Mr Eccles

L-785

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

OFFICE CORRESPONDENCE DATE January 22, 1941.

TO BOARD OF GOVERNORS SUBJECT: Analysis of the effect of the holding company bill, S. 310.

FROM MESSRS. WINGFIELD AND CAGLE

Pursuant to the request made at the Board meeting on January 14, 1941, there is submitted below a concise analysis of the bill, S. 310, with comments. A summary of the details of the bill is contained in an analysis submitted to the Board under date of January 17, 1941.

The more important provisions of the bill, with brief comments relating thereto, are as follows:

1. In addition to any "corporation", "business trust", "association", or "other similar organization" as referred to in the Banking Act of 1933 as a holding company affiliate, the definition of a holding company would include any "bank", "partnership", "joint stock company", "organized group of persons, whether incorporated or not", or "any receiver, trustee, or other liquidating agent of any of the foregoing in his capacity as such". The bill also contains broad definitions of "voting security", "own", "control", "hold", etc. (Sec. 2)

Comment. As indicated, the definition of a bank holding company would be somewhat broader than that contained in the Banking Act of 1933, particularly since the new definition would include "partnerships" and "organized groups of persons". It is not clear what groups would be considered as coming within this new definition but

it does not appear to go so far as to apply to a chain system of banks controlled by one individual. In view of the apparent effort to cover all possible loopholes through broad definitions of voting securities, ownership, control, etc., it is difficult to visualize all of the situations which might be covered by these definitions.

2. After June 30, 1944, a company would be prohibited from owning, holding, or controlling more than 10 per cent of the voting securities of an insured bank. The FDIC would be given the authority to exempt any company which it determines not to control the management or policies of any insured bank or to control only incidentally the management or policies of one or more insured banks, the company being primarily engaged in business not closely related to banking. (Secs. 3 and 4)

Comment. Under the Banking Act of 1933, the determination of whether a company is a holding company affiliate of a bank depends in general upon whether the company controls a majority of the stock of the bank or a majority of the shares voted for the election of its directors or controls in any manner the election of a majority of the bank's directors. Under the existing laws, the Reserve Board is given authority to exempt incidental bank holding companies which are not engaged as a business in holding or controlling bank stocks.

The above requirements for termination of holding companies by June 30, 1944, might have serious effects on the banking structure.

Such requirement would not only affect the known holding companies under the present definitions contained in the law but would also affect other companies which hold as much as 10 per cent of the voting securities of an insured bank and are not now considered holding companies. Also, the exemptive power which would be vested in the FDIC might not be exercised in the same manner and to the same extent as it has been exercised by the Board and certain companies which are now exempt by action of the Board might be required to terminate their relationships. In this connection, it appears that the FDIC would not have authority under its proposed exemptive power to exempt banks which are holding companies of other banks.

It is reasonable to believe that one of the probable results of the requirement for termination of holding companies would be the liquidation of some subsidiary banks and the termination of banking facilities in some communities (shares of bank stock could not be sold for their actual value in some cases and the holding company would have to liquidate the assets of the bank in justice to the shareholders of the holding company). Other results might be the transfer of control of some well-managed banks to undesirable or weak management; the distribution of a small number of fractional shares of subsidiary banks to numerous shareholders resulting in a lack of any responsible group being substantially interested in the management of the banks; financial loss to many shareholders through

attempts to dispose of fractional shares or a small number of shares of various subsidiary banks; and loss of confidence in some banks by depositors and the public, with the possibility of weakening and wrecking them.

There are 23 holding company groups covered by general voting permits from the Reserve Board. The holding companies of these groups own or have a substantial interest in 431 banks having a capital structure of approximately $715,000,000 and holding approximately $6,128,000,000 of deposits.

3. It would be made unlawful (1) for any insured national bank or District of Columbia bank to declare or pay any dividend over the objection of the Comptroller of the Currency, and (2) for any State insured bank, whether a member of the Federal Reserve System or not, to declare or pay any dividend over the objection of the FDIC. The Comptroller and the FDIC, respectively, would be authorized to make an objection when in their opinion the declaration or payment of any such dividend would not be compatible with the best interest of its depositors or other creditors or with the public interest. (Sec. 5)

Comments. It will be noted that this applies to all insured banks whether unit banks or subsidiaries of bank holding companies and the powers which would be vested in the FDIC and the Comptroller to restrict payment of dividends would continue in effect after June 30, 1944, when under the requirements of the bill holding companies would have been terminated. There is no similar provision

in the present law, but the voting permit agreements contain general requirements relating to the maintenance of a sound financial condition and the following of sound policies which are designed, among other things, to give the Board control over unwise payments of dividends by subsidiary banks.

The powers which would be vested in the Comptroller and the FDIC to restrict payment of dividends would ignore the Board's interest in supervision of State member banks and would grant the FDIC authority to restrict dividend payments by these banks as well as by nonmember insured banks. These powers in the FDIC, together with certain powers of administration and investigation which would be vested in the FDIC and which will hereafter be further referred to, could be construed as giving the FDIC supervisory powers over all insured banks of the greatest importance. These powers would seem to be superimposed upon supervisory powers now vested in the Board and the Comptroller of the Currency over State member banks and national banks and could be exercised without regard to the views of the Board or the Comptroller.

It should be noted in passing that the basis upon which the Comptroller and the FDIC could restrict the payment of dividends by an individual bank would not be limited only to reasons applicable to the condition of such bank but could be based on the broad ground of incompatibility with "the public interest". It would appear that the draftsmen of the bill intended to give the FDIC and the Comptroller

the broadest possible grounds upon which to restrict payment of dividends when they deem it desirable.

4. Any company violating the act would be subject to a fine not exceeding $100,000, and any individual violating the act would be subject to a fine not exceeding $10,000 or to imprisonment for not exceeding five years or to both. The FDIC would be authorized to remove from office any officer or director of an insured bank responsible for any violation of the provisions of the act or any rules or regulations thereunder or for failure to disclose any such violation. The FDIC would be authorized to bring an action to enjoin any person from violating the act or any rule or regulation thereunder. (Sec. 6)

Comments. In addition to the fines and imprisonment penalties prescribed, the authority which would be vested in the FDIC to remove officers or directors of insured banks would to a considerable extent duplicate the authority now vested in the Board and the Comptroller by section 30 of the Banking Act of 1933 with respect to the removal of directors and officers of member banks. Here again the functions of the FDIC would not be confined to groups of banks but could be exercised with respect to violations of the act by officers or directors of unit banks.

5. The FDIC would be authorized to administer the act and to make such rules and regulations as may be appropriate to carry out the provisions of the act. The FDIC would also be authorized

to investigate any facts which it may deem appropriate (1) for the purpose of determining whether any company or individual has violated or is about to violate any provision of the act or any rule or regulation thereunder, (2) for the purpose of aiding in the enforcement of the provisions of the act or aiding in the prescribing of rules and regulations thereunder, or (3) for the purpose of obtaining information to serve as a basis for recommending further legislation concerning the matters to which the act relates. (Sec. 8)

Comments. The administrative powers which would be vested in the FDIC with respect to unit banks do not have any limitation as to the time within which they may be exercised and would be superimposed upon and duplicate the supervisory powers over unit State member banks and national banks now vested in the Reserve Board and the Comptroller of the Currency, respectively. The administrative powers which would be vested in the FDIC with respect to bank holding companies would, until such holding companies are dissolved, be superimposed upon and duplicate the supervisory powers over bank holding companies now vested in the Reserve Board. No provision is made for the repeal of existing authority for supervision of unit banks and of bank holding companies and the superimposing of the additional powers in the FDIC would make for confusion and duplication of supervision of banks and bank holding companies.

The authority which would be vested in the FDIC to make investigations and recommendations with regard to further legislation

concerning the matters to which the act relates and administrative provisions of the act are in such broad terms that such authority could be construed as giving the FDIC power to examine and to a considerable extent supervise all State member banks and national banks without regard to any views of the Board or the Comptroller of the Currency in the matter.