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FIDUCIARY POWERS OF NATIONAL BANKS UNDER THE FEDERAL RESERVE SYSTEM

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UNDER the National banking act as originally enacted national banks were not given and could not acquire any power to act as fiduciaries. In consequence they found themselves seriously handicapped in their competition with state institutions. They were not able on the death of their customers to retain the balances standing in their names and saw this business going to rival trust companies or even state banks authorized to conduct a trust department. In addition, they were unable to acquire new business naturally growing out of their daily transactions if such business happened to be of a trust nature.

To obviate this difficulty many of the more powerful national banks associated with themselves trust companies created under the laws of their particular state and subject to its supervision but controlled either by the national bank as such or by its stockholders, or through some other legal device. Such a course however was open only to the more powerful banks and led to considerable perplexity in the adjustment of the rights of the two institutions which usually occupied the same quarters or adjoining buildings or buildings not far apart, and whose very names frequently indicated their close association. Such arrangements continue to the present day particularly in the larger cities.

This left the smaller national banks in a bad way so far as this phase of their competition with the state banks was concerned. A remedy was sought but it was felt that direct power should not be given to them in terms to conduct a trust business. On the other hand it was also felt that they should under proper supervision be allowed this privilege. The passage of the Federal Reserve Act in 1913 and the appointment of the Federal Reserve Board under it furnished both the occasion for this reform and the proper body to undertake the task of supervision.

In consequence Section 11 k of the Federal Reserve Act as originally enacted authorized and empowered the Federal Reserve Board "to grant by special permit, to national banks applying therefor, when not in contravention of state or local law, the right to act as trustee, executor, administrator, or registrar of stocks and bonds under such rules and regulations as the said board may prescribe." This provision was

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looked upon by many as a further step by Congress to extend its legislation into matters of purely local and state concern and naturally led to reactions. Accordingly the New Hampshire legislature in 1915 passed a statute disqualifying *all* banks to act as executors, administrators or guardians. This statute in terms applied to national banks, and was upheld by the state courts saying, "The act of Congress was not an attempt to invest probate courts with a power of appointment they did not possess before, but it was an authorization to national banks to accept appointments when the probate courts were authorized to make them."¹ The question of the constitutionality of section 11 k of the Reserve Act was raised in Illinois in 1915 independently of any legislative action. The court reasoned that certain powers of government belong exclusively to the state as distinguished from the Federal Government. The regulation of property within the state, the modes of acquiring and transferring it, and the rules of descent and distribution are exclusively the concern of the states. Trustees, executors and administrators are the instrumentalities through which estates are settled and transfers of property effected and the property itself protected and guarded. The court further argued that trust companies are very different from banking corporations. Though some states allow both functions to be exercised by the same corporation they usually are kept as separate departments. In some states banks do not act as trust companies and in others trust companies have no banking powers. National banks without fiduciary powers have efficiently served the government purposes for which they were primarily created. Since no showing was made that added powers are now necessary to the further success of the national banks the court concluded that the fiduciary section of the Federal Reserve Act is null and void and in contravention of state or local laws.² The same question was raised in Michigan in 1916 in a proceeding in the nature of quo warranto brought on behalf of a trust company by the Attorney General in the Supreme Court to enjoin a national bank from acting as a fiduciary. One judge placed his decision on the ground that the federal provision was in contravention of existing state laws and argued that no specific prohibitory law need be pointed out but that it is sufficient that the state legislature in the enactment of the state trust, deposit and security statutes conferring certain powers on trust companies has by unavoidable inference excluded all

¹ *Appeal of Woodbury* (N.H.) 96 Atl. 299, 301.

² *People v. Brady*, 271 Ill. 100, 110 N.E. 864.

In *State ex rel v. Russell*, 283 Ill. 520, 119 N.E. 617, *People v. Brady* is left undisturbed on the ground that it is the decision of the case though the court concedes that if the *Brady* case had been appealed to the United States Supreme Court it would have been reversed.

that this legislation is so particular and voluminous and the legislative other corporations within the state from the exercise of such powers and purpose so apparent that a conflict with the federal reserve act must necessarily result. With this conclusion the majority of the court disagreed and held expressly that since corporations were authorized to perform these functions the fact that national banks are federal corporations does not because of the difference of the administrative rules which govern them as distinguished from the state corporations disqualify them or make their act to be in contravention of state laws. However, the result reached by the majority was the same for the court decided that the federal reserve act directly invaded the sovereignty of the state and so far as this provision is concerned was null and void independently of what particular statutes might be on the Michigan statute books.³

This decision naturally made a case for the United States Supreme Court. It was so promptly appealed that it was argued less than six months after it was decided. The United States Supreme Court on June 11, 1916, reversed the case on the ground among others that it does not follow that because Congress recognized that a particular function of a national bank was subject to be regulated by the state law Congress was without power to confer such power and that the purpose of the Reserve Act was merely to co-ordinate such functions with the reasonable and non-discriminating provisions of such state laws as regulate their exercise when state corporations are concerned to the end that harmony and the concordant exercise of the national and state power might result.⁴

This, however, was not the extent of the federal decision. Other contentions were raised and decided. Not much time was taken up with the contention that the section was void because it conferred legislative power on the Reserve Board. The court merely said that this contention was so plainly adversely disposed of by many previous adjudications that it was unnecessary to do more than merely refer to them. However, the right of the Attorney General to resort to the state court was challenged on the ground that the functions thus bestowed are inherently federal in character, are enjoyed by a federal corporation and are susceptible of being tested only in the federal courts. The court disposed of this contention by referring to the fact that such powers are conferred only "when not in contravention of state or local law" and held that Congress by these words expressly or at least impliedly authorized the state courts to consider and pass upon the ques-

³ *Fellows v. First National Bank*, 192 Mich. 640, 159 N.W. 335.

⁴ *First Nat. Bank of Bay City v. Fellows ex rel. Union Trust Co.* 37 S.Ct. 734, 244 U.S. 416, 61 L.Ed. 1233.

tion whether a particular power was or was not in contravention of the state law.⁵

The language of the Supreme Court seemed to be susceptible of an interpretation that these permits might be granted in any case in which the State laws permit competing banks to exercise such powers. The question was submitted to the Attorney General who stated it as his opinion that while Congress is fully empowered to authorize the board to grant permits in such cases, it had not as yet done so.^{5a} This threw the controversy back into Congress. The Federal Reserve Board accordingly on September 26, 1918, obtained an amendment to the Federal Reserve Act by which the powers which may be bestowed by the Board on a national bank were expanded to include in addition to those of trustees, executors, administrators and registrars of stocks and bonds those relating to guardians of estates, assignees, receivers, committees of estates of lunatics "and any fiduciary capacity in which State banks trust companies, or other corporations which come into competition with national banks are permitted to act under the laws of the state in which the national bank is located."

The important provision in this connection, however, was the following: "Whenever the laws of such State authorize or permit the exercise of any or all of the foregoing powers by State banks, trust companies, or other corporations which compete with national banks, the granting to and the exercise of such powers by national banks shall not be deemed to be in contravention of State or local law within the meaning of this act."⁶ That this amendment must raise many intricate questions of law and policy⁷ was a foregone conclusion. The outstanding legal question of course was whether Congress had the power to establish the conclusive presumption that where there was competition with state banks or trust companies the granting of fiduciary powers to national banks was not in contravention to the particular state law. On this question the Rhode Island court indeed in 1922 took the strong position that it would not "admit the power of Congress to control this court in the construction of the state laws of Rhode Island."⁸ This case was not appealed to the United States Supreme Court because the decision was based primarily on the ground that the State treasurer

⁵ See *In re Turner's Estate*—Pa.—120 Atl. 701, 702, 10 Fed. Res. Bd. Rep. 304. The court following the United States Supreme Court decision says that it is clearly left to the state courts to ascertain whether, in any given case, the exercise of the powers granted are in contravention of state or local laws.

^{5a} 4 Fed. Res. Bd. Rep. 26.

⁶ See 5 Fed. Res. Bd. Rep. 262.

⁷ 6 Fed. Res. Bd. Rep. 57.

⁸ *Aquineck Nat. Bank v. Jennings* (R.I.) 117 Atl. 743, 746.

could not be compelled by mandamus to accept a tender of bonds from a national bank as security for the performance of its fiduciary functions.⁹ A contrary view was taken by the courts of Pennsylvania. Though an isolated District court refused to recognize or approve national banks as fiduciaries,¹⁰ Pennsylvania Superior Court held in 1922 that the only question on which the right to grant permits to national banks was whether the state permitted such competing corporations to act in that capacity and that if it did the national banks must be permitted to enjoy fiduciary powers and that the effect of the amendment to the federal reserve act is to permit national banks to act in fiduciary capacities whenever the laws of such state authorized or permitted the exercise of any or all such powers by state banks or other corporations competing with the national banks. The court said that Congress is the sole judge of the means appropriate to the end to be accomplished by the exercise of this additional power conferred on national banks. It expressly found that the act of Congress and the State laws are not alike, but that their differences do not establish in the light of the congressional definition of the terms that the Federal Statute is in contravention of the state law.¹¹ Accordingly, the Pennsylvania Supreme Court in affirming this decision argued that Congress with full knowledge of the different laws affecting trust companies in the various states gave the Federal Reserve Board power to prescribe regulations for the government of the national banks and that regulations thus established are paramount to state rules and the latter must yield when a conflict arises. When Congress in 1918 defined what was to be considered as in contravention of state laws reference was had to the right itself not to the rules governing the exercise of such right. Concede the existence of the right in the state banks and we have the same right bestowed on the national banks. Had Congress intended to have the national banks governed by state laws in the exercise of the rights given it would have said so. As it is it must be assumed that Congress was satisfied with the rules already prescribed by the Federal Reserve Board. If these rules happen to conflict with state regulations on the subject the latter must yield because the right being conceded the power to regulate the exercise of the right follows as a necessary incident.¹² The same result was arrived at as early as 1919 in New York,¹³

⁹ 11 Fed. Res. Bd. Rep. 28.

¹⁰ *In the matter of the National Bk. of Germantown*, 30 Pa. Dist. Rep. 003.

¹¹ *Estate of Turner* 80 Pa. Super. Ct. 88, 9 Fed. Res. Bd. Rep. 277 affirmed, 120 Atl. 701, 10 Fed. Res. Bd. Rep. 304.

¹² *In re Turner's Estate* 277 Pa. 110, 120 Atl. 701, 703, 704, 10 Fed. Res. Bd. Rep. 304.

¹³ *In re Mollineaux* 179 N.Y. Supp. 90.

and in 1920 in Connecticut,¹⁴ Wisconsin¹⁵ and the federal district court of the western district of Missouri.¹⁶

The question was finally squarely raised in Missouri and decided in such a manner that an appeal to the United States Supreme Court would result in a conclusive decision. In an action of mandamus to compel a probate judge to appoint a national bank as executor the Missouri court correctly construed the decision of the Supreme Court of the United States rendered in 1917 but reached the conclusion that the Reserve Act as amended in 1918 was in conflict with the Missouri statute which in terms permitted its own banks and trust companies to exercise fiduciary powers. The court said that both reason and authority supported the view that the exercise of the fiduciary powers mentioned in the federal reserve act are in contravention of the law of Missouri, the legislative policy and the express statutes.¹⁷ The case was appealed to the United States Supreme Court, and resulted in a division of the court. Holmes J. writing the opinion of the majority referred to the provision of the amendment of 1918 which raised the conclusive presumption and said: "This says in a roundabout and polite but unmistakable way that whatever may be the state law, national banks having the permit of the Federal Reserve Board may act as executors if trust companies competing with them have that power. The relator has the permit, competing trust companies can act as executors in Missouri, the importance of the power to the sustaining of competition in the banking business is so well known and has been explained so fully heretofore that it does not need to be emphasized, and thus the naked question presented is whether Congress had the power to do what it tried to do." The actual decision was in the affirmative, the court saying that the State cannot lay hold of its general control of administration to deprive national banks of their power to compete with state institutions.¹⁸ The effect of this decision is to establish conclusively the right of national banks to exercise trust powers in any state whose laws authorize or permit the exercise of similar powers by competing state institutions. The decision is so conclusive that the Rhode Island court though considering the dissenting opinion as eminently sound and convincing and based upon the just relation which exists under the constitution between the powers of Congress and those of the state authorities in matters of local concern finally holds in deference to the decision

¹⁴ *Hamilton v. State* 94 Conn. 648, 110 Atl. 54.

¹⁵ *Estate of Stanchfield* 171 Wis. 553.

¹⁶ *Fidelity National Bank and Trust Co. v. Enright* 264 Fed. 236.

¹⁷ *State v. Duncan* 302 Mo. 130, 257 S.W. 784.

¹⁸ *Burnes National Bank v. Duncan* 265 U.S. 17, 44 S.Ct. 427.

of the court that the national bank involved should not be ousted from the further exercise of its fiduciary powers.¹⁹

The practical result of this very interesting legal development is that the number of national banks which have obtained permits has increased from year to year. The number of such permits would doubtless be much greater than it is were it not for the fact that very many of the stronger banks control a trust company to which they transfer their trust business, which fact of course makes the establishment of a trust department under a permit by the Federal Reserve Board unnecessary. As it is, 125 applications were granted in 1916,²⁰ and the total was brought to 481 in 1917.²¹ In 1918 this total rose to 708;²² in 1919 to 1,074,²³ and on October 15, 1920, it was 1,387.²⁴ At the end of 1921 the list contained 1,547 banks,²⁵ and in 1923 the number was 1,819.²⁶ Here the saturation point may have been reached, for the Federal Reserve Board reports that on December 21, 1924, the number was 1,802, seventeen banks less than the year before.²⁷ This great growth has gone hand in hand with the development of a more friendly spirit on the part of the various state authorities and a gradual abandonment of opposition. Therefore the Federal Reserve Board in its report for the year 1921 stated that the opposition by state authorities had very largely disappeared; that in all but three or four states national banks are permitted to exercise fiduciary powers on a basis of substantial equality with state trust companies and that the amount of trust funds thus held was estimated at \$825,000,000. It is clear indeed that trust departments bring new business into the national banks and enable them to retain balances which upon the death of their customers would otherwise be diverted to competing trust companies. In addition, national banks in communities where there are no trust companies furnish, through their trust department, a service which the community greatly needs, though lack of acquaintanceship with trust companies is a handicap under such circumstances.²⁸

¹⁹ 11 Fed. Res. Bd. Rep. 237.

²⁰ 3 Fed. Res. Bd. Rep. 21.

²¹ 4 Fed. Res. Bd. Rep.

²² 5 Fed. Res. Bd. Rep. 72.

²³ 6 Fed. Res. Bd. Rep. 62.

²⁴ 8 Fed. Res. Bd. Rep. 85.

²⁵ 9 Fed. Res. Bd. Rep. 35.

²⁶ 10 Fed. Res. Bd. Rep.

²⁷ 11 Fed. Res. Bd. Rep. 28.

²⁸ 8 Fed. Res. Bd. Rep. 86.