

March 18, 1948

Governor Skymczak

Today's NAC meeting: proposed

J. Burke Knapp and L. N. Dembitz

legislation on International Bank securities

Mr. Eugene Black, the U.S. Executive Director of the International Bank, has now sent a formal letter (NAC Document No. 627) asking the N.A.C. to ask Congress to exempt the Bank's bonds from the Securities Act of 1933 and the Securities Exchange Act of 1934 and from the prohibition of Section 5136 against national banks\* (and state member banks\*) dealing in and underwriting investment securities. The bonds would remain subject to the rule of Section 5136 that a national bank or state member bank may not invest more than 10 per cent of its capital and surplus in securities of any one obligor.

Mr. Black also asks the Council (NAC Document No. 626) to ask Congress to permit District of Columbia insurance companies to invest in International Bank securities.

The effect of the two letters is to present in a formal way the same proposals that Mr. McCloy and Mr. Black discussed informally with you and Chairman Eccles in January, with the following exceptions:

(a) the earlier proposal would have exempted International Bank bonds completely from Section 5136, as government bonds are exempted, instead of leaving the Bank bonds subject to the existing 10 per cent limit on a member bank's holdings; and

(b) the earlier proposal included a section to exempt International Bank bonds from state blue sky laws, which has now been dropped.

#### 1. Exemption under banking laws

In April 1947 the National Advisory Council rejected the idea of the Bank and of the Aldrich Committee that Section 5136 be amended to permit banks to deal in International Bank bonds. This rejection was based in part on the view that such amendment was not needed to help sell the initial 250 million dollars of debentures which the bank was then proposing to issue and that if such amendment should seem necessary to help sell later issues, it might be better received in Congress in 1948 when the Bank would actually have some bonds outstanding.

While the initial offering of the Bank's securities in July 1947 was successful, there appear good grounds for the Bank's view that future offerings will run into greater difficulties and that the assistance of commercial banks as distributors and as dealers making a "secondary market" between offerings, may be essential.

The bonds that were sold last July at 100 and were then quoted in the market around 102 are now selling around 97. This decline is in line with the declines that have occurred in other comparable bonds, and does not of itself indicate any special weakness of the Bank's position. Nevertheless the officials of the Bank feel that future sales will run into difficulties because of the increased tension in the international situation. While it will be a long time before the volume of the Bank's bonds outstanding could exceed the amount that is fully guaranteed by the unpaid capital subscription of the United States Government, it will take more salesmanship to bring this fact home to investors. It is also understood that some of the dealers who have been "making the market" in the bonds during the recent period of declining prices have taken losses which are substantial in relation to their capital, and that therefore the maintenance of an active market in these securities may require the participation of stronger institutions such as the large banks.

It seems clear that an amendment permitting the banks to deal would make the bonds seem more attractive to many investors and would assist to at least some degree in distributing the bonds among investors, and in view of the quasi-governmental status of the Bank, an exemption for these bonds would not seriously weaken the principle of keeping commercial banks out of the business of dealing in corporate securities.

The language of the amendment proposed by Mr. Black may be ambiguous as to whether positions taken by banks as dealers must be included in the 10 per cent limitation. Our Legal Division has drafted a substitute proviso in order to make it clear that such positions are to be included; this will be cleared with the International Bank people this morning so that we can ask the Council to substitute it for the proviso in the Bank's draft.

## 2. Securities Act and Securities Exchange Act

Last year the International Bank asked for exemption of its securities from a number of provisions of the Securities Act and of the Securities Exchange Act. Some of these exemptions were granted by the S.E.C., on the recommendation of the N.A.C.; others were refused either on the ground that the S.E.C. had no power to grant them or on the ground that the S.E.C. did not feel able, as a matter of policy, to grant the requested exemptions without some instruction from Congress to that effect. The present proposal therefore is to ask Congress to exempt the securities by amending the two Acts.

In view of the quasi-governmental status of the Bank, we do not see any serious objection to the proposed amendments. At the same time, we feel that the Bank's case in favor of the amendments is somewhat overdrawn; we are not entirely convinced that the Bank would have any great difficulties in operating under the laws and regulations as they now stand. Therefore it might be preferable if the Council merely expressed "no objection" to the amendments requested by the Bank, rather than taking the position of the Council's sponsoring the amendments.

## 3. District of Columbia Insurance Companies

The Council has previously (in 1946) recommended legislation on this subject, and it seems entirely reasonable for the Council now to renew this recommendation as Mr. Slack requests.

JHX:LMD/jt