity that he was able to borrow from the bank upon paper eligible for rediscount at a Federal Reserve Bank and at the same time carried a deposit in the failed bank, he would not be entitled to offset his deposit against his loan, because the bank will have rediscounted his note (as it certainly would do). He must lose his deposit and also pay his loan in full.

Coming now to the shareholders of country banks, we find that these shares of stock are acquired as local investments. It is somewhat a source of pride to be a stockholder in a local bank. Such stockholders are usually found among the local merchants, prominent farmers and women who have been left small estates. When such a bank closes most of these stockholders awaken to the rude fact that under the banking laws they have incurred an additional liability to the depositors equal to the entire amount of the par value of their stock. A stockholder who owned ten shares of stock at one hundred dollars per share par value not only loses that entire amount in an ordinary country bank failure but in addition must pay to the receiver an additional thousand dollars as a penalty.

This legal provision, known as the double liability clause and which is common to both state and national banks, has operated with the utmost hardship upon local investors. In the case of national banks the stock is sometimes purchased upon the mistaken theory that the Government of the United States stands as guarantor of the stock. There have been many cases of appeal to the Comptroller of the Currency by country shareholders in national banks to restore the funds which had been lost through investment in national bank stock. When the Comptroller replies, as he must do under the law, that not only must such a shareholder suffer the complete loss of his investment in stock but that he must also pay to the receiver of the bank an additional one hundred per cent assessment, the shareholder is driven to raise the additional amount upon the security of whatever property he may have or else face a lawsuit by the receiver and have a judgment rendered against him in the Federal courts. Such a shareholder will as a rule also be a depositor in the bank and will have lost the money deposited, the investment in the stock, as well as suffered the additional liability. If in addition he was also a borrower and his note had been discounted with the

Federal Reserve Bank he would find himself in the position of suffering the worst loss of stockholder, depositor and borrower.

The directors of the bank are the fourth class affected. Under the American legal theory of banking the board of directors are the real operators of the bank and are responsible for the bank's policies and administration. Under the law when a person becomes a director of a bank, particularly a national bank, he assumes certain definite responsibilities the improper discharge of which involve serious penalties. As a practical matter, however, it seems almost impossible for bank directors to realize the full meaning of this situation. The board of directors is formed with no idea of an assumption of personal liability for the actual operations of the bank. That is left to the president and cashier, and to some extent to an executive committee. As a rule the country bank is operated almost entirely by these two officials—often by only one of them.

Nothwithstanding therefore the technical legal situation, the failure of the bank very often comes as a complete surprise to the majority of the members of the local board. Nearly all of them will be found to be depositors, borrowers and stockholders and will have incurred the misfortunes of these three classes. In addition they must have the rude awakening to the circumstance that they are liable in their personal assets for damages for any acts of negligence in the management of the bank. They are thus brought for the first time face to face with their responsibility to the depositors of the bank. In hundreds of such cases receivers of banks have brought suits and obtained judgments against the most prominent citizens in the local community upon their failure to discharge their legal responsibility as directors. No experience could be more bitter than to endure such a hardship. Many local citizens would hesitate to become a member of the board of directors if they had a full appreciation of the legal responsibilities involved. This legal responsibility is supplemented by a strong moral responsibility to the public for many are led to deposit their funds in a local bank because they have particular confidence in one or more of the directors. While therefore the directors of a local bank very often suffer the heaviest losses from bank failures, their position does not make a sympathetic appeal comparable to that of the depositor.

There is another aspect of director's liability. The banking laws contain many penal provisions the violation of many of which, with the knowledge and consent of members of the board of directors, may lead to criminal prosecution. Nearly every local bank failure brings up the question of misfeasance or malfeasance by directors.

We come next to a consideration of the officers of the bank, the president, vice president and cashier. Leaving out the question of their responsibility for the condition of the bank, the effect of the failure upon them is often complete disaster. They not only may suffer by virtue of being depositors, borrowers, shareholders and directors but must also endure the impairment of reputation. If there have been criminal violations of the law they may be indicted and prosecuted.

A bank failure also puts an additional burden upon the government, national or state. In the case of national banks the Comptroller of the Currency must go to the expense first of sending a national bank examiner to investigate and report on the exact financial condition of the closed bank. This involves the expenditure of time, energy and funds both in Washington and in the field. Next a receiver must be appointed, his attorney designated, and the machinery set up in Washington for a detailed supervision of the receivership. The attention of the governmental authorities is thereby diverted from the field of constructive development of bank operations to that of the purely negative and destructive economic activity of winding up by force of law the affairs of a defunct institution. The cost of these governmental operations are paid out of the funds of the closed bank and therefore come in the long run out of the pockets of the depositors.

Upon the local community itself a bank failure is a major economic disaster. Business becomes paralyzed, credit is destroyed and confidence is lost. In the place of peaceful pursuits there arises a warfare of conflicting claims for settlement. Lawsuits are brought by citizen against citizen, the receiver goes into the Federal court to force the collection of loans, securities are thrown on the market for sale and the grand jury deliberates over the question of criminal liabilities.

Such is the story of the effect of a single failure of a local community bank. Multiply this by about seven thousand, stretch it over a period of the past ten years, scatter it through the agricultural communities and small towns of the United States and there will be produced a composite picture of the social and economic effect of our bank failures. It has been conservatively estimated that more than eight million depositors have seen more than two billion dollars of their funds tied up in these seven thousand closed banks. What percentage of recovery will be made is problematical. The accumulated effect of these failures can have no other result than a serious curtailment upon the purchasing power of many of the most substantial persons in the rural communities.

In most of the states it has compelled the banking department to set up an administrative organization for winding up the affairs of local state banks. On the part of the Federal government the Comptroller of the Currency has had to create a division of his office for the supervision of the receivers of failed national banks of such size and importance as to require a considerable share of his personal attention.

CHAPTER X

BRANCH BANKING

THE term branch banking is used in contrast to unit banking. Both of these expressions arose in the nation-wide controversy over the California Bank Act which permitted banks to conduct their business at more than one office. The small country banks became aroused and organized themselves against the possible spread of this type of legislation to other States. They were successful in a number of States in securing the enactment of legislation which confined banking operations to a single office. The term unit banking therefore, as popularly used, is associated with the small banks.

Branch banking is not a method of banking but is rather a procedure of carrying on the conventional banking business. Branch and unit banks can operate side by side under the same banking code. Many metropolitan banks are by force of law compelled to operate as unit banks. There are great metropolitan unit banks in such commercial centers as Chicago and St. Louis, where banks are not permitted to have branches, but these are engaged in the same type of banking as metropolitan banks in such cities as New York, Detroit, Cleveland and San Francisco where banks are permitted to carry on their business at several different offices. The branch banking question therefore is largely a question of physical location of banking offices. It gains its chief significance in its application to the rural communities.

It has been said that branch banking is an attempt to ingraft a foreign system of banking upon a unit banking system peculiar to the United States. It is true that branch banking is in almost universal operation in all other civilized countries. There relatively a few metropolitan banks have offices situated in various parts of the country whether urban or rural. In these countries it has become the accepted financial policy to offer banking facilities to all classes of the population through means of large banks with numbers of offices. Persons in remote hamlets requiring the need of a bank may have immediate access to an office of a metropolitan bank. It should however be stated that many of these countries are small and thickly populated. Their business and economic activities may be more definitely established and the lines closer drawn than is the custom in the United States. Our near neighbor Canada may be regarded as an exception to this rule. Branch banking there, especially in the West, is operated under economic conditions very similar to our own. Notwithstanding however the successful operation of branch banking in the rest of the world, advocates of branches for banks in this country have very rarely referred to foreign branch banking in support of their position. Discussion has proceeded almost entirely upon economic and legal grounds peculiar to our own situation.

Branch banking as a means of carrying on the banking business nevertheless has been known to the American people since the creation of the first banks. It is not a new development. The Bank of the United States chartered by Congress in 1791 established eight branches in the leading business centers of the country at that time. When the Bank of the United States was rechartered in 1816 it established twenty-five branches in various parts of the country. Both of these banks, although instrumentalities of the Federal government, were engaged in the banking business for profit upon the same corporate basis as the national banks to-day. Branch banking was quite common by state banks under the authority of state laws prior to the Civil War. Mr. Platt, formerly vice governor of the Federal Reserve Board, has frequently directed public attention to the extent of this early development of branch banking.

In 1865 Congress amended the National Bank Act for the special purpose of permitting state banks to nationalize and keep their branches in operation regardless of where the branches were situated. Under this national policy branch banking found its way in various parts of the country into the national banking system. During the greater part of this time more than one-half of the States permitted the banks chartered by them to carry on their banking business at more than one office and in these States there was a slow but gradual influx of branch banking systems under the national charter. This movement became accentuated after 1918 when the National Bank Consolidation Act was passed permitting two or more national banks to consolidate and to retain such branches as either possessed.

In view of the fact that the National Bank Act did not grant to national banks the specific power to establish branches directly it became the practice for those interested in a national bank to secure control of a state bank which had branches under the state law, to convert it into a national bank, elect to retain its branches and then to consolidate the two national banks. This gave the consolidated institution all of the branches which the state bank had. This procedure was possible only in those States in which branch banking was permitted under state law.

Up to 1911 the question of the power of a national bank to establish branches had not been definitely decided although the Comptroller of the Currency had given no encouragement in this direction. In that year the question was put to the Attorney General of the United States and he held that a national bank was without power under the law to operate a branch bank. The opinion rather took the position that a branch was in the nature of another bank and that to permit such branches would allow several banks to operate under one capital structure, in contravention of the terms of the law which required all national banks to have a paid in capital of a definite legal requirement.

The congestion of traffic in the large cities due to the use of the automobile for local transportation caused a widespread movement under state law to permit banks to carry on their business at more than one office. The primary motive was one of public convenience, the offices operating very largely as places for the receipt of deposits and for paying checks. The national banks found themselves at a very serious disadvantage under the opinion of the Attorney General and many of them gave up their national charters in order to have the privilege of more than one city office.

In 1922 the Comptroller of the Currency began to permit national banks to establish what he termed "additional offices." These also were called "tellers' windows" because of the limited banking operations conducted in them. The following year in due course the question again reached the Attorney General of the United States. He distinguished these "additional offices" from branch banks as defined by his predecessor and held the "additional offices" to be within the legal powers of a national bank. In the meantime, in 1924, the Supreme Court of the United States in the case of the State of Missouri against the First National Bank in St. Louis confirmed the opinion of the Attorney General of 1911 which denied the power of a national bank to establish branch banks but the question of "additional offices" not being before the Court that point was not decided.

In 1927 the McFadden Act became a law. One of the principal purposes of that Act was to establish a negative equilibrium between the branch banking powers of state and national banks in so far as it lay within the power of Congress so to do. In States where branch banking was permitted under state law national banks were permitted to have branches within the limits of the city in which the bank might be situated. This offered an opportunity to bring under the terms of the statute all of the "additional offices." At the same time Congress used its power over the Federal Reserve System to exercise a restraining influence upon state chartered institutions. State banks and trust companies, so long as they remained members of the Federal Reserve System, were prohibited from establishing new branches beyond the limits of the city in which the parent bank was situated. The McFadden Act carried another provision which permitted all state banks to retain, upon becoming national banks, any branches which were in existence on February 25, 1927, regardless of the places where the branches might be situated. Some of the principal state branch banking institutions, theretofore engaged in state-wide branch banking, became national banks after the enactment of this law.

The branch banking question did not subside with the enactment of the McFadden bill nor did the restrictions in that bill upon state banks serve to effect a parity in branch banking between the Federal and the state chartered institutions. There are to-day several state institutions which are operating exclusively under state laws in the establishment of state-wide branches and which are not members of the Federal Reserve System. They are therefore beyond the reach of the McFadden Act.

Many students of banking do not regard as branch banking the operation of several offices by one bank within the confines of a single city. They reserve that term to describe the extension of banking offices beyond the limits of the city. Several years ago when the branch banking question was acute and there was much organized opposition to it the prevailing discussion centered around city branch banking, although much of this opposition was apparently based upon the fear that once branch banking was permitted in any form it would logically be extended into wider and wider areas. The changed point of view may be accounted for in part by the success of city-wide branch banking. The two principal predictions, namely, that branch banking in the large cities would fall of its own weight through lack of competent management and that a cutthroat competition would arise which would make this type of banking unprofitable, have both failed of realization. City branch banking has proceeded in those cities in which it is recognized by law with marked conservatism and the city offices of metropolitan banks are managed with efficiency. This type of branch banking has permitted the metropolitan banks to offer all of their facilities simultaneously in various sections of the city. In this manner they have contributed to the comfort and convenience of the entire urban population. It may now therefore be said that there is no public opposition to city branch banking in those cities in which it has been developed.

The other factor which contributes to the changing point of view on branch banking is the steady decay of unit banking in the country districts. The great amount of public inconvenience and suffering over wide rural areas in the United States due to the failure of thousands of small banks in increasing numbers year by year, has resulted in proposed measures for the extension of branch banking from the large cities to surrounding rural communities. The feeling is growing that the small depositor in the agricultural districts is entitled to the same protection which his neighbor in the cities is permitted to enjoy. The question is being asked, why should not the city banks be permitted to open offices also beyond the city limits especially in view of the fact that all of the important residents of the surrounding rural communities do their banking business with these same city banks? If a person in a small town fifty or a hundred miles distant may drive to a city and avail himself of the facilities of a branch of a city bank, why should not such a bank be permitted to take its facilities to the town in which he lives? Is it not a greater detriment to a local community for its citizens to take their banking business to the nearest large city than would be the case if that banking business remained in the small town although conducted through a branch of a city bank? The branch banking question to-day therefore is not whether banks should have branches but rather to what distance from a parent bank should branches be established.

The arguments for and against branch banking have been repeated over and over again but principally upon an assumed state of facts. Disregarding the experience of foreign countries the only practical demonstration of branch banking on an extensive scale in rural communities is in the State of California. The recent statement of Mr. James A. Bacigalupi, General Counsel for Bank of America National Trust and Savings Association of San Francisco, and that of Mr. A. P. Giannini, the founder of that institution (under the original name of Bank of Italy) are the only existent first-hand presentations of statistics and scientific analyses of operating policies and procedure based upon more than a decade of real branch banking. These statements were made before the House Committee on Banking and Currency, May 6, 7 and 8, 1930, and are a part of the official records of the banking investigation now in progress.

There is one feature of branch banking, the economic soundness of which has not been brought into question. This form of banking alone can meet in the rural districts the fundamental requirement of diversification. It has been seen that a small country bank cannot by virtue of its limited scope of operation secure a proper diversification in its business. Its nearest approach can be attained only through sending its funds to a distant city to a metropolitan correspondent bank for profitable investment. The rural branch of a city bank, on the other hand, is just another office of the bank itself. It is one of a number of operating units. It may make loans in the community in which the branch is situated without any attempt at local diversification because diversification is achieved through the operations of the bank in a large number of offices situated in other economic and geographical environments.

A properly organized city bank, where branch banking is permitted, will operate through a number of branches within the limits of the city in which the parent bank is situated in addition to rural branches. These branches will do a considerable amount of commercial banking business and diversity in this type of business is obtained both through the distribution of branches in various commercial centers in the city as well as through the variety of business which is normally done by a large city bank. Such a bank will also have branches in outlying manufacturing and industrial towns through which it will offer facilities to business enterprises engaged in the production of natural resources and in the manufacture of various products. It will also have branches in as many types of agricultural activity as may be available in the territory in which it operates.

A bank in this position is strongly protected against local economic depressions especially such as bring disaster to small country banks. Every country branch of a well-balanced branch system would have behind it the support of this diversity of banking business. Nothing short of a national economic collapse could cause serious embarrassment to this type of banking.

Branches established in rural districts must, in the nature of the case, take on some of the characteristics of local savings banks. The very fact that they would be safe repositories for accumulated funds will bring to them this type of business. In most rural communities this is the principal type of banking business available and an institution which can command confidence and respect will best meet this need. There will be some commercial business available in every community but in many places not enough to support a bank or to justify the operation of a branch. Many such branches might only be tellers' windows for the receipt of deposits and the payment of checks as this would meet all of the requirements of public convenience and advantage.

Under these circumstances there will naturally be found in a branch banking system embracing a number of smaller communities a large percentage of loans upon the security of real estate. In the discussion of the possibility of conducting the commercial banking business separately from the savings bank business and prohibiting by law each from doing the type of business in which the other is engaged, branch banking in its normal economic adaptation presents an overwhelming obstacle. It might be possible to acquire some sort of segregation of the two types of business under the roof of a single institution but to attempt to divorce them would render banking facilities more unavailable to the majority of our population than it is to-day. The branch of a city bank must be permitted to do all of the banking business potentially available in any outlying local community in which it may be established.

CHAPTER XI

GROUP BANKING

A NEW movement in bank organization and management of impressive proportions got under way during the year 1929. It is known as "group banking." Its chief organizational characteristic is holding company ownership of the majority of stock of several banks. This stock is acquired through the simple process of purchase and sale. The holding company purchases directly from the bank's stockholders a sufficient volume of stock in a given bank to give it voting control of the corporation at the annual or any special meeting of the shareholders. While some of these companies have paid cash for such bank stocks the prevailing method of acquisition has been to exchange the holding company stock for bank stocks upon an agreed value of exchange. The formula of exchange is arrived at through negotiations by the parties concerned. The method therefore by which the holding company comes into the possession of stock control over banks has its legal basis in the ordinary law of contract of sale.

It is the usual practice in the formation of these group bank holding companies for the movement to center around a large city bank. This is the most significant feature of the movement. It at once gives to the holding company the strength and prestige of experienced bank management and assures a board of directors of high standing. Leading bankers in several of the great commercial centers of the United States may be found in the management and on the board of directors of group bank holding companies. This fact in itself is enough to arrest attention and to require the most serious and deliberate consideration of this development.

The causes and the motives for group banking are interwoven in the developing economic fabric of our civilization. On one hand it relates itself to the mechanism of banking as a business enterprise and on the other it is closely associated with the general world-wide economic trend toward mass production through the creation of larger, stronger and more efficient operating organizations. That the time was ripe for a movement of this character is shown by its simultaneous appearance in nearly every section of the country, in each case under local guidance and control. In the Northwest, on the Pacific Coast, in the Southwest, the Middle West, the South, the Southeast, the North Atlantic States and in New England, holding companies were formed for the purpose of bringing together under some sort of metropolitan banking contact groups of banks in their respective territories. A significant feature of this phenomenon was that the motive was local in each case. There was no national organization and no nation-wide movement—in fact no conscious movement at all of one in concert with the other. They are separate and isolated growths arising out of the economic life of different and widely separated communities. The organizers themselves saw an opportunity to adapt the mechanism of the holding company—which is a well-known corporate device in other fields—to banking institutions.

In making an explanation of the reasons which prompted them to engage in group banking and in interpreting their own operations, there is naturally found a wide variety of presentations. This instead of being an element of weakness is on the contrary an evidence of strength. That such a movement of nation-wide proportions could within a short time spring up independently in so many communities under the sponsorship of business leaders is prima facie evidence of its fundamental nature. While accurate statistics are not available there are said to be nearly three hundred bank holding companies in which are brought together seven thousand banks, the aggregate resources of which are equal to nearly one-half of the banking resources of the United States. These estimates include some banks which are engaged in branch banking but the volume of banking which has found its way into the group bank movement within the past year may safely be said to embrace considerably more than one-half of the banking resources in the territory in which the respective groups operate.

While the mechanism of group banking may be different in details in its application to local conditions there are certain general principles which furnish the basis for a study of the theory of this type of banking. When a group of outlying banks are brought into operating contact with a metropolitan bank there arises an opportunity to extend to those communities the direct influence and in many respects the facilities of modern city banking. In the light of public policy this is the real meaning of group banking. From a business standpoint the endeavor must be profitable in order to justify its existence.

Every corporate enterprise must operate upon policies formulated by the directors who in turn are held accountable by the stockholders. The board of directors of banking institutions which are in the nature of quasi-public corporations, are in addition more or less responsible to the government which grants them their charters. It is necessary to bear in mind these two aspects of group banking. In what form and by what authority does the policy originate under which a group of banks operate? Can the management of the metropolitan bank, through means of the holding company, transmit its policies to each member bank in the group and thereby secure their enforcement? If this cannot be done group banking will have lost its opportunity to stabilize and enlarge banking in the country districts. This is one of the most important questions of group banking although its answer seems not to have proven difficult.

The very nature of group banking facilitates the creation of a sound policy. Member banks enter or affiliate themselves voluntarily with the group in order to gain the advantage of such a policy. It is not a case of a holding company controlled by a metropolitan bank forcing itself upon outlying banks. It can be reasonably assumed that the negotiations between the holding company and a prospective member bank is devoted in part to this very question of the creation and the application of unified operating policies. This gives to the group at its inception a coöperative feature which runs throughout the entire organization. The application of this principle to hitherto isolated banking units is one of the important contributions of group banking.

It has been the experience of the principal bank holding companies that there is no difficulty in the acquisition of banks for the group. They have not, as has been erroneously stated, gone out and paid fabulous prices for bank stock in order to get control of unit banks. On the contrary the unit banks themselves have in greater numbers than could be assimilated made application to holding companies for group membership on the basis of an exchange of bank stock for holding company stock.

The reason is easy to understand. The group organization offers to the stockholders of the outlying unit bank an investment of greater liquidity and of higher prospective dividends than is afforded by the stock in the local bank. At the same time the public confidence which the group management inspires gives assurance that the local bank as a member of the group can increase with safety its local banking facilities. When therefore a bank, through the action of its individual stockholders, becomes a member of a group it is quite likely that some of its principal directors will find their way upon committees for the group as a whole. Under such circumstances it can readily be seen that when a strong metropolitan bank which has long had the respect and confidence of the territory which is tributary to the city in which it is situated puts its strength and its reputation behind a group organization, the initiation and dissemination of central operating policies will become effective throughout all of the units of the group.

The holding company is the means through which the group is brought together. On its board of directors are found the principal officers and directors of the central city bank of the group as well as officers and directors from other member banks. The holding company however is not a bank and is not engaged in the banking business. The real banking influence is the combined banking experience of the group. Where a group is composed of one principal city bank and a number of smaller banks, principally in the country districts, it is the city bank which furnishes the motive force in bank operations.

When there is the prospect of a bank becoming a member of a group one of the first steps is an examination of the bank by an examiner or auditor representing the holding company. This examination taken along with the examinations theretofore made by the government authorities will show the financial condition of the bank—its past earnings, the state of its loans with respect to losses and items of slow or doubtful collection, and the state of its investments, whether the securities are readily marketable and are held at a profit or loss.

In nearly all cases, especially where a country bank is about to enter a group, it will be found that the local bank does not measure up to the standards of banking maintained by the city bank. They may also indicate the necessity of a certain amount of cleaning up by the local bank itself or by the holding company under city bank guidance before the local bank can become a member of the group. This will be the first contact of the local bank with the idea of the necessity of a central operating policy. The accomplishment however of this result at this point is a matter of negotiation and may become a condition precedent to group entry. After the bank becomes a member of the group an established procedure of centralized contact is necessary to the successful operation of the group as a whole.

In general it may be said that there are three necessary features of group banking of general application, namely, a centralized and coördinated loan policy, an investment policy of the same character and a more or less continuous audit of member banks by examiners responsible to the holding company. This last is of the highest importance as it furnishes the information upon which policies may be initiated or regulated. In like manner every operating department of the city bank, in so far as the members of the group can avail themselves of it and assimilate it, may be made available to the group as a whole. The experience and the technical skill developed over years of successful operation by the city bank can thus manifest itself in various local communities and thereby offer to them banking facilities of a higher order than is possible for the local bank operating alone.

It is recognized that the holding company, being simply in the position of the principal stockholder of a group member bank, is not in a position to issue mandatory instructions to directors and officers. The central bank of the group is entirely independent technically of every other member of the group and has no corporate connection with any of them. Each board of directors of the respective member banks is legally independent and is charged with the responsibility for the operation of the local bank. In many cases this responsibility is defined by law with provisions for penalties. Consequently the group bank organization must be maintained without interference with or abrogating the corporate integrity of each of its members. The central group policy is therefore a proposed or suggested policy in contrast to an authoritative and enforceable policy. Technically speaking the central group policy on any particular transaction whether it be a loan or an investment is offered as a suggestion to the local board of directors as a means of the attainment of conformity to the group standard originated by the group as a whole.

It is the natural assumption that the local board will make such a policy its own and take full local responsibility for it since that is the principal purpose of the formation of the group. The group member remains a unit bank operating as a local corporation in its particular community. In contrast to unit banks not members of a group it has behind it the power and prestige of the entire resources and experience of a number of other banks operating under high banking standards and adopting approved methods of modern banking.

Group banking may be compared with the correspondent relation on the one hand and with branch banking on the other. The central bank of a group will always be found to be the city correspondent of a number of banks in various parts of the surrounding country, particularly of small banks in the commercial trade area of the city in which it may be situated. For these banks it offers the ordinary correspondent facilities. This relationship antedates group banking but is found to continue alongside it. In the ordinary course of group formation the group members will be found to have been correspondents and customers of the large city bank of the group.

No principal group of banks has been formed with headquarters in the metropolitan cities of New York, Chicago, Philadelphia and St. Louis. The groups which are in operation to-day may be said to be regional in their influence, some being confined to state boundaries and some to economic areas of varying size. In general it may be said that from a territorial standpoint the group organization extends as far as its normal correspondent relation with outlying banks formerly extended.

The ordinary correspondent relation is based upon an open agreement, neither bank having any responsibility for the policies of the other and each being free to sever the connection at will. The outlying member bank of a group is also a correspondent of the central city bank of the group but there is behind this relationship a vital business interest inherent in the ownership of the stock of both banks by the holding company.

The large city bank of the group may be said to be the parent bank for all the banks in it. Responsibility rests upon the group management to endeavor to keep each one of the members in a sound condition. No such responsibility arises out of the correspondent relation. Group banking may therefore be said to be an intensification of the correspondent relation, bringing to the country bank every advantage which the correspondent relation offers while at the same time creating a joint enterprise in which each works for the common good and the resources of all can come to the support of each.

Group banking has also many of the practical features of branch banking although differing radically from it in corporate organization. There is the city parent bank with its metropolitan position and influence extending out to various country units, bringing to the members the high standard of banking which has heretofore been available only to those who live in metropolitan areas. It brings together in the group system that diversity of banking business which is essential to the ultimate and continued success of all banking. On the other hand, in contrast to branch banking it maintains the technical local independence of each member of the group. The effect of group operations is felt in any given community through a local bank established in that community. In many communities there are local banks long established, the names of which carry valuable good will. This advantage is retained in group banking whereas in branch banking the local corporation must disappear and the branch must bear the name of the parent city bank.

Branch banking however possesses a flexibility in operation, a responsiveness to centralized control and an undivided corporate responsibility which cannot be attained by group banking. In branch banking there is only a single corporation to be considered. There is only one board of directors and one central executive committee. The power and the responsibility for initiation and enforcement of policies resides solely in the bank. When it enters a community through the purchase of the stock of a local bank that bank must disappear as a local corporation and in its place arises a branch with a branch manager. In practice it will be found that the success of such a branch depends to a large extent upon holding, maintaining and developing the good will of the local bank which was taken over. To this end the outstanding officer of the local bank will as a rule be made the manager of the branch and the principal members of the board of directors be constituted a local advisory board. It is through this procedure that local contact is maintained and adequate information made available as to local conditions.

The question has been raised whether group banking is a temporary phenomenon in our banking system. It has been suggested that the principal motive for this type of banking was the expectation of early Federal legislation favoring a wider development of branch banking than is now possible. Upon such legislation becoming effective the units of the group would be expected immediately to be converted into branches of the central bank and the holding company disappear.

Recent testimony before the House Committee on Banking and Currency is sufficiently explicit to disabuse one of this notion. While group banking might be said to be a trend in the direction of branch banking, many of those engaged in this new development are strongly opposed to any branch banking legislation which would force them suddenly to convert the unit banks of their groups into branches. The president of the largest group in point of numbers of banks was emphatic in his expression of distaste for any immediate legislation which would compel his board of directors suddenly to thrust branches of his central bank into the various towns and cities in which his group was operating. Public opinion in his territory supported group banking but was hostile to branch banking.

While recognizing therefore the theoretical advantages of branch banking, many group bankers would prefer to see Federal recognition of group banking as a sound and substantial banking development. At the same time they have no objection to branch banking and indeed favor it if left the voluntary choice to embrace it where local conditions are favorable.

CHAPTER XII

CHAIN BANKING

THE term "chain banking" has been in use for many years to describe the ownership or control by a single agency of a number of banks. As distinguished from the recent development of group banking there is no definite approach in chain banking to a central management organization for all of the banks in the chain. It has not generally been considered to be a development in the direction of branch banking.

Chain banking has been particularly prevalent in the rural districts. In several parts of the country a single individual, a family or a copartnership will be found to own the majority of the stock of several banks. When such ownership is in the hands of a corporation it is difficult to draw a distinction between it and group banking. The difference is largely one of motive, the external features being very much the same. Chain banking brings together several small banks under a common ownership, usually not a corporate ownership. The primary motive appears to be one of investment. If the chain happens to be in good hands there is naturally an effort to improve the operating conditions of the banks but each bank operates upon its own responsibility as a local institution. They are subject as a matter of course to whatever influence the common ownership might see fit to bring to bear. If this influence is wholesome the banks operate in the direction of soundness. If unwholesome, the whole chain becomes permeated with unsound practices. In most of the chains there has been little opportunity for true diversification since the banks were predominantly rural and were situated in the same economic environment. Although the term chain banking is frequently used to include group banking there is one distinction which lifts group banking out of that classification. Group banking is a definite movement emanating from large city banks for the purpose of carrying the city bank influence, support, facilities and experience into the surrounding rural territory. Economically speaking it is distinctly a development in the direction of branch banking in the best sense of that term. It set up around the large city bank a system of management for the purpose of making effective its contact with the outlying units. Group banking has put itself into a position to acquire a training and experience which will permit it readily to convert into branch banking when public opinion favors that change. Chain banking on the other hand as it has existed in the rural districts for many years past is not adaptable to any such metamorphosis.

Chain banking several years ago came to be used somewhat as a term of reproach following the disastrous failure of several chains. It became the vogue to use the expression "a chain is no stronger than its weakest link." Experience has shown that this is true as to the common ownership of a string of small country banks—the failure of one causes the failure of all because there is no strong superimposed support. Group banking on the other hand cannot properly be described as a chain. It is more like a wheel, the strength being in the hub from which its influence radiates in every direction within a definite sphere of operation.

The failure of the so-called Witham chain several years ago was perhaps one of the strongest influences in bringing chain banking into disrepute. These banks were stretched out along the Atlantic seaboard from New York to Florida—all country banks. The collapse of the Florida land boom caused the failure of several of the Florida and Georgia Witham banks with the disastrous consequence of a collapse of the whole scheme. Some of the northern members did not fail but all suffered severe losses. This operation however should not be classed as chain banking for the reason that there was no common stock ownership of the banks. It was a service arrangement. A corporation in Atlanta—not a bank—undertook for certain banks to use its efforts to gain them new business, to increase their deposits and otherwise to give, if called upon, expert advice on various questions. As a compensation to the corporation the banks agreed to pay a stipulated fee in cash. These terms were embodied in a written contract between the corporation and the various banks. As a matter of practice however the corporation came into very close contact with these banks and although it took no responsibility for bank operations it nevertheless was able to effect the transfer of funds from the northern banks which had surplus cash on hand to southern banks for investment. The corporation technically was acting in an advisory capacity. It finally fell into the hands of unsound management and its speculative paper found its way in considerable volume into the southern banks which were parties to the so-called Witham contract. As much of this paper was based upon highly inflated real estate values the bankruptcy of the corporation and the failure of the banks were the inevitable consequences of the ensuing real estate depression.

In the House hearings on Branch, Chain and Group Banking,[1] there is inserted a table prepared by the Federal Reserve Board in which is shown by States all of the chains and groups of banks in the United States as of June, 1929. This list gives the name of the owner of the bank stock and the number of banks owned. This complication makes no distinction between chain and group banking but shows a list of 276 agencies, whether a person, family, co-partnership or corporation, which own the controlling interest in more than two banks. Of this number only about 25 may be classed as group banking.

[1] Volume I, Part 2, pages 163-184, March 4, 1930.

CHAPTER XIII

TRADE AREA BRANCH BANKING

On May 23d, 1929, the Comptroller of the Currency, Honorable John W. Pole, delivered an address before the Maryland Bankers Association in which there was an indication that the government was approaching a new point of view with respect to branch banking in its application to the rural communities. It is of interest to observe that for many years the Comptroller of the Currency had construed the banking laws in a manner which prohibited branch banking. The opinion of the Attorney General in 1911 and the later opinion of the Supreme Court of the United States in the St. Louis case in 1924 were very much influenced by what had come to be the traditional position of the Comptroller of the Currency against branch banking.

In 1918 when the National Bank Consolidation Act became a law an opportunity offered itself for county-wide branch banking by national banks. That Act provided that two or more national banks situated within the same county might merge into a single corporation and that the consolidated association could hold and enjoy all rights of property, franchises and interests in the same manner and to the same extent as was held and enjoyed by all of the banks entering into the merger.

It appears legally sound that the Comptroller of the Currency, being the executive officer charged with the duty of applying and enforcing this Act, could properly have construed it to give to the consolidated bank the right to engage in the banking business at each of the physical locations at which the constituent banks entering the consolidation were conducting a banking business upon the ground that the right to conduct a banking business at the place where a bank is situated is a franchise to which the consolidated bank could succeed. The Comptroller of the Currency however gave to this law a narrow construction. In cases where banks entering a merger were in the possession of branches, he permitted the branches to be retained but required the head office to be obliterated, although there was nothing in the consolidation act specifically authorizing the retention of branches. The branches went over to the consolidated bank as a franchise right. The franchise right to the business at the head office, although more important and valuable, had to be lost. Such became the established ruling.

It is significant that upon the convening of the 71st Congress at its regular session in December, 1929, the President of the United States in his annual message addressed himself to the banking situation. He stated that it was desirable that Congress should consider the revision of portions of the banking law and in support of this declaration he called attention to the growth of group banking and compared the size and stability of metropolitan banks with banks in the agricultural communities where there had been many failures and losses suffered. He invited also the attention of Congress to the suggestion that national banks be permitted to engage in branch banking within locally restricted rural areas. These questions he commended to a careful investigation by Congress.

The Secretary of the Treasury similarly in his annual report of 1929 directed attention in greater detail to the growth of branch banking in the United States and to the recent growth of group banking on a large scale. He said in conclusion, "The time has come when it would seem to be wise to undertake a thorough study of the situation with a view to determining the soundness of the present-day tendencies, and more particularly the limits of the economic units within which branch banking may be advantageously permitted."

The Comptroller of the Currency, being the officer of the government particularly charged by law with the duty of recommending to Congress that changes, in his opinion, should be made in the banking laws, has now addressed himself officially three times to this subject in addition to several unofficial utterances before bankers' associations within the past two years.

In his annual report to Congress for 1929, after reviewing rural banking conditions over the period of the preceding decade, he suggested to Congress the desirability of permitting the national banks in the large cities to operate branches in the geographical territory economically tributary to such cities, which territory he called the trade area. At his appearance before the House Committee on Banking and Currency beginning February 25, 1930, in his formal opening statement he entered into a much more exhaustive analysis of the reasons which led him to favor this type of branch banking as the only means of giving to the rural communities a safe and adequate banking system while at the same time retaining regional banking autonomy. He designated it as decentralized branch banking as compared with nation-wide branch banking which might lead to a concentration of all banking management within a few cities. He indicated that on the outer borders of such trade areas there would necessarily be overlapping with adjoining trade areas but he saw no great difficulty in delimiting their boundary lines upon the basis of the regional flow of trade to and from the commercial centers of the country.

In his annual report to Congress for 1930 it appears that the Comptroller of the Currency has presented his considered opinion on the question of rural banking reform, following a year of active discussion of the whole question. He points out that there has been no abatement of country bank failures since his last report but on the contrary a considerable increase over widely scattered agricultural areas. To the five thousand bank failures for the nine years preceding 1930 must now be added more than a thousand new failures bringing the total of deposits which have been tied up in failed banks during the ten years to more than two billion dollars.

In this new report he has definitely come to the conclusion that it would not be desirable at this time to grant to national banks the charter power to operate branches within a trade area of sufficient size to enable the large group bank systems to convert into branch banking institutions. This view appears somewhat at variance with his earlier expressions when he seemed to have had in mind the idea that branch banking might offer a ready solution to the group banking situation. The greater economy and flexibility of branch banking and the greater ease with which it can be supervised by the government would appeal to the best type of group banking provided that the branch system could be made geographically co-extensive with group banking. Such seemed the earlier official point of view. The hearings however before the House Committee developed a considerable body of fact and opinion on this question. Some of the larger groups had already gone beyond what might be called the trade area of the city from which they operated. It appeared also in some sections of the country where group banking was operating that there was a strong public opinion against branch banking and a favorable opinion toward group banking—a condition which would make it difficult to convert a group into a branch system. There were also indications that the smaller commercial centers of the country would not look kindly toward the transfer of the head offices of all of the banking institutions to the great metropolitan cities in case such metropolitan cities be made the trade area center of a territory embracing as much as, or more than, an entire Federal Reserve District.

Since the Comptroller of the Currency is the chief exponent of the theory of trade area branch banking —and in this it must be assumed that he has the support of the Secretary of the Treasury—his discussion of the definition of the trade area is herewith given in full from his Annual Report for 1930:

During the past 12 months I have discussed at length the question of the trade area as the logical basis for the development of branch banking in the rural communities. Particularly at my appearance before the House Committee on Banking and Currency last spring detailed consideration was given to many aspects of the trade area in connection with the question of the extension of the branch banking powers of the national banks. It may be desirable at this time to summarize these discussions.

In defining the trade area it is essential that we keep in mind the chief purpose of proposed amendments to the national bank act with respect to the establishment of branches. It is not the primary consideration that the large city bank should be placed in a position further to develop its business with attendant greater profits and wider influence notwithstanding this would and should follow, as a matter of course, through the extension of branches to the rural sections tributary to the city in which it is located. The primary purpose is the strengthening of rural banking itself through the influence of strongly capitalized and well-managed city banks of which the rural bank might become an integral part. It is, therefore, necessary to consider the trade-area question from the point of view of the rural-bank situation rather than from that of the city bank.

The difficulty in defining a trade area in the abstract is well recognized. The subject has been studied by experts in many phases. The country has been laid out into trade areas from the standpoint of the manufacturers of nationally advertised commodities, the manufacturers of more localized products, wholesale distributors, retailers and newspaper circulation. The present problem deals with a different type of trade area—one which requires that the viewpoint be taken from the rim of the area rather than from the hub.

The aim is the establishment in the rural communities of a sound system of banking which will give to the country depositor a reasonable assurance of safety and will offer to those requiring banking accommodation more adequate facilities than is at present available to them. Those requirements can be met only through the establishment of branches by city banks into the surrounding communities which have access to such a city as their principal market and financial center. It is this surrounding area which I have termed the regional trade area. It is the zone of the city's predominant economic influence in the sense that in that zone the city is both the trade and credit center.

There can be no formula which would determine in advance the exact size of any such trade area, but as has been frequently pointed out there is one economic principle of fundamental and controlling significance. Every city which may be selected as the center of a trade area must be of such importance as a trade center for the surrounding geographical territory as to draw to it a volume and a diversity of trade sufficient to form the potential basis for a well-balanced branch banking system. This is what I have termed the requirement for economic diversification. By this it is meant that the loans made by the bank to its customers in the trade area must rest upon the security of a wide range of business enterprises and industrial pursuits. The bank should be able to draw its business from the production of natural resources, agriculture, livestock, manufacturing, transportation by land and water, distribution, and communication. In each of these activities there would be further subdivisions of diversification as, for example, the production of natural resources would include the various types of mining, oil, gas, timber, hydroelectric power and so on. The essential weakness of rural banking as we now have it lies in the danger of its complete dependence upon just one such economic activity. By virtue of the small geographical area of its operations its loans rest principally upon one type of security. There is an insufficient economic diversification of its loan portfolio. This objective can be attained in a branch system of banking which taps a number of different types of security.

It has been suggested that proper diversification can be obtained through the purchase of investment securities on the general market. This procedure faces two obstacles. It presupposes a technical equipment which the rural bank does not possess and it would draw the funds of the bank in too great a proportion away from the local field of the bank's operations to the detriment of its legitimate borrowers.

In some sections of the country where industrial activity is concentrated and where the population is dense there are offered a number of different economic pursuits of relative independence, the one of the other. In such a case the physical extent of the trade area of a commercial center may be small as compared with another city in the more sparsely settled sections of the country where a greater territory may have to be embraced in order to gain the required diversification. Every city indeed, no matter how small, has a regional or local trade area but every such trade area would not be a suitable field for branch banking. Under the plan herein recommended it would be necessary for the committee proceeding under a general authority from Congress to select those cities the trade areas of which meet the requirements for economic diversification. In this respect the committee would be dealing with an economic situation very much similar to that presented to the committee which under similar authority laid out the Federal reserve districts. The Fed eral reserve districts vary in size according to the density of population and the physical concentration of commercial and business activity.

It will be recalled that Congress designated the Secretary of the Treasury, the Secretary of Agriculture, and the Comptroller of the Currency as a committee to lay out the Federal reserve districts under instructions to have "due regard to the convenience and customary course of business and shall not necessarily be coterminous with any State or States. The districts thus created may be readjusted and new districts may from time to time be created by the Federal Reserve Board, not to exceed twelve in all." This committee experienced no great difficulty in carrying out these instructions of Congress. There appears no reason to doubt the ability of a similar committee, such as I have recommended, to map out the trade areas around the principal cities in the United States.

These trade areas might be termed regional economic or trade zones to distinguish them from the wider geographical area with which the business enterprises of such city have contact. Banks and business generally in every large city may from time to time have trade relations and business transactions extending to every part of the country and indeed over the whole world. In contrast to this wider field there is an immediate geographical territory surrounding every large city and reaching out into the outlying rural communities, a definite area which can be determined by boundary lines embracing a population having customary access to such a city as the principal market.

Such a trade area might in some cases overlap an adjacent trade area of another commercial center. If upon a determination of fact it be found that the business of a given community flows in substantial volume to more than one city as a financial and business center, it might be found desirable to put such a community in more than one trade area. It would seem sound to permit the establishment of branches to follow the natural flow of regional commerce and trade, and cases of such overlapping would simply mean that a few communities might have branches emanating from more than one trade area center.

As contrasted with the proposal for county-wide branch banking, trade-area branch banking would follow economic rather than political boundary lines. County-wide branch banking could never form a sound economic basis for a national policy in banking. The county seat is often not the most important city in the county and in many cases it is more convenient for trade to flow to an adjoining county. In a few cases it might be found that the county seat is in fact an important center of trade but in such cases it will ordinarily have a stronger trade influence in the adjoining counties than any city situated within them. County-wide branch banking would force banking into artificial channels and would be economically unsound in those cases where the parent bank was of insufficient size to offer adequate banking facilities and safety to depositors or was situated in a county which did not permit of a diversification in the banking business available to it.

There seems, therefore, no escape from the conclusion that rural branch banking, in order to offer an improvement over the present system of rural banking, must proceed from a parent bank situated in a city of sufficient economic importance to sustain, by virtue of the commerce and trade within it and its surrounding economic zone, a well-managed bank of not less than $1,000,000 capital.

The suggestion for State-wide branch banking appears also economically unsound as the basis for a national policy. In many States there may be found cities whose regional trade areas are embraced within the boundary lines of the State. On the other hand, however, there will be found a great number of important cities situated in such close proximity to State boundary lines that a prohibition against crossing the State line would result in a one-sided branch-banking system for the banks in such a city. The trade area here under discussion is a geographical area for banking purposes. It has no direct political significance. Business and industry pay no heed to State lines in the use of banking facilities. The normal business of a bank in a city situated near the boundary line of more than one State flows over such lines in response to the impulse of convenient communication and transportation. Depositors and borrowers in one State have no prejudices in crossing over the State lines to gain access to their bank. To deny such a bank, under these circumstances, the power to establish branches to meet the convenience of its customers across State lines while at the same time permitting it to establish branches in another direction into the territory of an entire State —in many cases extending far beyond its normal trade area—would set up a system of branch banking under national authority which would appear unworkable and indefensible.

In the consideration of the type or size of a city which would be chosen as the center of a trade area adequate for branch banking purposes, regard must be had for the general banking situation in any given community. If the city be important enough to have strong, successful national banks and is surrounded by a community having a number of country banks whose principal bank correspondent is in such a city, that city might be made the center of a regional trade area. In many such cases the geographical area involved might be not only less than that of a Federal reserve district but less in area than the State in which the city is situated. There may be found a sufficient economic justification for several trade areas whose principal territory is within a single State. Having regard for the situation that branch banking by national banks began with the branch banking limited to the city in which the bank is situated, it would seem the logical economic development to permit a natural growth of these branch-banking systems into the territory where their influence in banking is predominant rather than to proceed solely from the greatest metropolitan centers of the country, which would give to relatively a few great metropolitan banks the exclusive privilege of branch banking in the country districts and lesser cities. It would be highly desirable to preserve as much as possible the element of local autonomy in the establishment of trade areas provided the areas are not so small as to sacrifice the principle of economic diversification.

It is not meant to imply that trade area branch banking should be confined to those States in which branch banking by national banks is now permitted within the city limits. The new policy of branch banking should be uniform in its operation throughout the nation, thereby giving to every rural community an opportunity of access to strong city banking facilities under national supervision and control.

It may, therefore, be said that the following elements contribute to the definition of trade area branch banking:

(1) The principal objective is to strengthen banking operations in the rural communities.

(2) A secondary but not less positive result would be a strengthening of the entire banking structure of the country.

(3) The surrounding geographical territory economically tributary to a city and for which such city provides the chief market and financial center, may be described as its trade area.

(4) Every city may be said to have a trade area but not every trade area is suitable for branch banking purposes.

(5) In order to lay the basis for a sound system of branch banking a trade area should embrace within its physical limits a diversification of economic activities in order that a bank operating branches throughout its extent may also acquire a diversification in the security for its loans.

(6) For branch banking purposes, therefore, only those trade areas should be chosen which surround cities important enough to be the commercial center of a territory sufficient to meet the requirement of economic diversification.

(7) Since the trade area under discussion is a regional economic area for banking purposes the status of the banks in a given city will furnish a guide to its character and extent, particularly the number and location of the surrounding country banks for which they are the principal bank correspondents.

(8) It would not be a difficult undertaking for a com-

mittee composed of the Secretary of the Treasury, the Governor of the Federal Reserve Board and the Comptroller of the Currency to select the principal commercial centers in the United States for branch banking purposes.

(9) Upon the selection of such a city the determination of the boundary limits of its trade area would be a question of fact and could easily be discovered through a study of its banking operations and its general trade influence and position.

Small country banks need have no fear that they would be driven out of business through the establishment in their communities of de novo branches by city banks. Such a procedure would be highly abnormal and it is inconceivable to me that any Comptroller of the Currency would lend his office to its support. The natural development of rural branch banking would occur through the consolidation with or purchase of country banks by the city branch banking institutions upon such terms as would be agreeable to each. The conversion of the local bank into a branch of the city bank in this manner would have no disturbing effect upon the local banking situation.

The type of branch banking here recommended would, as compared with the present system of unit banking, lead to a decentralization of banking resources. Within each trade area there would be a concentration of local or regional banking capital and the best interests of the branch banking systems would compel the employment of such capital in the various communities throughout the trade area. The present tendency under our system of a large number of very small banks and a small number of very large and strong banks is for the bulk of the banking resources of the country to be concentrated in a few great metropolitan centers. Under trade area branch banking there would undoubtedly arise in the inland commercial centers regional banks of sufficient strength to hold the banking business originating within their trade areas.

From the standpoint of group banking the importance of the Comptroller's final position lies in the fact that the type of branch banking legislation recommended by him will not automatically offer an opportunity for some of the larger group banking organizations to convert into national branch banking systems. In view of this situation the Comptroller has recommended that group bank holding companies be brought under the visitorial powers of his office and that no national bank be permitted to come under the control of a bank holding company unless all other members of the group are national banks. The purpose of these recommendations is self-evident. The Federal government wishes to be in a position to make a complete examination of the entire affairs of a group banking organization at any time and to supervise the operating policies of all of the banks in the group.

The Comptroller of the Currency, in his discussion of the size of the cities out of which branch banking would proceed under trade area branch banking, gives the impression that moderately sized cities of between fifty thousand and one hundred thousand population might in some cases be found of sufficient commercial importance to the surrounding country to be designated as the branch banking center of a trade area. If cities of such sizes are chosen as trade area centers it would seem to be necessary in considering the country as a whole to map out a system of large trade areas divided into sub-trade areas. The trade area of a great commercial center will be found to extend into and beyond certain cities which may themselves under the Comptroller's theory qualify as trade area centers. The banks in the sub-trade areas could be permitted to extend branches as far as may be expedient but the banks in the center of the larger trade areas should be permitted to establish branches throughout the entire trade area territory including the territory of the sub-districts.

While the attitude of the Comptroller of the Currency in favor of branch banking may seem to be a departure from the traditional position of his office an analysis will show that such is not the case. The greater number of national banks have always been situated in rural communities. In his interpretation of the banking laws the Comptroller has always been strongly influenced by the needs of the rural banks. His opposition to branch banking in past years has apparently been due to his opinion that there was in the rural districts no manifest need for that type of banking.

The great economic and social changes in rural life within the past ten or fifteen years have culminated in the present condition of rural banking, namely: the difficulty of the acquisition of an all-around banking business; the drift of the best business to the city banks; the consequent low earning power of the average rural bank; and the steadily mounting figures of rural bank failures. The Comptroller's approach therefore to the question of banking reform is what it has always been—that of a supervisor of a system of banks which is predominantly rural. In this connection, in his opening statement, February 25, 1930, before the House Committee on Banking and Currency, he said:

The views which I bring before this Committee are not primarily the result of recent research and the collection of information. I was myself a country banker. Later as a national bank examiner and as chief national bank examiner it became my duty to examine the affairs of hundreds of country national banks. For more than twenty years I have been in daily and intimate contact with the operations of our banking system. No one knows any better than I do that there are still strong and profitable country banks, and if I had any prejudices they would naturally be in favor of the system of unit banking to the sustenance of which I have been devoted for so many years. It is with great reluctance that I have slowly come to the conclusion that our small independent unit country banks are no longer fulfilling the purposes of their creation and that there is need for a better, sounder and stronger system.

CHAPTER XIV

NATION-WIDE BRANCH BANKING

EVERY mention of branch banking for the United States seems inevitably to lead to a discussion of nation-wide branch banking. Many who favor branch banking admit that theoretically the principal arguments in favor of branch banking in a limited form apply with even greater strength to unlimited branch banking—nation-wide and world-wide. One of the aims of branch banking is to attain the widest possible diversification in the business done by the bank. Strength is in proportion to the diversification of the risk, assuming sound management. A bank's opportunity for diversification is in relation to the geographical territory and the distribution of business enterprises in it, over which its operations extend. The ideal extent of diversification would be a geographical distribution of banking facilities to the leading types of enterprises throughout the civilized world. This theory has been recognized and acted upon by the banks of foreign countries. Congress itself has acceded to it for national banks with respect to all parts of the world except the United States.

National banks, under an amendment to the Federal Reserve Act, may establish branches in all parts of the globe but may not, under the existing national policy, establish them in the United States except, under certain conditions, within the same city in which its head office is situated. We have therefore adopted the apparently inconsistent policy of permitting national banks to establish and operate branches, as an integral part of their business, in the most remote corners of the earth in the aid of our foreign commerce while at the same time we have prohibited them from establishing and operating branches within the United States, the country in which their branch operations could be more easily conducted and supervised, in the aid of interstate commerce. We have national banks to-day successfully conducting branches throughout Central and South America, in Europe and in China, notwithstanding the many obstacles to be overcome as to language and foreign business customs.

There is however no likelihood of any immediate grant of power to national banks to engage in nation-wide branch banking. So great has been the opposition to branch banking in this country on the part of thousands of country bankers that even under conditions highly favorable to branch banking, as is true at the present time, the movement will proceed slowly. Branch banking having demonstrated its usefulness and its soundness within city limits seems likely now to be permitted to extend into somewhat wider geographical areas around such cities. If this movement is successful both from the operating and the governmental standpoint it would seem reasonable that the next step would be to widen the area. Eventually, it may be predicted, there will be nation-wide branch banking in the United States, but it will come through a gradual evolution of existing forms. It must be preceded by the support of a strong and well-informed public opinion for branch banking as the best method of bank organization. It will not be a movement in which the Wall Street banks will be found scrambling over the country to acquire country banks out of which to make branches.

As a matter of fact several of the leading Wall Street banks have expressed themselves in opposition to the further extension of branch banking in the United States. Some of these same banks are operating branches beyond the seas. Nearly all of them are operating branches throughout the area of greater New York. Their opposition to domestic branches in the interior appears to be based upon bank politics. They have a fear of antagonizing the small country banks for whom they act as correspondents. They undoubtedly feel that they cannot afford to pioneer in favor of a branch banking movement which may not materialize for years to come at the price of engendering the immediate antagonism of their country correspondents. The same situaiton is true with respect to some other large banks in the great commercial centers of the country. While they may secretly prefer to see branch banking upon a large scale they cannot afford to advocate it.

Nation-wide branch banking could not come suddenly upon the United States even though it were to-day permitted by law. No great non-branch banking organization can immediately turn to branch banking upon a large scale and be successful. There are to-day not more than one or two banks in the country with a sufficient body of experience and trained personnel to engage in branch banking upon a nation-wide basis.

Whether the trade area branch banking plan of the Comptroller of the Currency is adopted or modified the economic development of banking must in the future follow some such growth. While public opinion is not now sufficiently informed and bankers themselves not adequately prepared for nation-wide branch banking, local opinion in many sections of the United States already favors some type of branch banking. Our next step in branch banking apparently will take the form of a number of branch banking systems, each operating within a restricted geographical area, whether restricted by political boundary lines such as county or state or by economic boundary lines such as advocated by the Comptroller of the Currency. The economic trend from this stage will naturally be toward the creation of larger units and the extension of the geographical territory of operation. Out of this movement nation-wide branch banking may in time come but it will not be the kind of nation-wide branch banking about which so much discussion has been had. It will be an orderly development and may not in its final form proceed entirely from the Wall Street banks. There will first be strong local branch banking institutions with head offices in the various commercial centers. If, eventually, under a nation-wide system of branch banking, the principal banks are found operating from head offices in New York City such a movement will have been in response to economic law supported by public opinion.

It seems however almost useless to discuss such a contingency because it certainly has no immediate possibility of realization. The phenomenal development in world systems of communication and transportation may within a few years bring San Francisco and New York closer together than were New York and Philadelphia not many years ago. The discussion of nation-wide branch banking has been bound up with our old notions of time and space—the difficulty of conducting a banking business at distant points and the delay in communication between the branch and the head office. It seems quite possible at this writing that no place in the United States will be as much as a day's journey from any other and communication—even talking face to face visually—will be practically instantaneous.

CHAPTER XV

NEW BANKING LEGISLATION

FOLLOWING the recommendations of the President of the United States, the Secretary of the Treasury and the Comptroller of the Currency, the House of Representatives adopted a resolution authorizing the Committee on Banking and Currency to conduct an investigation into the questions of branch, group, and chain banking with a view to the need for new legislation. The Committee held its first meeting on February 25, 1930, and continued in session until the early part of June, during which time it had before it the Comptroller of the Currency, the Governor of the Federal Reserve Board, the leading exponents and operators in group banking and branch banking, several representatives of the large New York banks, a number of representatives of the smaller unit banks and several state bank supervisors. In addition to the statements of government officials with accompanying statistics and information, the Committee had before it from many of the leading bankers of the United States first-hand information and opinion on contemporary banking developments including the whole range of branch, group, chain and unit banking.

The Senate Committee on Banking and Currency has been authorized by a resolution of the United

States Senate to conduct also an investigation into the banking systems including especially the credit policies of the Federal Reserve System. It is authorized to proceed on a wide scope, the range of subjects embracing the consideration of all of the fundamentals of banking. The authority to sit is extended to the future sessions of Congress or during its recesses and vacations until a final report is reached. This investigation is in progress at this writing.

The House hearings have presented the following questions for legislative consideration:

1. The adaptation of branch banking as a remedy for defects of rural unit banking.
2. The extension of the branch banking policy of the McFadden Act to embrace wider areas.
3. The use of the national banking system as an instrumentality in the application of a Federal branch banking policy without regard to state legislation or political boundary lines.
4. The status of group banking in the determination of a new banking policy.

Notwithstanding the fact that Congress has many times in our national history been called upon to legislate with respect to banking, the present is the first occasion that the national legislature has been concerned with the prospect of a general banking law which has for its objective the improvement of the banking facilities to be offered to the general public and particularly with a view to greater safety to the depositor. The first attempt at banking legislation was by the Continental Congress and the motive there was to bring order out of the chaos of the finances of the War of the Revolution. The second national excursion into this field was the creation of the Bank of the United States in 1791. The purpose of this legislation was also principally concerned with the public finances. It was essential to the inauguration of the fiscal system of the new republic that the Treasury have the assistance of a bank operating under a charter from the national government. The reëstablishment of the Bank of the United States in 1816 was also occasioned by the deplorable state of public finance following the War of 1812-14 during which dependence was had only upon state chartered institutions. The fourth piece of Federal legislation was the National Bank Act of 1863-4, the immediate purpose of which was to establish a sound system of national currency in place of the multitude of complicated varieties of paper money issued by state chartered banks and to broaden and stabilize the market for government bonds. The fifth general legislation was the Federal Reserve Act of 1913, the principal purpose of which was to create an elastic currency directly responsive to the credit requirements of commerce and to decentralize and coördinate the banking reserves.

While all of these acts of Congress had some relationship to the ordinary business operations of banking, in none of them was this the chief concern. Now Congress is faced with a demand for general banking legislation at a time when we have a sound and an elastic system of currency, when the banking needs of public finance are adequately met, when the Federal Reserve System has practically unanimous public support and when metropolitan banking throughout the country has reached its highest degree of success and public favor. The question embraces a consideration of the character of banking operations adaptable to the vast rural sections of the United States. What type of banking facilities should be sponsored by Congress as a means of giving to the great agricultural communities of the United States a system of banking which will be safe for the rural depositor, will be economically sound as a banking practice and will administer to the normal requirements of country borrowers?

Sufficient data has already been laid before Congress to convince any reasonable person that no palliative measure can bring the present system of rural unit banking into line with what is universally recognized to be sound banking. The enactment of a law which will permit a gradual change from rural unit banking to branch banking is the only adequate remedy which has been seriously discussed. Four years ago Congress permitted national banks in certain large cities to operate branches but at that time the situation was not so acute in the country districts. One of the motives for that type of national branch banking policy was the comfort and convenience of urban populations. At that time Congress used the national banks as instrumentalities to offer a wider distribution of banking facilities. This however was not a law of national application since, as to a given city, it conditioned branch banking by national banks upon the prior act of a state legislature permitting branch banking in such a city to state institutions. Nevertheless the amendment of 1865 permitting state banks to convert with branches and the Act of 1927 permitting the establishment of de novo branches did commit the Federal government to a definite branch banking policy. The question now before the country is the adaptation of that policy to banking conditions outside of the large cities.

The Comptroller of the Currency has recommended that the rural communities surrounding the commercial centers be permitted to enjoy the direct operative benefits of the large city banks therein situated. Under his plan Congress would empower the large national banks to become the head offices of systems of branches embracing both city and rural territory. Such national banks would through the usual process of negotiation consolidate from time to time with small outlying banks, which in turn would become their branches. The extension of branches to the rural communities would be expected to be a slow process giving ample time for adjustment to local conditions, but it is to be recognized that in the end the predominant form of banking in the United States, both urban and rural, would be branch banking.

There are however some students of banking who although they have reached the conclusion that branch banking is the only remedy for the rural banking situation would nevertheless prefer to begin with the establishment of systems of rural banking entirely independent of the large city banks. Some of these advocate county-wide branch banking with a parent bank at the county seat—others, county-wide and contiguous counties. It is felt that an innovation of this character would provoke less opposition and would be an easier approach to a later consideration of the wider aspects of branch banking.

The difficulty with this type of branch banking is that it fails, as has been often mentioned, to provide the basis for a proper diversification in the banking business. Under a branch banking system of any kind diversification becomes of greater importance than in the case of the operation of a unit bank. A branch system in a one-crop country or in a one-industry community is subject to the same disaster which befalls the unit bank so situated when there occurs a local crop failure or a local industrial depression.

The present investigation will bring Congress face to face with the issue involved in the proposed abandonment of the policy of parity between national and state bank legislation as it affects national banks. Although the National Bank Act was enacted purely as a Federal measure and in face of the opposition of the state banks, the subsequent development of state banking institutions began to have their influence upon the national legislature. Within recent years the state banking systems have secured control over an increasing volume of the banking resources and the banking business. The bulk of commercial banking has now passed over to the state banks. On account of their excess in numbers state banking institutions control all of the banking associations, county, state and national, and through this means have a predominant influence over the established organs of banking opinion.

The reflex of this situation is naturally felt in Congress when legislation is proposed affecting the national banks. It is difficult for the national banking system to obtain legislative relief upon recommendations made by the Comptroller of the Currency if these recommendations are in conflict with the interests of the state banks, for in every Congressional district there will be found a greater number of state than national banks. The political influence in Congress of the state banks is now under ordinary conditions greater than that of the national banks. This readily accounts for the rise of the theory of parity which has made its influence felt in all Federal banking legislation since the Federal Reserve Act of 1913.

Under the parity principle Congress from time to time permits national banks to equalize their banking powers and opportunities by entering new fields of business already developed by the state banks. Taking this policy at its face value it is still not so easy of accomplishment. There are forty-eight state banking systems to be considered, and when Congress undertakes to equalize the powers of national banks with those of one State opposition arises from state banks of other States upon the ground that national approval of the new departure is undesirable. The theory of parity even in its most favorable application to the national bank is constitutionally unsound and has made a patchwork out of the national banking policy.

This theory of legislation is also one-sided. State legislatures in considering new banking legislation for the state banks are not bound by the limitations which Congress imposes upon national banks. The charter powers of the state banks possess in many

States strong operating advantage over the Federal charter. As a matter of fact the principle of parity is not in operation and the term is a misnomer. The practice which Congress has within recent years adopted leaves to the state legislature the responsibility for the initiation of all new banking legislation in the United States thus giving to the state systems of banks a permanent potential advantage. Under this method of national banking legislation the national banking system must inevitably decline to the point of complete loss of effectiveness as an instrumentality of the Federal government. If true parity were theoretically desirable as a public policy it could be achieved only through some sort of joint action of the state and national governments. This would produce one method of banking under forty-nine governmental jurisdictions. This idea however is for many reasons impossible of realization.

The Comptroller of the Currency has recommended to Congress the abandonment of the so-called theory of parity and has urged the consideration of new branch banking powers for national banks solely upon their merits. He has in effect asked Congress to be moved by sound economic and constitutional policies rather than by the expediency of political influences.

If a large city be taken as the center of a trade zone embracing the rural territory economically dependent upon it, or related to it, as the proper area for branch banking it will be found in many cases that the territory embraced will extend across state boundary lines. Cities have grown up in the United States wholly apart from state politics. There are cities the urban population of which may be in more than one State, although it may be politically subdivided into more than one city. Cities have been created under the influence of waterways, harbor facilities, railroads and proximity to raw materials. Convenient locations as market centers for the purchase and sale of goods and commodities and climatic environment have been important factors.

The zone of influence of cities is cultural and commercial rather than political and rural populations around cities have no prejudices in crossing state lines to transact city business or to enjoy its social advantages. If therefore the city is the place where the head office of a branch banking system by a national bank should be permitted to be situated, economic considerations require that state boundary lines be not taken into account. Congress is asked to take under consideration the grant of a new national banking power solely upon the basis of a public need although in so doing it may give to the national banking charter an advantage which state banks may not possess.

Not since the Federal Reserve Act has Congress faced the necessity for a dominant national policy in banking. The condition of banking in the vast agricultural areas of the country has become a national disgrace. The rank and file in rural districts are compelled to rely upon a system of banking that is an anachronism in this modern commercial age. The Federal Reserve System itself, for the sake of its own dignity and its high national mission, should not be allowed to permit the existence of low standard banks pretending to engage in commercial banking. It appears that Congress now has a great opportunity with the support of public opinion to initiate and enforce a uniform standard of commercial banking for the country as a whole. Such a policy would inevitably offer the rural communities a sound type of branch banking.

CHAPTER XVI

THE CONSTITUTIONAL POWER OF CONGRESS OVER BANKING

THE Constitution of the United States is silent on the question of banking. This is natural in view of the fact that there had never been any banks established in English colonies in America nor was there a bank in the United States at the time the Constitution was adopted. The broad principles of the Constitution provided for the basic machinery of public finance when it empowered the Federal government to lay and collect taxes, duties, imports and excises; to pay the national debts; to borrow money on the credit of the United States; to coin money; to raise and support armies; to provide and maintain a navy; to provide for the common defense and general welfare; and to make all laws which shall be necessary and proper for carrying into execution these and other powers vested in the Government of the United States.

When Hamilton proposed the creation by Congress of a national bank as an aid to the Federal government in the execution of its powers, the question of the constitutional power of Congress to charter a bank was immediately raised. After much debate on this point the first Congress of the United

States was convinced of its constitutional power to create a national bank and President Washington after seeking the advice of his cabinet was of the same opinion when he approved the Act of 1791, providing for the charter of the Bank of the United States. This question however remained the subject of debate until it was authoritatively settled by the Supreme Court of the United States in the years 1818 and 1819 in the two cases of McCulloch vs. Maryland and Osborn vs. Bank of the United States.

Both of these cases grew out of the imposition of a tax by a state government upon a branch of the second Bank of the United States. In the first case the State of Maryland in 1818 taxed the branch in Baltimore and in the following year the State of Ohio imposed a tax upon each of the two branches at Cincinnati and Chillicothe. The act of the Maryland legislature was designed to prohibit the bank from carrying on business in that State and the tax imposed was a special prohibitive tax. The theory of the Maryland law was that Congress exceeded its powers in creating the bank and the case thus brought the constitutional question squarely before the Supreme Court of the United States.

Chief Justice Marshall delivered the opinions in both cases and upheld the power of Congress under the Constitution to create a national bank. In so doing he laid down the Federal principle upon which all subsequent bank legislation by Congress is founded. The reasoning of Marshall in these cases is as clear and valid to-day as it was a hundred years ago. In the McCulloch case Daniel Webster made the principal argument for the constitutionality of the Act and in the Osborn case Henry Clay likewise supported the power of Congress.

The McCulloch case was primarily devoted to the question of the power of Congress to create a national bank as an instrumentality of the Federal government as an aid to that government in the exercise of the general powers granted by the Constitution. This question having been settled in the affirmative, the further and related constitutional question in the Osborn case was presented as to the power of Congress to permit such a Federal instrumentality to engage in the ordinary banking business for the private profit of its stockholders and yet remain exclusively under the jurisdiction of the Federal government. It is readily seen that these two points embrace the whole range of national banking as it subsequently developed in the United States.

It was held in the McCulloch case that although the word "bank" is not mentioned in connection with the enumerated powers of the Federal government, the great powers to lay and collect taxes; to borrow money; to regulate commerce; to declare and conduct a war and to raise and support armies and navies imply the grant of ample means for their execution. In the exercise of the paramount power of the sword and the purse, in the control over all external relations including foreign commerce and all international affairs, and the responsibility for so great a portion of the industry of the nation, not only imply the power to create the means for their realization but also give to Congress the choice of means; that Congress was the sole judge of what means are appropriate and when Congress created a national bank to serve its ends, instead of making use of state chartered banks which were then in existence, the decision of Congress was final and controlling. To quote from the opinion:

> No trace is to be found in the constitution of an intention to create a dependence of the government of the Union on those of the states, for the execution of the great powers assigned to it. Its means are adequate to its ends; and on those means alone was it expected to rely for the accomplishment of its ends. To impose on it the necessity of resorting to means which it cannot control, which another government may furnish or withhold, would render its course precarious; the result of its measures uncertain, and create a dependence on other governments, which might disappoint its most important designs, and is incompatible with the language of the constitution. But were it otherwise, the choice of means implies a right to choose a national bank in preference to state banks, and Congress alone can make the election. . . .
>
> The branches, proceeding from the same stock, and being conducive to the complete accomplishment of the object, are equally constitutional.

Parenthetically attention may be directed to the fact that the branches of the Bank of the United States, both of the first and the second bank, were situated in several different states and this reasoning is applicable to the proposed regional plan of branch banking by national banks.

The emphasis in the Osborn case was upon the right of the bank to bring suit in the courts, to make contracts and to engage in business for private gain. The McCulloch case clearly established the power of Congress to create the bank for Federal purposes.

The question in the Osborn case was, could the bank instrumentality thus established be empowered by Congress to engage in the ordinary routine business of banking. To quote from the opinion:

> If there be anything in this distinction, it would tend to show that so much of the act as incorporates the bank is constitutional, but so much of it as authorizes its banking operations is unconstitutional. Congress can make the inanimate body, and employ the machine as a depository of, and vehicle for, the conveyance of the treasure of the nation, if it be capable of being so employed, but cannot breathe into it the vital spirit which alone can bring it into useful existence.
>
> Deprive a bank of its trade and business, which is its sustenance, and its immortality, if it have that property, will be a very useless attribute.

The Court further held that it was for Congress to decide what facilities were necessary to enable the bank to perform the services which were exacted from it and for which it was created and if in the opinion of Congress the trade of the bank be essential to its character as a machine for the fiscal operation of the government, that trade must be as exempt from state control as the actual conveyance of the public funds.

It is upon the principles established in these two cases that the whole theory of a national system of banks is founded and upon which the legal sanction of the Federal Reserve System also rests. Many times in our history the authority of Congress to enact banking legislation has been brought into question before the Supreme Court of the United States but in no case of the grant of new powers to banking corporations has the authority of Congress been successfully contested. In 1877 there was brought before the Supreme Court in the case of Casey vs. Galli (94 U.S. 673) the question of the power of Congress to permit a state banking corporation to convert itself into a national bank without any affirmative action by the state legislature. This was the amendment of 1865 to the National Bank Act under which the rank and file of state banks entered the national system. In this case the court held that the authority of Congress to permit the conversion and to provide the procedure therefor was complete and that no assent or permission from the state government was necessary or required.

Another outstanding case is that of the First National Bank vs. Fellows (244 U.S. 416) decided in 1917. In that case the State of Michigan denied the power of Congress to confer upon national banks the power to act as trustee, executor, administrator, guardian and in such other fiduciary capacities as was customary with the trust companies. Here again the Supreme Court upheld the power of Congress upon the ground that the national legislature was the sole judge of the powers to be conferred upon national banks.

It appears proper in this connection to mention the case of the First National Bank in St. Louis vs. Missouri (263 U.S. 640). This case was decided in 1924 and had as its issue the authority of a state government to proceed against a national bank which had established a branch in that State in contravention of the state law. The constitutional power of Congress was not involved since the court held that under the Federal statutes national banks did not have the power to establish branches; that in view of the fact that Congress had imposed no penalty for the establishment of such a branch, the field was left open to state legislation and that the State was therefore competent to take action to close the branch until such time as Congress saw fit to exercise its paramount authority. This case by implication unquestionably affirms the power of Congress to permit national banks to establish branches in the absence of or contrary to state legislation. In this respect it is in accord with the long line of decisions from the McCulloch case down to the present.

Under the national authority in the field of banking, unquestionably Congress could within its constitutional powers adopt a regional plan of branch banking for national banks which would disregard political boundary lines and the status of state legislation. It would be solely a matter of the exercise of the wisdom of Congress. If Congress determined that the national banks could better serve the government of the United States under the plan above mentioned, its judgment could not be successfully gainsaid by any state authority.

There is another aspect of the power of Congress to create and control a system of national banks which has never been brought before the courts because Congress has never seen fit to proceed in that direction. It is involved in the relationship of commercial banking to the regulation of interstate and foreign commerce. One of the most important enumerated powers of Congress in the Constitution is to regulate commerce between the States and with foreign countries. Chief Justice Marshall in the McCulloch case mentions this power among those which he enumerates in illustration of the necessity for a bank instrumentality of the Federal government. If in the opinion of Congress it be necessary to establish a uniform system of commercial banking throughout the United States under a common standard, in order to make effective the Federal regulation of commerce between the states and between the United States and foreign countries, would not the principles of the McCulloch and Osborn cases apply?

It is generally conceded that the most important contribution of the national banking system to American banking was to set up a national standard of commercial banking under the supervision of the general government. Historically speaking this important result may be said to have been an indirect effect of the National Bank Act, the avowed purpose being more directly related to the fiscal operations of the government itself and to the question of currency reform. The Act did however by its very terms set up a comprehensive system of commercial banking and it can properly be assumed that Congress had also this purpose in mind. There were however no prohibitions upon other systems of banks becoming engaged in banking to promote commerce between the States and with foreign countries. Congress therefore has never set up an exclusive system of national commercial banking directly related to its power to regulate commerce.

Under present banking conditions it is conceivable that the present national system of banks may drop to an insignificant position in the field of commercial banking and that the flow of commerce, foreign and interstate will be dependent for financial facilities upon the state chartered institutions. More than sixty per cent of the volume of commercial banking is now in the hands of state banks. Under these conditions it is conceivable that the national standard of commercial banking, lacking national support, will drop out and in its stead will arise forty-eight local standards of commercial banking each subject to the exclusive control of the local state legislature. It would be natural under such circumstances that there would arise a great variety of local banking restrictions and regulations upon the financing of interstate and foreign commercial transactions such as would compare with the heterogeneous currency systems in vogue under state authority in the period following the demise of the second Bank of the United States and preceding the National Bank Act. The influence of the Federal Reserve System as now constituted would not be effective as a means of establishing a uniform system of commercial banking by state member banks nor would state banks remain as members of the system if it were to their operating advantage to carry on business under the state law alone. It is within the realm of probability that history will repeat itself if the current trend away from national control of banking is permitted to continue.

Commercial banking is essential to the movement of goods in interstate and foreign commerce. It is a facility or mechanism of that commerce itself. But banking is carried on by virtue of charters which derive their powers from specific statutory enactments. Even now, with the National Bank Act in force as a national standard, no two state banking codes are alike. If therefore the time should come when a merchant or manufacturer in one State enters into a commercial transaction which involves the use of banking facilities in several other States and thereby encounters many different standards of commercial banking due to differences in local banking policy, he would be vexed in the transaction of his business. The flow of trade across the state lines would under these conditions be impeded and the public would suffer the inconvenience of delay. That such chaotic conditions could occur in a great commercial nation, the very founders of which foresaw the vital public importance of commerce and in the Constitution itself put the responsibility for its regulation squarely upon the shoulders of Congress, may indeed seem strange. Present conditions would seem to indicate that Congress will now find it necessary to view the national system of banks not only as an instrumentality of the Federal government with respect to its own fiscal operations but also as a Federal instrumentality with respect to the regulation of commerce between the States and with foreign nations.

The foregoing considerations have dealt with the power of Congress over banking in contrast with that of the state legislatures. There is another aspect of national legislative power of practical interest to banking and that is the power of Congress over the national banks and over state banks through the medium of the Federal Reserve System. The national banks are creatures of Congress and they are therefore wholly under the domination of the Federal government. The National Bank Act itself can be repealed by Congress and the national banking system thus abolished. Upon the principle therefore of the greater including the less it would seem clear that Congress possesses the constitutional power to make any requirements regarding the national banks which might seem to it to be necessary or expedient. The national banks hold their charters and their charter powers at the will of Congress.

Congress has the same mastery over the Federal Reserve System which it has over the national banks. It is an instrumentality of the Federal government set up by Congress for the initiation and enforcement of financial policy. Its basic principles are set out by Congress in the Federal Reserve Act. Its membership, compulsory upon national banks, is open, upon conditions, to state banks. The only control which Congress has exercised over state banks and state banking policy is through the imposition of conditions under which they may become Federal Reserve members.

In some sections of the country among a certain class of state banks, membership in the Federal Reserve System is so highly prized that conditions considerably burdensome would be complied with rather than a resort to operations outside of the system. In other sections of the country even the existing conditions of membership upon state banks have led some strong institutions to operate independently of the Federal Reserve. The existing policy of Congress therefore as to state banks is conditioned by the voluntary compliance of those institutions and the tenure of national control depends upon the margin of operating advantage. If Congress in its desire to enforce a national policy in banking goes no further than to pursue the method of approach to the state banks through setting up conditions of membership in the Federal Reserve System, thereby setting up standards for state chartered institutions which they could escape with advantage by the voluntary relinquishment of their Federal Reserve stock, the effort of Congress will be in vain.

But Congress can no doubt go further. Its current investigations have forcefully revealed the lack of a compulsory national standard of commercial banking. The theory of parity in banking legislation has led to the gradual but steady lowering of the operating standards of the national banks in order that they might compete with state banks. The fear has been that if Congress does not make these concessions from time to time the shareholders of national banks would turn them into state banks. This is exactly what has transpired. Congress has been reluctant to lower the national bank standards, although it has so done in a number of notable instances. The more attractive, because more profitable, state charters have drawn to them national banks large and small throughout the country. Congress has failed to hold the national banks because of the existence of the state banks operating in the same field under local standards.

Congress has created the Federal Reserve System as a Federal instrumentality of currency and credit. It cannot be disassociated from commerce and commercial banking. It is a national institution born of purely a national policy and directed to national ends. Suppose that Congress now concludes that the Federal Reserve System cannot endure the existence of standards of banking beyond its control; that in order to accomplish the high public purpose for which it was designed all commercial banks must be brought into its membership under a common national standard of operation? Would not Congress have the constitutional power to set up and enforce such a standard in order to protect and preserve its own instrumentality? If it could not it must then be admitted that it lies within the power of the state banks to defeat by indirection the fundamental purposes of the Federal Reserve System and to destroy its usefulness. The constitutional doctrine of McCulloch vs. Maryland and Osborn vs. Bank of the United States applies in all of its original force to this situation.

CHAPTER XVII

THE STATUS OF THE NEW YORK CITY BANKS

AT an early period in our national life the City of New York moved to its place as the chief commercial center and the money capital of the country—a position which it has consistently maintained. By the time of the census of 1790, the first census of the United States, its population was 33,000, exceeding that of Philadelphia by 3,000. At that time there was one bank in each of the cities of New York, Philadelphia and Boston. The geographical location of New York City with its ready access to the sea on the one side and its convenient approach by level land to the Mississippi Valley on the other, gave to it a natural advantage as a trade center superior to that of the other American cities. The fact also that New York City was founded by commercial interests seeking to establish profitable business enterprises in the New World also distinguished it somewhat in motive from that of the other cities where social, religious and political issues played so large a part in their creation.

New York City has thus been dominated from the beginning by the influence of commerce. It is in New York City that the highest form of banking has been developed and the highest standards of banking ethics enforced. The strongest banks of the country have always been situated there. Competition in banking in New York City has been so keen that no bank could survive which did not give the fullest measure of safety and the widest variety of banking facilities. Metropolitan banks in other commercial centers of the United States have looked upon New York City as the best school of banking. The most advanced forms of commercial procedure have as a rule first manifested themselves in New York City and have made corresponding demands upon banking for the technical adjustment of its facilities. The banks of New York therefore have not only always led the rest of the country in size but also in their development of higher types of management and in their extension of banking facilities into new fields of banking.

It may be assumed that New York State banking legislation has always felt the prevailing influence of the New York City banks and that the chief banking reforms were originated by them. In the period prior to the National Bank Act it is in the State of New York that we find the most enlightened banking legislation. The New York Free-Banking Act of 1838 provided the first sound state system of banking in the United States. It relieved the state legislature of the burden of granting special charters to persons desiring to incorporate banks and set up a general standard for the organization and operation of banks. This Act also provided the first sound system of paper money issued by banks. It is a tribute to this Act of 1838 that it was used as a model in the drafting of the National Bank Act of 1863-4, many of its principal provisions having been incorporated in the latter. In 1851 New York State established its system of bank supervision under a superintendent, which office has continued to the present time without substantial change. The banks of New York City established the first clearing house. This was organized in 1853. In the seventy-seven years of its existence it has exercised a sound influence upon metropolitan banking not only in New York but throughout the United States.

The position of New York City as a trading center very early brought it into commercial contact with an ever-increasing domain of surrounding territory limited only by the facilities of communication and transportation. As new communities grew up trade relations were established with New York. Beginning with transportation by water, then by stage roads, canals and railroads, as they respectively developed, the commercial life of the country was quickened and access to New York became more and more convenient. In the same manner, as banking developed in other parts of the country, it became necessary to establish banking connections in New York City to facilitate the sale and transportation of goods. The New York City banks became the correspondents of the country banks, a relationship which has in its essentials been maintained to the present time.

In an address before the New York Chamber of Commerce in 1882, John J. Knox, then Comptroller of the Currency, in discussing New York as a banking center said:

These facts show how closely connected is the business of the banks elsewhere with this great commercial city. Nearly every bank and banker, in all numbering about 7000, located in all the principal cities and villages of the country, have deposits subject to sight draft upon this point. Every mail not only brings remittances for deposit from your neighboring cities, but from the most inaccessible points in the country. The railroad and telegraph, the cable and the telephone have revolutionized business, and made everybody at home and abroad your neighbors. To-day there is a single rude, long tavern or outpost upon the great dreary plains of the frontier, to-morrow the railway is constructed, and in place of the tavern of the frontiersman, or the military outpost, there is the city of Cheyenne in the embryo State of Wyoming or the City of Bismarck in the embryo State of Dakota, or the City of Winnipeg in the province of Manitoba; and almost upon the day of the birth of these young villages and cities, banks are organized under the authority of the laws of the United States or of Canada, which almost immediately thereafter are brought into close communication with some correspondent in your city. As business may require, the telegraph is brought into service, and at any moment communication may be opened between the business men of New York and other points hitherto inaccessible. . . .

It was officially stated at the recent public hearings before the House Committee on Banking and Currency that one New York bank alone in the year 1930 had seven thousand correspondent banks.

From the time of the establishment of the first banks in the United States down to the present there has been somewhat of a distrust of banks and bankers. It became a tradition among public men in the interior to attack Wall Street as the center of banking power. For nearly a century and a half the New York City banks have looked upon this type of criticism and have appraised it. It has become customary for them to make no reply, apology or explanation. This fear of money power and of the possible domination of credit is due in no large part to the extreme difficulty of understanding on the part of the average person of the principles and methods of finance. When Hamilton organized the Bank of New York in 1784, the first bank in the City of New York and the third bank in the United States, there was a public outcry against the institution. He was charged with favoring foreigners and with an attempt to control money and credit —two cries which have followed the progress of banking throughout our history. It was seven years before Hamilton was able to secure a charter from the state legislature.

Nowithstanding these political attacks from time to time, the banking resources of the country became more and more concentrated in New York City. In the year 1912, a year before the enactment of the Federal Reserve Act, out of an aggregate of banking resources for the whole country of $22,500,000,000, $4,700,000,000 were held by the banks in New York City.

One of the intended effects of the Federal Reserve Act was the decentralization of the control over credit and it was thought by many that the banking position of New York City would thereby become relatively of less importance. The twelve Federal Reserve Banks did in fact decentralize the machinery of credit and the Federal Reserve System has laid the basis for a trend toward regional economic autonomy. The Federal Reserve Banks did not create financial centers but there have grown up in the interior great commercial centers in which is transacted business comparable in importance to that of New York City a few decades ago. Notwithstanding these considerations the banks of New York City have steadily progressed in size, strength and influence and they continue to maintain their relative preëminence. The total of the aggregate resources of the New York banks in 1930 was about $18,500,000,000 while the grand total of all banking resources for the country was about $67,000,000,000. The question however has now arisen—what of the New York banks in case a system of regional trade area branch banking should be established under national authority?

Some of the leading bankers in New York City are looking with considerable misgiving upon the prospect of regional branch banking emanating from other commercial centers into surrounding rural territory. Spokesmen for one or two of them before the House Committee on Banking and Currency strongly advocated the maintenance of the status quo in banking whereby the present correspondent system would continue to be maintained. They do not wish to see any legislation which would in their opinion have the effect of converting their country correspondents into branches of banks of other cities. They see in this an extremely practical situation involving the possible loss of a large amount of banking business. In this connection significance may be attached to the official statements of the Comptroller of the Currency in which he said that one of the effects of the plan of decentralized branch banking which he favored would be to encourage the growth of great banking institutions in commercial centers other than New York City with the result, in his opinion, of decreasing the relative importance of the Wall Street banks.

It is indicative of the general commercial growth of the United States that there could arise outside of New York City a banking question of national importance. The group banking movement has already created a regional banking situation in several widely separated parts of the country thus bringing a number of country banks under the dominating influence of large city banks in the interior of the country. So far as Wall Street is concerned this movement is already accomplishing the result which is feared from legislation authorizing regional branch banking. A form of local coöperative banking has grown up which may greatly lessen the need of the local country bank for a New York correspondent. On the other hand the business of the central bank of the group with the New York banks has greatly increased.

In the past history of banking in the United States the Wall Street banks have in the long run recognized, supported and profited by the changes which have been made in our banking system from time to time although at first blush they may have seemed in opposition. They at first opposed the National Bank Act—and in this they were in accord with the state banks generally—but practically all of them became national banks and under the national charter laid the foundation for their present strength in commercial banking. They opposed the Federal Reserve Act but now no stronger supporters of that Act can be found. In the present case with Congress, confronted with the most imposing data on the country bank situation which has ever been laid before it, demanding in the view of the highest officials of the Federal Government a serious investigation with the prospect of national legislation, have not the Wall Street bankers who seek only to maintain the status quo taken a short-sighted view of the situation? The unprecedented number of country bank failures and the small prospect of the future operation of rural banks upon sound banking principles would seem to call for something more than the doctrine of laissez faire.

No one can foretell with accuracy the effects of any given legislation but it would be reasonable to assume that the establishment of a plan of regional branch banking such as has been recommended by the Comptroller of the Currency might change the procedure of the correspondent relation but would not alter the principle. The volume of banking business would certainly not be decreased. It would still be necessary for banks outside of New York City to maintain correspondent relations with the Wall Street banks because New York City would still be the money center of the country, the home of the stock market and the central point of national commercial contact. Would not therefore the New York banks, while losing theoretically a considerable number of country correspondents, gain a more valuable connection with large branch banking institutions?

Under our present banking system metropolitan banking has been developed to a high point within city limits while the rural field remains undeveloped. The establishment of city branches in the rural communities will initiate a movement for the intensive development of the banking business on a nationwide scale. There are potential reservoirs of banking to be tapped in the country districts which will greatly increase the general volume of business and will affect every department of banking. Would not this situation in the natural course of events be reflected in a greater volume of correspondent business with the New York City banks than now exists? And would not the establishment of a sound system of banking throughout the country as a whole make for general national prosperity and thereby redound to the benefit of the New York City banks which are the immediate recipients of the benefits of a quickened commercial life?

It should be borne in mind that in our country of many diverse conditions regional branch banking could not possibly be suddenly achieved. Permissive legislation would be availed of in a gradual process of building branch systems. The acquisition of branches would no doubt be through the process of negotiation between country banks and city banks. They would consolidate upon terms agreed upon. For many years and perhaps indefinitely independent country banks as a system of banking would continue in operation in competition with branch systems. The ultimate result would no doubt be the final establishment of a complete system of branch banking but in the process it will be found that the stockholders of the best type of country banks in many parts of the country will prefer to see the new system thoroughly tested. Under these circumstances regional branch banking legislation will not suddenly bring to a close the country correspondent relations with the New York City banks. In the natural course of events there will be time for adjustment. The strength of the position of the Wall Street banks is inherent and may be expressed in the saying that no considerable aggregation of banking capital can be operated with profit in the United States without a New York connection.

CHAPTER XVIII

GOVERNMENT CONTROL OVER BANK MANAGEMENT

THE great economic depression which was severely felt throughout the entire year of 1930 caused the failure of a few city banks large enough to be classed as metropolitan banks. It also accentuated the failures of small country banks the total of which exceeded 1200 for the year. In making a comparison of these two types of failures a distinction should be made between the fundamental causes which adversely affect the rural banks regardless of the recent economic depression and the more specific causes of failure of these city banks. In the latter case, whereas there existed the potential opportunity for success, the causes of disaster may be traced to the lack of attainment in operating policy and in management, the accepted standards of good banking. They were failures through bad management. Thousands of country banks on the other hand have failed in all sections of the United States because they could not gain in the local community in which they operated a sufficient volume and diversity of business to make operations profitable. Under these conditions even the best management would be of no avail. The handful of large city banks which have failed would have succeeded with sound management. Nevertheless, the failure of a large city bank is attended by considerable publicity and each such failure is usually followed by a specific public investigation out of which comes suggestions for new legislation.

One of the remedies now put forward is a revival of a proposal that the government be given authority to remove officers and directors of banks upon the ground of violation of law and/or non-conformity to sound banking practice. The Comptroller of the Currency made this suggestion following the panic of 1893 and again in the year 1914. When the McFadden Act was before the House, in 1925, a similar suggestion was considered but was laid aside. The present Comptroller of the Currency, in his statement before the Senate Committee on Banking and Currency, January 19, 1931, indicated that he would be inclined to favor national legislation in this direction. The Superintendent of Banks of the State of New York has specifically recommended similar legislation to the New York State legislature.

In the case of removal for violation of law the principle is fairly definite although the procedure of removal may present difficulties. Most banking codes provide specific penalties for violations of law, civil or criminal. The penal provisions are enforceable only after indictment and conviction in a court of record and the civil violations after a suit at law and a judgment obtained. In the case of national banks the Comptroller of the Currency may induce the Attorney General of the United States to bring suit in the Comptroller's name against any national bank which has violated any provision of the National Bank Act. A similar provision exists with respect to violations of the Federal Reserve Act. This particular procedure has been adopted in only a few and unimportant cases although its restraining influence has no doubt been of considerable effect. In each of these two classes of cases however the accused has his day in court and his right of appeal. Could the government properly set up an agency in the executive branch of the government with power to remove bank officials from office by direct action without making provision for an adequate hearing and a right of appeal?

The question of such removal by direct action for engaging in unsound banking practices is even more consequential. To what extent the government should go to protect the public from defective bank management presents one of the most difficult and delicate problems of administration. It is because we consider banking a quasi-public business, operating under government supervision under specific charter powers, the exercise of which is carefully watched by government officials, that the question of bank management becomes distinctive.

The system of governmental supervision is very much the same in theory both by the national and the state governments. Taking the national banks as the norm, there are two principal contacts with the Federal government. One is the report of condition and the other is the semi-annual examination by a national bank examiner. Reports of condition are called for by the Comptroller of the Currency several times a year but usually with about three months intervening. The bank is called upon for a complete report of its financial condition as of some prior date as to which its books are closed. For example, on April 10th the Comptroller may call for the report of the condition of all national banks as of the close of business March 29th. The bank having no notice of the day when the call will be made must report its true condition upon schedules of information furnished by the Comptroller. This is one means the Comptroller has of informing himself as to the financial condition of the banks under his supervision.

The examination of the bank through the personal inspection of one or more national bank examiners is also conducted upon a day unknown in advance to the bank. The examiner appears in the bank, seals the vaults with the official seals and proceeds without notice to examine in detail all of the affairs of the bank. He makes a detailed report to the Comptroller of the Currency accompanied by confidential comments upon the management and any other feature of the bank operations which may appear of interest. This is the second source of governmental information. From these two sources the government obtains complete information as to the condition of the bank and the character of its management. The facilities for gathering information therefore appear fairly complete.

In case the Comptroller has information that there are definite losses in the bank sufficient to impair its capital stock he may assess its shareholders to make good the impairment. This is in the nature of an intermediate penalty. It falls as a burden however upon the shareholders and not upon the management as such. It has proven an extremely laborious method of procedure and may be said not to be a satisfactory method of control. Its true significance is found in its application only to the country banks since the losses of city banks rarely reach a volume which would involve an impairment of capital. The Comptroller of the Currency has no power to impose any other intermediate penalties upon national banks by way of rectification of their condition.

The Comptroller of the Currency has had many unsatisfactory encounters with recalcitrant bank management. The loans in a bank may be within the limits allowed by law and the capital of the bank may not be technically impaired but at the same time the Comptroller may have positive evidence of unsound management policies which may cause the bank eventually to fail. He cannot bring suit for forfeiture of charter because there may be no specific violation of law. He cannot impose a money assessment upon the stockholders because the capital is not actually impaired. The only recourse he has is to hold interviews and to engage in a course of correspondence with the president and directors of the bank with a view to a voluntary correction of the situation. Ordinarily these letters are directed to the very officers of the bank who are responsible for the conditions of which he complains. For years the Comptroller of the Currency has been faced with this difficulty but the recent failures through bad management of three or four large national banks have apparently led him to suggest the more drastic penalty of direct removal of the management by executive action.

In case of the removal of bank officers upon the initiative of the Comptroller of the Currency it does not appear to be the idea that the power of removal itself should be vested in him but rather that he would report a given case to such an agency like the Federal Reserve Board or to an executive committee composed of the Secretary of the Treasury, the Governor of the Federal Reserve Board and the Comptroller of the Currency. In any case the influence of the Comptroller of the Currency in such a procedure would necessarily be a great force since he alone would be in first-hand possession of the facts upon which the complaint is made.

This suggestion is a new departure in government regulation and appears at variance with our traditional point of view. It may be construed in two aspects, one, the question of removal for violation of law, and the other, removal for engaging in unsound practices. In the cases of alleged violations of law, civil or penal, it has been our practice to have a trial before a regularly constituted court of justice in the judicial branch of the government. The executive branch of the government may not as a rule, in cases of alleged violations of law by a citizen, act as prosecutor, judge and jury but rather must make out its case in a Federal court where the accused or the defendant has the benefit of all of the traditional protections of judicial procedure. While it may be within the constitutional power of Congress to set up in the executive branch of the government a tribunal for the punishment of violations of the banking laws the question might well be raised whether it would be in conformity to the spirit of our institutions. In this connection it may be observed that when the Comptroller was given power in the original National Bank Act to take action against a bank for violations of any provision of that Act he was required to lay his case before the Attorney General of the United States with the request that suit be brought in the Comptroller's name against the offending bank. This procedure involves first the approval of two separate departments of the executive branch of the government before formal action is taken and second a suit at law in a Federal court where the bank might have an opportunity to make its defense and the usual right of appeal. The principle of direct action against a citizen by the executive branch of the government charging him with violation of a law upon the statute books and imposing upon him a drastic penalty would seem to establish a new and undesirable precedent in our system of jurisprudence.

The proposed removal of the officer of a bank for engaging in unsound banking practices presents an even more difficult situation from the standpoint of procedure. The board of directors of a corporation are legally responsible for its policies and its management. It is assumed that the removal procedure would be employed only after the board of directors refused to take the action desired by the Comptroller of the Currency. In cases of violations of law the question involved would be definite, that is to say, definite allegation of the violation of a specific statutory provision. In the case of unsound or undesirable practices there are no formal standards by which to judge an act. Banking ethics and banking standards are the result of the gradual and changing development of the banking business and banking opinion. There are certain generally accepted canons of good banking as there are canons of good business practices. Many of these are reflected in the clearing house rules of the larger cities. They have however no generally binding force and in a specific case the question of whether a given banking practice is unsound may resolve itself into one of judgment or opinion.

If one could be assured that the Comptroller of the Currency would always be a person of the highest integrity, of the greatest experience in practical banking and of the soundest knowledge of human nature there would be no danger of an abuse of the lodgment in him of this almost arbitrary power, but it is well known that government officers may upon occasion be found to be prejudiced, inexperienced and dictatorial. This phase of the question should be taken under consideration lest we establish in the executive branch of the government a form of star chamber procedure at variance with our fundamental tradition. It should be borne in mind that although the national banks are under the supervision of the Federal government their officers are not government employees. Practical complications would arise in case the government removed, for example, the president of a bank. It would be necessary for the board of directors of the bank to put in a new president satisfactory to the government and this would put the government somewhat in the position of operating the bank in that it would involve the substitution of governmental policy for that of the bank but at the same time leaving the responsibility upon the board of directors.

It is quite probable that any movement by the government to enforce such a removal of officers, either for violation of law or for unsound practices, would cause such uneasiness on the part of the depositors, should that fact become known, that there would be a run on the bank which would compel it to close its doors. The class of banks which would be affected by the above suggested procedure perhaps should not be allowed to keep open at all and if indeed the Comptroller of the Currency must be vested with arbtitrary authority in such cases to protect the depositors it would probably be better to permit him to close the bank before it becomes insolvent if, in his judgment, mismanagement will eventually cause its failure. He is now vested with arbitrary power to determine the solvency of a bank and to close it for insolvency without notice and by summary action. Rather than adopt these new forms of questionable judicial procedure, it would appear preferable to empower the Comptroller to proceed to wind up the affairs of any national bank which has in his opinion fallen into the hands of recalcitrant bad management.

The question of direct action by the government as a remedy for improper bank management would not arise had there been developed in this country a strong nation-wide banking tradition among those engaged in the banking business. Such a banking tradition, coupled with penal provisions upon the statute books which would be enforced with swiftness and certainty, would be the best remedy for unsound management.

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