September 7, 1939

Board of Governors
of the Federal Reserve System
Federal Reserve Building
Washington, D. C.

Re: Construction of Subsection (c) of Section 5144 of the Revised Statutes in relation to the holding by Transamerica Corporation of shares of Bank of America, N. T. & S. A., in its reserve of readily marketable assets.

Dear Sirs:

On August 14, 1939, the Federal Reserve Bank of San Francisco transmitted to Mr. John M. Grant, President of Transamerica Corporation, a letter in which was incorporated an expression of opinion that the proper construction of Subsection (c) of Section 5144 of the Revised Statutes required that there be read into its phraseology the words "other than bank stock," thereby making Subsection (c) impose the same prohibition upon bank stock as is contained in Subsection (b) of Section 5144 of the Revised Statutes.

On August 19, 1939, Mr. Grant replied by letter to the Federal Reserve Bank of San Francisco in which he took issue with this construction made by the Board of Governors and asked the Federal Reserve Bank to transmit his letter to the Board with his request for a reconsideration of the matter.

In connection with the question of a reconsideration by the Board of Governors, Mr. Grant has requested me to lay before the Board my views of the statute and I herewith respectfully submit them for your consideration.

I.

LEGISLATIVE HISTORY

In the Banking Act of 1933 (Act of June 16, 1933, 48 Stat. 162), Congress for the first time undertook to bring bank holding companies under the jurisdiction and control of the Federal Government. This was accomplished through an amendment of Section 5144 of the Revised Statutes which was that section of the National Bank Act (Act of June 3, 1864, 13 Stat. 102) which provided that each shareholder of a national bank should be entitled to one vote on each share of stock held by him in all elections of directors.

This amendment of 1933 prohibited a bank holding company from voting the stock of a controlled national bank unless the company were in possession of a voting permit issued by the Board of Governors of the Federal Reserve System. As a condition precedent to the issuance of the permit by the Board of Governors, such a bank holding company--defined as a "holding company affiliate"--was required to agree to comply with a number of conditions specifically set forth by Congress in the amendment. Among these is Subsection (c) which, as enacted in the Banking Act of 1933 [Section 19(c)], reads as follows:

> "(c) Notwithstanding the foregoing provisions of this section, after five years after the enactment of the Banking Act of 1933, (1) any such holding company affiliate the shareholders or members of which shall be individually and severally liable in proportion to the number of shares of such holding company affiliate held by them respectively, in addition to amounts invested therein, for all statutory liability imposed on such holding company affiliate by reason of its control of shares of stock of banks, shall be required only to establish and maintain out of net earnings over and above 6 per centum per annum on the book value of its own shares outstanding a reserve of readily marketable assets in an amount of not less than 12 per centum of the aggregate par value of bank stocks controlled by it, and (2) the assets required by this section to be possessed by such holding company affiliate may be used by it for replacement of capital in banks affiliated with it and for losses incurred in such banks, but any deficiency in such assets resulting from such use shall be made up within such period as the Federal Reserve Board may by regulation prescribe;" (Underscoring supplied.)

This particular provision was designed to embrace a special class of holding company affiliates, namely, those upon the shareholders

of which rested individually and severally a legal liability for the statutory liability imposed upon such holding company affiliates under the banking laws. Subsection (c) makes only one condition with respect to such holding company affiliates and that is that they shall be required to establish and maintain out of net earnings a reserve of readily marketable assets in an amount not less than 12 per centum of the aggregate par value of the bank stocks controlled.

Subsection (b) to which the Board of Governors has referred for its construction of Subsection (c) was designed to embrace that class of holding company affiliates the stockholders of which were not legally liable for the statutory liability imposed upon such holding company affiliates by the banking laws. It reads as follows:

> "(b) After five years after the enactment of the Banking Act of 1933, every such holding company affiliate (1) shall possess, and shall continue to possess during the life of such permit, free and clear of any lien, pledge, or hypothecation of any nature, readily marketable assets other than bank stock in an amount not less than 12 per centum of the aggregate par value of all bank stocks controlled by such holding company affiliate, which amount shall be increased by not less than 2 per centum per annum of such aggregate par value until such assets shall amount to 25 per centum of the aggregate par value of such bank stock; and (2) shall reinvest in readily marketable assets other than bank stock all net earnings over and above 6 per centum per annum on the book value of its own shares outstanding until such assets shall amount to such 25 per centum of the aggregate par value of all bank stocks controlled by it;"

It will be readily seen that Congress intended Subsection (b) to be much more burdensome and stringent in its operation than Subsection (c). For example, holding company affiliates subject to (b) are required to possess on June 16, 1938, unpledged readily marketable assets other than bank stock in an amount not less than 12 per centum of the aggregate par value of all bank stock controlled and which amount shall be increased by not less than 2 per centum per annum until the total reaches 25 per centum. No such condition is imposed upon the holding company affiliates subject to Subsection (c). They enter the fifth year after the Act without having to bear any such burdens. Also, (b) provides that holding company affiliates subject to this provision shall reinvest in readily marketable assets other than bank stocks all net earnings over and above 6 per centum per annum on the book value of its own shares until such assets shall amount to 25 per centum of the aggregate par value of bank stock controlled. No such condition is imposed by Subsection (c).

Subsection (c), on the other hand, simply provides for the reserve above mentioned and, further, permits the reserve to be used for replacements of capital and losses.

The marked leniency shown to holding company affiliates subject to the conditions of Subsection (c) as compared with the rigid terms imposed on those subject to (b) was no doubt due to the intention of Congress to protect or conserve, in effect, the statutory liability which the shareholders of holding company affiliates subject to (b) might otherwise entirely escape.

In the Banking Act of 1933 (Section 22) Congress amended Section 5151 of the Revised Statutes and Section 23 of the Federal Reserve Act by exempting from the statutory additional liability, imposed upon shareholders of national banks, all new shares issued by any national bank after June 16, 1933, the date of the approval of the Act. About two years later, in the Banking Act of 1935 (Section 304) Congress extended this exemption by amending Section 22 of the Banking Act of 1933 to provide for the complete abrogation of the statutory additional liability on all shares of national banks engaged in active business on July 1, 1937. These two provisions therefore provided the means for the final elimination of the statutory additional liability on the shares of all national banks.

At the same time, the Banking Act of 1935 further amended Section 5144 of the Revised Statutes by adding at the end of Subsection (c) thereof the following provision:

> "and the provisions of this subsection, instead of subsection (b), shall apply to all holding company affiliates with respect to any shares of bank stock owned or controlled by them as to which there is no statutory liability imposed upon the holders of such bank stock:"

Congress therefore, through the above series of statutory enactments, provided the means for the removal of holding company affiliates which owned or controlled national banks from the class of holding company affiliates subject to the provisions of Section 5144(b) of the Revised Statutes and made them subject to the much more lenient provisions of Section 5144(c).

Since there are now no holding company affiliates subject to the statutory additional liability under the national banking laws and perhaps also no such liability under the various state laws, the three amendments made by Congress above mentioned relating to such statutory liability have had the effect of rendering Subsection (b) obsolete. It has, in effect, been repealed by Congress by indirection.

Transamerica Corporation qualified under Subsection (c) and set aside a reserve of readily marketable assets out of net earnings over and above 6 per centum of the book value of its own shares outstanding. The marketable assets in this reserve at the present time consist of 150,000 shares of stock of Bank of America, National Trust & Savings Association. The Board of Governors communicated to the Federal Reserve Bank of San Francisco its view that this reserve could not hold bank stock.

II.

CONSTRUCTION OF THE STATUTE

There are three well known rules of interpretation and construction of statutes applicable to the present discussion which are of such long standing in Anglo-American jurisprudence that they may be said to have themselves the force of law. They are briefly indicated below:

1. The Intent of Congress Should First Be Sought in the Phraseology of the Statutory Provision Itself.

The words employed by Congress should be taken in their ordinary meaning and where the provision is free from ambiguity in itself, there exists no room for construction. Where the language of the statute is susceptible of a sensible interpretation, it should not be controlled by any extraneous considerations. In the present instance, the particular language under consideration is the requirement that holding company affiliates subject to (c) "...shall be required to establish and maintain out of net earnings over and above 6 per centum per annum on the book value of its own shares outstanding a reserve of readily marketable assets..." This language appears to be without any ambiguity and given its ordinary meaning, it would impose no restrictions upon the assets of the required reserve except that they be "readily marketable." This provision would seem to furnish no occasion to attempt to give it a different meaning by inserting the phraseology used by Congress in the preceding Subsection (b), namely, "other than bank stock." These words were omitted by Congress in the enactment of (c). Sound principles of construction require that where Congress omits phraseology from a provision, such omission must be held to have been made by design and the statute should be so interpreted and construed.

The preliminary clause used in Subsection (c), namely, "Notwithstanding the foregoing provisions of this section," (Section 19) indicates clearly that Congress had in mind all of the conditions and restrictions set forth in Subsection (b) but nevertheless intended

that (c) should stand in the Act not only independently of the provisions of (b) but in contradiction to it. Although one may not inquire into the question of the wisdom of an act of Congress, yet it may be pertinent to say that the situation clearly presented an occasion to Congress for separate treatment of the two classes of holding company affiliates then existing. Technically, there is nothing unworkable in the establishment and maintenance of a reserve of readily marketable assets which includes bank stock and the words employed by Congress clearly do not require the exclusion of bank stock.

2. Subsection (c) Requires a Strict Interpretation and Construction

a. Because it is a penal statute. The rule for the strict construction of penal statutes is apparent because it is necessary to avoid any expansion or enlargement of the penalties imposed by Congress. The degree of strictness required is in proportion to the gravity of the consequences flowing from the infraction of the statute.

In order to classify a statute as "penal," it is not necessary that it provide for the punishment of a crime. It is also a penal statute if the violation of it can result in the imposition of special burdens or take away or impair existing privileges or rights.

In the present case, the provisions of Subsection (c) form a part of an act of Congress which is an important innovation in the field of banking. It imposes new conditions and restrictions upon certain classes of shareholders of national banks. One of these conditions is embraced in Subsection (c), namely, the requirement for a reserve of readily marketable assets. The penalties for violation of this condition are extremely drastic. They bear not only upon the shareholder (the holding company affiliate) but upon the banks controlled by it. In the case of the shareholder, the imposition of the penalty would mean a loss of power to vote the shares. In the case of the controlled banks, further dividends could be prohibited to the shareholder, the banks deprived of the right to receive deposits of the public monies of the United States, and proceedings could be instituted for the forfeiture of the charter of such banks in order to accomplish their complete liquidation.

In other words, the penalties would result in no less than a complete destruction of the investments in the financial institutions involved.

This extreme penalty requires a correspondingly extreme strictness of interpretation and construction in order that the Board of Governors might not take a view of the statute which would impose a greater burden than Congress intended.

b. Because power to punish its infraction is granted to the Board. Where power is granted or delegated by Congress to an executive agency of the Government, the rule requires that the terms of the grant be strictly construed. Thus in the present case, two principles concur, namely, that of strict construction of penal statutes and of strict construction of the grant of power to impose the penalty. In the present case, the condition to be met is set forth in Subsection (c). The grant of power to punish the offender for the infraction of that condition is found at the end of Subsection (e) in the same section (Section 19). If the clause, "reserve of readily marketable assets," be construed by the Board of Governors to include a prohibition against the incorporation of bank stock in the reserve, the Board by that construction has enlarged its own power to punish. Having made this construction, the Board could then proceed to punish the offender because it held bank stock in the reserve, whereas under a strict construction bank stock would be permitted to be included and therefore no offense will have been committed and consequently no liability for punishment.

III.

CONCLUSION

In view of the above considerations, it is respectfully submitted that Subsection (c) is free from any ambiguity as to the intent of Congress in so far as the nature of the reserve is concerned. It is to be a reserve of "readily marketable assets." The principles of sound construction require that the language be taken in its ordinary meaning without any expansion or enlargement. Furthermore, the provision itself being a part of a penal statute and the consequences of its infraction being most drastic, it should be strictly construed accordingly in order to avoid the possibility of an enlargement of the penalty beyond the intent expressed by Congress. And, finally, the strict construction is further required because the statute contains new grants of vast power to the Board of Governors to impose punishment for its infraction. It is, therefore, incumbent upon the Board of Governors in this connection to be careful not to enlarge its powers of punishment through its own construction of the statute.

There is attached hereto a memorandum in which are cited some leading cases decided by the Supreme Court of the United States upon the questions here presented.

Respectfully,

Charles R. Collins
Counsel, Transamerica Corporation

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