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001.411
Volcker, Paul A

For release on delivery
9:00 A.M., E.D.T.
May 8, 1985

Statement by

Paul A. Volcker

Chairman, Board of Governors of the Federal Reserve System

before the

Committee on Banking, Housing and Urban Affairs

U. S. Senate

May 8, 1985

orig filed 252.2

I am pleased to appear before this Committee today to review the banking bill -- S. 2851 -- that was adopted by the Senate in September of last year and to assess the continuing need for this legislation. On several occasions in the past I have advised this Committee of the need to move with a sense of urgency to reform the existing statutory framework governing "banking" organizations, prompted by my concern that there are real dangers in permitting the financial system to evolve, as it is now, in a haphazard and potentially dangerous way. Nothing has happened in the seven months since September 1984 that would cause me to change this assessment. Quite the contrary, the basic framework for the conduct of depository institution business that would have been established by S. 2851 is sorely missed and still urgently needed.

In previous statements before this Committee, I have stressed the unique and complex role played by

depository institutions in our financial system and our economy. For the convenience of the Committee, I have attached to this statement a copy of my statement before this Committee on March 27, 1984, which sets out in detail the conceptual framework from which we at the Board approach the present legislative effort to revise the banking structure in the light of changed market conditions. (Attachment I)

The legislation adopted by the Senate last year took some basic steps necessary to adapt the financial system to changed circumstances. It provided for:

(a) a new definition of banks and thrifts;

(b) a streamlining of the procedural provisions of the bank and thrift holding company acts;

(c) a broadening, within an appropriate regulatory framework, of the powers of depository institution holding companies;

(d) a better delineation of the scope of state authority in the area of banking organization powers; and

(e) a start on developing rules governing interstate expansion of depository institutions.

The broad consensus on these and other provisions was reflected in the overwhelming Senate support for S. 2851.

The need for new legislation to clarify and reinforce certain continuing goals of public policy toward banking has only intensified in the past year. There has been further proliferation of nonbank banks, new state initiatives to greatly expand the powers of state-chartered banks and thrifts, and new applications by banks and bank holding companies to engage in insurance, securities and other activities that must be decided with or without Congressional guidance.

Since July 1, 1983, the grandfather date in S. 2851, twenty-two applications for nonbank banks by commercial companies, including major securities, insurance and retail firms, have received approval. Since September 1984, 276 applications by bank holding companies for nonbank banks located in forty different states have also been approved. While a U. S. District Court in Florida has enjoined the Comptroller from issuing any new final charters, and the Federal Reserve has returned pending applications because of this injunction, there is a continuing and important need for legislative action on the definition of bank.

I need only stress that in the appeal process, the lower court decisions could be reversed, with a resultant flood of new nonbank banks immediately being put into place. In any event, the Court's ruling does not apply directly to

nonbank banks authorized under state law or to existing national banks, that could be converted to nonbank banks. I fully expect that commercial firms prepared to take advantage of loopholes will turn in this direction as a means of evading the separation of banking and commerce that is now required.

The accelerating trend in the states toward authorization of new nonbanking powers for banks and thrifts is another point of serious concern. These laws appear to be part of a kind of bidding process to attract and retain depository institutions to enhance revenues and create new employment opportunities rather than a reflection of a coherent philosophy toward banking. These essentially competitive efforts in the end will offset one another, but at the cost of establishing banking practices that could well be inconsistent with the requirements of a safe and sound

banking system. For instance, legislation was adopted last year in California and New York to authorize real estate development activities and in Ohio to authorize investment in corporate equities as well as real estate development, posing real risks for the banks that engage in these activities. Of equal concern is the legislation in some states that has given carte blanche to state-chartered thrifts allowing them to virtually make any type of investment almost without restriction.

Faced with these laws, and their likely proliferation, the three federal regulators with responsibilities in these areas -- the Board, the Federal Home Loan Bank Board, and the Federal Deposit Insurance Corporation -- have adopted or have under consideration regulations to establish a framework for the conduct of state-chartered depository institution activities. The three depository institution

regulators have in effect reached the conclusion that unrestrained, these activities can seriously endanger depository institutions themselves and the financial system in which they are such an important part. Administrative authority to act in this delicate area of state-federal relations needs a clear mandate of Congressional support.

The unsatisfactory state of existing law is also manifest in recent applications by bank holding companies to engage directly or through subsidiaries in a considerable range of insurance and securities activities, taking advantage of perceived new interpretations of federal law or new state laws. Holding company applications are now before the Board to engage in nationwide insurance brokerage and underwriting through state banks and to participate in underwriting and distribution of commercial paper, revenue bonds and mortgage-backed obligations. These applications raise

serious questions of policy in areas that have been of important Congressional concern. We are required, nevertheless, by law to act on them. It would be far preferable to act in these areas on the basis of a fresh statutory mandate, rather than attempt to apply existing rules to circumstances that were unforeseen 10, 20 and 50 years ago.

All these developments have created a continuing large volume of complex litigation -- and more can be expected. Almost every important banking policy is now the subject of judicial review and the courts, or we the regulators, are faced with the unhappy dilemma of attempting to apply old laws adopted in very different circumstances to new facts and new arrangements which the Congress did not envision when these laws were originally adopted. In these circumstances, inconsistent rulings should be no surprise. The banking system is simply too important to leave this to haphazard development.

The legislation adopted by the Senate last year would have made a major contribution toward establishing a new and more stable framework in which depository institutions and other financial firms can operate, while protecting the basic foundations of a safe and sound financial system. However, I believe changes are needed in at least three important areas to strengthen the Senate bill to assure that these objectives are fully met. (An Appendix, Attachment II, contains our recommended changes to Title I of S. 2851 in legislative language.)

Strengthening The Thrift Test

First, the so-called "thrift test" should be strengthened substantially. Conceptually, S. 2851 seems to accept the importance of assuring that thrifts extensively engaged in commercial activities, like commercial banks, be subject to national policy requiring a separation of banking

and commerce. However, the thrift test set out seems to me too weak, and would permit "nonthrift thrifts" with bank-like powers to develop, undercutting the prohibition on "nonbank banks."

To achieve the necessary strengthening, the thrift test should, at a minimum, require that at least 65 percent of a thrift's own assets be devoted to home lending. It should exclude a "pass-through" of loans originated and sold to other investors, an activity freely engaged in by a wide variety of institutions that have no special protection under Federal law, as well as by many commercial banks. If liquid assets are to qualify, they should do so only in amounts required by law. In addition, a thrift should not be used to market the products of a nonthrift or bank parent and vice versa.

Clarification of State Banking Powers

Second, the provisions on limiting state powers to authorize new banking activities should be extended and clarified. The bill now prevents states from authorizing new powers for banks that are not permitted under section 4 of the Bank Holding Company Act unless these activities are confined to the authorizing state. On the basis of recent developments it seems clear this limitation should be extended to include activities authorized by states that are inconsistent with safe and sound banking. The Congress has extensively reviewed the powers that should be permitted to banks and their holding companies and has carefully balanced considerations involving both fair competition and risk. We believe it is both unwise and dangerous to the stability of the system to permit the expansion of powers that raise serious safety and soundness considerations, particularly

where the primary motivation for the adoption of these powers is parochial considerations of jobs and revenues.

Transition to Interstate Banking

Third, legislation adopted this year should also go beyond approving regional arrangements, as provided for in Title IX of S. 2851, and address the rules for interstate expansion. The present situation of loophole exploitation and discriminatory regional arrangements is inherently unsatisfactory. Title IX only goes so far as to legitimize regional arrangements for a period of five years. These arrangements are satisfactory only as a transition to a less discriminatory system of interstate banking. New arrangements for interstate banking should also include provisions to assure fair competition and avoid undue concentration of resources, elements that would well be lost to the extent that interstate expansion was confined for an indefinite

period to regional arrangements. I have attached to my testimony a more detailed exposition of our thinking in this area. (Attachment III)

Definition of Bank

Finally, I would like to emphasize one area where I believe a change should not be made. I understand that proposals have been made by others to undermine the definition of bank contained in S. 2851 by permitting nondepository institutions -- industrial firms, retail firms, securities and insurance firms -- to enter the banking business without being subject to the Bank Holding Company Act, provided that they have no more than a limited portion of their assets in commercial loans. This concept, now beguilingly called the consumer or family bank, would clearly undercut the basic public policies sought by closing the nonbank bank loophole. A detailed statement on the nonbank

bank issue that also focuses on the reasons why the so-called consumer or family bank should not be included is contained in Attachment IV.

Moreover, I believe there is an important defect in the bill's definition of "bank". S. 2851 now exempts from the definition of bank institutions that take demand deposits and are not federally insured, so long as they hold no more than 10 percent of their assets in commercial loans. I have urged, and recent experience seems to me to confirm my concerns, that all institutions that take transaction accounts (not just demand deposits narrowly defined) and make commercial loans and that are not covered by the S&L Holding Company Act should be covered by the Bank Holding Company Act. For just these same reasons, I would urge that the provisions of S. 2851 which allows bank holding companies to own nonfederally insured banks be deleted from the bill.

I would also urge that the nonbank bank grandfather provisions of S. 2851 be modified to assure that grandfather status is not abused by expansion of commercial lending or geographically.

Last year the Senate took a significant step forward toward adopting the urgently needed new framework of public policies for the conduct of the banking and thrift businesses. Recent events have demonstrated the continuing need for final Congressional action and I believe have created the atmosphere in which this action can be taken. I believe S. 2851 needs to be strengthened in the areas I have indicated and strongly urge your early action.

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ATTACHMENT I

For release on delivery
Expected at 9:30 A.M. EST
March 27, 1984

Statement by

Paul A. Volcker

Chairman, Board of Governors of the Federal Reserve Sytem

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United States Senate

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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 supplementary (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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ATTACHMENT II

AMENDMENTS TO THE DEFINITION OF BANK IN THE BANK HOLDING COMPANY ACT

1. Definition of Commercial Loan
2. Trust Company Exemption
3. Limits on Demand Deposit Taking and Commercial Lending of Grandfathered Nonbank Banks
4. Limits on Activities and Geographic Expansion of Grandfathered Nonbank Banks
5. Treatment of FDIC Insured Savings Banks
6. Requirement for Federal Insurance for Bank Holding Company Subsidiary Banks

AMENDMENTS REGARDING STATE CHARTERED DEPOSITORY INSTITUTIONS

1. Amendment Regarding Banks
2. Amendment Regarding Thrifts

AMENDMENTS TO THE QUALIFIED THRIFT LENDER PROVISIONS OF THE SAVINGS & LOAN HOLDING COMPANY ACT AMENDMENTS

1. Definition of Qualified Thrift Lender
2. Prohibition on Marketing by an Affiliate of an Insured Thrift's Deposits

OTHER AMENDMENTS

1. Amendment Regarding Mortgage-backed Securities
2. Amendment Regarding Leasing Authority of National Banks

Amendment to Definition of
Commercial Loan in S. 2851

Amend section 104(a)(3)(k) to read as follows:

"(k) The term 'commercial loan' means any loan other than a loan the proceeds of which are used for personal, family, household, or charitable purposes, and includes broker call loans, loans secured by real estate the proceeds of which are used for other than personal, household, family, or charitable purposes, and the purchase of retail installment loans, accounts receivable, and commercial paper. Commercial loans shall not include the purchase of certificates of deposit, bankers acceptances, or obligations of the United States or local and State governments or agencies or instrumentalities thereof, the sale of Federal funds, or the deposit of interest bearing funds."

Explanation

S. 2851 defines commercial loan to exclude a number of instruments that traditionally have been regarded as commercial loans, including commercial real estate loans and the purchase of retail installment loans, accounts receivable, and commercial paper. The bill also includes a definition of "engaged in the business of making commercial loans" under which an institution is not regarded as engaged in the business of commercial lending if it devotes less than 10 percent of its assets to commercial loans. As so structured, the definition

such institutions from the Bank Holding Company Act if they are and have been privately insured since the date of enactment of the bill. The exemption would terminate if the institution undergoes a change in control by a company engaged in activities that are impermissible for bank holding companies under the BHC Act.

This amendment is designed to exempt those nonfederally insured institutions that accept transaction accounts and that would be covered as banks under the Bank Holding Company Act by virtue of the commercial lending definition contained in the previous proposed amendment to S. 2851. This amendment is necessary only if proposed commercial lending amendment is adopted.

Amendment to S. 2851 to Limit
Trust Company Exception

Amend section 104(a)(1)(v) to read as follows:

"(c) 'Bank' means . . .

(v) any institution that functions solely in a trust or fiduciary capacity, such as described in subsection (a) of the first section of the Act of September 28, 1962 (12 U.S.C. 92a(a)), provided that--

(I) all or substantially all of the deposits of such institution shall be in trust funds and received in a bona fide trust capacity, as determined by the Board, and solely as an incident to bona fide trust services;

(II) any deposits of the institution shall not be offered or marketed by or through a company that controls the institution or any affiliate of such company;

(III) the institution does not offer demand deposits or deposits subject to withdrawal by check or any other similar means;

(IV) the institution does not obtain from Federal Reserve Banks services specified in section 11A of the Federal Reserve Act and does not exercise discount and borrowing privileges pursuant to section 19(b)(7) of the Federal Reserve Act; and

(V) all or substantially all of the income of the institution is derived from trust, custodial or related fiduciary service fees and not from lending or investing of deposits; . . ."

Explanation

This amendment ensures that the proposed trust company exemption from the bank definition is limited to institutions that function as fiduciaries. The amendment limits the trust company exemption from the bank definition to institutions that do not accept checking accounts, market deposits through affiliates, or make use of Federal Reserve services and that derive all or substantially all of their income from fiduciary activities.

Amendments to Grandfather Provision in S. 2851 to Limit Demand Deposit Taking and Commercial Lending by Grandfathered Nonbank Banks

Amend clause (ii) in the second and third sentences of section 104(c)(2) to read as follows:

", such institution commences accepting demand deposits or deposits that the depositor may withdraw by check or similar means for payment to third parties and engages in the business of making commercial loans,"

Explanation

This amendment would prevent a grandfathered nonbank bank that engages in the business of making commercial loans from also accepting NOW accounts.

Amendments to Grandfather Provision in
S. 2851 to Limit Geographic Expansion of, and to Prevent
Joint Marketing Operations By, Grandfathered Nonbank Banks

Amend section 104(c)(2), to delete the "or" before "(iii)" in the second and third sentences, and add in the second and third sentences before the periods the following:

", (iv) such institution increases the number of locations from which it conducted its activities on June 27, 1984," or

"(v) such institution offers or markets the products or services of any affiliate engaged in activities not permitted for bank holding companies under paragraph (8) of subsection (c) of this section or the products and services of the institution are offered to or marketed through any affiliate engaged in activities not permitted for bank holding companies under paragraph (8) of subsection (c) of this section"

Explanation

This amendment would prevent a grandfathered nonbank bank from expanding geographically. The amendment would also prevent the grandfathered nonbank bank from being operated together with affiliates engaged in impermissible nonbanking activities. This joint marketing limitation covers the marketing or offering of the nonbank bank's products and services through such an affiliate or the offering or marketing of the affiliate's products and services through the nonbank bank.

Amendments to S. 2851 to Limit the Grandfather Rights of FDIC Insured State Savings Banks

Amend the first sentence of section 104(1) as follows:

"(f) Notwithstanding any other provision of this Act, a savings bank, as defined in section 3(g) of the Federal Deposit Insurance Act, which is chartered under state law, and which is or becomes a subsidiary of a bank holding company may engage, directly or through an affiliate, in any activity which it was permitted to conduct as a state-chartered savings bank, pursuant to express, incidental, or implied powers under state statute or regulation or under judicial interpretation of state law on June 27, 1984. . . ."

Explanation

The bill currently provides open-ended grandfather rights to state-chartered FDIC insured savings banks to engage in any nonbanking activities that are currently authorized for the bank under state law or that may in the future be authorized for state savings banks. This amendment limits such grandfather rights to those activities performed by the savings bank on June 27, 1984.

Amendment to Require Federal Deposit Insurance for Bank Holding Company Subsidiary Banks

Delete section 104(k) of S. 2851.

Explanation

Section 3(e) of the Bank Holding Company Act currently provides that every bank that is a subsidiary of a bank holding company shall become and remain an FDIC insured bank. S. 2851 would amend this requirement to permit the bank to insure its deposits under state law in lieu of federal deposit insurance. This amendment would maintain the current requirement for FDIC insurance for all subsidiary banks of bank holding companies.

Amendment to S. 2851 to Limit In-State Activities of Holding Company Bank Subsidiaries

Amend section 104(g) by deleting the word "and" before the numeral (2) and by adding before the period at the end thereof the following:

", and (3) a State chartered bank subsidiary of a bank holding company many not engage in, or acquire the shares of a company engaged in, any activity within the state where the bank is chartered that the Board has determined, after notice and opportunity for the submission of written views, to be unsafe or unsound for banks"

Explanation

S. 2851 prohibits state chartered banks that are owned by bank holding companies from engaging outside of the state in which the bank is chartered in nonbanking activities that are prohibited for bank holding companies under the Bank Holding Company Act. S. 2851 would, however, permit state banks to engage in such prohibited nonbanking activities within the authorizing state. This amendment would allow state banks to engage in nonbanking activities authorized by state law within the state unless the activity is determined by the Board to be unsafe or unsound for banks.

Amendment to S. 2851 to Limit Activities
of Insured Institutions

Amend section 107 of S. 2851 by adding the following new paragraph (h):

"(h) Section 408 of the National Housing Act (12 U.S.C. 1730a) is amended by adding the following new paragraph:

"(o) Notwithstanding any other provision of law, an insured institution and any subsidiary thereof shall not engage in (1) any activity outside of the state in which the institution is chartered unless the activity is permissible for a savings and loan holding company under paragraph (2) of subsection (c) of this section or (2) any activity within the state in which the institution is chartered that the Corporation has determined, after notice and an opportunity for the submission of written views, to be unsafe or unsound for insured institutions. Nothing in this subsection shall prohibit an insured institution from engaging in any activity permitted by statute for a Federal savings and loan association or Federal savings bank.

Explanation

S. 2851 prohibits a subsidiary bank of a bank holding company from engaging outside of the bank's home state in impermissible nonbanking activities. This amendment would amend the Savings & Loan Holding Company Amendments of 1967 to prohibit an FSLIC insured thrift institution from engaging outside of the thrift's home state in nonbanking activities

that are not permissible for a multiple savings and loan holding company.

In addition, this amendment provides that insured institutions may not engage within their home states in nonbanking activities that the Federal Savings and Loan Insurance Corporation determines, after notice, to be unsafe and unsound for insured institutions. A similar amendment is proposed for subsidiary banks of bank holding companies.

Amendments to Qualified
Thrift Lender Test in S. 2851

Amend section 107(b) to read as follows:

"(c) * * *

(4) * * *

"(B) A qualified thrift lender is any insured institution that, as determined by the Corporation, has an aggregate of not less than 65 per centum of its assets (including investments made by any subsidiary of such institution) invested in loans or securities related to domestic residential real estate or manufactured housing, property used by an institution in the conduct of its business, and liquid assets of the type and in such amounts as are required to be maintained under section 5A of the Federal Home Loan Bank Act, and thereafter remains at or above such percentage on an average basis in three out of every four quarters. For the ten-year period following the date of enactment of the Financial Services Competitive Equity Act, a qualified thrift lender shall also include any insured institution that was chartered prior to October 15, 1982, as a savings bank under state law if the Corporation determines that the insured institution does not decrease the percentage of its assets invested in investments described in this clause below the percentage it held on such effective date, and increases such percentage of its assets by an amount at least equal to the following percentages of the difference between 65 per centum and the percentage of its assets so invested on the date

of enactment of this paragraph within the following time periods from the date of enactment of this paragraph:

(I) within 2-1/2 years, 25 percent;

(II) within 5 years, 50 percent; and

(III) within 7-1/2 years, 75 percent. . . ."

Explanation

This amendment would raise the qualifying asset test in S. 2851 from 60 percent to 65 percent, exclude mortgage originations and equity positions as qualifying assets, limit qualifying liquid assets to the amounts required by the FHLBB for liquidity purposes, and delete the provision allowing compliance with the asset test in only two out of every three years. An institution thus would be required to devote a significant portion of its assets to home lending in order to qualify as a qualified thrift lender.

Amendment to S. 2851 to Prevent Federally-Insured Thrifts From Engaging in Joint Marketing Operations with Holding Company Affiliates

Amend section 107(c) to insert the following at the end thereof:

"(4) A new subsection (d)(1)(G) shall be added to read as follows:

"(G) offer or market the products or services of any affiliate that is not a qualified thrift lender nor offer or market its own products or services through any affiliate that is not a qualified thrift lender.".

Explanation

This amendment would prevent joint marketing operations between FSLIC insured thrifts and their affiliates if such affiliates engage in activities impermissible for a bank holding company. The amendment thus would subject thrifts to the same limitation that applies to banks in furtherance of the policy of separating banking and commerce.

Amendment to S. 2851 Regarding
Mortgage-backed Securities

Amend the first sentence of section 104(e)(3) of S. 2851 by inserting after the words "promisory notes secured by" the words "one-to-four family".

Explanation

This amendment limits underwriting of mortgage-backed securities to 1-4 family real estate mortgages.

Amendment to S. 2851 Regarding
Leasing Authority of National Banks

Strike section 111 of the bill.

Explanation

Non-full payout leasing raises significant issues of safety and soundness that have not been adequately evaluated.

ATTACHMENT III

STATEMENT ON INTERSTATE BANKING

The basic Federal branch banking law, the McFadden Act of 1927, has not been amended in any substantive manner since 1933. The law effectively prohibits national banks from branching interstate by limiting each national bank to branching only within its home state, subject within that state to any branching restrictions imposed by that state on state-chartered banks. The Douglas amendment to the Bank Holding Company Act of 1956 prohibits interstate expansion by means of a bank holding company acquiring banks in another state unless such acquisitions are explicitly authorized by that state.

In spite of the statutory McFadden and Douglas prohibitions, de facto there has been a large and increasing amount of interstate banking in recent years. Some of that has taken place through avenues specifically permitted by law.

According to a study by the Federal Reserve Bank of Atlanta, U.S. bank holding companies in 1982 had 202 loan production offices and 143 internationally oriented Edge Act Corporations operating outside the parent's home state; foreign banking organizations had another 254 banking offices outside their home state. There are probably more today. More important are the variety of finance companies, mortgage companies, industrial banks and other offices with at least partial banking capabilities operating outside the holding company's home state and many more exist now.

Technological advances are also providing large opportunities for banks to expand geographically without brick and mortar offices. By joining ATM networks, banks in some cases have been able to reach out to existing or new customers over state lines. Looking ahead, banking through home computers would be difficult to confine within a state's boundary. But even without exotic technology, the relative speed and simplicity of communications and transportation today makes it much easier, particularly on the deposit side, to conduct banking at a distance. Large businesses routinely "sweep" deposits into "concentration accounts" at selected banks. The combinations of print and broadcast advertising, 800 number telephone lines, deposit brokerage, and efficient clearing mechanisms mean that the day of rather insulated local deposit markets are gone. On the loan side, nationwide credit cards are available to customers throughout the country.

The substantial number of "nonbank bank" applications by bank holding companies, stretching the fabric of existing law, is one indication of the strength and depth of some banks' desires to operate over a wider geographic area. The pressures toward interstate operations arise from a number of sources. Competition from non-depository businesses that can and do provide financial services -- including money market accounts and other bank-like services -- through interstate networks is strong and pervasive. Thrift institutions, which have no statutory bar to interstate branching, offer interstate facilities in a significant number of cases. Moreover, banks in slower growing areas naturally want to participate in more rapidly expanding regions. Florida alone, for instance, has attracted about 20 percent of all nonbank bank applications by bank holding companies.

A number of relatively large banks that nevertheless rank well below the largest money center institutions in size apparently feel, with some urgency, that a stronger competitive position in national and international markets requires a larger size than can reasonably be attained within the boundaries of a singly state. Some of the largest banks, conversely, urgently wish to attain a wider and more stable base of "retail" deposits and to expand their consumer lending. At the other end of the spectrum, there are small banks concerned about their ability to compete effectively without being able to combine with others in a natural market area that may extend over state boundaries.

Resistance to interstate banking for a variety of reasons -- including a desire of many banks to continue as independent institutions -- clearly remains strong. But the pressures for change are apparent in initiatives by a number to states toward more interstate banking. The growing number of regional interstate banking arrangements is the most important reflection of that change in attitude. Today 14 states have enacted laws permitting reciprocal entry by bank affiliates of bank holding companies headquartered in states within a designated region; 12 more states are actively considering such arrangements. Four states allow entry from any other state, three without and one with reciprocity. These liberalized approaches toward interstate banking over recent years suggest a significant change in thinking since the McFadden act and the Douglas amendment were enacted.1/

1/ Attached are a chart showing interstate banking regions and a table listing the status of interstate banking legislation in the 50 states and the District of Columbia.

Substantive Issues in Interstate Banking

The time has come to review and clarify national policy toward interstate banking, recognizing the economic and competitive pressures driving toward liberalization of present restrictions, while also protecting the safety and efficiency of the banking system, preventing undue concentration of economic resources, and assuring benefits to the users of banking services.

One continuing objective of public policy is to assure competition in banking, as in other industries. Ordinarily, we would not expect that competition would be promoted by confining an industry to a singly geographic market or a single state. Indeed, we rely on the ability of additional firms to enter markets as a competitive force leading to the best possible products at least cost. Moreover, existing anti-trust law appears to provide considerable protection against local markets becoming non-competitive as the result of entry of larger organizations.

Available empirical studies do not suggest that large states with large banks and statewide branching are experiencing increasing concentration of local markets. The presumption that restrictions on entry into particular markets imply some loss of competitive vigor, unless overridden by other considerations of public policy, suggests that some liberalization of interstate banking is appropriate. That presumption had added force in an environment in which other large financial service firms are able to operate nationwide, exploiting what economies of scale in technology or marketing may be available. In effect, those firms may now be in a position to skim off profitable areas of business from banks committed to providing a full range of banking services.

Historically, a counter-argument to interstate banking has been a strong antipathy to concentration of economic power, particularly in the banking system, and a desire to maintain banking resources in significant measure under control of local banks, knowledgeable about the needs and circumstances of smaller businesses and individuals.

Experience in states with large banks and statewide branching suggests that these are not questions of "either-or." Attachments I and II provide a brief analysis of experience in two of our largest states, one of which has had statewide branching for decades and the other of which has permitted statewide operations only since 1976. In both cases, large numbers of relatively small independent banks remain. In California, a rapidly growing state, new banks are being formed

in relatively large numbers; in New York, a state that is growing more slowly, relatively few new banks have been formed, but the number of small independent banks (i.e., under $100 million) has dropped only modestly since statewide branching was permitted. In both states, the competitive environment appears healthy, with the consumer and businessman able to choose between some of the largest banking institutions in the world and small locally oriented banks. Should banks be permitted to expand interstate more freely, we would anticipate similar patterns to prevail.

A rush to expand geographically could pose certain risks -- temptations to pay exceptionally high prices and to leverage capital, to spread management thin, and to enter into new types of lending or operations where experience may be limited. These risks can be dealt with through normal supervisory processes, particularly in evaluating financial and managerial factors with respect to applications. In particular, a banking organization planning sizable expansion programs should be able to demonstrate its ability to maintain fully adequate capital and liquidity positions, to avoid excessive use of goodwill on its balance sheet, and to provide capable management for acquired institutions. The risks -- actual and potential -- from expansion into new banking markets are typically more identifiable, and often less, than those posed by entry into new nonbanking activities where bank management may have little or no experience.

Concentration

Viewed from a national perspective, restrictions on interstate banking have been effective in forestalling large concentrations of domestic banking resources, at least by the standards of other countries. The 10 largest banking organizations control only abut 20 percent of all domestic banking assets, and the 100 largest only a little more than half.

Presumably, concentration ratios would tend to rise with interstate banking, quite significantly so if such activity is unrestricted. At the same time, the California and New York experience referred to earlier suggests the process would stop very far short of the concentration of institutions common in other countries, with thousands of independent organizations remaining.

A variety of safeguards should be included in legislation liberalizing interstate banking to encourage continuing diversification of banking resources. Taken alone, anti-trust laws -- focused on the market shares of competitors

in particular markets -- do not appear fully responsive to that need. Essentially, those laws as applied to banking make little distinction between the overall size of organizations competing in particular markets, but rather focus on the size of their presence in a single market alone. Consequently, those laws might be consistent with considerably greater concentration, measured on a national or regional basis, than would be desirable.

Two kinds of limitations might be taken to forestall any substantial risk of excessive concentration. The approaches are not mutually exclusive and would be complementary. Both would, at the margin, involve essentially arbitrary judgments, for they would envisage a simple quantitative measure of relative size. But, by responding directly and logically to the concerns about concentration, they would provide a more coherent approach than the present "system" of implicitly relying on an almost total prohibition on interstate acquisition as an indirect means of controlling concentration levels.

The first approach would envisage limitations of the largest banking institutions acquiring other banks. For instance, the very largest holding companies in terms of domestic banking assets (or depository institution assets) -- say the top twenty-five -- might be prohibited from merging with each other. In addition, banks could be prohibited from obtaining through acquisition more than some fixed share of the nationwide total of such assets, although de novo or relatively small acquisitions in other states could be permitted.

The second approach would permit, or even encourage, states to set limitations on the proportion of banking assets (or depository institution assets) within their own borders that could be acquired through acquisitions or mergers of institutions of significant size. Specifically, such acquisitions could be denied if the resultant institution would hold more than, for example, 15 or 20 percent of a state's banking assets. Any such rule should be nondiscriminatory between in-state and out-of-state banking organizations.

Of course, rules implementing these approaches would have to be carefully drawn to avoid anomalous results. The important point is that the national and state-wide concentration limits be fully observed.

Exceptions to these limitations should be permitted for failing institutions. Indeed, in light of the remaining strains evident in some sectors of the thrift and banking industries, the emergency arrangements for failing institutions in the Garn-St Germain Act should be extended. They should be

liberalized in two ways: by not requiring that an institution actually be "closed" to qualify for emergency treatment, and by reducing or eliminating the $500 million size cut-off in the Act.

The Dual Banking System

Interstate banking, by its nature, has implications for the dual banking system. Indeed, it is difficult to conceive of a system of interstate branching that would enable state law and supervision to govern the operations of banks in sister states. Consequently, interstate branching could well lead to a massive expansion of the national banking system.

If interstate banking operations are instead generally confined to separately incorporated and chartered components of a holding company, particular states could maintain authority over the in-state operations of the holding company. Moreover, there would be opportunity for a greater degree of local control. For those reasons, a requirement that interstate acquisitions generally take the form of a holding company affiliate appears to fit more naturally our banking traditions, at least over a long transitional period to a fully developed interstate banking environment.

A Possible Policy Approach

Various approaches toward interstate banking have been proposed over the years, ranging from modest changes in existing arrangements to nationwide branching. For instance, possible transitional approaches well short of nationwide banking include:

(1) Branching throughout metropolitan areas that extend across state lines, of which there are 35 at present.

(2) Expansion into contiguous states.

(3) Expansion de novo or by acquisition, into any metropolitan area above a minimum size.

(4) Encouragement of reciprocal arrangements among states.

(5) Interstate banking limited to de novo operations or small acquisitions (conversely, some have proposed limiting or prohibiting small acquisitions in the interest of maintaining local banks).

(6) Regional arrangements.

Each of those approaches (and any others that could be developed) has particular strengths and weaknesses; each could be debated. However, much of the recent thinking in states, and within the banking community, has focused largely on the last of those options -- regional arrangements. Consequently, it would be useful to focus on that approach as a point of departure.

An advantage of regional arrangements seen by many is the opportunity for regional organizations to reach a size necessary for an effective national or international presence, and then to become more effective competitors of the largest banking institutions in all phases of banking.

However, the approach suffers from some clear weaknesses. The regions may be defined in a discriminatory way, aimed at encouraging particular combinations of banks and excluding others, without clear and objective rationale. Specifically, some proposals appear to be driven by a desire to exclude New York and California banks, or simply large money center banks. By their nature, sizable regional arrangements would permit combinations of banks long distances (and several states) apart, without permitting even limited operations in some contiguous states. Metropolitan areas might be left, in a banking sense, bifurcated. Viewed as a permanent arrangement, regional compacts would tend to Balkanize banking, with a tendency toward regional concentrations.

Because of these potential weaknesses, a federal framework is required for regional arrangements. For example, such weaknesses can be substantially ameliorated if states entering into such regional arrangements were also required after relatively few years -- say three -- to permit reciprocal entry by banks in any state that has enacted a regional arrangement or otherwise provides for entry of banks of any other states.[2/]

2/ Regional arrangements are the subject of a constitutional challenge that is now before the Supreme court. A federal framework, such as suggested above, could be put in place if the Supreme Court sustains regional arrangements or even if the court were to find them unconstitutional on grounds of violation of commerce or compact clause requirements. However, if the court were to find that such arrangements violate the equal protection clause, there would be a substantial question whether such arrangements could be permitted even if sanctioned by Federal law. See Exhibit C.

In this approach, any state, if it so chose, could continue entirely to "opt out" of full interstate banking. But, if it chose to enter into a regional arrangement, it would also have to be prepared to consider those arrangements as a transitional approach toward a broader arrangement encompassing all states willing to provide reciprocal privileges.

As suggested above, all interstate acquisitions would be subject to federal limitations designed to protect against undue concentration, and states would be able to limit the proportion of their banking assets acquired by a single banking organization. In the first stages at least, these interstate operations should be undertaken by means of separately incorporated units of a holding company rather than by direct branches.

The number of states that ultimately might wish to enter into regional (or nationwide) arrangements within this broad framework must, for the time being, remain unknown. Consequently, the possibility would exist that little progress would be made toward interstate banking, even for limited operations within metropolitan areas. Yet, the status quo is hardly satisfactory, and the legitimate pressures toward interstate operations that have impelled "nonbank banks" would continue to seek "unnatural" channels. Consequently, with due notice, the Congress should authorize interstate branching within metropolitan areas and for neighboring areas of contiguous states.

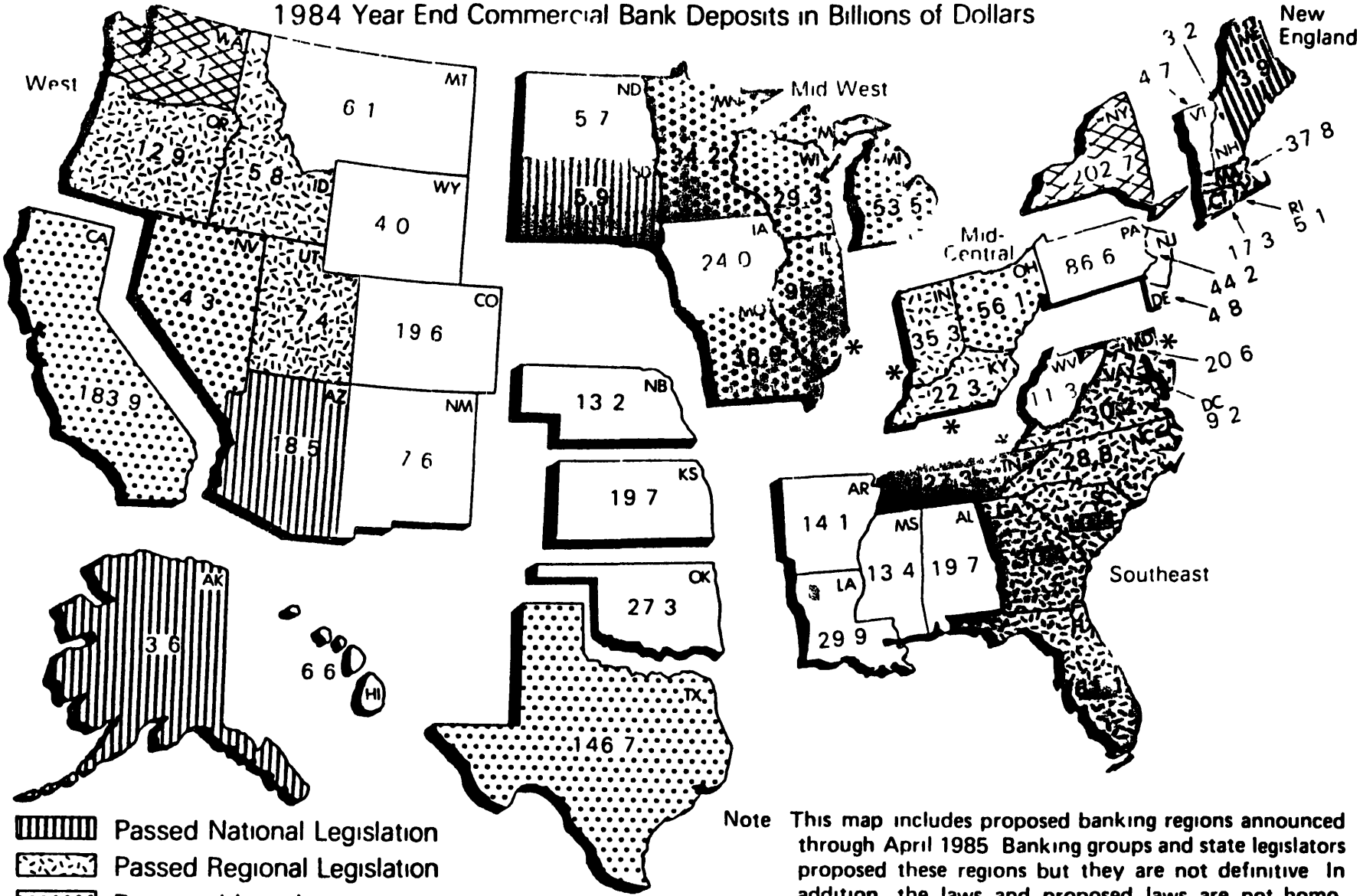
Conclusion

The need for Congressional action is urgent to guide the orderly evolution of the banking system and to reaffirm certain basic principles that have guided the banking and financial systems, adapting them to present circumstances. Markets will continue to respond and change will take place. The only question is whether that change will take place in a constructive framework of rules established by the Congress after a careful weighing and balancing of the vital public interests that are now before you for review. Taking account of both market forces and recent state initiatives, a comprehensive approach now requires a resolution of the issues involved in interstate expansion.

Principal Interstate Banking Regions Being Considered by the States

(As of April 1985)

1984 Year End Commercial Bank Deposits in Billions of Dollars



Passed National Legislation

Passed Regional Legislation

Proposed Legislation

Passed National Reciprocal Legislation

No Legislation Actively Pending

* Important See attached notes

Note This map includes proposed banking regions announced through April 1985 Banking groups and state legislators proposed these regions but they are not definitive In addition, the laws and proposed laws are not homo geneous This map does not indicate states with limited purpose, grandfathered or troubled institution laws

Federal Reserve Bank of Boston

NOTES

NEW ENGLAND REGION

Rhode Island's law provides for a "national trigger" under which the regional requirement expires on July 1, 1986, and thereafter acquisitions will be permitted from any state with a reciprocal statute.

SOUTHEAST REGION

The southeastern states that have enacted regional-reciprocal laws differ to some extent in their definitions of the region. For example, the Georgia statute excludes Maryland, West Virginia and Arkansas, while the North Carolina, South Carolina, Florida and Virgina statutes include these states.

MIDCENTRAL REGION

Kentucky has a law which allows interstate acquisitions with its contiguous states with reciprocal agreements. Kentucky has been included and proposed for inclusion in the Southeast region and portions of the Midcentral region. The Kentucky statute contains a national trigger provision under which acquisitions from any state will be permitted on a reciprocal basis after July 15, 1986.

Maryland, Tennessee, Virginia, West Virginia and Washington, D.C. have been included or proposed for inclusion in both the Southeast and portions of the Midcentral regions.

MIDWESTERN REGION

Indiana and Illinois have been proposed for inclusion in portions of both the Midcentral and Midwest regions.

The South Dakota law permits any out-of-state bank holding company to acquire one existing South Dakota bank, but thereafter limits the bank's ability to open additional branches.

WESTERN REGION

The western states that have enacted regional-reciprocal laws differ to some extent in their definitions of the western region. For example, both the Utah and Idaho statutes exclude California, while the Oregon statute includes this state.

The proposed Nevada statute contains a national trigger provision effective January 1, 1989.

Texas has not been proposed for inclusion in any of the regions, but is considering legislation to establish a 10 state region, including certain states in the Western, Southeast, and Midwest regions.

The Washington legislature passed its proposed national reciprocal law on April 19, 1985.

INTERSTATE BANKING LEGISLATION BY STATE
(as of May 1, 1985)

STATE	STATUS OF LEGISLATION	TYPE	REGION (if any)
Alabama	None		
Alaska	Effective	National	All States
Arizona	Effective October 1, 1986	National	All States
Arkansas	Defeated	Regional-Reciprocal	SOUTHEAST (14 States & DC) AL, FL, GA, LA, MD, MS, MO, NC, OK, SC, TN, TX, VA, WV, DC
California	Proposed	National-Reciprocal	
Colorado	None		
Connecticut	Effective	Regional-Reciprocal	NEW ENGLAND (5 States) ME, MA, NH, RI, VT
Delaware	None		
District of Columbia	Proposed	Regional-Reciprocal	SOUTHEAST (11 States) AL, FL, GA, LA, MD, MS, NC, SC, TN, VA, WV
Florida	Effective July 1, 1985	Regional-Reciprocal	SOUTHEAST (11 States & DC) AL, AR, GA, LA, MD, MS, NC, SC, TN, VA, WV, DC
Georgia	Effective July 1, 1985	Regional-Reciprocal	SOUTHEAST (9 States) AL, FL, KY, LA, MS, NC, SC, TN, VA
Hawaii	None		
Idaho	Effective July 1, 1985	Regional-Reciprocal	WEST (6 States) WA, OR, MT, NV, UT, WY

STATE	STATUS OF LEGISLATION	TYPE	REGION (if any)
Illinois	Proposed	Regional-Reciprocal	MIDWEST/MIDCENTRAL (6 States) IN, IA, KY, MI, MO, WI
Indiana	Awaiting Governor's signature. Effective date January 1, 1986	Regional-Reciprocal	MIDCENTRAL (4 States) IL, KY, MI, OH
Iowa	None		
Kansas	None		
Kentucky	Effective	Regional-Reciprocal (National trigger after 2 years (1987))	MIDCENTRAL (7 States): MO, IL, IN, OH, TN, VA, WV
Louisiana	None		
Maine	Effective	Open Entry	All States
Maryland	Awaiting Governor's signature. Effective date July 1, 1985	Regional-Reciprocal	SOUTHEAST/MIDCENTRAL (contiguous only until 1987; 14 states & DC thereafter) AL, AR, DE, FL, GA, KY, LA, MS, NC, PA, SC, TN, VA, WV, DC
Massachusetts	Effective	Regional-Reciprocal	NEW ENGLAND (5 States) CT, ME, NH, RI, VT
Michigan	Proposed	Regional-Reciprocal (National trigger after 2 years)	MIDWEST (5 States) IL, IN, MN, OH, WI
Minnesota	Proposed	Regional-Reciprocal	MIDWEST (4 States) IA, ND, SD, WI
Mississippi	None		
Missouri	Proposed	Regional-Reciprocal	MIDWEST-SOUTH (8 States) AR, IL, IA, KS, KY, NE, OK, TN

STATE	STATUS OF LEGISLATION	TYPE	REGION (if any)
Montana	None		
Nebraska	None		
Nevada	Proposed	Regional-Reciprocal (National trigger 1/1/89)	WEST (11 States) AK, AZ, CO, HI, ID, MT, NM OR, UT, WA, WY
New Hampshire	Defeated	National-Reciprocal	
New Jersey	None		
New Mexico	Defeated	Regional-Reciprocal	SOUTHWEST (5 States) AZ, CO, OK, TX, UT
New York	Effective	National-Reciprocal	All States
North Carolina	Effective July 1, 1985	Regional-Reciprocal	SOUTHEAST (12 States & DC) AL, AR, FL, GA, KY, LA, MD, MS, SC, TN, VA, WV, DC
North Dakota	None		
Ohio	Proposed	Regional-Reciprocal (National trigger after 4 years)	MIDCENTRAL/MIDWEST (13 States & DC contiguous States only for 2 years) DE, IL, IN, KY, MD, MI, MO, NJ, PA, TN, VA, WV, WI, DC
Oklahoma	None		
Oregon	Effective July 1, 1986	Regional-Reciprocal	WEST (8 States) AK, AZ, CA, HI, ID, NV, UT, WA
Pennsylvania	None		
Rhode Island	Effective	Regional-Reciprocal (National trigger 6/30/86)	NEW ENGLAND (5 States) CT, ME, MA, NH, VT

STATE	STATUS OF LEGISLATION	TYPE	REGION (if any)
South Carolina	Effective July 1, 1986	Regional-Reciprocal	SOUTHEAST (12 States & DC) AL, AR, FL, GA, KY, LA, MD, MS, NC, TN, VA, WV, DC
South Dakota	Effective	National[1/]	All States
Tennessee	Effective July 1, 1985	Regional-Reciprocal	SOUTHEAST (13 States) AL, AR, FL, GA, IN, KY, LA, MS, MO, NC, SC, VA, WV
Texas	Proposed	Regional-Reciprocal	SOUTHWEST (10 States) AZ, AR, CO, KS, LA, MS, MO, NM, OK, WY
Utah	Effective	Regional-Reciprocal	WEST (11 States) AK, WA, OR, ID, WY, MT CO, NM, AZ, NV, HI
Vermont	None		
Virginia	Effective July 1, 1985	Regional-Reciprocal	SOUTHEAST (12 States & DC) AL, AR, FL, GA, KY, LA, MD, MS, NC, SC, TN, WV, DC
Washington	Awaiting Governor's signature. Effective date July 1, 1987	National-Reciprocal	All States
West Virginia	None		
Wisconsin	Proposed	Regional-Reciprocal	MIDWEST (7 States) IL, IN, IA, MI, MN, MO, OH
Wyoming	None		

1/ A South Dakota bank that is acquired by an out-of-state bank holding company may not thereafter open additional branches by merger, consolidation or otherwise, and the out-of-state holding company may not acquire any additional existing banks in South Dakota.

Exhibit A

SMALL BANKS IN THE CALIFORNIA BRANCH BANKING ENVIRONMENT

Proposals to reduce barriers to bank geographic expansion, whether on a statewide basis or an interstate basis, raise questions relative to the future of smaller banking institutions. Specifically, can small banks compete with the statewide firms? Will there be incentives for the formation of new banks in markets characterized by a large percentage of total assets being held by a few statewide firms?

The data suggest that, while the large banks in a statewide banking state control a large percentage of state banking assets, this does not mean that smaller banks cannot compete in the state's major banking markets. The California experience, developed over several decades of statewide branch banking, illustrates the possibilities for small banks. Table 1 presents the size distribution of California banks at year-end 1984. As the table indicates, 332 of 435 banks have assets of less than $100 million, and only six institutions have over $5 billion of assets.

Table 1
Number and Asset Size Distribution of California Banks

Asset Size	Number of Banks	Percentage of Total State Banking Assets Held by Firms in Each Size Class
Less than $10 million	17	0.05
$10 million to $25 million	100	0.78
$25 million to $50 million	121	1.93
$50 million to $100 million	94	3.00
$100 million to $250 million	58	3.90
$250 million to $500 million	21	3.35
$500 million to $1 billion	7	2.44
$1 billion to $5 billion	11	10.59
Over $5 billion	6	73.96
	435	100.00

In spite of the dominant asset position of the largest banks, there appears to have been adequate incentives for the formation of new banks in California. Table 2 presents the rate of bank formation in California over the years 1970 through 1983. In these years, 355 new banks were chartered in California. In 1983, California accounted for 16.9 percent of all new banks in the United States. Thus, the existance of statewide branch banking does not appear to have deterred investors in new banks.

Table 2
Bank Chartering in California, 1970 - 1983

Year	Number of New Banks	New Bank Charters in California as a Percentage of All New U.S. Bank Charters
1970	6	3.4
1971	7	3.6
1972	17	7.3
1973	24	7.2
1974	18	5.0
1975	17	6.9
1976	13	8.1
1977	14	9.1
1978	13	8.8
1979	24	11.8
1980	46	22.4
1981	42	21.1
1982	53	16.8
1983	61	16.9

These data suggest that, at least in California, the existence of large statewide banks has not led to the demise of small banks. In addition, the incentives for new bank formation have been maintained.

SMALL BANKS IN THE NEW YORK BRANCH BANKING ENVIRONMENT

The State of New York has had a shorter history of statewide banking than California, and the comparison may be of interest in evaluating the existence of small banks in a state containing many of the nation's largest banking organizations. New York adopted statewide banking in 1976, and therefore has had less than a decade of experience, as compared to the long history of statewide banking in California.

Table 1 presents the asset size distribution for banks in New York as of the end of 1984. As in California, the largest banks hold the overwhelming percentage of total statewide banking assets. Yet, as in California, there are a significant number of smaller institutions, 85 of the 149 banks, or 57 percent of all banks, have assets of less than $100 million.

Table 1
Number and Asset Size Distribution of New York Banks

Asset Size	Number of Banks	Percentage of Total State Banking Assets Held by Firms in Each Size Class
Less than $10 million	11	0.02
$10 million to $25 million	17	0.09
$25 million to $50 million	28	0.29
$50 million to $100 million	29	0.60
$100 million to $250 million	23	1.09
$250 million to $500 million	9	0.95
$500 million to $1 billion	7	1.28
$1 billion to $5 billion	12	6.20
Over $5 billion	13	89.46
	149	100.00

Table 2 presents the record of new bank charters in New York for the period 1970 - 1983. Although the bank formation rate in New York was substantially lower than in California, the difference can probably be explained by the

differences in growth rates between the two states. Like the California

Table 2
Bank Chartering in New York, 1970 - 1983

Year	Number of New Banks	New Bank Charters in New York as a Percentage of All New U.S. Bank Charters
1970	2	1.1
1971	4	2.1
1972	4	1.7
1973	3	0.9
1974	6	1.7
1975	4	1.6
1976	1	0.6
1977	5	3.3
1978	2	1.4
1979	1	0.5
1980	2	1.0
1981	2	1.0
1982	1	0.3
1983	3	0.8

experience, however, the New York data do suggest that small banks survive the expansion of branch banking and that new banks will be formed regardless of the degree of statewide dominance of the largest organizations.

EXHIBIT C

Litigation Involving Regional
Reciprocal Statutes

The Board has issued seven orders approving interstate acquisitions of banks by bank holding companies pursuant to regional interstate banking statutes. Six of the orders involve New England acquisitions pursuant to statutes enacted by Connecticut, Massachusetts and Rhode Island[1/] and one

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1/

1. Bank of New England Corporation/CBT Corporation, 70 Fed. Res. Bull. 374 (March 26, 1984), approving the merger of the fourth largest Massachusetts bank holding company and the largest bank holding company in Connecticut.

2. Hartford National Corporation/Arltru Bancorp, 70 Fed. Res. Bull. 353 (March 26, 1984), approving the acquisition by the second largest Connecticut bank holding company of the eighth largest bank holding company in Massachusetts.

3. Bank of Boston Corporation/Colonial Bancorp, 70 Fed. Res. Bull. 524 (May 18, 1984), approving the acquisition by the largest bank holding company in New England of the fourth largest bank holding company in Connecticut.

4. Bank of Boston Corporation/RIHT Financial Corporation, 70 Fed. Res. Bull. 737 (Aug. 20, 1984), approving Bank of Boston's acquisition of the second largest bank holding company in Rhode Island.

5. Fleet Financial Group, Inc., 70 Fed. Res. Bull. 834 (October 4, 1984), approving the acquisition by the largest bank holding company in Rhode Island of de novo banks in Boston and Hartford.

6. Hartford National Corporation, 71 Fed. Res. Bull. 43 (November 19, 1984), approving the acquisition by the second largest bank holding company in Connecticut of a de novo bank in Providence.

order involves the southeast region, the merger of Florida and Georgia bank holding companies.[2/]

Each of the applications for Board approval to acquire a bank across state lines pursuant to regional interstate statutes was protested before the Board[3/] on the basis that the regional interstate statutes violate the Commerce, Compact and Equal Protection Clauses of the United States Constitution. The Board addressed each of these issues and made detailed findings in a lengthy Appendix to its first two approval orders involving regional interstate statutes.[4/]

With respect to the Commerce Clause issue, the Board determined that absent the authorization of Congress in the Douglas Amendment of the Bank Holding Company Act, 12 U.S.C. 1842(d), the regional interstate statutes impose a burden of the type found by the courts to violate the Commerce Clause. The Board then considered the authorization by Congress in the Douglas Amendment and found that the Douglas Amendment does not appear on its face to show an intent by Congress to authorize

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2/ SunTrust Banks, Inc./SunBanks, Inc./Trust Company of Georgia, 71 Fed. Res. Bull. 176 (January 8, 1985), approving the merger of second largest Florida bank holding company and the third largest bank holding company in Georgia.

3/ Citicorp, New York, New York, protested each application, and it has sought judicial review of each of the Board's approval orders. Northeast Bancorp, Stamford, Connecticut, challenged the first two Board orders.

4/ See the first two cases listed in note 1.

discriminatory restrictions of the type involved in regional interstate arrangements and that the provision's scant legislative history offered little guidance. Despite its doubts about the authorization of discriminatory state action in the Douglas Amendment, the Board decided it should hold state statutes authorizing interstate banking arrangements unconstitutional only upon clear and unequivocal evidence. Applying this test and based upon judicial guidance contained in Iowa Independent Bankers Association v. Board of Governors, 511 F.2d 1288 (D.C. Cir. 1975), the Board concluded that "while the issue is not free from doubt, there is no clear and unequivocal basis for a determination that [the Massachusetts and Connecticut statutes] are inconsistent with the Commerce Clause. . . ." Bank of New England Corporation, 70 Fed. Res. Bull. 374, 377 (1984); Hartford National Corporation, 70 Fed. Res. Bull. 353, 354 (1984).

The Board also found there was no basis to hold that the regional interstate statutes clearly and unequivocally violate the Compact Clause. The Board applied the standard ennunciated by the Supreme Court in United States Steel Corp. v. Multistate Tax Commission, 434 U.S. 452, 470 (1978), that an agreement among the states does not establish a compact in violation of the Compact Clause unless it enhances state power at the expense of federal supremacy. The Board read the Douglas Amendment as conferring on the states authority to regulate entry of out-of-state bank holding companies without

impinging on the federal interest in such regulation as that concept has been articulated in the Supreme Court's Compact Clause cases.

Finally, the Board concluded the regional interstate statutes do not clearly and unequivocally violate the Equal Protection Clause. Under the traditional case law of the Supreme Court applicable at the time of the Board's decision, which upheld state economic legislation if it was rationally related to a legitimate state purpose, the Board found regional interstate statutes to be rationally related to legitimate state purposes in establishing a banking system responsive to local and regional needs, including responsiveness to local credit needs, avoiding undue concentration of banking resources and providing an opportunity for an experiment with limited interstate banking.

Each of the Board's approval orders has been challenged in the United States Court of Appeals for the Second Circuit.[1] The Court of Appeals has stayed consummation of the interstate acquisitions and mergers on two occasions -- to allow the Court of Appeals to hear the case and, even after the Court of Appeals rendered its decision upholding the Connecticut and Massachusetts statutes as constitutional, to permit Supreme Court review. As a consequence of these stays by the Court of Appeals none of the interstate transactions approved in the Board's seven orders, including the de novo acquisitions, has been consummated.

The decision of the Court of Appeals,[5/] filed August 1, 1984, upheld the constitutionality of the Connecticut and Massachusetts regional interstate statutes and affirmed the Board's approval orders. The Court found that the Douglas Amendment constituted a renunciation of federal interest in regulating the interstate acquisition of banks by bank holding companies. In deciding that the states have the authority to lift selectively the ban on interstate acquisitions of banks imposed by Congress in the Douglas Amendment and thereby to create interstate banking regions, the Court noted that nothing in the language or legislative history of the Douglas Amendment supports the contention that an individual state must permit acquisitions by all out-of-state bank holding companies if the state permits acquisitions by any.

The Supreme Court was requested to review the decision of the Court of Appeals, and in January 1985 the Supreme Court agreed to hear the case.[6/] The State of New York, New York State Bankers Association and both United States Senators and certain members of the House of Representatives from New York filed briefs with the Court opposing regional interstate statutes as unconstitutional. The State of Massachusetts

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5/ Northeast Bancorp, Inc. v. Board of Governors of the Federal Reserve System, 740 F. 2d. 203 (2d Cir. 1984).

6/ Northeast Bancorp, Inc. v. Board of Governors of the Federal Reserve System, No. 84-363 (argued April 15, 1985).

joined with the bank holding companies of Massachusetts and Connecticut that were parties to the challenged acquisitions in filing briefs in support of the regional statutes. The case was argued before the Supreme Court on April 15, 1985.

The issues originally placed before the Court involved the Commerce Clause and Compact Clause of the Constitution, and centered, as they had before the Board and the Court of Appeals, on an interpretation of the Douglas Amendment and whether that Amendment provided an "unmistakably clear"[7/] authorization by Congress to permit the states to discriminate and burden commerce through regional interstate statutes.

The Supreme Court decision, with four justices dissenting, on March 26, 1985, in the case of Metropolitan Life Ins. Co. v. Ward, No. 83-1274, prompted the petitioning parties to raise an argument under the Equal Protection Clause not originally raised before the Supreme Court although, as noted above, it was raised before the Board. The Metropolitan decision held that state legislation that taxes out-of-state insurance companies at a higher rate than in-state companies in order to promote in-state business at the expense of out-of-state competitors was unconstitutionally

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7/ South-Central Timber Development v. Wunnicke 104 S.Ct. 2237, 2242 (1984) -- requiring that federal legislation authorizing a departure from normally applicable Commerce Clause standards must be "unmistakably clear" -- was decided after the Board issued its first interstate order but employing the standard used by the Board.

discriminatory. The Court held that this statute did not advance interests rationally related to legitimate state purposes under the Equal Protection Clause. This case thus raises a question as to whether regional interstate statutes which apply different rules to different groups of out-of-state banks, depending on geographic location, violate the Equal Protection Clause.

A decision by the Supreme Court that the regional statutes are unconstitutional on Commerce Clause or Compact Clause grounds could be remedied by an amendment to the Bank Holding Company Act showing the intent of Congress to permit regional interstate compacts, since the Congress has the authority to sanction by federal statute state laws burdening commerce or creating a compact. Congress does not appear to have the authority to sanction violations of the Equal Protection Clause should the Court decide that regional statutes are unconstitutional on that basis.

The past practice of the Court indicates that a decision is likely to be issued in June or July, 1985.

ATTACHMENT IV

STATEMENT ON DEFINITION OF BANK

Public policy has long recognized that commercial banks perform a unique and critical role in the economy and the financial system. They are operators of the payments system; they are custodians of the bulk of liquid savings; they are the principal suppliers of short-term credit; and they are the critical link between monetary policy and the economy. Moreover, the fortunes of individual institutions are so intertwined that instability of one may infect another. In recognition of these circumstances, a federal safety net -- specifically the Federal Reserve discount window and federal deposit insurance -- has long been provided to help protect the system. Individual banks are subject to a system of regulation and supervision to help assure their safety and soundness.

Integral to that approach, the Bank Holding Company Act allows ownership of a bank by another company only if that company engages in activities that "are closely related to banking and a proper incident thereto." That provision is designed to enforce a basic separation of banking and commerce, and thus limit conflicts of interest and avoid undue concentration of resources. The law also provides for some supervision and inspection of the holding company as a whole, recognizing that, in practice, the fortunes of one enterprise within a holding company cannot be wholly separated from those of its affiliates. The provisions of the Bank Holding Company Act also provide restrictions on interstate banking by a holding company, paralleling the restrictions on interstate branching in the McFadden Act.

The basic concerns about the separation of commerce and banking remain valid, and should be a point of departure today in considering the "nonbank bank" issue. The definition of a bank is critical to a policy that sets out to separate banking and commerce and to enforce restrictions on interstate banking. The Bank Holding Company Act defines a bank as an institution that <u>both</u> accepts demand deposits and makes commercial loans. That definition was designed to exclude savings and industrial banks (which at the time had little or no demand deposits or other transactions accounts or commercial lending authority) and limited-purpose trust companies.

While thrift institutions today increasingly do commercial lending and can accept transaction accounts of individuals, FSLIC-insured institutions remain exempt under the terms of the Garn-St Germain Act passed in 1982. Moreover, as

other forms of transactions accounts have developed with the basic characteristic of demand deposits, institutions with a bank charter can also take all kinds of deposits from the public (including under court rulings NOW accounts) other than demand deposits and make commercial loans without coming under the restrictions of the Bank Holding Company Act. These are the so-called "nonbank banks," for which there have been hundreds of applications.

Specifically, one form of "nonbank bank" may be owned by any company -- a steel company, a retailer, a securities firm, an insurance company, or a real estate developer. The parent company is not subject to any of the limitations of the Bank Holding Company Act designed to limit risk or conflicts of interest and to avoid unfair competition or excessive concentration of economic power. Thus, in its present guise, the "nonbank bank" undermines the basic separation of banking and commerce -- a concept with deep roots in both English and American traditions.

That seems to be the fundamental issue at stake in closing the "nonbank bank" loophole. By permitting commercial companies to provide through subsidiaries almost all the same functions as full service banks, and to obtain access to the payments system, the discount window, and deposit insurance, both the principle and the practical reality of the present restrictions of the Bank Holding Company Act will be seriously undermined over time. The competitive position of those banks still subject to the Act will inevitably be damaged, potentially weakening the system as a whole.

The "nonbank bank" is also, and today more commonly, a device by which a bank holding company, or a commercial firm, can escape from the restrictions on interstate banking encompassed in the Douglas Amendment to the Bank Holding Company Act. In fact, interstate banking is a reality in many areas through Edge Act subsidiaries, loan production offices, finance company and mortgage banking affiliates, credit card operations, ATM networks, and otherwise. The nonbank bank offers the added avenue of on-site offices for a full range of consumer business or commercial lending combined with deposit taking. Although some liberalization of current restrictions is justified, that question should be approached on its own merits rather than by permitting interstate banking through an unintended "back door" device, with the inefficiencies and inequities that involves.

There is a broad consensus that it is important to preserve the basic policies of the Bank Holding Company Act and that, accordingly, it is essential to close the "nonbank bank"

loophole as part of any legislative approach toward banking. Basically satisfactory legislative provisions to achieve that were contained in separate bills last year. One was reported by the House banking committee and another adopted by the full Senate. While detailed differences in approach were not fully resolved, it appeared that it was other provisions of proposed banking legislation, rather than basic disagreements on the "nonbank bank" question that stymied enactment.

H.R. 20 basically follows the approach of this consensus. It broadly applies the provisions of the Bank Holding Company Act to all FDIC-insured commercial banks whatever their particular mix of business. In addition, those uninsured institutions that offer transaction accounts and make commercial loans would continue to be covered. This approach is broadly satisfactory so far as it goes, as would be the similar provisions of H.R. 15.

These bills would bring so-called consumer banks clearly within the scope of the provisions of the Bank Holding Company Act. The suggestion has been made by others that banks primarily aimed at serving the consumer might be exempted from the general principle of the separation of banking and commerce and from any restrictions applicable to ordinary banks on interstate banking.

However beguilingly presented as a "family bank" proposal, such an initiative is misguided. The great bulk of the number of existing banks and other depository institutions are already "family" or "small business" oriented. There are almost 20,000 banks and thrifts in this country, nearly all actively competing for consumer business. Many of them do little commercial lending; for instance, almost 20 percent of commercial banks have 5 percent or less of their assets in loans to businesses, and nearly half have less than 20 percent of assets in such loans.

There is no justification for permitting commercial, industrial or securities firms to compete with these institutions for insured deposits and other banking services under different ground rules as to ownership. The effect could only be to undermine the public policy objectives incorporated in the Bank Holding Company Act generally, and there would be the appearance and reality of unfair competition with banks subject to the Act.

Do we really want, for example, a retail business to be able to gather deposits under the protection of federal insurance and to use those deposits to fund a credit card they sponsor more cheaply than retailing competitors? Do we want to

bless interstate consumer banking simply because there is a nonbank owner? Do we want to encourage joint marketing efforts and "tie-ins," implicit or explicit?

If we are not sensitive to these concerns, then what is the justification for the present restrictions in the Bank Holding Company Act?

Some of the "family bank" concepts propose a kind of sugar coating in the form of higher capitalization, "life-line" banking requirements, and rules requiring prompt deposit availability. If these are indeed valid objectives of legislation -- and no justment is made on that point now -- the legislation should apply to all depository institutions and not to just a special few.

In other respects, the coverage of H.R. 20 must be broadened. As drafted, H.R. 20 has no provision with respect to the treatment of thrift institutions -- savings banks and savings and loans.

For some federally insured thrifts -- namely, those owned by multiple savings and loan holding companies -- no legislative action appears required since their holding companies would remain subject to the Savings and Loan Holding Company Act, which has restrictions similar to those of the Bank Holding Company Act. However, others -- including FDIC-insured savings banks and privately insured thrifts -- would be subject to neither Act, and unitary S&L's may engage in substantial nonresidential lending activities without any limitations on the commercial or industrial activities of their corporate owners. Left unattended, the effect would plainly be to deflect the energies now reflected in "nonbank banking" into banking in the guise of thrift institutions -- "nonthrift thrifts."

In recent years, powers available to thrifts have become much more like those available to banks, and indeed the range of thrift powers today, particularly those of state-chartered institution, often exceeds that of banks. Paralleling that development, there has also been increasingly clear recognition of the need to adopt rules to assure reasonably comparable regulatory treatment.

Considerations of competitive equity alone dictate that the privileges of, and restrictions on, banks and thrifts be brought into a more coherent relationship. But it is not just a matter of competitive equity. Restrictions on powers of bank holding companies and on "nonbank banks" will inevitably be undercut, and rapidly, to the extent thrift institutions

with banking powers can simply substitute as a vehicle for undertaking a wide range of banking services, violating the basic separation of banking and commerce.

Difficult questions are posed by firms that already have operations on both sides of the line between commerce and "thrift banking." A number of industrial or commercial firms own thrifts, and operate those thrifts as separate and distinct entities without significant problems arising. Those combinations might logically be permitted to continue on their present basis. However, in the environment we now face, these questions need to be approached with an eye toward the future, and a firm policy established with respect to which new combinations are acceptable and which are not.

To deal with this problem, only those thrifts that have a high percentage of their assets in home mortgages should be exempt from the same rules as to ownership applicable to banks and multiple S&L holding companies. Accordingly, present law should be strengthened to require that such a "qualified" thrift institution have at least 65 percent of its assets in residential mortgages or housing-related investments.

There is no sound rationale for including residential mortgage originations and sales in such a calculation. Commercial banks, mortgage banks, and others are all active mortgage originators. The distinguishing characteristic of an S&L and many savings banks historically -- and the characteristic that historically has justified special federal support -- was that they devoted relatively large portions of <u>their own</u> resources to support housing.

A substantial commitment to investment in housing should continue to be the test for exemption from certain policies embodied in the Bank Holding Company Act and the Savings and Loan Holding Company Act for multiple S&L holding companies. Furthermore, any holdings of liquidity included in a thrift test should be confined to amounts legally required.

A further step is necessary to limit conflicts of interest and tie-ins when a qualified thrift has a commercial owner. Specifically, joint marketing of services and products should be prohibited.

"Nonthrift thrifts" need not be brought under the Bank Holding Company Act administered by the Federal Reserve. Rather, institutions that have essentially the same characteristics as commercial banks should have broadly parallel restrictions on combinations with commercial firms, and those restrictions should be administered by the

appropriate regulator -- for savings and loans and federal savings banks, the Federal Home Loan Bank Board. Moreover, about three-quarters of all savings and loans would meet this proposed thrift test and thus would not be restricted as to commercial ownership.

H.R. 20 does not prohibit an affiliation of thrift institutions and nonmember banks with securities firms. That existing loophole in the Glass-Steagall Act should be closed in the interest of competitive equity and the purposes of the Glass-Steagall Act. Such a provision has been recommended by the Federal Home Loan Bank Board with respect to thrifts. In all these areas, appropriate transition periods should be provided and other detailed questions need to be resolved.

Finally, the Chairmen of the Senate and House Banking Committees have strongly supported July 1, 1983, as the appropriate date for grandfathering nonbank banks. Even before that date, institutions were well aware that the nonbank bank loophole was a matter of policy and Congressional concern. H.R. 20 would grandfather about 24 FDIC-insured nonbank banks; most of these are small in asset size, with at least 10 essentially engaged in trust activities and six or seven in credit card operations. Given this situation, grandfathering as of the July 1, 1983, subject to appropriate conditions to assure that their grandfather status is not abused by expansion geographically or otherwise, would not be inconsistent with the objectives of the Act.

Should the grandfather date be moved toward the current date, an increasing number of insurance, securities, and retail firms that were fully on notice about the likelihood of federal legislation would be permitted to retain bank operations. Few of these institutions have yet made substantial investments, and the larger number of charter rights that would be involved would increasingly impair the objectives sought by H.R. 20.

A Federal District Court in Florida has enjoined the Comptroller from issuing final nonbank bank charters because it found, as a matter of law, that the National Banking Act does not permit the Comptroller to issue a charter which does not provide for the exercise of full National banking powers. As a result of that decision, final National bank charters for new nonbank banks are not currently possible, and the Federal Reserve Board has suspended processing such applications by bank holding companies. However, state-chartered nonmember "nonbank banks" can still be created. While final disposition of the legal issues involved for the National banks may take some time, any reversal of the District Court opinion will

quickly touch off a flood of new National nonbank banks. Consequently, the need for clear and effective action to deal with the nonbank bank questions continues to rest with the Congress.