

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date December 12, 1946.

To Chairman Eccles

Subject: Paper concerning member bank
distribution of International Bank
securities.

From Mr. Knapp

The attached paper concerning member bank distribution of International Bank securities has just arrived. I would suggest that you look at the conclusion and the alternative recommended actions on page 3. The Staff Committee has definitely rejected the idea of commercial banks acting as dealers in securities of the International Bank, but I hope that you will feel able to go along with the suggestion that legislation might be sought authorizing their functioning as distributors of these securities on a commission basis if Congressional leaders react favorably to such a proposal. It would be up to Secretary Snyder to sound out the Congressional leaders. Incidentally, Pete Collado has recently received a communication from Ed Brown arguing the advantages of having the commercial banks assist in the distribution of International Bank securities.

The Council will also need to consider today whether or not its conclusions should be communicated in writing to the Aldrich Committee. If it is desired to do this, the Staff Committee has prepared a draft paper stating the Council's conclusions and the reasons therefor.

Attachment (N.A.C. Document No. 305)

MEMORANDUM To: National Advisory Council

From: National Advisory Council Staff Committee

Subject: Marketing of International Bank Securities through
Member Banks

The Staff Committee has given further study to the proposal that member banks be permitted to distribute or to deal in securities of the International Bank.

1. Legal Aspects and Background

Member banks are prohibited by the Federal banking laws from underwriting, or dealing in, all except certain expressly exempted securities. With respect to exempted securities, a bank may buy and sell freely for its own account, underwrite or distribute and engage in promotional activities and in solicitation of orders. The existing laws permit a bank to distribute securities in the form of execution of customers' orders (not involving solicitation on the part of the bank) for a fee approximating costs of handling.

Legislation enabling member banks to assist on a more active basis than presently permitted in the marketing of International Bank securities might take either of two forms (1) an authorization for the banks to distribute as agents for the International Bank on a commission basis only or (2) a complete exemption of the securities of the International Bank, thus permitting not only such distribution but also buying and selling for the Banks' own accounts.

The exemption of federal, state and municipal securities may be justified on two grounds: (1) such securities are of relatively high quality and, therefore, involve a minimum of underwriting risk and (2) since the banks' officers can have no personal financial interest in the affairs of a governmental issuer, there is no incentive to abuse the underwriting function. Similar grounds might be used to justify revisions which would enable member banks either to deal in or distribute (or both) International Bank securities. Nevertheless, an attempt to exempt International Bank securities from the prohibitions of the Banking Act might invite vigorous criticism.

If the member banks should be authorized to act as distributors or dealers of International Bank securities, the question arises whether the member banks would be willing to assume any legal liability that might be held to attach to member banks under the Securities Act of 1933. The information obtained from representative commercial bank interest indicates that some banks would be willing to assume any such liability, while others would not.

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Much of the criticism, particularly from security dealers, which might result from a proposal wholly to exempt International Bank securities from the restrictions of the federal statutes might be avoided by proposing only that the member banks be authorized to distribute the securities on a commission basis and for the account of the International Bank.

Representatives of the International Bank have indicated that an authorization to distribute on a commission basis might be sufficient for the Bank's purposes.

2. Discussion

Apart from the question of political advisability involved in the possible reopening to Congressional debate of the Banking Act of 1933 and the Bretton Woods Agreements Act if amendatory legislation should be proposed, the following would appear to be the relative advantages and disadvantages of permitting member banks to act as dealers and distributors in International securities.

(a) Advantages

On the basis of the information available to the Staff Committee, it is believed that the member banks could contribute substantially to the marketing of International Bank securities by acting as distributors. The member banks would thereby have an incentive to disseminate information to their customers concerning the International Bank's securities, and generally to promote their sale. Advantages would also flow from the increase in the number and caliber of retail outlets for the Bank's bonds which the commercial banks could provide.

Representative security dealers appear to hold the opinion that there is an actual need to have commercial banks participate as distributors on an agency basis for the International Bank. This is partly due to the fact that the investment community has apparently not been sufficiently convinced of the merits of the Bank's bonds to assure a ready market among private investors. Investment brokers and dealers may feel that without the commercial banks as distributors, a somewhat too heavy responsibility would be placed upon their own distribution facilities in the early offering periods. This is further emphasized in view of what appears to the investment community to be indifference or resistance to the Bank's bonds from some groups of institutional investors and state banking officials.

The Staff Committee is generally of the view, supported by information obtained from representative banking interests, that dealing by member banks (as distinguished from their acting as distributors) would aid in developing a continuing demand by investors for International Bank securities, and would be likely to assist generally in stabilizing the market for the securities. The Staff Committee recognizes, however, that

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the need for and measure of such aid from the member banks will depend in large part on the extent to which the International Bank itself decides to engage in stabilization activities.

(b) Disadvantages

One of the purposes of the Banking Act of 1933 was to prevent banks of deposit from assuming risks of security market operations and to prevent a bank from giving advice to an investor which was prejudiced by the Bank's own interest as seller of securities or by its position in the securities as a dealer. Any exemption of International Bank securities might be regarded as an apparent weakening of the foregoing principle.

Information obtained from representatives of security dealers indicates that legislation authorizing member banks to deal in International Bank securities might engender active opposition from the security dealers and their organization. The investment brokers and dealers might contend that they could supply a sufficiently liquid market for the Bank's bonds without the addition of the trading facilities of the commercial banks, particularly if the bonds are to be registered for listing on national securities exchanges. However, the same information suggests that the security dealers might not oppose legislation limited to authorizing member banks to distribute these securities.

3. Conclusion

The Staff Committee believes that it would clearly be to the advantage of the International Bank to have member banks authorized to distribute or deal in the bonds of the International Bank. The Council must weigh these advantages against the possible disadvantages of apparently weakening the principles of the Banking Act of 1933 and of reopening debate in Congress concerning that Act and the Bretton Woods Agreements Act. The Staff Committee feels that there would be less basis for opposition if the legislation were limited to authorizing commercial banks to act as distributors on a commission basis rather than as dealers in securities of the International Bank.

Recommendation:

The following action is submitted for consideration by the Council:

The National Advisory Council agrees that legislation [should] [should not] be sought authorizing commercial banks to act as distributors on a commission basis in securities of the International Bank [if the Congressional leaders react favorably to such a proposal].