Form F. R. 131

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date April 29, 1938

To Mr. Eccles

Subject:

From Mr. Clayton

I think George Harrison's letter to Senator Glass is very helpful. First, by way of introduction, he states that although he opposed the organization of bank holding companies on principle, he believes that in many instances they have been beneficial to the banking system and states further that since they are now in existence he thinks it is inadvisable from the standpoint of the present banking and credit situation to enact any legislation of such broad character at this time.

He then makes three general suggestions for revision of the pending bill.

1. He thinks the definitions contained in Section 2 should not be superimposed upon the existing definitions in the Banking Act of 1933. In other words, that the existing definitions should be clarified but not confused. Also, that the provisions respecting the extension of credit to affiliates contained in Section 3 should conform more closely to the existing law (Section 23a of the Federal Reserve Act) having due regard to their extension to cover insured nonmember banks.

2. Those various sections conferring powers upon the FDIC concerning matters which are already in some measure under the jurisdiction of the Board are inadvisable. He feels that until "we have decided where authority is finally to lie and how far unnecessary duplication of responsibility can be avoided, it would be better to preserve existing boundaries (Comptroller of the Currency - national banks; Federal Reserve System - state member banks; Federal Deposit Insurance Corporation - insured nonmember state banks) that to confuse the situation further by extending the authority of one agency into the jurisdictions of the others as this bill appears to do.

3. He thinks that the criminal penalties of Section 14 should be eliminated, believing that the existence of criminal penalties hampers rather than facilitates the administration of legislation of this kind by the supervisory authorities.

Following these three general criticisms and suggestions, Mr. Harrison makes a number of suggested changes in phraseology which he has indicated on his attached copy of the bill. Some of these are important, including the suggestion that the percentage of ownership be increased from 10 percent to 20 percent. Another important suggestion is that if a holding company has more than 50 percent of the stock of a bank it should be permitted to increase its holdings in such bank and also that

where a bank needs to acquire more capital that all stockholders should be permitted to subscribe in proportion to their existing holdings. I have not commented on several suggested changes which are rather minor in character.

On the whole the Harrison letter is very temperate but I think will have an effect upon the Senator, making him realize that the bill as drawn is full of provisions which would confuse the existing situation. In other words, it is not a vigorous criticism, but considering the person addressed, it is probably more effective.

LG

April 15, 1938.

PERSONAL

Dear Senator Glass:

I am sending this letter because when I last saw you, you said that I might reduce to writing some of the comments which I have made to you orally with reference to S. 3575 (75th Congress, 3rd Session), a bill which you introduced to provide for the regulation of bank holding companies and affiliates.

First, I think I should repeat what I told you orally, that while I consistently opposed the organization of bank holding companies as a matter of principle, nevertheless, now that they are in existence, it seems to me inadvisable, solely from the standpoint of the banking and credit system, to enact any legislation of this broad character just at this time. The general subject of the ownership of bank stock by other corporations is a very large one, and it is probably impossible to predict what the broad effect may be of legislation such as this just now. As a matter of fact, in spite of my original opposition, I believe that in many instances holding company ownership of bank stock has been beneficial in some ways, such as in improved management, in the restoration of the capital position of many banks and thus in the protection of their depositors. That being so, might it not be better to postpone general legislation with reference to bank holding companies or affiliates until we have come appreciably nearer a decision on the ultimate form of our bank-

ing system, which should include some decision on the unification of the system, and particularly on the question of branch banking? Assuming, however, that some legislation such as your bill is to be enacted now, there are, I think, some modifications or clarifications in the present draft which would be advisable. Apart from some suggestions as to changes in phraseology of the bill to which I shall refer later in this letter, there are three general comments which I think should be made.

First: In so far as it is consistent with the purposes of the bill, it might be better to build upon existing provisions of law in the administration of which we have already had some experience. I have in mind specifically that the definitions contained in Section 2 of the bill, as it now stands, should perhaps be designed to improve where necessary, but should not be superimposed upon the definitions of a holding company and an affiliate contained in the Banking Act of 1933, and that the provisions with respect to the extension of credit to affiliates, contained in Section 3 of the bill, should conform more closely to the provisions of Section 23a of the Federal Reserve Act, as amended, having due regard to their extension to cover insured non-member banks.

Second: Sections 7, 8, 9, 11, 12 and 15 of the proposed bill confer certain powers upon the Federal Deposit Insurance Corporation having to do with matters which are already in some measure under the jurisdiction of the Board of Governors of the Federal Reserve System. I cannot, of course, speak for the Federal Reserve System and I realize that, in any case, it is a subject for consideration by the several Federal supervisory agencies, and not for just one of them.

Nevertheless, I do feel that until we have decided where authority is finally to lie and how far unnecessary duplication of responsibility can be avoided, it would be better to preserve existing boundaries (Comptroller of the Currency - national banks; Federal Reserve System - state member banks; Federal Deposit Insurance Corporation - insured nonmember state banks) than to confuse the situation further by extending the authority of one agency into the jurisdictions of the others as this bill appears to do. In the attached draft of bill I have not attempted to note the changes that would be necessary to respond to these general comments on the question of jurisdiction.

Third: There is much to be said in favor of eliminating the criminal penalties of Section 14 of the bill. Experience has demonstrated, I think, that the existence of criminal penalties hampers rather than facilitates the administration of legislation of this kind by the supervisory authorities. It tends to put a brake upon corrective action by reason of a natural unwillingness to invoke the penalties of fine and imprisonment in matters of this sort, unless the evidence of violation is abundantly clear. It seems to me that such powers as termination of insurance, removal of officers, and prevention of payment of dividends, are sufficient deterrents without the addition of criminal penalties.

I now come to a number of suggested changes in phraseology, which have been indicated upon the enclosed copy of the bill, and which are designed, in general, to preserve its effectiveness, while preventing it from hitting a lot of innocent bystanders. The references given below are to the sections, sub-sections, pages and lines as

numbered in the copy of the bill S. 3575, dated January 5 (calendar day, March 2) 1938.

Section 2 (5) page 2, line 7:

I suggest the elimination of the words "drafts and acceptances." It is not believed that they properly belong in a definition of securities, and it is feared that their inclusion might conceivably interfere with normal and desirable banking transactions of a kind which it is not the purpose of the bill to prohibit.

Section 2 (7) page 2, lines 14 to 17:

I suggest that percentage of ownership of capital stock or of holding of voting rights which constitutes control be increased from 10% to 20%. A holding company may retain actual control while reducing its ownership or holdings below 50%, but to cover this possibility, I think it is not necessary to reduce the control figure to 10%. To do so would bring within the scope of the bill relationships which are not of the kind against which I understand the bill is directed. In my suggested modification of this section, the words "or holding" have been moved down from line 14 to line 15a, where they are directly connected with the phrase "total number of voting rights" to which I assume they refer. Otherwise, it might be contended that securities held as collateral, or in safekeeping, should be included in determining the existence or non-existence of "control" as defined. This would result in wholly unnecessary limitations of a kind clearly not intended by the bill. For instance, as now drafted, the bill might be construed to prohibit a bank from lending to a corporation if, by chance, a stockholder of that corporation has pledged 10% of its stock as collateral for a personal loan.

The words "domination, directly or indirectly" have been eliminated, as by their vagueness they pose an impossible administrative task, and the word "control" has been substituted.

Section 2 (9) page 3, line 18:

I suggest the addition of "Rider A" for two purposes: (1) To exempt companies primarily engaged in international or foreign or similar financial operations as described in Sections 25 and 25a of the Federal Reserve Act, as amended, which I assume it was not the intention to include within the bill's prohibitions; and (2) To exempt such institutions as the Discount Corporation of New York, which, as you know, was organized by some of the banks in New York City primarily to facilitate the establishment of an acceptance market in this country, and which now also deals importantly in government securities. Institutions of this kind are an important part of a money market and do much to maintain a free market in both acceptances and government securities. They do not take deposits or make loans. In substance, they are simply retail merchants of acceptances and government securities and I believe should be excepted from the definition of an affiliate. In the event that the 10% limit in sub-division 7 of Section 2 should be increased to 20%, as I have suggested, then so far as I can see, there would probably be no necessity, as a practical matter, of making a specific exception in favor of these particular institutions. However, in principle, it might be just as well to except them in any event.

Section 3, page 2, line 24:

The purpose of this suggested change is to exclude funds held in a fiduciary capacity, the investment of which is not controlled by the insured bank, from the prohibitions of the bill; otherwise, the bill might unintentionally interfere with the execution of trusts in cases where the insured bank is bound by the trust and has no initiative in the matter.

Section 4, page 5, line 2:

"Rider B" is added in order: (1) To permit an affiliate to provide new capital for an insured bank, if such affiliate holds more than 50% of the total capital stock or voting rights, on the theory that the degree of control is not thereby changed; and (2) To provide for those cases where an insured bank issues additional stock or voting rights, in order to obtain new capital, and where it would be desirable to permit all existing stockholders to take up such new stock or rights in proportion to their existing holdings.

Section 15 (changed to Section 13 by elimination of Sections 13 and 14), page 13, line 15:

"RiderC" makes provision for the possible exclusion from the prohibitions of the act, in the discretion of the appropriate supervisory authority, of companies whose affiliate relationships arise out of fiduciary transactions. Such permissive exclusion seems desirable to avoid unnecessary interference with appropriate fiduciary relationships and the proper participation of banks and trust companies in fiduciary business.

I hope that these suggestions may be helpful to you in your further consideration of the bill. This letter does not, of course, purport to cover all the matters which might warrant comment.

Those who have made a more thorough study of the bill itself, especially in its relation to other provisions of law, undoubtedly have other suggestions to make, and I presume they will be given an opportunity to present them whenever hearings are held. My purpose has been merely to write to you about some of the more obvious points which have occurred to me or been called to my attention. If you would like to discuss them with me at any time, I should, of course, be glad to call upon you at any time you care to have me do so.

Faithfully yours,

GEORGE L. HARRISON

Honorable Carter Glass,
United States Senate,
Washington, D. C.

Enc.