May 17, 1957.

Chairman Martin

Mr. Hackley

Subject: "National investment company" bill suggested by Senator Fulbright

~~In his~~ letter to you of May 14, Senator Fulbright indicated that he would like to talk to you about a suggested "substitute" for the Sparkman bill (S. 719) relating to national investment companies. For whatever assistance it may be to you, there follows a brief summary of the provisions of the substitute bill enclosed with Senator Fulbright's letter, and a comparison of this bill with previous bills on the subject.

SUMMARY OF SUBSTITUTE BILL

Organization of companies. - The bill would authorize the organization of "national investment companies" either by private groups or by Federal Reserve Banks, subject to the approval of the Board of Governors. The total number of companies formed by the Reserve Banks could not exceed one in each State, the District of Columbia, the territories and possessions of the United States, and Puerto Rico.

Conversion of State development corporations. - Any State development corporation could convert into a national investment company; and for a period of six months after the date of the Act no Federal Reserve Bank could form a national investment company in any State in which there is such a State development corporation unless that corporation shall have stated in writing to the Board that it does not intend to convert into a national investment company.

Capital stock. - The minimum capital of each company would be $5 million. A Federal Reserve Bank forming a company would be required to purchase stock up to $5 million or so much thereof as might not be subscribed by banks and other private investors. A Reserve Bank could buy stock in companies formed by other Reserve Banks. In no case, however, could a Reserve Bank own an aggregate amount of stock in all such companies equal to more than 4 per cent of the combined capital and surplus of all of its member banks.

Stock could also be purchased by member banks, nonmember banks, and other financial institutions and individuals; and every member bank would be authorized to acquire such stock up to an amount equal to not more than 4 per cent of its capital and surplus. The Reserve Banks would be required to sell their stock in such companies upon demand to private investors. The Board could limit the amount of stock in any company owned by any single stockholder, and no stockholder (other than a Reserve Bank) could own more than 10 per cent without the Board's approval.

Borrowing power. - Each company would have authority to borrow money and issue its obligations subject only to such general conditions and limitations as the Board might prescribe.

Loans and investments. - Each company would be authorized to make loans and commitments to "eligible enterprises" and to purchase stock and other capital shares of such enterprises. However, the sum total of financing for single enterprises in excess of $1 million could not exceed one-third of a company's capital, surplus, and maximum indebtedness.

Eligible enterprises. - The Board, after consultation with the Secretary of Commerce, would be required to prescribe standards as to the eligibility of business enterprises for purposes of the Act.

Exemptions and tax provisions. - Real estate loans by national banks subject to commitments by the companies would be exempt from the limitations of section 24 of the Federal Reserve Act. The Securities and Exchange Commission would be authorized to exempt securities of the companies from the Securities Act of 1933 and the Trust Indenture Act of 1939. For tax purposes, the companies would be treated as regulated investment companies, but with even more liberal provisions for reserves and for carry-over for losses and some other differences.

Supervision. - The Board would be authorized to prescribe regulations and each company would be subject to examination by the Board and would be required to submit reports to the Board.

Repeal of section 13b. - Section 13b of the Federal Reserve Act would be repealed, effective one year after the date of the bill; amounts heretofore paid to the Reserve Banks under that section would be repaid to the Treasury; and the investment companies would have authority to purchase section 13b assets from the Reserve Banks.

COMPARISON WITH PREVIOUS BILLS

The substitute bill is substantially similar to the bill on this subject which was endorsed by Chairman McCabe in 1950, and with the Sparkman bill (S. 719) on which the Board reported in February 1957, but there are some material differences.

The principal difference between S. 719 and the 1950 bill was that the aggregate limit on large loans to individual enterprises was liberalized by defining large loans as those of over $1 million rather than those of over $300,000. The purpose of this limitation, of course, was to make certain that the funds of the investment companies would be available for loans to small businesses.

The substitute bill enclosed with Senator Fulbright's letter, like S. 719, makes the limitation just referred to applicable to individual loans of over $1 million instead of $300,000. In addition, it differs from both S. 719 and the 1950 bill in the following important respects.

1. The 1950 bill limited the total number of companies that could be formed by the Reserve Banks to 36. The substitute bill would permit at least one company to be formed by a Reserve Bank in each State and the District of Columbia, i.e., 49 in the continental United States.

2. The provision in the substitute bill for the conversion of State development corporations into national investment companies is new.

3. Previous bills limited the amount which a Federal Reserve Bank could invest in all national investment companies to 2 per cent of the combined capital and surplus of the Reserve Bank's member banks, or $5 million, whichever is greater. The substitute bill would increase this limitation to 4 per cent of the combined capital and surplus of member banks, without the alternative $5 million limitation.

4. Similarly, the substitute bill would authorize a member bank to invest in a national investment company up to 4 per cent of the member bank's capital and surplus, whereas previous bills limited such investments to 2 per cent.

5. The substitute bill would place no specific limit on total borrowings by a national investment company, although they would be made subject to limitations and regulations by the Board. Previous bills would have limited the maximum indebtedness of an investment company outstanding at any one time to the amount of its capital stock and surplus.

In brief, the proposed substitute bill would <u>not</u> eliminate participation by the Federal Reserve System in the organization and supervision of the national investment companies, as was recommended in the Board's letter of February 19, 1957, reporting on S. 719. On the contrary, the substitute bill would, to some extent, as above indicated actually increase the System participation by authorizing greater investments by the Reserve Banks in the stock of the investment companies.