Chairman Eccles -

This has been rewritten to reflect the changes suggested in the meeting in your office - The drafting work is proceeding

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LEGISLATIVE PROGRAM FOR BANK HOLDING COMPANIES

The need for bank holding company legislation is immediate. Branch banking is, of course, a related issue but it need not be involved and, to the extent that there are differences of opinion on the latter issue, it would seem desirable that it not be involved in any settlement of the present holding company issues. I believe such a position can be rationalized.

There is an existing Congressional policy with respect to branch banking. This policy, briefly stated, is one to put Federal permission to establish branches on the level of the legislative policy of the various States. The Federal supervisory authorities, now and without any further legislation, have adquate authority to control the direct establishment of branches because, in order to establish branches, national banks must first obtain permission from the Comptroller of the Currency; State member banks from the Board; and nonmember insured banks from the F.D.I.C. The trouble is that, through the corporate device (holding company), these controls are defeated. A holding company can do by indirection what a bank cannot do directly. Thus, a management which can be controlled in its operation under a bank charter can, through the holding company device, acquire unit banks and defeat the will of Congress by, in effect, (1) establishing branches without the prior permission of the appropriate supervisory authority, (2) operating indirectly a branch banking system in a State where branch banking directly is prohibited, and (3) extending a branch banking system beyond State lines.

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Moreover, such authority as the Board has comes into effect only after the damage, if any, is done. The Board can chase the horse but it cannot lock the stable door before the horse is loose.

There are also compelling reasons for establishing effective controls over the operations of bank holding companies in other fields. Here again, the corporate device is used to do by indirection that which cannot be done directly. The statutes and the common law have long recognized the danger and sought to prevent banks from engaging in extraneous businesses. No one would question the soundness of the rule of law which says that banks cannot own and operate industrial and manufacturing concerns. But that is exactly what is happening by indirection through use of the corporate device. Both the lender and the borrower or potential borrower are dominated and controlled by the same management. Moreover, Congress in the "Investment Company Act of 1940" has undertaken to provide controls for investment companies other than "holding company affiliates" holding a voting permit from the Board, which latter companies are specifically exempted from the Act. I believe it is sound policy to work toward eliminating the mixed character of bank holding companies.

Finally, the Board should have powers to prevent the adoption and maintenance of unsound policies by the management of bank holding companies equal to those supervisory authorities have with respect to the banks themselves.

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PROGRAM

As a basic premise for bank holding company legislation I think that the Board can take the position that the immediate need is not to change branch banking laws but to lift bank holding company controls to the level of existing branch banking controls in order that the corporate device cannot be used to defeat branch banking and other banking laws. With this in mind I suggest the following as a program which might be considered:

1. Defining Control.--This would require a definition of bank holding companies. As one suggestion, a "company" might be defined as being any corporation, partnership, joint stock company, business trust, association or similar organization. A "bank holding company" might be defined as being: (a) Any company which, directly or indirectly, owns, controls, or holds with power to vote 20 per cent or more of the outstanding stock of any bank unless the Board determines such company not to be engaged, directly or indirectly, as a business in holding the stock of, or managing or controlling banks; (b) any company which the Board determines, after notice and opportunity for hearing, controls in any manner the election of a majority of the directors of any bank; and (c) any person or organized group of persons which the Board determines, after notice and opportunity for hearing, directly or indirectly, to exercise such a controlling influence over the management and policies of any one bank or bank holding company as to make it necessary or appropriate in the public interest that such person be subject to the obligations and duties imposed on bank holding companies.

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2. Freezing.--Make it unlawful for any company to acquire or hold as much or more than 20 per cent of the outstanding stock of any bank. Make it unlawful for a bank holding company to acquire any stock in any bank except at the request of the Board or accept stock of minority stockholders in a bank more than 50 per cent of the stock of which is owned by the holding company. Make it unlawful for any holding company after January 1, 1948, to retain any stock of any bank acquired after _____ unless in the meanwhile it shall have obtained the consent and approval of the Board.

3. Acquisition or Retention of Unrelated Businesses.--Make it unlawful, except in connection with the surplus requirements hereinafter provided, for any holding company to acquire the obligation of or any stock or interest in any concern other than a bank without the consent and approval of the Board and unless the Board has determined the business of such concern to be incidental to the holding company's business of holding the stock of, or managing or controlling banks. Make it unlawful, except in connection with the surplus requirements hereinafter provided, for any such company to retain after January 1, 1948, any obligation, stock, or interest which it now holds in any concern other than a bank unless in the meanwhile the consent and approval of the Board has been obtained and the Board has determined the business of such concern to be incidental to the holding company's business of holding the stock of, or managing or controlling banks. Give the Board continuing authority to make the aforesaid determinations. Give the Board authority,

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upon proper showing by the holding company and with respect only to specific obligations, stocks, or interests, to extend the January 1, 1948, date for limited periods. Repeal the present provision requiring a reserve of readily marketable assets but require holding company to build up surplus of 20 per cent offset by cash or securities eligible under section 5136, United States Revised Statutes.

4. Sanctions.--Retain present voting permit procedure including application for and agreement incident to voting permit. Add a provision to section 5144(e) stopping payment of dividends after notice and pending decision of Board on question of revocation. Strengthen present provisions by adding penal provisions applicable to corporation and to participating officers and directors.

CONCLUSION

I believe that the additional powers above mentioned would be adequate to control any foreseeable situation. The holding company could not acquire any new unit banks nor increase its interest in any now held. Yet the Board could permit it to consolidate its position. The subsidiary bank could not establish new branches. The only avenue for lateral expansion without supervisory permission would be by way of absorbing the assets and assuming the liabilities of another bank. The holding company could not do this. The subsidiary bank, of course, could but it could not establish a branch where the unit bank had been without the necessary permission. This would not seem to be much of a loophole.

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