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Chairman Eccles

Mr. Townsend

Proposed bank holding company bill

It has been well over a year since our meetings with the Attorney General and the representatives of Treasury and FDIC concerning proposed bank holding company legislation. Following those meetings a number of conferences were held between attorneys of Justice, Treasury, FDIC and the Board in an effort to agree on a draft of such proposed legislation. These meetings were discontinued approximately a year ago. To the best of my recollection the only significant differences of opinion between Treasury representatives and ourselves related to (1) the definition of a bank holding company, (2) the statutory formula for limiting expansion of bank holding companies, and (3) dealings between a bank holding company and its subsidiary banks. One of the Treasury proposals relating to reserve requirements was incorporated in the Board's bill of last October, but the Board has since changed its position on this. This subject should, therefore, be added to those itemized above.

1. Definition of bank holding company.--One Treasury proposal was to leave the present definition of a bank holding company basically unchanged. This definition in substance defines a holding company as any company which holds or controls a majority of either the voting shares of a bank or of the shares voted at the preceding election of directors of a bank, or which controls in any manner the election of a majority of the directors of a bank. The Board bill changes this definition by establishing a legislative presumption of control from the fact of ownership of 10 per cent or more of the voting securities of a bank, reserving however a statutory right to the putative holding company to demonstrate that, notwithstanding its ownership of more than 10 per cent of the shares of a bank, it does not in fact control such bank. (This definition and exemption procedure is patterned upon similar provisions in the Public Utility Holding Company Act of 1935.)

The Board's position on this matter is simply that the old definition is archaic -- it does not give recognition to actualities in intercorporate relations. It long since has been demonstrated that working control of a corporation can be effectively maintained without the ownership of a majority of its voting shares. Congress expressly recognized this fact in the Public Utility Holding Company Act. Nor will such a definition work any unnecessary hardships. All companies owning the critical number of bank shares are similarly situated. Each has a ready procedure at hand for escaping regulation by demonstrating that it does not control the management or policies of two or more banks. In the clear cases (such as insurance companies whose ownership of bank shares may be purely for investment purposes) lack of such control is easily demonstrated. In the close cases the burden of proof is put where in the public interest it belongs, namely, upon the putative holding company to demonstrate lack of control and not upon the Board affirmatively to demonstrate the existence of control.

2. Statutory formula for limiting expansion.--On this subject the Treasury representatives took the position that a fixed mathematical formula should be employed for limiting bank holding company expansion. Thus, it was suggested that a holding company should not be permitted to acquire the stock or assets of any bank where the effect of such acquisition would be to result in such company controlling either 25 per cent of the banking offices, including branch offices, in any state, or 25 per cent of the bank deposits in any state. Under the Board's bill the bank holding company can expand only with the consent of the Board if the acquiring company be the holding company itself or a State member bank, the Comptroller of the Currency if the acquiring company be a national or district bank, or the FDIC if the acquiring company be a nonmember insured bank. Before such approval may be granted, however, the agency to which application is made must give consideration to, among other things, "the national policy against restraint of trade and undue concentration of economic power and in favor of the maintenance of competition in the field of banking".

It is felt that the Board's proposal is more in harmony with traditional concepts of banking legislation generally. Thus, the Comptroller of the Currency is authorized in his discretion to approve the charter of a new bank without any fixed or rigid standards to measure the exercise of that power. Again (and which may be more to the point), there is no such rigid limitation upon the Comptroller's power to authorize the establishment of branches of a national bank. (As of June 30, 1944, the total banking offices controlled by Transamerica in California totaled about 60 per cent of all the banking offices in that State. Most of these offices were branch offices of the Bank of America N. T. & S. A.)

Furthermore, while such a rigid formula might be appropriate for one section or community, it might be wholly inappropriate for another. Thus, control of 25 per cent of all of the deposits or banking offices of the State of Montana might in nowise jeopardize the banking structure of that area, through monopolistic effects or otherwise, whereas as little as 10 per cent ownership of such deposits and banking offices in the State of New York might very well constitute such a hazard. The Board's formula affords a flexible but effective standard for the guidance of the banking agencies in meeting individual cases.

Finally, it is believed that the Justice Department would oppose the fixing of any fixed statutory percentage relating to the potential size of bank holding company organizations. Such a provision might effectively tie its hands in attempting to proceed under the anti-trust laws in given situations.

3. Dealings between bank holding companies and their banks.--Another Treasury proposal would permit a bank subsidiary to invest in, or loan upon, the stock or other obligations of the parent company, provided the aggregate of such loans or investments do not exceed 10 per cent of the capital stock and surplus of such bank. As now drafted, the Board's bill prohibits a bank subsidiary from investing any of its funds either in the capital stock of the parent company or any of the subsidiaries of the parent company; it also prohibits the subsidiary bank from accepting the capital stock of the parent company or any of its subsidiaries as securities for loans made to anyone.

On this subject the Board takes the position that to allow investments in or loans upon the equity securities of the parent company or any of its affiliated companies would be to encourage the holding company to exert its influence over the banking subsidiaries to finance risk ventures which the holding company may otherwise be unable to finance. Here again the examples furnished in the past by the Transamerica organization are sufficiently cogent to require such a prohibition. In addition, it may well be argued that to permit a banking subsidiary to loan upon the stock of the parent is in effect to allow it to loan on its own stock. After all, the value of the holding company stock reflects in varying degrees the success or lack of it of the bank itself. This observation is especially true in the situation where the stock of the bank involved constitutes the principal asset of the holding company.

4. Reserve requirements.--Another Treasury proposal (which was incorporated in the Board's bill as introduced at the last session) was to require that a holding company maintain a reserve fund of 12 per cent of the book value of the bank shares owned by the corporation, such fund to consist of cash or United States obligations. Since the bill was introduced, however, the Board has concluded that to change the basis for computing the reserve requirements from par value, as now provided in the law, to book value would be to diminish rather than increase the possibility of strengthening the capital structures of the various banks in the bank holding company groups. Officials of several of the

companies have pointed out that to meet such an increase in reserve requirements would require their companies to drain off more and more of the earnings of the banks in such groups. In one case alone the increase in such reserve requirements would amount to more than $5,000,000.

The Board also feels that the holding company should be permitted to invest its reserve fund in as productive a manner as is possible, consistent with the requirement now imposed that the fund should consist of readily marketable assets.

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