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Statement by

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before the

Committee on Banking, Housing and Urban Affairs

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I am pleased to come before you as one of the concluding witnesses in what has been a thorough and searching examination of proposals to restructure the law governing bank and thrift holding company activities. These hearings are a culmination of a long process of evaluation of legislative proposals to simplify regulatory procedures and to assure a competitive environment for the provision of financial services.

Hearings on various bills of this kind began in the fall of 1981. Since then this Committee has held 44 days of hearings, heard more than 235 witnesses, and has before it over 7,000 pages of testimony. This extensive record -- including analysis of historical problems, present difficulties, and future solutions -- provides a solid foundation on which to build legislative decisions at this session of Congress.

I have on several occasions emphasized to this Committee the basic framework within which we in the Federal Reserve approach these questions. We want to see a competitive and innovative banking and financial system, providing economical and efficient services to consumers. At the same time, we believe that banks, and depository institutions generally, perform a unique and critical role in the financial system and the economy -- as operators of the payments system, as custodians of the bulk of liquid savings, as unbiased suppliers of short-term credit, and as the link between monetary policy and the economy. This unique role implies continued governmental concerns about the stability and

impartiality of these institution -- concerns that are reflected in the federal "safety net" long provided by the discount window and deposit insurance, by regulatory protection against undue risk, and by policies to discourage conflicts of interest and undue concentration of banking resources. As a corollary to these concerns, and as a result of our practical experience in regulating bank holding companies, we also believe that these basic policies must, to a degree, apply to the holding companies of which banks and other depository institutions are a part; banking institutions cannot be wholly separated from the fortunes of their affiliates and from the success or failure of their business objectives.

A review of the testimony before this Committee indicates that these principles are broadly accepted. Progress has been made toward achieving some convergence of views on the definitions of a bank and thrift institution, on the scope of regulatory authority, and on possible simplification of regulatory approaches toward bank holding companies.

In my testimony in January in Salt Lake City, I suggested new legislation is urgently needed dealing with several areas:

(a) a strengthened definition of bank;

(b) a definition of a qualified thrift;

(c) new procedures to streamline application of the bank and thrift holding company Acts;

(d) the powers of depository institutions holding companies; and

(e) statutory guidelines to govern the division of state and federal authority in the area of banking organization powers.

There are a growing number of issues about interstate banking that soon will need to be dealt with as well, but, with one exception, those questions could be deferred to later legislation. The exception concerns Congressional policy toward the present movement toward regional interstate banking arrangements.

Our analysis of the bills and much of the testimony that have been placed before this Committee indicate elements of agreement in several of the necessary areas. There appears to be an emerging consensus on defining what is a bank -- a fundamental building block for any legislation to clarify the role of banks and bank holding companies within our financial and economic system. New procedures for applying the Bank Holding Company Act and simplifying regulation seem to be broadly accepted. Some convergence on the appropriate role of thrift institutions and their holding companies may be developing, as well as on the need to rewrite guidelines for state-federal relationships. Equally clearly, substantial differences in defining the appropriate range of powers for bank holding companies remain apparent.

It seems to me the time has come to consolidate areas of agreement, to consider objections to the proposals before the Committee, and to test alternative approaches to bridging the remaining differences. Today, I would like to share with you our further thinking on the five key problem areas and, in particular, address some possible solutions to the remaining problems.

I. Definition of Bank

The definition of "bank" is a crucial provision of the Bank Holding Company Act. It defines those institutions which are covered by the Act, and for them the boundaries for the safeguards against excessive risk, conflicts of interest and concentration of resources deemed appropriate as a matter of public policy. The application of these policies depends upon a meaningful definition that encompasses all depository institutions that perform essential banking functions.

Marketplace, technological, and regulatory developments have seriously undermined the present definition, which defines a bank as an institution which accepts demand deposits and makes commercial loans. Functional evasion of the purpose of the Act is becoming the rule rather than the rare exception through the creation of "nonbank banks" and other devices that permit combinations of banking activity and commercial, retail, insurance and securities firms. As a result, established policies on conflicts of interest and concentration of

resources are undercut or jeopardized. These same techniques are being used to undermine the Congressional prohibition on interstate banking. The haphazard exploitation of "loopholes" in existing law is reflected in an understandable sense of competitive unfairness and could, in time, jeopardize the safety and soundness of the banking and payments system. The developments are broad in scope, as reflected in the tabulation in Appendix A.

To deal with this situation, last year we suggested a re-definition of the term "bank" to include any depository institution (other than a FSLIC insured institution) that is (a) FDIC insured, (b) eligible for FDIC insurance, or (c) which takes transaction accounts and makes commercial loans. This definition was included in the FIDA legislation and was adopted in Senator Proxmire's bill (S. 2134) and a number of bills introduced in the House.

Our review of this proposal in the light of comments made at the hearing suggests consideration should be given to three changes. First, industrial banks that are not federally insured and do not offer deposit accounts with checking or other third party transaction capabilities should be excluded. Appendix B describes these institutions and the scope of their activities.

Second, state-chartered thrift institutions (also described in Appendix B), which are not federally insured and

which would have been covered by the definition of bank described above, should be encompassed within the same holding company rules as federally insured S&Ls because of the focus of many of these state institutions on home lending. These institutions could be exempted from coverage by the Bank Holding Company Act if the relevant state regulator certified their activities were appropriately confined.

Third, the nonfederally insured thrifts and industrial banks that would be excluded from the coverage of the Bank Holding Company Act should be subject to rules which would prevent "tandem" operation -- that is, joint sale of banking or thrift products or integrated operations -- of these institutions with owners engaged in impermissible activities for bank holding companies. This limitation, on which we place considerable importance, is explained in detail in Appendix C. Its basic objective is to prevent the kinds of tying that are judged to be unfair or unsound for depository institutions, including joint offering of deposit products or loans with other products of affiliated industrial and commercial firms.

We believe that Congress should not exempt the so-called "consumer bank" from the definition of a bank. Such a proposal is contained in Section 104 of S. 2181, which would allow a "consumer bank" to take all forms of deposits, including transaction accounts, and make consumer loans, as well as a wide variety of other types of credit extensions, including some commercial loans.

Such an approach would permit commercial and industrial firms to enter into essential depository institution activities, including access to the payments system, in a manner that would inevitably undermine public policy objectives incorporated in the Bank Holding Company Act generally, and there would be the appearance of unfair competition with banks subject to the Act. In such circumstances, the regulated banking sector would inevitably wither and much of the banking business would take place in institutions not subject to the policy restrictions on risk, conflicts of interest, and concentration of resources. The lengthening list of nonbank bank acquisitions demonstrates that we are beginning to see that migration today. In this connection, I would point out that 19% of commercial banks now have commercial loan portfolios (narrowly defined) equal to not more than 5% of assets and that 47% have 10% or less of their assets in this form. Thus, almost half of the number of commercial banks in this country, could, with some minor restructuring of their portfolios, conduct basically the same activities as they do today and escape application of the policies of the Bank Holding Company Act.

Finally, I believe competitive equality requires that the recent and current proliferation of nonbank banks not be blessed by grandfather provisions, subject to a reasonable period of time to permit divestiture where this is necessary.

II. Definition of Qualified Thrift

Essentially the same problems of consistency with the public policy objectives of the Bank Holding Company Act arise when commercial and industrial firms acquire thrift institutions, particularly in the light of the broader powers provided such institutions in recent legislation. Indeed some state initiatives have provided state-chartered thrifts essentially the full panoply of banking powers and more. At the same time, there may be institutions with no restrictions on the activities of the parent firm, an ability to obtain long-term government-sponsored credit, favorable tax treatment, and a freedom to branch intrastate and interstate -- privileges that are denied commercial banks. As in the case of nonbank banks, there has been increasingly clear recognition of the need to adopt rules to assure equality of treatment of various kinds of depository institutions exercising similar or overlapping powers. The need for action is reflected in the strong interest of a variety of financial and nonfinancial businesses in the acquisition of thrifts in order to benefit from thrifts' bank-like powers, to gain access to federal deposit insurance, and to participate in the payments mechanism.

The Administration proposals attempt to deal with this question by requiring all thrifts, with certain exceptions for grandfathered service corporations, to meet the requirements of bank holding companies. This approach has been opposed mainly

on the grounds that it is not necessary to apply the same rules applicable to bank holding companies to those thrifts that concentrate their assets in home mortgages. In an attempt to recognize these concerns, the concept of a "qualified thrift" has been developed, reflected in the proposals of both Senators Garn and Proxmire, to exclude thrifts truly specializing in residential mortgage credit from comparable rules to those limiting the scope of activities of bank holding companies.

We would support this general approach. Thrifts that meet an adequate "specialization" test rooted in the public policy concern of support for residential mortgage lending could be owned by commercial or industrial firms as unitary thrifts are now.

In developing the specifics of such an approach, we would endorse the recommendation of the FHLBB that an underwriter of corporate debt and equity not be permitted to own a thrift, whether or not it meets the qualifying assets test. We would also rely upon a single direct test of the proportion of assets held in residential mortgages or mortgage-backed securities. An optional test of limited commercial lending, such as not more than 25% of its assets in certain qualifying commercial loans, as proposed in S. 2181, would leave open the clear possibility that institutions not engaged substantially in home mortgage lending would retain the

liberal treatment with respect to permissible activities now accorded to unitary S&Ls. For example, with such a test, 75% of all commercial banks today could be treated as thrifts because they have less than 25% of their assets in qualifying commercial loans; only six commercial banks would qualify under the 60% of assets in residential mortgages part of the dual test of S. 2181.

We believe an appropriate test would require that to be eligible for unitary savings and loan holding company treatment, institutions must devote at least 65% of their assets to residential mortgages or mortgage-backed securities. For this purpose, mortgages would include both 1-4 family and multi-family dwelling mortgages, mortgage-backed securities, mobile home loans, loans for home improvements, including participation interests in such instruments. Based on this definition, according to our calculations, almost three-fourths of FSLIC institutions would currently meet this test. We also believe the limits on commercial lending set in the Garn-St Germain Act remain appropriate for federally chartered institutions, and in the light of the much wider powers provided by some states for commercial lending, a <u>supplementary</u> (not optional) limit on commercial lending could be considered for eligibility of these state-chartered institutions.

We recognize some S&Ls and mutual savings banks that could not meet the qualified thrift test currently, but still wish to emphasize home lending and who wish to retain the

privilege of "unitary" S&L treatment, should be permitted a substantial period in which to conform their activities. During this transition period, which could be five to ten years, milestones should be set in terms of measuring progress toward achieving the required asset composition. While ownership by an industrial or commercial firm could be retained during the transition period and thereafter, we do not believe such thrifts should be permitted to operate in "tandem" with the parent commercial or industrial firms. (The details of this suggestion are outlined in the form of legislative language in Appendix D. The description of the limitations on tandem operations is, as noted above, contained in Appendix C.)

In general, under this approach, those thrifts (and their service corporations) not meeting the asset test (or in transition toward them) would generally have to conform to the limitations on ownership of, and powers provided to, bank holding companies generally. Special tax benefits and the access to long-term credit from the Home Loan Banks for these nonqualifying institutions should be reviewed. At the same time, methods should be developed to permit mutual institutions to take advantage of powers permitted bank or thrift holding companies in stock form.

III. Bank Holding Company Procedures

The third core element of legislation is the provisions on bank holding company procedures. S. 2181,

S. 2134, and FIDA contain essentially identical provisions on this point and I believe that this reflects widespread support for procedural simplification.

These provisions make improvements in two major areas: they change the present somewhat complex applications process into a notice procedure; and they put bank holding companies on more equal footing with their competitors by changing the "benefits vs. adverse effects" test and formal hearings requirements. Instead, new activities could go forward, after notice to the Federal Reserve Board, unless the Board found grounds for disapproval under specific statutory criteria. Those statutory tests include adequacy of financial and managerial resources, protection of impartiality in the provision of credit and avoidance of adverse effects on bank safety and soundness.

The thrust of these provisions, and a provision reducing the scope for judicial review by competitors, is intended to reduce the burden placed upon bank holding companies by government regulation to a minimum level consistent with protection of the public policy interests embodied in the specified criteria. Agency procedures would not be burdened by formal hearings and judicial review at the instance of competitors. Formal rulemaking procedures would, of course, remain necessary before decisions to add new activities to the list of permissible holding company powers,

and the Board could continue to request public comment on notices and hold informal hearings, where necessary, to obtain information necessary to make decisions.

We also believe the new procedures set out in S. 2181, S. 2134 and FIDA provide the Board with adequate supervisory authority over the activities of the holding company and its nonbank subsidiaries after they are in operation. Those procedures would emphasize the desirability of relying upon other regulatory agencies, such as the Commodity Futures Trading Commission in the area of commodity brokerage and the SEC in the case of securities activities, for supervisory and reporting requirements in order to avoid unnecessary duplication of effort. However, the statute provides adequate authority to take whatever regulatory or data gathering steps that may be necessary to ensure compliance with the Bank Holding Company Act.

My conclusion is that these provisions adequately balance the need for reducing unnecessary regulatory burdens with the requirements for adequate supervision to enforce fully the provisions of the Bank Holding Company Act. These provisions seem to me ready for inclusion in legislation.

IV. New Activities of Bank Holding Companies

The fourth element of needed legislation is expanded powers for holding companies. S. 2181 provides new authority for holding companies to: (a) sponsor and distribute mutual

funds and underwrite and distribute revenue bonds and mortgage-backed securities (b) engage in real estate brokerage and development, (c) provide insurance brokerage and underwriting, (d) own a thrift institution, and (e) take part in other services of a financial nature.

Considerations of competitive equality and potential benefits to consumers of a broader range of suppliers of financial services strongly suggest a presumption broadening the range of powers permitted bank holding companies. The point is reinforced by technological developments that enhance the options in the delivery of such services. However, as I stressed at the outset, those objectives must be balanced against other public policy concerns: assurance of fair and open competition in the provision of credit and other services, maintenance of impartiality of banks in credit judgments, and avoidance of practices that can undermine the strength of the bank itself. Balancing these objectives is surely the most difficult task before you.

Certain of the proposed activities, including those involving essentially "agency" activities, such as real estate and insurance brokerage, raise few questions of safety and soundness. In certain other areas, such as real estate development, much more significant risks to the holding company, and potentially to the bank itself, arise. Questions about conflicts of interest and tying for a number of the

activities have been discussed in detail by the witnesses that have preceded me in recent weeks.

Review of comments made during these hearings and other information has suggested a number of areas in which the Committee might bridge differences by modifying or limiting earlier proposals. In particular, we have attempted to address carefully the safety and soundness and the competitive fairness considerations that appear to stand in the way of broad agreement on a substantial broadening of bank holding company powers. In my testimony today I would like to review each of the categories of proposed new activities in light of those considerations.

(a) Securities Activities - Underwriting Municipal Revenue Bonds and Mortgage-backed Securities, and Sponsoring and Distributing Mutual Funds

Both S. 2181 and S. 2134 would authorize bank holding companies to underwrite municipal revenue bonds and similar instruments and to sponsor and distribute mutual funds. The Board supports both of these activities, based on a considerable period of experience with bank underwriting of general obligation bonds and managing trust assets. The Board believes that these activities involve a manageable degree of risk for banking organizations and there is potential for substantial gain for customers in terms of a variety of services and lower costs.

At the same time, bank performance of these services has been opposed because of several concerns. One line of concern suggests that the provision of credit by a bank affiliate, or guarantees of underwritten obligations by bank affiliates, would provide a distinct advantage to bank affiliated underwriters, or that temptations to link underwriting and loan business would be strong, to the potential detriment of the bank or its customers. It is alleged that investment flows might be influenced by the bank's interests, or that poor investment or underwriting performance by a holding company affiliate might reflect adversely on the bank itself.

We approach these arguments with some care taking account of the fact that bank underwriting of corporate securities is not proposed and of the rather successful coexistence of bank affiliated and independent underwriters of municipal general obligation bonds. Moreover, S. 2181 and S. 2134 already contain a number of provisions specifically designed to promote competitive equity and limit risk to affiliated banks.

Those bills already require that all securities activities of the holding company, including its subsidiary banks, be conducted in a separate holding company affiliate. The affiliate must be separately capitalized in a manner comparable to similar firms not affiliated with a bank holding

company. The present rules contained in section 23A of the Federal Reserve Act and the proposed new section 23B would limit intercompany transactions and require that they be on market terms. All these provisions provide fundamental protections against conflicts of interest and unequal tax and regulatory treatment.

Nevertheless, a cautious approach in this area is justified and a number of suggestions proposed by others to assure competitive equity and avoid conflicts deserve attention. Thus, it may be reasonable to prohibit a bank holding company's securities or investment company affiliate from using the name of an affiliated bank or bank holding company (in the interest of appropriate disclosure, an indication of company affiliation should be permissible). It may also be desirable to require that the officers and employees of a securities affiliate or investment company advisor be separate from those that operate an affiliated bank, and that information on the financial activities of the bank's customers not be made available to the securities affiliate and vice versa. Banks might be prohibited from guaranteeing or providing letters of credit to support obligations that are underwritten by a securities affiliate.

So far as mutual funds are concerned, the existing provisions of the Investment Company Act, together with the applicable suggestions above, appear generally adequate to

assure independent investment judgment. However, those provisions could be reviewed to determine if any other special provisions are necessary to assure independence from the bank affiliate.

I have noted in earlier testimony a trend toward conglomerates of financial services, and toward the explicit or implicit tying of various financial products by financial conglomerates not including banks. To assure competitive equality, I believe that restrictions of the kind I have described above, if adopted, would need to be accompanied by provisions giving the Board certain discretion in their application should nonbank conglomerates develop combinations of services prohibited bank holding companies.

Questions have also arisen over bank holding company participation in brokerage services. The Federal Reserve, as you know, has permitted "discount" brokerage -- that is, the passive provision of brokerage services without investment advice -- under present law. Because that ruling is under court challenge, we believe it should be explicitly provided for in the proposed legislation. You may wish to review, however, the further question of the appropriateness of combining such services with investment advice -- that is, providing a full range of brokerage services -- within the framework of a bank holding company.

The mortgage market is being transformed by innovations in communications technology and in marketing techniques. Banking organizations are major mortgage lenders and are familiar with the credit analysis and have other expertise necessary to establish mortgage pools and evaluate the underlying risks of the constituent elements in the pool. They can already underwrite mortgage bonds guaranteed by the government or sold by government-related agencies.

What is at issue here is whether a bank affiliate should be permitted to underwrite private securities. Should the authority be confined to securities backed by 1-4 family mortgages, potential risks would be substantially defused. Risks and conflicts of interest in bank holding company participation in underwriting in those circumstances would appear to be manageable within the confines of the anti-tying rules already contained in present law and in S. 2181. As in other areas, however, questions of competitive equity have been raised, particularly in view of the ability of depository institution holding companies to provide, through their subsidiary banks, guarantees or letters of credit to support mortgage pools established and underwritten by securities affiliates. The appropriateness of combining those two aspects of financing services could be re-examined.

In summary, we believe adequate techniques are available to satisfy legitimate concerns about bank holding

company activity in the securities area, so long as corporate security underwriting remains prohibited. The potential benefits to competition and in terms of reducing underwriting costs, in these circumstances, point to action along the lines proposed by the Administration, and by Senators Garn and Proxmire.

(b) Real Estate Brokerage and Development

As I suggested earlier, the main issue in providing authority for bank holding companies to engage in real estate brokerage is not risk but potential conflicts of interest and problems of competitive equity. It has been suggested that the ability of a bank holding company real estate broker to offer assured bank financing, or even the impression that such assured financing is available because of the ownership tie between affiliated broker and bank lender, could be sufficient to divert business away from the independent and toward the bank or thrift affiliated broker.

As with the case of securities affiliates, limitations on the holding company broker using the same name as the holding company or its subsidiary bank, strengthening the already strict rules against explicit or implicit tying, and enhancing enforcement through providing a private right of action, could provide considerable protection against abuse. Possibly, a further step could be taken by prohibiting any mortgage loans by a subsidiary bank or thrift of a depository

holding company to any customer of an affiliated real estate brokerage firm.

It should not be necessary -- nor would it seem fair -- to limit loans by a holding company mortgage banking subsidiary to the customers of the affiliated broker. Nondepository firms are today permitted to combine ownership of brokerage and mortgage banking subsidiaries. Of course, appropriate supervisory steps would and could be taken to prevent reciprocal lending arrangements or other steps to evade this limitation.

Smaller banks, without mortgage banking subsidiaries, might be put in a difficult competitive position by such a limitation. Consequently, such an approach might be accompanied by an exemption for smaller banks, reasonably related to a relative unavailability of competing brokerage services. It should be possible, for instance, to draw an analogy to provisions of Title VI of the Garn-St Germain Depository Institutions Act of 1982, which permits bank holding companies to offer insurance brokerage services where they would otherwise be impermissible if their consolidated assets were $50 million or less, or in towns of under 5,000, provided a brokerage affiliate is required to permit or encourage a home purchaser to explore other possible sources of credit.

Technology is providing both independent brokers and those now associated with financial and retail conglomerates

with almost instant access to an array of providers of mortgage credit, enabling their customers to compare terms and conditions. In these circumstances, real estate brokerage appears to be an area in which bank holding companies can draw on relevant experience, undertake little additional risk (particularly if tie-ins are avoided), and increase competitive outlets.

In my past appearances before this Committee, I have expressed serious concern about the potential risks and conflicts for bank holding companies under the general rubric of "real estate development." Those concerns remain.

Present proposals deal with those risks by limiting the capital a bank holding company could apply to real estate development activities or by prohibiting construction activity -- limitations which should be reinforced by also limiting the leverage of the real estate development subsidiary. I would go further by urging you to consider: (a) confining "real estate development" to passive equity participation in projects or developments managed by others, and (b) limiting bank loans to projects sponsored by affiliates of a bank holding company.

The first change would be consistent with what we understand to be the basic objective of most bank holding companies in the real estate development area -- to participate in the potential benefits accruing only to equity participants in a real estate project. To achieve this goal, the rather broad scope of the authorization for real estate development activities contained in FIDA or S. 2181 could well be narrower; for example, participation could be confined to investment vehicles such as nonvoting common stock, preferred stock, or limited partnership interests.

Some of those testifying have expressed concern about the competitive and risk implications of a bank, as lender, participating in a project in which an affiliate has an equity interest. They suggest that a bank in those circumstances will be more willing to extend credit and to carry a weaker credit longer to one of its "own" projects, and perhaps be less willing to extend credit to competing projects, than if no equity interest is involved. To deal with this situation, it might be useful to provide the Board with clear discretionary authority to impose an aggregate or particular limitation on loans by a bank to projects in which a bank real estate affiliate is an equity participant.

(c) Insurance Brokerage and Underwriting

Insurance brokerage by bank holding companies, as is the case with real estate brokerage, does not involve major

issues of risk; rather the focus of the testimony has been on assuring competitive equity between bank affiliated brokers and independent distributors of insurance products. Thrift institutions already have unlimited authority to engage in insurance brokerage, and the broadening of this activity for bank holding companies should provide competitive benefits so long as abuse of the bank relationship is avoided.

S. 2181, in Section 107, contains a number of new provisions that attempt to reduce tying and competitive inequity problems. It would, for example, require banks to inform their customers of the availability of insurance products elsewhere, allow customers purchasing insurance products from bank holding subsidiaries an adequate opportunity to reject their contracts, and prohibit banks and their holding companies from offering insurance until the customer is given a commitment that credit will be extended. It does not seem practically feasible to go much further in this area without destroying completely the ability of holding company organizations to participate in this activity. We would, however, suggest that to the extent Congress deems these provisions necessary when financial institutions sell insurance, they should also be applied to thrift institutions and their holding companies, which are permitted to broker insurance without restrictions such as contained in Title VI of the Garn-St Germain Act.

Consideration could also be given to possible approaches for phasing in greater bank participation in the insurance brokerage area. Again, it might be useful to build upon Title VI of the Garn-St Germain Act, which permits bank holding company participation in insurance brokerage activities in cases where the holding company's consolidated assets are $50 million or less, in towns of 5,000 or less, or otherwise where the holding company demonstrates that existing insurance agency facilities are inadequate. For instance, those limitations might be gradually increased by some amount over time up to a limit, which would provide an occasion for further Congressional review.

If bank holding companies are permitted to engage in underwriting, careful attention will have to be given to containing risk, avoiding concentration of resources and more subtle conflicts of interest. For example, there may be particular lines of insurance underwriting that raise issues of risk that require special safeguards and limitations on such matters as amount of capital investment. Moreover, I have earlier suggested that banks not be permitted to lend to companies in which their holding company affiliates had very substantial equity interests.

In order to limit the potential for concentration of resources associated with large bank holding companies acquiring large insurance firms or vice versa, S. 2181 would

limit bank holding company investment in nonbanking activities to not more than 25% of the holding company's capital if the holding company's consolidated assets amount to more than 0.3% of total domestic deposits. However, our review of the data indicates that this test does not effectively limit the ability of some of the largest bank holding companies to acquire control of some of the largest insurance companies.

I recognize that our attempt to devise a numerical test of that kind must be arbitrary at the margin. However, an alternative approach could be to provide specific criteria on the size of bank holding company participation in insurance underwriting and insurance underwriter participation in banking. This could be done by requiring that bank holding companies enter insurance underwriting de novo or through relatively small acquisitions. Similarly, insurance underwriters would also be confined to de novo or foothold acquisition of banks. This approach would deal with the concentration issues and it would provide time for the participants, the Board, and state insurance regulators to gain experience in dealing with combined insurance and banking entities.

An alternative approach would be to expand bank holding company participation in insurance underwriting in directions that flow naturally from existing bank functions. For example, it would seem appropriate for bank holding

companies to participate in insuring or guaranteeing the credit risk in home mortgages and in real estate title insurance. Dollar limits on individual credit-related property and casualty insurance policies underwritten by bank holding company nonbank affiliates could be lifted. After some experience, Congress could then consider other areas of insurance underwriting activity that might be appropriate as part of a gradual evolution of bank holding company insurance underwriting.

(d) Ownership of Thrifts

S. 2181 specifically permits bank holding companies to acquire FSLIC insured thrifts, subject to the same kind of limitations on interstate acquisitions as are written in the Douglas Amendment and the same kind of branching restrictions on the acquired thrift as are contained in the McFadden Act. The Board has supported bank holding company acquisition of thrift institutions as a reasonable extension of their presently authorized scope of activities. We recognize, however, that acquisition of thrifts by bank holding companies on an interstate basis may, in some situations, not be fully consistent with the prohibition on interstate banking contained in the Douglas Amendment. The Board has indicated its views that Congress should, in the future, address the overall question of interstate banking in comprehensive legislation. However, pending Congressional action on the overall question,

the Board believes it is reasonable to incorporate Douglas and McFadden type limitations on thrift acquisitions that are proposed in S. 2181.

(e) Financial Services

S. 2181 authorizes holding companies to engage in "services of a financial nature." This provision provides useful flexibility for the Board to deal with uncertain and unknown circumstances in the future. We recommend its inclusion in legislation.

The decision of Congress on the inclusion or exclusion of the various activities that have been discussed above will provide some guidance on the intended scope of this provision. Additional guidance would be desirable with respect to other activities that the Congress might consider to be within the scope of this authorization.

V. Activities of State-Chartered Banks

Much concern has been expressed about possible authorizations to state-chartered banks of new authorities to conduct nonbanking businesses that would not be permitted to bank holding companies under present or new federal laws. It is reasonable to ask the question whether it makes sense for the Congress to work out carefully balanced arrangements for the conduct of nonbanking activities of bank holding companies only to see far different and inconsistent arrangements established for state banks under state law.

Some states have adopted, and others are considering, legislation to authorize state-chartered banks to engage in insurance, securities, and real estate development activities; and others have authorized state-chartered thrifts to engage in virtually unlimited activities. Last year, South Dakota authorized state-chartered banks to engage in insurance-related activities essentially in all of the states of the Union except South Dakota. The states are motivated in part by a desire to make their financial institutions competitive with those in other states and in part by a desire to obtain new employment and revenues -- inevitably at the expense of others. As the process gains momentum, more and more states will feel themselves forced, in self-defense, to take similar steps. The threat is obvious -- any sense of Congressional or federal control over the evolution of the banking and financial system will be lost.

S. 2181 attempts to deal with this problem by requiring that insurance activities be conducted in the state and outside the state on the same terms. S. 2134 would go considerably further by requiring that states may only authorize activities for state-chartered banks to be conducted within the state and for residents of that state.

In the light of current developments, it now appears desirable to go somewhat further than the provisions of S. 2134, while still maintaining flexibility for state

experimentation and innovation. In balancing these considerations, perhaps it is desirable to distinguish between those activities that Congress may decide to prohibit or limit for banking organizations because of safety and soundness problems, and those that arise from conflicts of interest that are particularly important for the protection of local customers.

For example, if Congress reaffirms its decision to exclude banking organizations from participating in underwriting corporate debt and equity, and limits the participation of these organizations in real estate development, it would not seem to be desirable for the states to have the authority to overrule the judgment of Congress and expose the insured depository system to the greater risks of these activities. On the other hand, if Congress decides not to authorize real estate or insurance brokerage because of reasons of consumer protection and competitive equity, it would not seem inconsistent with the federal interests if state legislatures authorize banking organizations to participate in these activities within the confines of their own state. Here the state may be in the best position to make the judgment about what is necessary to protect local customers and local interests.

Thus, the balance between federal and state interest could be struck as follows: states may not authorize

activities that Congress has ruled out of bounds for safety and soundness reasons; the states may optionally authorize other activities but only if they are conducted within their borders. We would be prepared to assist the Committee in drafting such a provision.

Other Provisions of S. 2181

My comments today have focused only on Title I of S. 2181 as I believe it is that Title that requires the priority attention of the Congress. Detailed comments on a number of other Titles are contained in Appendices to be submitted separately for the record. Before my concluding remarks, I would like to comment specifically on the provisions contained in Title X on regional interstate banking.

Title X provides specific authority, for a five-year period, for states to authorize regional interstate banking acquisitions. Such legislation would presumably resolve the question of the constitutionality of regional arrangements that have been authorized in New England and have been proposed in a number of other areas of the country. Yesterday, the Board approved two bank holding company mergers under the reciprocal arrangements of Massachusetts and Connecticut. Although there is a strong argument that these state laws are not consistent with the prohibitions against discriminatory burdens on interstate commerce established by the Commerce Clause of the Constitution, there is an absence of clear and unequivocal

evidence to that effect. Consequently, the Board proceeded on the assumption of constitutionality and applied the criteria of the Bank Holding Company Act. But plainly, the differing constitutional interpretations raised by parties to merger applications demonstrates the need for Congressional action to clarify this issue at this time.

We believe this is all the more important because of our concern about the permanent establishment of regional banking areas. If Congress should decide to endorse regional arrangements, in our view it would be desirable to limit them to a transitional period. We would also urge you to consider the interstate banking question more broadly at an early date, once the powers issues are settled.

Conclusion

I cannot emphasize strongly enough the urgent need for definitive Congressional action on the legislation now before you during the current session. Decisions cannot be postponed -- the failure to act only means that others have acted and will continue to act, to markedly restructure the financial system without the participation of the Congress. These actions, arising out of market initiatives, state legislation, court decisions and new federal regulatory rules, are pushing at the outer boundaries of the legal framework established by Congress for the banking and financial systems. In my judgment, they are pushing beyond the basic policies

established by the Congress in setting out a broad distinction between banking and commerce.

I am not speaking about theoretical concerns. The policies of the Bank Holding Company Act against excessive risk, conflicts of interest, impartiality in the credit-granting process, and concentration of resources have long been considered essential parts of our financial system. They are now being undermined by a haphazard pattern of inter-industry and interstate acquisitions and by new combinations of banking, securities, insurance and commercial products.

The Bank Holding Company and Glass-Steagall Acts were intended to prevent combinations of firms that underwrite securities and take deposits. Yet today there are 32 securities firms that own so-called nonbank banks which can perform many of the essential functions of banks. Court and regulatory decisions are opening new avenues for bank holding companies to undertake securities functions without clear legislative guidance.

The Bank Holding Company Act was intended to prevent combinations of commercial or industrial firms from owning banks, yet today there are retailers, diversified industrial-commercial conglomerates, and insurance firms that own either nonbank banks or thrifts with banking powers.

The states are rapidly considering and adopting legislation granting state-chartered banks powers that, in some cases, have not even been contemplated under federal law for banks and bank holding companies, in large part reflecting inter-state competition for jobs and tax revenue rather than any judgment of the national interest in a stable banking structure.

The federal financial regulators are also pressing against the outer boundaries of their delegated authority. The Board has adopted the broadest definition of the term bank it felt feasible under existing law in an effort to carry out what it believes to be Congressional intent and to preserve the ability of Congress to act without being faced with a fait accompli. That action is being challenged in the courts with, thus far, unfavorable results. The SEC has before it a proposal to consider banks as broker-dealers when they engage in discount brokerage, despite the exclusion of banks from the securities laws because of the comprehensive system of bank regulation. Under existing law, the FDIC is considering the question of whether state non-member banks should be authorized by regulation to underwrite corporate debt and equity, despite long-presumed Congressional intent to separate commercial banking and corporate underwriting. The Comptroller has before it a well-known proposal to authorize a family of "nonbank" national banks in 25 states. We have been compelled to approve

the establishment by a New York bank holding company of a nonbank bank in Florida, which would take demand deposits but not make commercial loans as we have broadly defined them.

As things now stand, many of these specific issues will be decided on a case-by-case basis in the courts -- but we cannot expect those decisions to be guided by a policy perspective on how the financial system as a whole should evolve. That, in the end, is the task of the legislature, not of the courts which must struggle to adapt today's circumstances to yesterday's laws. Until all of us -- the regulators, the banks, other competing industries, and the courts -- have more Congressional guidance, every new decision will be subject to legal challenge.

If Congress does not decide, decisions will still be made. But they seem certain to be conflicting, and not fit into a coherent whole. One clear risk is that the overriding public interest in a strong, stable, and competitive financial system will be lost.

The time for action is here. Many elements of comprehensive legislation are already broadly accepted. I believe the remaining elements and the necessary compromises can be put together soon. I hope and believe this Committee can be the vehicle for moving ahead.

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TABLE OF APPENDICES

APPENDIX A

OWNERSHIP OF NONBANK BANKS

1. Securities firms (32). Most of the nonbank banks are owned by securities firms. At least 32 securities firms own nonbank banks, including major firms such as E.F. Hutton, Prudential-Bache, Shearson/American Express, Merrill Lynch, Fidelity Management & Research Co., Marsh & McLennan, Drexel Burnham Lambert, and J. & W. Seligman. Although some of these nonbank banks are state chartered trust companies that do not accept demand deposits and that have been organized to perform trust services to the parent organization, a number of other nonbank banks owned by securities firms do engage in demand deposit taking and consumer lending (e.g., Dreyfus Consumer Bank).

2. Diversified financial and industrial conglomerates (6). A number of companies engaged in diversified commercial and industrial activities also have acquired nonbank banks, including Gulf & Western Industries (movies, commercial finance, etc.), Avco Corp. (manufacturing of aircraft engines, electronics, thrift and finance companies), Control Data Corp. (data processing, finance companies), Chrysler Corp. (automobile manufacture), Parker Pen Company (manufacturing, insurance, and thrift companies), and Automated Data Processing (data processing).

3. Other financial services organizations (9). Nonbank banks also have been acquired by organizations that offer a wide range of financial services, such as Household Finance Corporation and Beneficial Corporation, and Bradford National Corp. and some bank holding companies, such as Citizens Fidelity, Comerica, and U.S. Trust Corporation. Norwalk Savings Bank, Anchor Savings Bank, Greater Providence Deposit Corporation, and Teachers Service Corporation also own nonbank banks.

4. Insurance companies (3). Several insurance companies have acquired nonbank banks, including Prudential, Travelers, and Mutual Benefit Life Insurance Co. Aetna has withdrawn its application to acquire a nonbank bank.

5. Retail companies (3). Retail companies also have acquired nonbank banks, including McMahan Valley Stores, and J.C. Penney Company.

NONBANK BANKS*

Bank	Parent Company	Acquired/ Formed
CALIFORNIA		
1. American Pacific Natl. Bank & Trust Co., Newport Beach	American Pacific Corp., Irvine, California	application denied
2. Associates National Bank, Concord	Gulf & Western Corp., New York, New York	1980
3. Avco National Bank, Anaheim	Avco Corp., Greenwich, Connecticut	1982
4. Capital Guardian Trust Co., Los Angeles	The Capital Group Inc., Los Angeles, California	1968
5. Pacific Securities Depository Trust Co., San Francisco	Pacific Coast Stock Exchange, San Francisco, California	1974
6. Security Trust Co., Los Angeles	Bradford National Corp., New York, New York	1981
7. Trust Services of America Inc., Los Angeles	Calif. Federal Savings & Loan Association, Los Angeles, California	1982
8. Valley National Bank of Salinas	Household International, Prospect Heights, Illinois	1981
9. Western Family Bank N.A., Carlsbad	McMahan Valley Stores, Carlsbad, California	1982
COLORADO		
10. Resources Trust Co., Englewood	Integrated Resources Inc., New York, New York	1983
CONNECTICUT		
11. Citizens National Bank, Fairfield	Norwalk Savings Bank, Norwalk, Connecticut	1983

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* In addition, Dimension Financial Corporation has filed applications to charter 31 national banks in 25 states.

Bank	Parent Company	Acquired/ Formed
DELAWARE		
12. Beneficial National Bank (USA), Wilmington	Beneficial Corp., Wilmington, Delaware	1983
13. Colonial National Bank, Wilmington	Teachers Service Organization, Willow Grove, Pennsylvania	1982
14. Delaware Charter Guarantee & Trust Co., Wilmington	Corporation Service Co., Wilmington, Delaware	1977
15. First National Bank of Wilmington	Commercial Credit Corp., Baltimore, Maryland	1983
16. E.F. Hutton Trust Co., Wilmington	E.F. Hutton Group Inc., New York, New York	1983
17. E.F. Hutton Bank, Wilmington	E.F. Hutton Group Inc., New York, New York	1983
18. First National Bank of Harrington, Harrington	J.C. Penney Company, Inc., New York, New York	1983
FLORIDA		
19. Templeton Management & Trust Co. N.A., Ft. Lauderdale	Principals of the Templeton Group of mutual funds, Nassau, Bahamas	1983
20. U.S. Trust Company of Florida, N.A. Palm Beach	U.S. Trust Corporation New York, New York	1984
GEORGIA		
21. Capital City Bank, Hapeville	Prudential-Bache Securities Inc., New York, New York	1983
ILLINOIS		
22. Chicago Title & Trust Co., Chicago	Lincoln National Corp., Fort Wayne, Indiana	1979
23. Midwest Securities Trust Co., Chicago	Midwest Stock Exchange, Chicago, Illinois	1973
24. Washington National Trust Co., Evanston	Washington National Corp.	1975

Bank	Parent Company	Acquired/ Formed
MARYLAND		
25. T. Rowe Price Trust Co., Baltimore	T. Rowe Price & Associates Inc., Baltimore, Maryland	
MASSACHUSETTS		
26. Boston Safe Deposit & Trust Co.	Shearson/American Express Inc., New York, New York	1981
27. Investors Bank & Trust Co., Boston	Eaton & Howard, Vance Sanders Inc., Boston, Massachusetts	1969
28. Fidelity Management Trust Co., Boston	Fidelity Management & Research Co., Boston, Massachusetts	1981
29. Marsh & McLennan Trust Co., Boston	Marsh & McLennan Inc., New York, New York	1983
30. Massachusetts Co., Boston	Travelers Corp., Hartford, Connecticut	1969
31. Trust Management Bank, Boston	Rollert & Sullivan Inc., Boston, Massachusetts	1983
32. Wellington Trust Co. of Boston NA	Wellington Management Co./Thorndike, Doran, Paine & Lewis, Boston, Massachusetts	1982
MICHIGAN		
33. Automotive Financial Services, Inc., Highland Park	Chrysler Corp., Inc. Detroit, Michigan	1981
MINNESOTA		
34. IDS Trust Co., Minneapolis	Investors Diversified Services Inc., Minneapolis, Minnesota;	1979

Bank	Parent Company	Acquired/ Formed
MISSOURI		
35. Investors Fiduciary Trust Co., Kansas City	DST Inc., Kansas City, Missouri	1972
NEW HAMPSHIRE		
36. Fidelity Bank & Trust Co., Salem	Fidelity Management & Research Corp., Boston, Massachusetts	1983
37. First Deposit National Bank, Tilton	Parker Pen Co., Janesville, Wisconsin	1981
NEW JERSEY		
38. City Trust Services N.A., Elizabeth	City Federal Savings & Loan Assn., Elizabeth, New Jersey	1975
39. Drexel Trust Co., Paramus	Drexel Burnham Lambert Group Inc., New York, New York	1983
40. Dreyfus Consumer Bank, East Orange	Dreyfus Corp., New York, New York	1983
41. Merrill Lynch Bank & Trust Co., Plainsboro Township	Merrill Lynch & Co. Inc., New York, New York	1984
NEW YORK		
42. Bradford Trust Co., New York	Bradford National Corp., New York, New York	1972
43. Brown Brothers Harriman Trust Co., New York	Brown Brothers, Harriman & Co., New York, New York	
44. National Trust Company, White Plains	Automated Data Processing, Inc.	1983
45. Depository Trust Co. of New York, New York	New York Stock Exchange and other users	1973
46. Dreyfus National Bank & Trust Co., New York	Dreyfus Corp., New York, New York	1983

Bank	Parent Company	Acquired/ Formed
47. Fidelity National Bank & Trust Co., New York	Fidelity Management & Research Corp., Boston, Massachusetts	1984
48. Savings Bank Trust Co., New York	Mutual savings banks of New York State	1933
49. J. & W. Seligman Trust Co., New York	J. & W. Seligman & Co., New York, New York	1982
NORTH CAROLINA		
50. Manning & Napier Trust Co. Inc.	Manning & Napier Advisors, Inc., New York, New York	
OHIO		
51. The Ohio Co. trust department, Columbus	The Ohio Co., Columbus, Ohio	1976
52. Citizens Fidelity (Ohio), N.A., Cincinnati	Citizens Fidelity Corporation, Louisville, Kentucky	1983
53. Comerica Bank-Midwest, N.A., Toledo	Comerica, Incorporated Detroit, Michigan	1983
OREGON		
54. Columbia Trust Co., Portland	Columbia Management Co., Portland, Oregon	1980
PENNSYLVANIA		
55. Philadelphia Depository Trust Co., Philadelphia	Philadelphia Stock Exchange	1979
56. Vanguard Fiduciary Trust Co., Valley Forge	Vanguard Group of Investment Cos., Valley Forge, Pennsylvania	1982

Bank	Parent Company	Acquired/ Formed
RHODE ISLAND		
57. Mutual Benefit Trust Co., Providence	Mutual Benefit Life Insurance Co., Newark, New Jersey	1983
58. Great Providence Trust Co., Providence	Greater Providence Deposit Corporation, Providence, Rhode Island	1971
UTAH		
59. American Investment Bank N.A., Salt Lake City	Leucadia National Corp., New York, New York	1983
WASHINGTON		
60. Frank Russell Trust Co., Tacoma	Frank Russell Co. Inc., Tacoma, Washington	1980
61. Savings Bank Trust Co. Northwest, Seattle	Shearson/American Express Inc., New York, New York	1970

APPENDIX B

ACTIVITIES OF INDUSTRIAL BANKS AND PRIVATELY INSURED SAVINGS AND LOAN ASSOCIATIONS

A. Industrial Banks

Historically, industrial banks (also referred to as Morris Plan banks or industrial loan companies) were consumer-oriented institutions that engaged in extending installment credit to consumers and that accepted savings deposits or sold investment certificates, which are similar to certificates of deposit. They were called industrial banks because they served industrial workers who in the early part of this century often could not obtain credit from commercial banks. Industrial banks traditionally did not accept checking accounts of any type. Although some industrial banks appear to have had the power to make commercial loans, this authority was not widely exercised.1/

Since approximately 1980, however, the activities of industrial banks have expanded substantially, and these institutions today offer a wide range of financial services,

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1/ General background information regarding industrial banks may be found in H. Jennings, The Consumer in Commercial Banking (1939); R. Saulnier, Industrial Banking Companies and Their Credit Practices (1940) and Amend the Bank Holding Company Act of 1956; Hearings on S.2353, S.2418, and H.R. 7371 before a Subcomm. of the Senate Comm. on Banking and Currency, 89th Cong. 2d. Sess. 155 (1966).

which make them essentially indistinguishable from commercial banks. As Table I shows, there are approximately 1,200 industrial banks located in 21 states.[2/] Substantially all of these institutions are now permitted to make commercial loans. Ten states have authorized their industrial banks to offer NOW accounts, and approximately 95 industrial banks in those states have commenced offering such accounts.

Nine states provide some sort of insurance for funds deposited in industrial banks.[3/] The FDIC has ruled that industrial banks in Colorado, Hawaii, Nebraska, Tennessee and Utah are eligible for FDIC insurance. Industrial banks in a number of other states appear to be eligible for FDIC insurance as a result of the Garn-St Germain Depository Institutions Act of 1982, but the FDIC has not taken a position regarding those states. Under the Garn-St Germain Act, institutions that are eligible for FDIC insurance include

> any bank, banking association, trust company, savings bank, industrial bank or similar financial institution which the board of directors [of the FDIC] finds to be operating substantially in the same manner as an industrial bank . . . .

12 U.S.C. § 1813.

2/ Three additional states authorize industrial banks but have no institutions operating.

3/ California, Colorado, Hawaii, Iowa, Kansas, Minnesota, Nebraska, Rhode Island, and Utah.

A few institutions in Florida, North Carolina and West Virginia secured FDIC insurance prior to the Garn-St Germain Act, but the FDIC has not decided whether other institutions in those states are eligible for insurance. Industrial banks located in California, Florida and Iowa presently have applications for insurance pending with the FDIC. Four states require their industrial banks to secure FDIC insurance if they wish to accept deposits (or in some instances if they wish to offer NOW accounts).[4/] Industrial banks that are eligible for FDIC insurance are also subject to reserve requirements and have access to the Federal Reserve's discount window.[5/]

In summary, industrial banks have full commercial lending powers and are able to fund their commercial loans with checking accounts and savings accounts that may be insured by the FDIC. They also have access to the Federal Reserve System in its role as lender of last resort for the banking system. The NOW accounts offered by industrial banks are checking accounts that perform the same function as demand deposits, that are advertised as checking accounts, and for the majority of consumers are the equivalent of a conventional

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4/ Florida, Hawaii, Tennessee and West Virginia.

5/ 12 U.S.C. § 461.

demand checking deposit.[6] The significant expansion of the powers of industrial banks that has occurred since 1980 and their eligibility for FDIC insurance has rendered them institutions capable of frustrating the purposes of the Bank Holding Company Act.

Indeed, the potential that industrial banks have to function as commercial banks has prompted a number of the largest bank holding companies in the country to acquire industrial banks and approximately 50 such acquisitions have occurred since 1980, when industrial banks first gained NOW account powers. This rate of acquisitions is more than double that which occurred in the period of 1971-1979. A number of these industrial banks have obtained FDIC insurance.

B. State Chartered, Privately Insured S&Ls

State chartered, privately insured savings and loan associations exist in five states.[7] As Table II shows, there are approximately 394 such institutions, which control

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6/ Unlike the traditional passbook or savings account, withdrawals from NOW accounts may be made by checks given directly to third parties. Although technically subject to the right of the depository institution to require the depositor to provide advance notice of withdrawal, this right is never invoked with respect to NOW accounts. Indeed, because invocation of the notice by the depository institution would require the dishonoring of checks given by the depositor to third parties for value, the technical notice requirement cannot as a practical matter be imposed with respect to NOW accounts.

7/ Maryland, Massachusetts, North Carolina, Ohio and Pennsylvania.

some $16 billion in deposits.[8/] All of these institutions are authorized to make commercial loans and accept NOW accounts and many may accept demand deposits. The great majority of these institutions are mutual associations and thus raise no issues under the Bank Holding Company Act or the Savings and Loan Holding Company Act.

State chartered, privately insured S&Ls are eligible for FSLIC insurance, but have opted for private insurance instead. Although these S&Ls are sometimes simply referred to as "state insured S&Ls," it is more accurate to describe them as state chartered S&Ls, the deposits of which are privately insured under authority of state law. These S&Ls are primarily engaged in making residential mortgage loans and have the same powers as other state chartered S&Ls in the relevant state. For the most part, such powers are generally comparable to those of federally chartered S&Ls, although in some instances the powers of state chartered S&Ls exceed those of federally chartered institutions.

Many state chartered, privately insured S&Ls are mutual in form, but approximately 30 such institutions have corporate parents. These corporate parents are concentrated in Ohio, Maryland, and North Carolina, and engage in a variety of

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8/ If state insured savings banks are included, this amount would be $27.5 billion.

activities, from simply holding the subsidiary S&L's shares to operating a chain of restaurants. In addition, some of these parent organizations, such as Warner National Corporation and Control Data Corporation, operate on a nationwide basis, and engage in a variety of nonbanking activities such as the computer business.

Although state chartered, privately insured S&Ls are currently primarily engaged in home lending, they have the capability to function in the same manner as a commercial bank to the extent that they may make commercial loans and offer NOW accounts. In addition, such institutions qualify as "depository institutions" for purposes of the Monetary Control Act, and therefore have access to the Federal Reserve discount window. Despite these facts, such institutions are not subject to the Savings and Loan Holding Company Act, and may also be able to avoid coverage under the Bank Holding Company Act, particularly if they do not engage in commercial lending. The ability of these institutions to gain access to the payments mechanism and the Federal Reserve discount window therefore presents an anomalous situation in view of the freedom from prudential regulation enjoyed by their corporate parents. Consequently, these institutions should be subjected to the Savings and Loan Holding Company Act, just as other S&Ls.

Industrial Bank Activities By State[1/]

State	NOWs Authorized (Date)	No. of Institutions	Est. No. Offering NOWs	Total Deposits (All Types) ($ millions)
Arizona	No	0	0	0
Arkansas	Yes (1980)	3	3	34
California	Yes (1982)	86	8	1900
Colorado[2/]	Yes (1980)	154	70	322
Connecticut	Yes (1949)	0	0	0
Florida[3/]	Yes (1980)	3	3	32
Hawaii[2/3/]	No	69	0	480
Indiana	Yes	5	0	309
Iowa	No	52	0	181
Kansas	No	12	0	9
Kentucky	No	125	0	NA
Maine	No	0	0	0
Minnesota	No	29	0	53
Missouri	No	2	0	10
Nebraska[2/]	No	34	0	320
Nevada	No	6	0	175
North Carolina	No	1	0	4
Oklahoma	Yes	9	2	NA
Rhode Island	Yes (1971)	11	5	668
Tennessee[2/3/]	No	420	0	NA
Utah[2/]	Yes (1980)	54	2	469
Virginia	No	12	0	0
Washington	No	26	0	0
West Virginia[3/]	Yes (1980)	92	2	33
TOTALS	Yes=10 No =14	1205	95	4999

1/ Data as of 12/83. Substantially all industrial banks are permitted to make commercial loans.

2/ Eligible for FDIC insurance. Many other industrial banks appear to be eligible for FDIC insurance as a result of the Garn-St Germain Act, but FDIC has not taken a position regarding them.

3/ FDIC insurance required if deposits are offered. In some instances, this requirement is applicable only if NOW accounts are offered.

Privately Insured S&Ls

State	NOWs Authorized (Date)	No. of Institutions	Total Deposits (All Types) ($ millions)
Maryland	Yes	105	6,000
Massachusetts	Yes (1973)	103 1/	4,700
No. Carolina	Yes (1981)	43	1,800
Ohio	Yes (1981)	74	3,500
Pennsylvania	Yes (1980)	69 2/	115
TOTALS	Yes=5	394	16,115

Privately Insured Savings Banks

Massachusetts	Yes	159 3/	11,400

1/ Only 2 of these are stock institutions, and neither of those two has a corporate parent.

2/ Only a few stock institutions exist, and only one of them has a corporate parent.

3/ Some of these institutions are also insured by the FDIC, in which case the Massachusetts fund covers deposits in excess of $100,000.

APPENDIX C

LIMIT ON TANDEM OPERATIONS

The availability of the exemption from the activity restrictions of the Savings and Loan Holding Company Act for unitary savings and loan holding companies of both federally and non federally insured thrift institutions should be limited to those thrift institutions that are engaged primarily in housing lending and that do not operate in tandem with affiliated nonbanking organizations. Without a limitation on tandem operations, many business organizations may feel compelled to become affiliated with a thrift in order to remain competitive, and competition and stability would be increasingly compromised. The growing number of securities, insurance, retail, and manufacturing firms that have already acquired S&Ls or nonbank banks suggests the danger.

To prevent such an occurrence, a variety of relationships falling under the general heading of "tandem operations" should be prohibited for companies that wish to take advantage of the unitary S&L holding company exemption. The major element of this limitation is a prohibition on the mutual offering of products and services. Thus, prohibited tandem operations would encompass the sale or marketing of the S&L's products by nonbanking affiliates and the sale or marketing by the S&L of the products or services offered by those affiliates. For example, the deposits of the S&L

could not be sold or marketed by its nonbank affiliates. Similarly, the S&L could not offer or market the insurance, securities, real estate or retail products of its affiliates. The offering of discounts or incentives by an S&L or its affiliate to encourage a customer to purchase products or services from the other organization is another example of a practice that would be barred.

The tandem operation provision could be implemented in other ways. Consideration might be given to prohibiting the subsidiary S&L or a unitary S&L holding company from operating at the same location with affiliates engaged in nonbanking activities. This would mean, for example, that an S&L could not provide space in its lobby for its nonbanking affiliates, nor could it establish branch offices or RSUs at the locations of offices of those nonbanking affiliates.

Similarly, a subsidiary S&L of a unitary S&L holding company might not be permitted to provide customer referrals for its nonbanking affiliates, nor could those affiliates refer business to the S&L. Thus, a retail affiliate could not rely on the S&L to make loans to the retailer's customers to finance purchases from the retailer; and real estate, insurance or securities affiliates could not refer customers to the affiliated S&L.

APPENDIX D

Amendments to the National Housing Act to Establish a Qualifying Test for the Unitary Savings and Loan Holding Company Exemption (Assuming a Ten Year Phase In.)

Section 408(n) of the National Housing Act (12 U.S.C. 1730a(n)) is amended as follows:

"(n)(1) A savings and loan holding company, the subsidiary insured institution of which devotes less than 65 percent of its assets to residential mortgages and related investments on average during any year, shall not thereafter commence, or continue for more than three years, either directly or indirectly, including through a subsidiary (other than an insured institution), any business activity not permissible for a multiple savings and loan holding company under subsection (c) of this section. For the purposes of this subsection, the term "related investments" means (A) securities backed by residential mortgages; (B) retail mobile home loans; (C) home improvement loans; (D) loans to finance the construction of residential properties; (E) participations in the above loans; and (F) investments in service corporations except that such investments shall be reduced by an amount proportionate to the amount of such corporation's assets that are not residential mortgages or related investments as defined in this subsection. This paragraph shall not apply during the ten year period following the date of enactment of this paragraph to a unitary savings and loan holding company, the

subsidiary insured institution of which does not meet the asset composition test established by this paragraph on the date of enactment of this paragraph, provided that the insured institution does not decrease the percentage of its assets devoted to residential mortgages and related investments below the percentage it held on the date of enactment of this paragraph and increases, within the following time periods from the date of enactment of this paragraph, such percentage of its assets devoted to residential mortgages and related investments by an amount at least equal to the following percentages of the difference between 65 percentum and the percentage of its assets devoted to residential mortgages and related investments on the date of enactment of this paragraph:

(i) within two and one-half years, 25 percentum;

(ii) within five years, 50 percentum;

(iii) within seven and one-half years, 75 percentum.*/

"(2) In the event that an insured institution that is owned or controlled by a savings and loan holding company offers or markets the products or services of such savings and loan holding company or of any other subsidiary of such holding company, or the products and services of such insured institution are offered to or marketed through such holding

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*/ If a five-year phase-in period were adopted, these transition periods could be reduced.

company or any of its other subsidiaries, such savings and loan holding company and all subsidiaries thereof (other than an insured institution) shall not thereafter commence, or continue for more than three years, any activity not permissible for a multiple savings and loan holding company under subsection (c) of this section.*/

"(3) For the purpose of determining compliance with the three and ten year periods described in this subsection, the last sentence of paragraph (2) of subsection (c) hereof shall not be applicable."

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*/ These provisions against tandem operations are identical to those in S. 2134, 98th Cong., 1st Sess. (1983), introduced by Senator Proxmire.