

Statement by Chairman Martin of the  
Board of Governors of the Federal Reserve System  
Regarding Bank Holding Company Legislation  
Before the Senate Banking and Currency Committee

July 5, 1955

During the past 15 years numerous bank holding company measures have been introduced in the Congress ranging from so-called "death sentence" to "freeze" bills. One proposal after another has bogged down in disagreement among those who wanted no legislation at all and those who sought to put an end to the holding company device. Each has been beset by intense controversy. Past efforts of members of Congress and those in Federal or State regulatory agencies who have sought to reconcile sharply divergent viewpoints and at the same time devise effective measures have not met with success. Over the years, the Reserve Board has changed its own views as to the nature of legislation best adapted to meet the existing problems in this field.

Existing provisions of law, originally enacted in the Banking Act of 1933, have proved entirely inadequate to deal with the special problems presented by bank holding companies. It has been, and still is, the Board's view that additional legislation is essential to deal effectively with these problems.

Three years ago when asked to express its views on a then pending bill, the Board undertook a complete review of the bank holding

situation and of the legislation it felt would best deal with it. After intensive study the Board reached conclusions that were set forth in a letter and accompanying memorandum to the House Banking and Currency Committee on April 11, 1952.

In complying with your request for our views, we must, of course, give you our best judgment. The fact that we are not in accord with H.R. 6227, which has been passed by the House, cannot be ascribed to any desire to delay further or defeat legislation on this subject, for you also have before you a measure, S. 2350, that does accord with our best judgment. And as I have indicated, remedial legislation to deal with these problems is essential and is long overdue.

We believe, as we have said previously, that the principal problems in the bank holding company field arise from two circumstances:

(1) The unrestricted ability of a bank holding company group to add to the number of its banking units, thus making possible the concentration of commercial banking facilities in a particular area under single control and management; and

(2) The combination under single control of both banking and nonbanking enterprises, thus permitting departure from the principle that banking institutions should not engage in business wholly unrelated to banking, which involves the lending of other people's money, whereas other types of business enterprise do not involve this element of trusteeship.

I should like to submit for the record a memorandum of the Board's views, including comments on H. R. 6227 which you have under consideration.

This memorandum reiterates the views expressed on behalf of the Board before the House Banking and Currency Committee on February 28, 1955.

In brief, the Board believes that the major objectives of the legislation could be effectively accomplished by a bill which would--

(1) Define a bank holding company as a company which controls a majority (or possibly 25 per cent) of the stock of any one bank, with no exceptions from the definition;

(2) Require approval by an agency of the Federal Government, after consulting with the appropriate State authorities, before a bank holding company could acquire the stock of any bank, if thereafter its stockholdings in that bank would exceed five per cent;

(3) Require bank holding companies within a prescribed period to divest themselves of their nonbanking interests, with a minimum of specific exemptions, but with administrative authority to make certain limited exemptions with respect to companies engaged in bank-related businesses and with respect to situations in which an exemption would be desirable to prevent hardship or to protect the public interest.

The bill H. R. 6227 would go beyond these minimum requirements in regulating bank holding companies. Operations under its provisions would be possible for the Board but would present some serious administrative difficulties.

While we would favor a number of changes in the provisions of the bill, the principal provisions that concern us may be briefly mentioned.

In the first place, the bill's definition of bank holding company would not only impose an undesirable discretionary responsibility on the Board, but would not, we believe, accomplish one of the major purposes of the bill. In addition to covering any company which owns 25 per cent or more of the stock of two or more banks, the definition would cover any other company which might be determined by the Board to exercise a controlling influence over two or more banks. We feel that it is unnecessary and undesirable to vest the administering agency with such discretionary authority. Moreover, we believe that the definition should cover a company which controls only a single bank, since it seems clear that the potential abuses which may result from the combination of both banking and nonbanking interests under single control could very well exist in a case in which only one bank is involved as in cases in which a holding company controls two or more banks.

Secondly, the bill would prohibit a bank holding company from acquiring additional banks outside of the State in which it has its principal office or carries on its principal business or in any State except in accordance with the branch laws of that State. The Board believes that these provisions are unnecessarily severe and also that they would deprive the States of the right to regulate holding company banking in a manner different from branch banking. We feel that Federal regulation of bank holding companies should not be tied to the branch banking laws of the

In the third place, the bill would prevent the approval of the acquisition of stock of a State or national bank unless the transaction is first approved by the appropriate State banking authority or by the Comptroller of the Currency in the case of a national bank. We believe that this requirement would result in an undesirable diffusion of responsibility and give rise to duplication of effort and administrative difficulties. Consideration should be given to the views of the Comptroller and the State authorities, but final responsibility should rest with a single administering agency.

Finally, the judicial review provisions of section 9 of the bill would give any person affected by any action or inaction of the administering agency a right to institute proceedings for judicial review, with a trial of the facts de novo in the reviewing court. These provisions would in the Board's opinion be at variance with the spirit of the Administrative Procedure Act and would possibly result in a considerable amount of litigation. Of course, even without such provisions, any arbitrary, capricious, or unlawful action of the administering agency would be subject to review by the courts. In any event, if provisions for judicial review are to be included in the bill they should be confined to the principal parties involved and should not provide for a trial of the facts de novo.

The memorandum which I offer for the record discusses these matters in more detail.

In summary, the Board recommends legislation along the lines of S. 2350 because we feel that it would effectively and equitably provide needed regulation of bank holding companies.

**Attachment**

MEMORANDUM OF THE VIEWS OF THE  
BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM  
REGARDING BANK HOLDING COMPANY LEGISLATION  
SUBMITTED TO THE SENATE BANKING AND CURRENCY COMMITTEE  
ON JULY 5, 1955

The essence of the Board's position with respect to further regulation of bank holding companies is that any new legislation on this subject should be kept to a minimum necessary to meet whatever problems may exist in this field which are not met by present law and cannot effectively be dealt with by the States alone.

PRESENT PROVISIONS OF LAW

There are now on the statute books certain provisions enacted in 1933, regulating affiliates and holding company affiliates of banks which are members of the Federal Reserve System. Affiliates of member banks are made subject to reports and examinations. Limitations are placed upon the amount which a member bank may loan to any of its affiliates, including any holding company affiliate. Finally, any holding company affiliate which desires to vote stock owned by it in any member bank must first obtain from the Board of Governors a voting permit and, as a condition to the permit, the company must agree to submit itself and its controlled banks to examination, to establish certain reserve funds, to dispose of any interest in securities companies, and to declare dividends only out of actual net earnings.

These provisions of existing law, however, regulate the activities of a bank holding company only if it happens to control a bank which is a member of the Federal Reserve System and then only if the holding company desires to vote the stock of that bank. In effect, regulation is largely voluntary on the part of the holding company, since it may be able to exercise effective control over its banks without voting their stock. Even if a voting permit is obtained, the regulation to which a bank holding company is subject is aimed mostly at protecting the soundness of the member banks in the group.

Present law, therefore, does not deal at all with two apparent problems in the bank holding company field:

(1) In the first place, there is nothing in present law which restricts the ability of a bank holding company to add to the number of its controlled banks. Consequently, there can well be situations in which a large part of the commercial banking facilities in a large area of the country may be concentrated under the management and control of a single corporation.

(2) In the second place, there is nothing in existing law which prevents the combination under the same control, through the holding company device, of both banking and nonbanking enterprises. Obviously, this makes it possible for the credit facilities of a controlled bank to be used for the benefit of the nonbanking enterprises controlled by the holding company. Moreover, the ordinary nonbanking business requires a managerial attitude and involves business risks of a kind entirely different from those involved in the banking business. Banks operate largely on their depositors' funds. These funds should be used by banks to finance business enterprises within the limitations imposed by the banking laws and should not be used directly or indirectly for the purpose of engaging in other businesses which are not subject to the safeguards imposed by the banking laws.

#### ESSENTIAL FEATURES OF LEGISLATION

These two existing problems in the bank holding company field could be met by legislation which would need to cover only four essential features:

(1) The term "bank holding company" should be defined in language generally adequate to cover all known bank holding company groups which need to be covered, without attempting at this time to cover all situations that might possibly arise.

(2) Bank holding companies should be required to obtain the prior approval of a Federal agency before acquiring additional bank stocks; and in granting such approval the administering agency should give consideration to relevant standards stated in the law and to the views of the appropriate State and Federal authorities.

(3) Bank holding companies should be required within a reasonable time to divest themselves of ownership of stock and similar equity interests in nonbanking enterprises with a minimum of specific exceptions. The bill might give statutory exemption to bank holding companies operated principally for charitable, religious, and similar purposes. In addition, it should permit the administering agency to exempt bank holding companies from the divestment requirements in exceptional cases in which control of a bank may actually be necessary in the public interest. Furthermore, the administering agency should be given a limited authority to exempt shares of stock in businesses closely related to the business of banking.

(4) Finally, there should be a few administrative provisions requiring the registration of bank holding companies, authorizing the administering agency to obtain information necessary to pass judgment on proposed acquisitions of bank stocks, and providing criminal penalties for violations of the statute.

#### COMMENTS ON H. R. 6227

With these four essential features in mind - coverage, expansion, nonbanking interests, and administration - the principal comments of the Board with respect to the bill H. R. 6227 are summarized below.

##### (1) Coverage

One of the most basic and at the same time most controversial aspects of bank holding company legislation has always been the matter of coverage or definition.

The present bill would define a "bank holding company" as any company which owns 25 per cent or more of the voting shares of two or more banks or any company which might be determined by the Board of Governors to exercise a controlling influence over two or more banks.

This definition goes further than necessary in certain respects. In the first place, it is unnecessary and undesirable to vest the administering agency with discretionary power to bring under coverage of the bill companies not meeting the stated definition. In the second place, a definition based primarily upon majority stock control of a bank would probably be adequate to cover all companies which would need to be regulated in order to accomplish the objectives of the legislation. However, if in the judgment of Congress such a definition would not be adequate for this purpose, it would not appear objectionable to base the definition upon some lower percentage test, even down to 25 per cent as provided by the pending bill.

In one respect the Board believes that the definition in this bill would not be adequate to effectuate one of the two main objectives of the legislation. It would not apply to a company which controls only one bank and would not, therefore, require such a company to divest itself of its nonbanking interests. Yet, it seems clear that the potential abuses resulting from combination under single control of both banking and nonbanking interests could easily exist in a case in which only one bank is involved. In fact, if the one controlled bank were a large bank, the holding company's interests in extensive nonbanking businesses might very well lead to abuses even more serious than if the company controlled two or more very small banks. For these reasons, the Board would continue to urge that, whatever the percentage test may be, the definition should be related to control of a single bank.

The pending bill would exempt from the definition of "bank holding company" any mutual savings bank and any organization operated exclusively for religious, charitable, and similar purposes where the organization would otherwise be a bank holding company by reason of its ownership of bank stocks on the effective date of the Act. It would also exempt any company if the aggregate deposits of the banks controlled by it did not exceed \$15 million on December 31, 1954.

In the Board's opinion, it is questionable whether any company which meets the stated definition of a "bank holding company" should be exempted from the necessity of obtaining the prior approval of the administering agency if it should decide to acquire additional banks. In this respect the Board has somewhat modified the views expressed by it in 1953 before the Senate Banking and Currency Committee. It would not now recommend the inclusion of discretionary authority in the administering agency to exempt companies from the expansion requirements of the bill. It does not believe that any hardship would result from requiring even a charitable institution to comply with these requirements.

On the other hand, it is recognized that there may well be cases in which the exemption of certain companies from the divestment requirements of the bill would be desirable in order to prevent hardship and to protect the public interest, as, for example, religious, charitable, and similar organizations. However, the Board questions the necessity for exempting mutual savings banks from the divestment requirements.

In order to cover unforeseeable emergency situations, it might be desirable to give the administering agency a limited authority to exempt a bank holding company from the divestment requirements if the administering agency determines that the company's control of a bank is necessary in order to provide needed banking facilities or to assure the sound financial condition of the bank involved, subject to revocation of the exemption when the need disappears.

Before leaving the matter of coverage, it should be noted that the provision of the pending bill defining the term "company" would include not only corporations and business trusts, but also any partnership and "any similar organized group of persons". The meaning of the phrase "organized group of persons" is not clear. In any event, however, the Board feels that such a broad definition goes beyond the necessities of the situation.

## (2) Limitations on Expansion

The second requisite feature of the legislation - restrictions on the expansion of bank holding company groups - would be dealt with in the pending bill by provisions requiring the Board's prior approval for any action which would result in a company becoming a bank holding company or for any acquisition of bank stocks by a bank holding company

or its subsidiary or for the acquisition of substantially all of the assets of a bank by a holding company which is not a bank or by a nonbanking subsidiary. In determining whether to give its approval, the Board would be required to consider certain specified factors, including whether the effect would be consistent with the preservation of competition in the field of banking.

It is believed that these provisions should be expanded to require prior approval before any bank holding company may merge or consolidate with another bank holding company. On the other hand, it would seem unnecessary to include any provision with respect to acquisitions of bank assets by a holding company or subsidiary which is not itself a bank.

In the interest of minimum control, the Board suggests that it would be sufficient to require prior approval for the acquisition of bank stocks only if, after the acquisition of the stock of a bank, the holding company will own a substantial percentage of the outstanding stock of that bank, say 5 per cent. Such a modification of the requirements of the bill would permit properly diversified investments in bank stocks where control is not the motive.

The Board's principal comments, however, with respect to the expansion features of the bill relate to those provisions of section 5 which are apparently aimed at protecting the rights of the States in this field.

In the first place, the bill would make it impossible for a bank holding company to acquire stock of any State bank, unless the appropriate State banking authority also approves the application within 30 days. Similarly, if the bank involved is a national bank, the application could not be approved unless also approved by the Comptroller of the Currency. These provisions would have the effect of diffusing responsibility for administration of the legislation and result in a lack of uniformity in the application of the law. They would also involve duplication of effort and give rise to administrative difficulties. The Board believes that it would be desirable to require the administering agency to give due regard to the views of the State authorities and the Comptroller of the Currency but that the final responsibility for approving or disapproving any application should rest with the administering agency alone.

The bill would further prohibit a bank holding company or any of its subsidiaries from acquiring the stock of a bank or substantially all the assets of a bank outside of the State in which the holding company or the subsidiary involved has its principal office or conducts its principal operations. In addition, a bank holding company or any of its subsidiaries would be prohibited from acquiring bank stocks or assets in any State except within the geographical limitations applicable to the establishment of branches under the laws of such State, or unless the acquisition is specifically and affirmatively authorized by State statute.

These severe provisions would in effect "freeze" the existing status of most bank holding companies and would go beyond what the Board conceives to be the necessities of the situation.

As the Board has previously indicated, it believes that regulation of bank holding company groups should not be related to the branch banking laws of the States and that the States should be left free to deal differently, if they desire, with these two types of multiple-office banking. The pending bill includes a provision which would permit expansion of bank holding companies in non-branch States *if such expansion is affirmatively authorized by the statutes of the State in question.* However, there are, of course, no States which have affirmative legislation of this kind. This provision of the bill follows almost literally a provision of the national banking laws which permits a national bank to establish out-of-town branches only if affirmatively authorized by State law with respect to State banks. However, before the enactment of that provision national banks had no authority at all for the establishment of branches. The situation is quite different with respect to bank holding companies whose existence has been legislatively recognized for many years. It is believed, therefore, that it is inappropriate to apply to bank holding companies exactly the same principles which were applied to branches of national banks. If any analogous provision is necessary here, it should make the expansion of bank holding companies dependent, not upon affirmative authorization by the States, but upon the absence of express prohibition by the States.

In the Board's judgment the rights of the States in this field can be effectively protected by provisions which would require the administering agency to obtain and consider the views of the State authorities before passing upon any application for the acquisition by a bank holding company of control of additional banks. In any event, provisions for this purpose should not go further than a prohibition against the acquisition of the stock of any State or national bank in any State in which the statutes of such State would prohibit such acquisition in the case of a State bank.

### (3) Divestment of Nonbanking Interests

In order to meet the third requisite of the legislation, the bill would require bank holding companies within two years to divest themselves of any shares or other securities or obligations of any company other than a bank and to cease engaging in any business other than that of banking, or of managing or controlling banks, or certain related activities described in the bill.

To the extent that this requirement relates to obligations, as distinguished from shares of stock, of nonbanking enterprises, the Board believes that it goes further than necessary. Single control of both a bank and a nonbanking business is usually made possible by control of stock rather than by ownership of obligations.

The bill would provide a number of specific exemptions from the divestment requirements. While some such specific exemptions may be appropriate, they should be kept to a minimum and be explicit. It may be desirable, for example, to exempt shares of a company engaged solely in holding properties used by a subsidiary bank, in conducting a safe deposit business, or in providing investment counsel to the subsidiary banks. Also, it may be appropriate, as provided in this bill, to exempt the ownership of not more than 5 per cent of the outstanding voting securities of a nonbanking company. It is questionable, however, whether some of the exemptions provided are necessary or desirable. For example, exception (5) in section 6(c) of the bill would seem to permit a bank holding company which is itself a bank to own any shares of nonbanking companies which it would be permitted to own under State law. There appears to be no logical reason for such an exemption. In fact, this exemption might operate to defeat the purposes of the legislation in some situations. The desirability of certain of the other exemptions is also questionable, particularly that in paragraph (4) with respect to shares owned prior to the date of the Act, and that in paragraph (6) with respect to shares of an investment company.

In any event, as against numerous specific exemptions, it would seem preferable to vest the administering agency with a limited authority to exempt ownership of shares of companies which are determined to be closely related to the business of banking or of managing or controlling banks. Such a provision should be coupled with the additional provisions, previously suggested in this memorandum, for the exemption of certain bank holding companies from the divestment requirements in a very limited class of cases.

#### (4) Administration

The administrative provisions of the bill are contained in sections 4, 9, and 10, which relate, respectively, to registration, reports and examinations of bank holding companies, hearings, and judicial review of administrative action and criminal penalties for violations of the Act.

The Board's only comment on these provisions relates to section 9 which would give to any person directly affected by any order or determination of the Board, or "affected" by a failure of the Board to take action, a right to judicial review, with a trial of the facts de novo by the reviewing court. It is believed that no specific provisions for judicial review are necessary, since, even without such provisions, any arbitrary, capricious, or unlawful action on the part of the administering agency would be, and should be, subject to review by the courts. However, if any provisions on this subject are included in the bill, the Board feels that a provision for trial of the facts de novo would be at variance with the spirit and intent of the Administrative Procedure Act. The Board also believes that, instead of the vague provision for review at the instance of any person "affected", the right to review should be limited to the principals in the proceedings involved.

(5) Other Provisions of the Bill

Certain provisions of the pending bill have no direct connection with the two main objectives of the legislation.

Under section 7 of the bill, subsidiary banks would be absolutely prohibited from making loans to, or investing in the stock or securities of, their bank holding company or any other subsidiary of the bank holding company. The Board believes that these provisions are unnecessarily restrictive. Moreover, if any provisions on this subject are deemed to be necessary, it is the Board's view that they should be enacted in the form of amendments to section 23A of the Federal Reserve Act, which now places certain limitations upon loans by member banks to their holding company affiliates or other affiliates. As to nonmember banks, the States should be left free to determine what restrictions they may wish to impose upon loans by State banks to their affiliated organizations.

Section 11 of the bill would make a number of technical amendments to provisions of existing law. Insofar as these provisions would amend the Internal Revenue Code to afford appropriate tax relief to bank holding companies complying with the divestment requirements of the bill, they appear to be desirable, although the Board does not feel specially qualified to comment on their adequacy. However, the amendments proposed to be made to existing provisions of law relating to holding company affiliates of member banks have no apparent relation to the principal objectives of the bill. The existing provisions are aimed primarily at maintaining the soundness of member banks in holding company groups. It may be that in some respects they should eventually be modified, but there appears to be no reason why they should not be continued in force for the present.

CONCLUSION

The above comments on the pending bill have been made for the purpose of helping, as far as possible, in the working out of reasonable and effective legislation on this subject. By way of summary, the Board believes that the principal objectives of the legislation could be accomplished by a bill which, in addition to certain administrative provisions, would include only -

- (1) a definition of "bank holding company" as a company controlling a majority (or possibly 25 per cent) of the stock of any one bank, with no exceptions;

(2) a requirement that every bank holding company obtain prior approval before acquiring the stock of any bank if thereafter its holdings of the stock of that bank will exceed 5 per cent, with provision for obtaining the views of State and Federal authorities; and

(3) a requirement that bank holding companies divest themselves of their nonbanking interests, with a minimum of specific exemptions, but with administrative authority to make the limited exemptions heretofore mentioned.