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National Advisory Council
Staff Draft 112
April 9, 1947

To: National Advisory Council

From: National Advisory Council Staff Committee

Subject: Federal Legislative Problems Involved in Marketing International Bank Securities.

Problem. The United States Executive Director of the International Bank has strongly recommended that existing banking legislation be amended in order that member banks might be authorized to deal in International Bank securities. He further recommends that the Securities Act be amended to relieve banks and other dealers of the civil liabilities as underwriters and distributors under this Act. A prompt decision is desirable on this problem so that the Bank can plan its program for marketing securities.

The U.S. Executive Director considers it desirable that legislation be passed which would authorize member banks to deal in securities of the International Bank and to distribute them on a commission basis. In addition he considers it desirable that the Securities Act of 1933 be amended; he would consider either of the two following types of amendment to be satisfactory for this purpose, although he has expressed a preference for the first form:

(1) An amendment to add International Bank securities to the list of securities under Section 3 (a) (2) of the Securities Act of 1933, thereby exempting them from all provisions of the Securities Act, including the registration provisions; or

(2) An amendment to exempt all dealers, in dealing in International Bank securities or in distributing them on a commission basis, from liability under Sections 11 and 12 of the Securities Act (but not exempting International Bank securities from the registration provisions of that Act).

Present Laws and Regulations. Transactions of member banks of the Federal Reserve System in non-exempt securities are limited to (1) buying and selling without recourse solely upon the order and for the account of a customer and (2) buying and selling for a bank's own account for investment purposes only. At present national banks may invest an amount not in excess of 10 percent of their capital and surplus in non-exempt "investment securities" of a single obligor. The law expressly prohibits the bank from underwriting non-exempt securities, and, rulings by the Comptroller restrict the resale to customers of securities which a bank has purchased for investment.

The law exempts certain securities, however, from both the statutory restrictions and the Comptroller's regulations. With respect to exempt securities, a bank may buy, in unlimited amounts and for the bank's own account, may underwrite the issuance, and may sell such securities to customers after having purchased them for its own account. Exempt securities include obligations of the United States, the States and their subdivisions, obligations issued under the Federal Farm Loan Act and by the HOLC or FHL Banks. Obligations of

national mortgage associations and certain obligations issued by FHA are also exempt. Securities of the International Bank could be made eligible for dealing by member banks only by legislation.

The Executive Director states that even if permitted to deal by amendment of the Banking Act, member banks would not be willing to do so in view of the fact that they would be subject to liabilities as underwriters and distributors under the Securities Act of 1933. These liabilities under Sections 11 and 12 of that Act flow from the sale of securities by an underwriter or distributor based upon a false or misleading prospectus. Amendment of the Securities Act would be necessary to remove these liabilities.

Discussion. It is anticipated that the Bank will float a sizable issue of securities before the September meeting of the Board of Governors. The basic problems are (1) whether there will be a sufficient market for these securities at a satisfactory price without a large degree of participation by member banks, and (2) whether such member bank participation will be forthcoming in the absence of legislation permitting them to deal in the Bank's securities and exempting them from civil liability.

One viewpoint on these problems may be summarized as follows:

(a) The participation of member banks would contribute to a better market for the Bank's securities. The U.S. Executive Director points out in this regard that issues of the size and kind of security contemplated by the Bank have never been undertaken before. He states categorically, based on his experience in the marketing of securities, that he believes commercial bank dealing is essential in order that a sufficient market at a satisfactory price may be obtained. He adds that he will of course do the best he can with the existing situation if the NAC does not concur in his opinion but wishes to advise the NAC he feels strongly that failure to obtain the suggested amendments may jeopardize the entire program for marketing the securities.

(b) Member banks, if permitted to act as dealers, are in a position to establish a broad secondary market for the Bank's securities, whereas investment bankers do not have sufficient funds available for this purpose relative to the scale of Bank securities issues contemplated. Furthermore, the use of names of leading member banks, as sponsors of the issue, would stimulate sales. The prospects of a good secondary market should assist the initial sales.

(c) Member bank participation will not be forthcoming to the maximum extent in the absence of legislation

permitting them to deal and exempting them from civil liability. If limited to investment buying, member banks will not want to tie up a large part of their available funds in the Bank's securities for an extended period; whereas, if permitted to deal, they will purchase a much larger amount of the Bank's securities - possibly up to their 10 percent limit.

A viewpoint on the other side is:

(a) Investment bankers, insurance companies, savings institutions, and member banks to the extent that they invest under present law, can be expected to provide adequate financing for the Bank's initial operations.

(b) It would be better to determine the adequacy of the market under present legislation before risking the reopening of the entire subject of the Bretton Woods Agreements Act by requesting an amendment of the Banking Act of 1933. The prospects of a possible debate in Congress at this time on the Bretton Woods institutions and, particularly, on the question of why the Bank's securities may not be marketable might unfavorably affect the future salability of the Bank's securities. On the other hand, resort to Congress at a later date, after the market may been found insufficient, would be very difficult.

(c) Since the Banking Act of 1933 was passed expressly to curb the securities dealing practices of banks, any revision of the Act to extend the exemptions might be regarded as a weakening of the Act.

(d) In any event, it will probably be desirable for the International Bank to be prepared to operate in its own securities in such a manner as to assure a continuous and reasonably liquid market--in somewhat the same way as the Federal Reserve Bank of New York has operated in U.S. Government securities. Commercial banks or other dealers, necessarily operating with their own profit in view, could hardly be relied on to stabilize the market for the Bank's securities when most needed. Article IV, Section 8, of the Bank's Articles of Agreement authorizes the Bank to conduct such operations in its own securities.

Sec 5136 RS. Par 7 p 176 FR
See also Reg pp 19 FR Act p 25

Civil Liability under Sections 11 and 12 of the Securities Act of 1933

Representatives of member banks have indicated that even if the banking

laws were amended to permit them to act as dealers and distributors in International Bank securities, they would be unwilling to do so unless they were also in some way exempted from civil liability under the Securities Act of 1933. At present, the only securities in which member banks may act as dealers or distributors are securities which are completely exempted from the Securities Act of 1933, and it appears that banks are unwilling to undertake an active role in marketing securities which would involve civil liabilities under that Act.

The U.S. Executive Director has therefore indicated that if the banking laws are amended in accordance with his recommendation, some amendment of the Securities Act should also be made. It appears clear that as a matter of fairness any exemption given to banks should also extend to all other persons acting as dealers or distributors in International Bank securities. Against this view, it is contended that the actual risk and liabilities of banks in connection with the distribution of the securities of the International Bank would be insubstantial, in view of the special nature of the Bank and of its close relation to the U.S. Government. Therefore, if the banking laws were amended to permit banks to deal in these securities, it seems unlikely that they would in fact be seriously deterred by the liabilities under the Securities Act.

Registration Statement.

If any amendment to the Securities Act is to be made, the question remains whether the amendment should simply exempt banks and other dealers in these securities from civil liabilities, leaving the securities subject to the registration requirements.

One viewpoint on this question is as follows:

> No particular purpose would be served by having the Bank's securities subject to the registration provisions of the Securities Act of 1933. This is true since the National Advisory Council consults with the U.S. Executive Director on the loan operations and security flotations of the International Bank. Dealers might regard the Bank's securities even more favorably if they were not registered, since their status might then be associated more closely with the status of "exempt" securities.

The arguments against the proposal to exempt from registration:

(a) Even though the Council consults with the U.S. Executive Director on the operations of the Bank, it does not consider what disclosures should be made to the public with respect to the Bank's securities. It is the statutory responsibility of the Securities and Exchange Commission and not of the National Advisory Council to assure

full disclosure in connection with the public issue of securities in the United States.

(b) The legislative history of the Bretton Woods Agreements Act would appear to indicate that the filing of a registration statement by the Bank was contemplated.

(c) It is understood leading members of the investment community have expressed the view that registration would assist in the sale of the Bank's securities and have, therefore, indicated their belief that a registration statement should be filed by the Bank.

(d) Public support of the Bank or reliance upon its securities would not be enhanced by attempts to obtain special exemptions for securities of the Bank. Moreover, registration under the Securities Act will furnish a convenient way to give full publicity and information about such securities to the public.