THE BANKING REFORM ACT OF 1971

HEARINGS

BEFORE THE

COMMITTEE ON BANKING AND CURRENCY
HOUSE OF REPRESENTATIVES

NINETY-SECOND CONGRESS

FIRST SESSION

ON

H.R. 5700

A BILL TO PROHIBIT CERTAIN CONFLICTS OF INTEREST AND ENCOURAGE COMPETITION IN THE BANKING INDUSTRY AND RELATED FIELDS, TO PROVIDE FOR RESTRICTIONS AND DISCLOSURES WITH RESPECT TO CERTAIN LOANS, TO PROHIBIT BROKERED DEPOSITS IN BANKS AND OTHER FINANCIAL INSTITUTIONS, TO PROHIBIT THE USE OF GIVEAWAYS IN THE SOLICITATION OF DEPOSITS, TO PERMIT FULL DEPOSIT INSURANCE FOR GOVERNMENT DEPOSITORS, AND FOR OTHER PURPOSES

H.R. 3287

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H.R. 7440

A BILL TO CLARIFY THE AUTHORITY OF THE FEDERAL HOME LOAN BANK BOARD TO REGULATE CONFLICTS OF INTEREST IN THE OPERATION OF INSURED SAVINGS AND LOAN ASSOCIATIONS, AND FOR OTHER PURPOSES

PART 1

APRIL 20, 21, 22, 23, 26, 27, 1971

Printed for the use of the
Committee on Banking and Currency

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THE BANKING REFORM ACT OF 1971

TUESDAY, APRIL 20, 1971

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
Washington, D.C.

The committee met, pursuant to notice, at 10 a.m., in room 2128, Rayburn House Office Building, Hon. Wright Patman (chairman) presiding.

Present: Representatives Patman, Barrett, Sullivan, Reuss, Ashley, Moorhead, Stephens, St Germain, Gonzalez, Hanna, Gettys, Annunzio, Rees, Griffin, Hanley, Brasco, Chappell, Koch, Mitchell, Widnall, Johnson, Stanton, Blackburn, Williams, Wylie, Heckler, Rousselot, McKinney, Archer, and Frenzel.

The CHAIRMAN. The committee will please come to order.

I would like to announce that the Subcommittee on Small Business, under the chairmanship of Congressman Stevens, ordered, reported, favorably H.R. 4604, to increase lending ceilings for Small Business Administration, referred back to the full committee. The full committee will take up this legislation at 10 a.m. on Thursday, April 22, just prior to hearing the witnesses on H.R. 5700. It is not anticipated we will have any need for discussion or controversy, and we would like to dispose of it as quickly as we can, since there appears to be no objection.

Today the committee begins hearings on H.R. 5700, the Banking Reform Act of 1971, and H.R. 3287, a bill introduced by Congressman Gonzalez to prohibit the use of bank loans to purchase bank stock.

(The text of H.R. 5700 and H.R. 3287 follows:)

[H.R. 5700, 92d Cong., first sess.]

A BILL To prohibit certain conflicts of interest and encourage competition in the banking industry and related fields, to provide for restrictions and disclosures with respect to certain loans, to prohibit brokered deposits in banks and other financial institutions, to prohibit the use of giveaways in the solicitation of deposits, to permit full deposit insurance for government depositors, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, **That this Act may be cited as the "Banking Reform Act of 1971".**

INTERLOCKING RELATIONSHIPS AND RELATED MATTERS

SEC. 2. The Federal Deposit Insurance Act is amended by adding at the end thereof the following new sections:

"SEC. 23. (a) Except as provided in subsection (b) of this section, a person who is a director, trustee, officer, or employee of an insured bank may not at the same time be a director, trustee, officer, or employee of—

"(1) any other insured bank;

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"(2) any insured institution as defined in section 401 of the National Housing Act;

"(3) any Federal credit union;

"(4) any insurance company;

"(5) any company which is a bank holding company as defined in the Bank Holding Company Act of 1956, a savings and loan holding company as defined in section 408 of the National Housing Act, or a subsidiary of a bank holding company or a savings and loan holding company;

"(6) any broker or dealer registered under the Securities Exchange Act of 1934, or be a proprietor or general partner of any such broker or dealer; or

"(7) in the case of a company with which such insured bank has a substantial and continuing business relationship, any (A) title company, (B) company engaged in the business of appraising property, or (C) company which provides service in connection with the closing of real estate transactions.

"(b) An individual may hold any number of positions as director, trustee, officer, or employee of any number of companies if one of the companies is a bank holding company as defined in the Bank Holding Company Act of 1956 and all the rest of them are subsidiaries of that holding company.

"SEC. 24. No—

"(1) insured bank;

"(2) officer or director of an insured bank; or

"(3) member of the immediate family of an officer or director of an insured bank

shall directly or indirectly control any (A) title company, (B) company engaged in the business of appraising property, or (C) company which provides service in connection with the closing of real estate transactions.

"SEC. 25. A person who is a trustee, director, officer, or employee of an insured bank may not at the same time perform legal services, in connection with a loan or other business transaction with such insured bank, for or on behalf of any person."

SEC. 3. Title IV of the National Housing Act is amended by adding at the end thereof the following new sections:

"SEC. 411. (a) Except as provided in subsection (b) of this section, a person who is a director, trustee, officer, or employee of an insured institution may not at the same time be a director, trustee, officer, or employee of

"(1) any other insured institution;

"(2) any insured bank as defined in section 3 of the Federal Deposit Insurance Act;

"(3) any Federal credit union;

"(4) any insurance company;

"(5) any company which is a bank holding company as defined in the Bank Holding Company Act of 1956, a savings and loan holding company as defined in section 408 of the National Housing Act, or a subsidiary of a bank holding company or a savings and loan holding company;

"(6) any broker or dealer registered under the Securities Exchange Act of 1934, or be a principal or a general partner of any such broker or dealer; or

"(7) in the case of a company with which such insured institution has a substantial and continuing business relationship, any (A) title company, (B) company engaged in the business of appraising property, or (C) company which provides service in connection with the closing of real estate transactions.

"(b) An individual may hold any number of positions as director, trustee, officer, or employee of any number of companies within any given group of companies if one of the companies is a savings and loan holding company as defined in section 408 of the National Housing Act and all the rest of them are subsidiaries of that holding company.

"SEC. 412. No—

"(1) insured institution;

"(2) officer or director of an insured institution; or

"(3) member of the immediate family of an officer or director of an insured institution

shall directly or indirectly control any (A) title company, (B) company engaged in the business of appraising property, or (C) company which provides service in connection with the closing of real estate transactions.

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"SEC. 413. A person who is a trustee, director, officer, or employee of an insured institution may not at the same time perform legal services, in connection with a loan or other business transaction with such insured institution, for or on behalf of any person."

SEC. 4. (a) Except as provided in subsection (b) of this section, a person who is a trustee, director, officer, or employee of a mutual savings bank other than an insured bank may not at the same time be a director, trustee, officer, or employee of

(1) any other mutual savings bank which is not an insured bank;

(2) any insured bank as defined in section 3 of the Federal Deposit Insurance Act;

(3) any insured institution as defined in section 401 of the National Housing Act;

(4) any Federal credit union;

(5) any insurance company;

(6) any company which is a bank holding company as defined in the Bank Holding Company Act of 1956, a savings and loan holding company as defined in section 408 of the National Housing Act, or a subsidiary of a bank holding company or a savings and loan holding company;

(7) any broker or dealer registered under the Securities Exchange Act of 1934, or be a principal or a general partner of any such broker or dealer; or

(8) in the case of a company with which such mutual savings bank has a substantial and continuing business relationship, any (A) title company, (B) company engaged in the business of appraising property, or (C) company which provides service in connection with the closing of real estate transactions.

(b) An individual may hold any number of positions as director, trustee, officer, or employee of any number of companies within any given group of companies if one of the companies is either a bank holding company as defined in the Bank Holding Company Act of 1956 or a savings and loan holding company as defined in section 408 of the National Housing Act and all the rest of them are subsidiaries of that holding company.

SEC. 5. No—

(1) mutual savings bank other than an insured bank;

(2) officer or director of a mutual savings bank other than an insured bank; or

(3) member of the immediate family of an officer or director of a mutual savings bank other than an insured bank

shall directly or indirectly control any (A) title company, (B) company engaged in the business of appraising property, or (C) company which provides service in connection with the closing of real estate transactions.

SEC. 6. A person who is a trustee, director, officer, or employee of a mutual savings bank may not at the same time perform legal services, in connection with a loan or other business transaction with such mutual savings bank, for or on behalf of any person.

SEC. 7. A person who is a director, trustee, officer, or employee of a financial institution may not at the same time serve on the board of directors of any corporation with respect to which such financial institution manages an employee welfare or pension benefit plan. For the purposes of the preceding sentence, the term "financial institution" refers to

(1) any mutual savings bank which is not an insured bank;

(2) any insured bank as defined in section 3 of the Federal Deposit Insurance Act;

(3) any insured institution as defined in section 401 of the National Housing Act;

(4) any company which is a bank holding company as defined in the Bank Holding Company Act of 1956, a savings and loan holding company as defined in section 408 of the National Housing Act, or a subsidiary of a bank holding company or a savings and loan holding company;

(5) any Federal credit union;

(6) any insurance company; or

(7) any broker or dealer registered under the Securities Exchange Act of 1934.

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SEC. 8. (a) Except as provided in subsection (b), a director, trustee, officer, or employee of a financial institution may not at the same time serve as an officer or director of any other corporation with respect to which such financial institution holds in the aggregate, with power to vote, more than 5 per centum of any class of stock of such corporation. For the purposes of the preceding sentence, the term "financial institution" refers to

(1) any mutual savings bank which is not an insured bank;

(2) any insured bank as defined in section 3 of the Federal Deposit Insurance Act;

(3) any insured institution as defined in section 401 of the National Housing Act;

(4) any company which is a bank holding company as defined in the Bank Holding Company Act of 1956, a savings and loan holding company as defined in section 408 of the National Housing Act, or a subsidiary of a bank holding company or a savings and loan holding company;

(5) any Federal credit union;

(6) any insurance company; or

(7) any broker or dealer registered under the Securities Exchange Act of 1934.

(b) An individual may hold any number of positions as director, trustee, officer, or employee of any number of companies within any given group of companies if one of the companies is either a bank holding company as defined in the Bank Holding Company Act of 1956 or a savings and loan holding company as defined in section 408 of the National Housing Act and all the rest of them are subsidiaries of that holding company.

SEC. 9. (a) Except as provided in subsection (b), a person who is a director, trustee, officer, or employee of any insured bank as defined by section 3 of the Federal Deposit Insurance Act, any insured institution as defined in section 401 of the National Housing Act, or any mutual savings bank not an insured bank may not at the same time serve on the board of directors of any corporation with which such insured bank, insured institution, or mutual savings bank has a substantial and continuing relationship with respect to the making of loans, discounts, or extensions of credit. For the purposes of the preceding sentence, that which constitutes a "substantial and continuing relationship" shall be determined (1) by the Federal Reserve Board in the case of an insured bank and a mutual savings bank not an insured bank and (2) by the Federal Home Loan Bank Board in the case of an insured institution.

(b) An individual may hold any number of positions as director, trustee, officer, or employee of any number of companies within any given group of companies if one of the companies is either a bank holding company as defined in the Bank Holding Company Act of 1956, a savings and loan holding company as defined in section 408 of the National Housing Act and all the rest of them are subsidiaries of that holding company.

SEC. 10. No mutual savings bank shall own stock in—

(1) any insured bank as defined in section 3 of the Federal Deposit Insurance Act;

(2) any insured institution as defined in section 401 of the National Housing Act;

(3) any insurance company;

(4) any company which is a bank holding company as defined in the Bank Holding Company Act of 1956, a savings and loan holding company as defined in section 408 of the National Housing Act, or a subsidiary of a bank holding company or a savings and loan holding company;

(5) any broker or dealer registered under the Securities Exchange Act of 1934.

SEC. 11. (a) Chapter 11 of title 18 of the United States Code is amended by adding at the end thereof the following new section:

"§ 225. Influencing certain banking and related matters

"(a) Whoever, without the consent of his (1) corporation in the case of an officer or director, (2) principal in the case of an agent, or (3) employer in the case of an employee, solicits, accepts, or agrees to accept any substantial benefit from a financial institution under an agreement or understanding that such benefit will influence his conduct with respect to the affairs between such financial institution and such corporation, principal, or employer, as the case may be, shall be fined not more than $10,000 or imprisoned not more than one year, or both.

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"(b) A financial institution which, without the consent of (1) a corporation in the case of an officer or director, (2) a principal in the case of an agent, or (3) an employer in the case of an employee, confers, or offers or agrees to confer, any substantial benefit upon such officer, director, agent, or employee, with the intent to influence his conduct with respect to the affairs between such financial institution and such corporation, principal, or employer, as the case may be, shall be fined not more than $25,000.

"(c) For the purposes of this section, the term 'financial institution' refers to

"(1) any mutual savings bank which is not an insured bank;

"(2) any insured bank as defined in section 3 of the Federal Deposit Insurance Act;

"(3) any insured institution as defined in section 401 of the National Housing Act;

"(4) any company which is a bank holding company as defined in the Bank Holding Company Act of 1956, a saving and loan holding company as defined in section 408 of the National Housing Act, or a subsidiary of a bank holding company or a savings and loan holding company;

"(5) any Federal credit union;

"(6) any insurance company; or

"(7) any broker or dealer registered under the Securities Exchange Act of 1934."

(b) The chapter analysis of such chapter is amended by inserting immediately below the item relating to section 224 the following new item:

"225. Influencing certain banking and related matters."

SEC. 12. Section 7 of the Federal Deposit Insurance Act is amended by adding at the end thereof the following new subsection:

"(k) With respect to the aggregate of all securities (other than Government securities) it holds a fiduciary capacity, each insured bank shall submit annually to the Corporation—

"(1) a list indicating the name, class, value, and number held of each security;

"(2) a report indicating the extent to which it has authority to exercise voting rights with respect to each security; and

"(3) a report indicating the manner in which it has exercised proxies, if at all, with respect to voting rights in connection with each security.

For the purpose of the preceding sentence, the term 'fiduciary capacity' refers to the position of trustee, executor, administrator, guardian, or any other position occupied by a bank in which it manages money or property for the benefit of others. The Corporation shall make available for public inspection the contents of all lists and reports filed under this subsection."

SEC. 13. The Federal Deposit Insurance Act, as amended by section 2 of this Act, is further amended by adding at the end thereof the following new section:

"SEC. 26. With respect to the aggregate of all securities it holds in a fiduciary capacity, no insured bank shall hold

"(1) in connection with any one corporation, more than 10 per centum of any class of stock for which a registration statement has been filed under the Securities Act of 1933; or

"(2) bank stock which it has itself issued or stock which has been issued by its parent company.

For the purposes of the preceding sentence, the term 'fiduciary capacity' refers to the position of trustee, executor, administrator, guardian, or any other position occupied by a bank in which it manages money or property for the benefit of others."

RESTRICTIONS AND DISCLOSURES WITH RESPECT TO LOANS

SEC. 14. (a) For the purposes of this section—

(1) The term "lender" means any—

(A) insured bank as defined in section 3 of the Federal Deposit Insurance Act;

(B) insured institution as defined in section 401 of the National Housing Act;

(C) company which is a bank holding company as defined in the Bank Holding Company Act of 1956, a savings and loan holding company as defined in section 408 of the National Housing Act, or a subsidiary of a bank holding company or a savings and loan holding company;

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(D) mutual savings bank which is not an insured bank; or

(E) any insurance company.

(2) The term "equity participation" refers to—

(A) an ownership interest in any property or enterprise; or

(B) any right to any payment or credit which is proportionate to or contingent upon the net or gross income from any property or enterprise, including but not limited to

(i) a share in the profits, income, or earnings from a business enterprise of the borrower;

(ii) warrants entitling the lender to purchase stock of the borrower at certain prices; or

(iii) shadow warrants entitling the lender to compensation based upon changes in the market price of the borrower's stock over a specified period.

(b) No lender may accept any equity participation in consideration of the making of any loan.

(c) Any lender which acquires an equity participation from a borrower in violation of this chapter shall, upon demand, assign all its right, title, and interest therein to the borrower and in addition be liable to the borrower in an amount equal to twice the fair market value of the equity participation at the time of its creation or at the time of demand, whichever is higher, and shall in addition be liable to the borrower for his reasonable attorney's fees and costs of suit as determined by the court in any action to enforce the liability created by this section. Any such action may be brought in any district court of the United States regardless of the amount in controversy, or in any other court of competent jurisdiction, within six years after the date on which the liability arises.

(d) Whoever willfully violates the provisions of subsection (b) of this section, or willfully and knowingly participates in any such violation, shall be fined not more than $100,000 or imprisoned not more than one year, or both.

SEC. 15. The Federal Deposit Insurance Act, as amended by section 2 and section 13 of this Act, is further amended by adding at the end thereof the following new sections:

"SEC. 27. (a) Each insured bank shall report to the Corporation on the nature and amount of all loans, discounts, or other extensions of credit which it makes to any of its directors, trustees, officers, or employees or to any member of the immediate family of any such director, trustee, officer, or employee.

"(b) The Corporation shall make available to the public the information contained in the reports submitted under subsection (a) of this section.

"(c) No insured bank shall make any loan, discount, or other extension of credit to any agent, trustee, nominee, or other person acting in a fiduciary capacity without the prior condition that the identity of the person receiving the beneficial interest of such loan, discount, or extension of credit shall at all times be revealed to the bank.

"SEC. 28. No insured bank shall make any loan, discount, or other extension of credit to any corporation with respect to which 5 per centum of the total outstanding shares of any class of stock is owned in the aggregate by the directors, trustees, officers, or employees, or the members of their immediate families, of such insured bank."

SEC. 16. Title IV of the National Housing Act, as amended by section 3 of this Act, is further amended by inserting at the end thereof the following new sections:

"SEC. 414. (a) Each insured institution shall report to the Federal Home Loan Bank Board on the nature and amount of all loans, discounts, or other extensions of credit which it makes to any of its directors, trustees, officers, or employees or to any member of the immediate family of any such director, trustee, officer, or employee.

"(b) The Federal Home Loan Bank Board shall make available to the public the information contained in the reports submitted under subsection (a) of this section.

"(c) No insured institution shall make any loan, discount, or other extension of credit to any agent, trustee, nominee, or other person acting in a fiduciary capacity without the prior condition that the identity of the person receiving the beneficial interest of such loan, discount, or extension of credit shall at all times be revealed to the institution.

"SEC. 415. No insured institution shall make any loan, discount, or other extension of credit to any corporation with respect to which 5 per centum of

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the total outstanding shares of any class of stock is owned in the aggregate by the directors, trustees, officers, or employees, or the members of their immediate families, of such insured institution."

SEC. 17. (a) Each mutual savings bank other than an insured bank shall report to the Federal Deposit Insurance Corporation the nature and amount of all loans, discounts, or other extensions of credit which it makes to any of its directors, trustees, officers, or employees or to any member of the immediate family of any such director, trustee, officer, or employee.

(b) The Federal Deposit Insurance Corporation shall make available to the public the information contained in the reports submitted under subsection (a) of this section.

(c) No mutual savings bank shall make any loan, discount, or other extension of credit to any agent, trustee, nominee, or other person acting in a fiduciary capacity without the prior condition that the identity of the person receiving the beneficial interest of such loan, discount, or extension of credit shall at all times be revealed to the institution.

SEC. 18. No mutual savings bank shall make any loan, discount, or other extension of credit to any corporation with respect to which 5 per centum of the total outstanding shares of any class of stock is owned in the aggregate by the directors, trustees, officers, or employees, or the members of their immediate families, of such insured institution.

BROKERED DEPOSITS PROHIBITED

SEC. 19. Subsection (g) of section 18 of the Federal Deposit Insurance Act (12 U.S.C. 1828(g)) is amended by striking out the next to last sentence thereof, relating to penalties for violations of such subsection, by inserting "(1)" at the beginning thereof, and by adding thereto the following paragraphs:

"(2) No insured bank or officer, director, agent, or substantial stockholder thereof may pay or agree to pay a broker, finder, or other person compensation for obtaining a deposit for such bank. For the purposes of this paragraph, any payment made by any other person to induce the placing of a deposit in a bank shall be deemed to be a payment of compensaton by the bank if the bank had or reasonably should have had knowledge of such a payment when it accepted the deposit.

"(3) Any violation by an insured bank of the provisions of this subsection or of regulations issued hereunder shall subject the bank to a penalty of not more than 10 per centum of the amount of the deposit to which the violation relates. The Corporation may recover the penalty, by suit or otherwise, for its own use, together with the costs and expenses of the recovery.

"(4) For the purposes of this subsection, the term 'payment of interest' includes an agreement to pay interest and includes payments to the depositor or any other person directly or indirectly made by any officer, director, agent, or substantial stockholder of the bank in which the deposit is made if the bank had or reasonably should have had knowledge of the agreement or payment when it accepted the deposit. The Board of Directors shall by regulation prescribe definitions of the terms 'payment of compensation' and 'substantial stockholder' and shall prescribe such further definitions of 'payment of interest' as it may deem appropriate for the purposes of this subsection. The Board of Directors shall prescribe such rules and regulations as it may deem necessary to effectuate the purposes of this subsection and prevent evasions thereof."

SEC. 20. Section 5B of the Federal Home Loan Bank Act (12 U.S.C. 1425b) is amended (1) by inserting "(a)" after "SEC. 5B." and (2) by adding at the end thereof the following:

"(b) No member which is an insured institution as defined in section 401(a) of the National Housing Act and no officer, director, agent, or substantial stockholder thereof shall pay or agree to pay a broker, finder, or other person compensation for obtaining funds to be deposited or invested in such member (hereinafter in this section referred to as deposits). For the purposes of this paragraph, any payment made by any other person to induce the placing of a deposit in such a member shall be deemed to be a payment of such compensation by the member if the member had or reasonably should have had knowledge of such a payment when it accepted the deposit.

"(c) Any violation by a member of the provisions of this subsection or of regulations issued hereunder shall subject the member to a penalty of not more than 10 per centum of the amount of the deposit to which the violation

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relates. The Board may recover the penalty, by suit or otherwise, for the use of the Federal Savings and Loan Insurance Corporation, together with the costs and expenses of the recovery.

"(d) For the purposes of this section, the term 'payment of interest, or dividends' includes an agreement to pay interest or dividends and includes payments to the depositor or investor or any other person directly or indirectly made by any officer, director, agent, or substantial stockholder of the member in which the deposit is made if the member had or reasonably should have had knowledge of the agreement or payment when it accepted the deposit. The Board shall by regulation prescribe definitions of the terms 'payment of compensation' and 'substantial stockholder' and shall prescribe such further definitions of 'payment of interest or dividends' as it may deem appropriate for the purposes of this section. The Board shall prescribe such rules and regulations as it may deem necessary to effectuate the purposes of this section and prevent evasions thereof."

SEC. 21. (a) Chapter 11 of title 18 of the United States Code as amended by section 11 of this Act is further amended by adding at the end thereof the following new section:

"§ 226. Obtaining funds for deposit or investment in certain banks

"Whoever, directly or indirectly, knowingly asks, demands, exacts, solicits, seeks, accepts, receives, or agrees to receive from any insured bank as defined in section 3 of the Federal Deposit Insurance Act or any insured institution as defined in section 401 of the National Housing Act anything of value for himself or for any other person or entity in return for obtaining or assisting in obtaining funds of another for deposit or investment in such insured bank or insured institution shall be fined not more than $10,000 or imprisoned not more than one year, or both."

(b) The chapter analysis of such chapter is amended by inserting immediately below the item relating to section 225 the following new item:

"226. Obtaining funds for deposit or investment in certain banks."

CERTAIN GIVEAWAYS PROHIBITED

SEC. 22. Section 18(g) of the Federal Deposit Insurance Act (12 U.S.C. 1828(g)) is amended by adding at the end thereof the following: "Except for the payment of interest on deposits subject to limitation under this section, no insured bank may offer or deliver any merchandise or any certificate, stamp, ticket, or other obligation or memorandum which is or may be redeemable in merchandise, money, or credit as an inducement to any person to make or add to any deposit."

SEC. 23. Section 5B(a) of the Federal Home Loan Bank Act (12 U.S.C. 1425b) is amended by adding at the end thereof the following: "Except in the case of interest or dividends subject to limitation under this section, no member may offer or deliver any merchandise or any certificate, stamp, ticket, or other obligation or memorandum which is or may be redeemable in merchandise, money, or credit as an inducement to any person to make, open, or add to any deposit or account."

SEC. 24. Except for the payment of ordinary interest or dividends, no mutual savings bank not an insured institution may offer or deliver any merchandise or any certificate, stamp, ticket, or other obligation or memorandum which is or may be redeemable in merchandise, money, or credit as an inducement to any person to make or add to any deposit.

FULL DEPOSIT INSURANCE FOR PUBLIC UNITS

SEC. 25. The Federal Deposit Insurance Act is amended—

(1) in subsection (m) of section 3 (12 U.S.C. 1813(m)), by inserting immediately after "depositor" in the first sentence the following: "(other than a depositor referred to in the third sentence of this subsection)";

(2) in subsection (i) of section 7 (12 U.S.C. 1817(i)), by striking out "Trust" and inserting in lieu thereof the following: "Except with respect to trust funds which are owned by a depositor referred to in paragraph (2) of section 11(a) of this Act, trust"; and

(3) in subsection (a) of section 11 (12 U.S.C. 1821(a)), by inserting "(1)" immediately after "(a)", by striking out "The" in the last sentence and in-

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serting in lieu thereof the following: "Except as provided in paragraph (2), the", and by inserting at the end of such subsection the following:

"(2) (A) Notwithstanding any limitation in this Act or in any other provision of law relating to the amount of deposit insurance available for the account of any one depositor, in the case of a depositor who is an officer, employee, or agent of the United States, of any State of the United States, of the District of Columbia, of any territory of the United States, of Puerto Rico, of the Virgin Islands, of any county, of any municipality, or of any subdivision thereof having official custody of public funds and lawfully investing the same in an insured bank, his deposit shall be insured for the full aggregate amount of such deposit.

"(B) The Corporation may limit the aggregate amount of funds that may be deposited in insured banks by any depositor referred to in subparagraph (A) of this paragraph."

SEC. 26. Title IV of the National Housing Act is amended—

(1) in section 401(b) (12 U.S.C. 1724(b)), by striking out "Funds" in the third sentence and inserting in lieu thereof the following: "Except in the case of an insured member referred to in the preceding sentence, funds";

(2) in section 405(a) (12 U.S.C. 1728(a)), by inserting after "except that no member or investor" the following: "(other than a member or investor referred to in subsection (d))"; and

(3) by adding at the end of section 405 (12 U.S.C. 1728), the following new subsection:

"(d)(1) Notwithstanding any limitation in this subchapter or in any other provision of law relating to the amount of deposit insurance available for any one account, in the case of an insured member who is an officer, employee, or agent of the United States, of any State of the United States, of the District of Columbia, of any territory of the United States, of Puerto Rico, of the Virgin Islands, of any county, of any municipality, or of any subdivision thereof having official custody of public funds and lawfully investing the same in an insured institution, the account of such insured member shall be insured for the full aggregate amount of such account.

"(2) The Corporation may limit the aggregate amount of funds that may be invested in insured institutions by any insured member referred to in paragraph (1) of this subsection."

SEC. 27. (a) Except as otherwise specified in this section, the provisions of this Act become effective upon enactment.

(b) Sections 4, 5, 6, 7, 8, 9, and 10 and the amendments made by sections 2, 3, and 13 become effective on the first day of the fourth calendar year which begins after the date of enactment.

[H.R. 3287, 92d Cong., first sess.]

A BILL To prohibit federally insured banks from making loans to provide for the purchase of bank stock and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 18 of the Federal Deposit Insurance Act (12 U.S.C. 1828) is amended by adding at the end thereof the following new subsection:

"(k) No insured bank shall make any loan, discount, or extension of credit to provide for the purchase of stocks, bonds, debentures, or other obligations of any bank."

The CHAIRMAN. The proposals embodied in H.R. 5700 are based on several years of thorough study and investigation of various problems in the field of banking and finance. Many of these proposals, as we will find out during the course of these hearings, have been endorsed by various agencies of the Federal Government, experts in the field of banking and finance, and even some members of the banking community.

This legislation seeks to achieve two basic goals: (1) The enhancement of competition among financial institutions and the reduction of concentrations of economic power within the financial community; and (2) the elimination of certain serious conflict-of-

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interest situations which have been allowed to continue because of existing practices carried on by financial institutions.

The bill covers five basic areas:

(1) Certain interlocking relationships among financial institutions, and between them and other corporations;

(2) Certain restrictions and disclosures in connection with loans made by financial institutions;

(3) The problem of brokered deposits, which has caused a number of bank failures in recent years;

(4) The practice of offering gifts to potential depositors by financial institutions in order to attract deposits;

(5) Expanding insurance coverage on the deposits of public funds in insured banks and savings and loan associations to 100 percent.

These proposals cover a wide variety of complex economic, legal, and practical problems. Some of the problems dealt with here have been explored in detail in several studies carried out by this committee, as well as work done by various individual experts, commissions, and agencies. These matters, such as the inadequacy of present laws regulating interlocking relationships among competing financial institutions, adequate disclosure of investments by bank trust departments and the problem of brokered deposits, have been investigated to the extent that there is a general agreement that existing law must be strengthened. There is also general agreement on how to go about accomplishing this. It seems to me that in the areas that have been explored in depth over a long period of time this committee and this Congress should be able to produce effective legislation without further delay.

For example, in a study carried out in 1967 by the Domestic Finance Subcommittee of this committee, it was revealed that 48 leading commercial banks in 10 major metropolitan areas had 572 officer and director interlocks with other financial institutions including other commercial banks, mutual savings banks, savings and loan associations, and insurance companies. This was more than 10 interlocks per bank. Recent statistics confirm similar interlocking patterns among these actual and potential competitors for savings, loans, pension fund management, and other services. Such relationships among competitors in other fields have been largely prohibited for more than 50 years.

In another area, trust departments of commercial banks, until this committee undertook a thorough investigation of their size and investments in 1968, almost nothing was known about them. This study revealed that at that time, there were more than $250 billion in trust assets in about 3,100 commercial banks. Just the top 50 banks held over 70 percent of this total, or $176 billion. Only 19 banks held over 50 percent of all trust assets.

Subsequent studies by the Federal bank supervisory agencies and the Securities and Exchange Commission reveal that as of late 1969 the total assets in bank trust departments had risen to over $280 billion. Bank trust department assets are the largest single element of all institutional investor assets, representing about 38 percent of the total. The next largest is life insurance companies with $190 billion or about 26 percent of the total of $143 billion.

While there has for years been public disclosure of the investment assets of two of the largest types of institutional investors—insurance companies and mutual funds—there is no such disclosure for bank trust departments, the largest institutional investor. There is grow-

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ing agreement among those who have studied this field that there should be such a disclosure.

As for the problem of brokered deposits, the Federal Deposit Insurance Corporation has acknowledged that they have been an important cause of a large number of bank failures in recent years. In this area, too, some kind of strict regulation is clearly required.

Other issues raised by this legislation, while extremely important are relatively new, and thus have not received detailed examination over a long period of time. However, they have created problems in recent years that demand consideration of our committee and a decision as to whether legislation should be enacted and, if so, what form it should take. These issues, such as the question of prohibiting or limiting gifts by financial institutions in order to attract deposits, the problem of equity participation by lending institutions, strong regulatory legislation involving the operations of the trust departments of banks, including limitations on certain relationships between banks and nonfinancial institutions, certain conflict of interest issues involving various financial institutions, and 100 percent insurance of public funds, should be explored carefully by the committee during these hearings, keeping in mind that the legislative proposals embodied in H.R. 5700 are an attempt at a reasonable solution to the problems raised. The legislative proposals in these areas are not necessarily the final solution to the problems raised. We should carefully consider all alternatives proposed so that we can solve these problems without creating too many new ones.

Before we hear from our first witnesses, let me point out that we have tried to schedule witnesses presenting as wide a point of view as possible. An unusually large number of groups and experts have requested to testify so that we have had to schedule hearings on 12 of the next 15 days. In order to cover the ground fairly and completely we will also have to meet on several days during the afternoon. The only alternative to this procedure would have been to extend these hearings over many more weeks. However, this would have precluded the committee considering other important issues that it must take up during this session of Congress. Therefore, I ask the committee to bear with the Chair in trying to expedite these hearings so that everyone will be given a fair opportunity to present their views to the committee.

Our first witnesses on the legislation before us are the Honorable Frank Wille, Chairman of the Federal Deposit Insurance Corporation, and the Honorable Preston Martin, Chairman of the Federal Home Loan Bank Board. Gentlemen, we appreciate your taking the time to appear before the committee today on these bills and we are sure that your contribution during consideration of them will be extremely helpful.

Let me just say that at the request of Mr. Martin's office, the members of the committee have been sent copies of the proposed legislation entitled the Housing Institutions Modernization Act of 1971. The proposed legislation has not yet been referred to this committee, but when it is, we will give it proper consideration. It obviously would be inappropriate to take up this proposal during consideration of H.R. 5700.

I will ask Mr. Wille to present his statement first and then we will hear from Mr. Martin, after which we will have questions from the committee members.

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Mrs. SULLIVAN. Mr. Chairman.
The CHAIRMAN. Mrs. Sullivan.
Mrs. SULLIVAN. Mr. Chairman, may I make a short statement?
The CHAIRMAN. Yes.
Mrs. SULLIVAN. Mr. Chairman, in view of the fact that the bill I introduced, H.R. 7440, dealing with savings and loan conflicts of interest, was not specifically mentioned in the committee notice last week listing bills being considered in these hearings, I would like the record to show that it definitely is before us as one of the "related matters" referred to in the committee notice of April 15. I believe that what happened last year on an amendment of mine to the housing bill which was identical to the text of H.R. 7440 was an important factor in your preparation of the much broader bill you have introduced, H.R. 5700, and the scheduling of these hearings on conflict of interest situations in all thrift institutions.

As you recall, Mr. Chairman, when we were working on the 1970 Housing Act, I called the committee's attention to the recommendations of the Ad Hoc Subcommittee on Home Financing Practices and Procedures which had spotlighted some of the conflict of interest abuses which we had uncovered among a few savings and loans here in Washington during our investigation. I pointed out that the Home Loan Bank Board had testified it did not have all the authority it said it would need under the law to carry out the reforms we had recommended.

The language I offered last year was prepared for me, as a bill drafting service, by the technicians of the Board whom I asked to write exactly what they felt was necessary as an amendment to the law to give the Board the authority our subcommittee wanted it to have.

This committee agreed to that language, and it was in the housing bill as reported. The Home Loan Bank Board itself neither supported nor opposed this provision. When the housing bill was before the House, on one of the few occasions I was not present in the last Congress, a substitute for my amendment was offered by Mr. Brasco, supported by Mr. Widnall and others, which was supposed to be clearer, easier to understand and more precise than my amendment, and it was adopted. After the housing bill went to conference, the Home Loan Bank Board then reported that the substitute amendment adopted on the House floor was inadequate and unacceptable. At the same time, the Board supplied the conferees with a draft of new language it said it wanted and needed. That new language was unacceptable to me because it left out some of the major provisions of the legislation the Board's technicians had previously drafted to enable the Board to carry out the Ad Hoc Subcommittee's recommendations.

In the conference on the housing bill, the Senate conferees said they had held no hearings on the conflict of interest issue and were not prepared to act on this matter at that time, but Senator Sparkman said his committee would hold hearings on it in this Congress, and you, Mr. Chairman, said you would also schedule hearings in our committee, which you have now done. The statement of managers on the part of the House then added that both the House and Senate conferees felt the Home Loan Bank Board already has more authority to regulate conflict of interest situations than it has attempted to use,

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and should vigorously utilize its existing powers to cope with abuses in this field. That is the history of this issue.

Mr. Chairman, I want to make it clear that in introducing H.R. 7440 earlier this month I was not attempting to take anything away from your bill, H.R. 5700, which, as I said, goes much further than my bill. H.R. 5700 would prohibit by law the things my bill would give the Home Loan Bank Board additional discretionary authority to regulate. Furthermore, your bill applies to all lending institutions—banks, credit unions, et cetera, as well as to savings and loans. So the question before us will be whether we allow the regulatory agencies to set the policies on conflict of interest situations or whether we spell out in the law itself exactly what arrangements are illegal. I think both approaches should be pursued in these hearings so that we will have the information we need in order to make informed judgments.

The CHAIRMAN. Have you finished?

Mrs. SULLIVAN. I just want to ask unanimous consent that H.R. 7440 and the background documentation that I have just talked about goes into the record at this point, to explain what the bill does and why I feel that it should be considered in these hearings. I therefore ask such unanimous consent.

The CHAIRMAN. If I understand your request it is that you are giving notice that you will submit this as an amendment to H.R. 5700, in other words, H.R. 5700 deals with it specifically, and you want to have an alternative that the Federal Home Loan Bank Board deal with it by regulation?

Mrs. SULLIVAN. That is right. Yours would do it by law, mine by regulation.

The CHAIRMAN. Why don't you just wait until the time comes and offer it as a substitute?

Mrs. SULLIVAN. Mr. Chairman, I think that while we are having hearings on the subject, both regulatory methods should be pursued, one which spells out prohibitions in the law and the other by permitting the regulatory agency to issue appropriate regulations.

The CHAIRMAN. It would be all right to discuss it and ask questions about it, but you will offer it at the proper time as a substitute if you decide, or as an amendment?

Mrs. SULLIVAN. If that is decided, yes; only I think at the beginning of the hearing——

The CHAIRMAN. Your bill was introduced, I believe, at the last day before the recess, wasn't it?

Mrs. SULLIVAN. That is right, April 6, right before the recess.

The CHAIRMAN. I am not sure all Members are acquainted with it. Did you furnish them a copy of the bill?

Mrs. SULLIVAN. It was in the Congressional Record with an explanation of what the bill did.

The CHAIRMAN. Personally I have no objection. It would require unanimous consent.

Is there objection to the consideration of this bill along with the other?

(No response.)

The CHAIRMAN. Without objection, it is so ordered.

Mrs. SULLIVAN. Thank you, Mr. Chairman.

(The following material was submitted by Mrs. Sullivan for inclusion in the record at this point, consisting of the text of H.R. 7440,

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excerpts from the Congressional Record of April 7, 1971, and December 2, 1970, relevant excerpts from a letter of December 11, 1970, from the Federal Home Loan Bank Board, and an excerpt from House Conference Report 91–1784:)

[H.R. 7440, 92d Cong., first sess.]

A BILL To clarify and expand the authority of the Federal Home Loan Bank Board to regulate conflicts of interest in the operation of insured savings and loan associations, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 17 of the Federal Home Loan Bank Act is amended by adding at the end thereof the following new subsection:

"(c)(1) The Federal Home Loan Bank Board (hereinafter referred to as the Board) is directed, to such extent as it may deem necessary or appropriate in the public interest or for the protection of members, investors, or borrowers, or the Federal Savings and Loan Insurance Corporation, to regulate relationships, including without limitation on the generality of the foregoing business, financial, or other transactions, between—

"(A) a member and another member;

"(B) a member or an affiliated person of such member or of another member and an investor in or borrower from any such member or another member;

"(C) a member and an affiliated person of such member or of another member;

"(D) a member or an affiliated person of a member, or an investor in or borrower from a member or an affiliated person, and a person from or through which services are or may be rendered (i) to such member or another member, (ii) to an affiliated person of such member or of another member, except where no member is involved and all affiliated persons involved are individuals, or (iii) to an investor in or borrower from a member or an affiliated person of a member; or

"(E) an affiliated person of a member and an affiliated person of such member or of another member, where the relationship involves or may involve any relationship described in subparagraphs (A) through (D) above.

"(2) The authority conferred by paragraph (1) of this subsection shall include authority to regulate with respect to the providing, under circumstances set forth in subparagraph (D) of such paragraph, of appraisal or valuation services or other services, including, without limitation by or on the foregoing, standards and requirements with respect to such services and with respect to qualifications for and conduct of persons providing or eligible to provide such services. In or in connection with the exercise of authority under this paragraph the Board is authorized to make provision for registers or rosters of eligible persons and for involuntary or other removal of persons therefrom.

"(3) In or in connection with the exercise of any function vested in or exercisable by the Board under this Act or otherwise, the Board (which term is used in this paragraph includes the Federal Savings and Loan Insurance Corporation) is authorized (A) to act through any corporate or other agency or instrumentality of the United States and utilize services, facilities, and personnel thereof, and any such agency or instrumentality is authorized to provide the same as requested by the Board, (B) to make payment therefor, and (C) to impose and collect fees and charges for the provision by the Board of Services, facilities, or personnel to any person, and for purposes of this subsection the references in the last two sentences of subsection (b) of section 5B as now in effect to penalties shall be deemed to be references to such fees and charges. Any such payment or collection may be in advance or by reimbursement or otherwise.

"(4) As used in this subsection—

"(A) the term 'affiliated person' means—

"(i) a director, officer, employee, or controlling person of a member, or an attorney regularly serving, or a member or associate of a firm regularly serving, a member in the capacity of attorney-at-law;

"(ii) a member of the immediate family of any individual referred to in clause (i) above;

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"(iii) a partnership in which any individual referred to in clause (i) or (ii) above is a general or limited partner;

"(iv) a corporation in which stock carrying 10 per centum or more of the voting rights is directly or indirectly owned or controlled by any one or more of the persons referred to in (i) through (iii) above, either alone or in concert; or

"(v) any person or class of persons with respect to which there is outstanding a determination by the Board by regulation or otherwise that it is necessary or appropriate in the public interest or for the protection of members, investors, or borrowers or the Federal Savings and Loan Insurance Corporation that such person or class be treated as an affiliated person, but the term 'affiliated person' as used in this subsection and the term 'controlling person' as so used shall not include any person or class of persons with respect to which there is outstanding a determination by the Board by regulation or otherwise that the exclusion of such person or class from the meaning of the term 'affiliated person' or the term 'controlling person' as so used is not inconsistent with the protection aforesaid and is necessary or appropriate in the public interest;

"(B) the term 'controlling person' means any person who, alone or in concert with another or others, directly or indirectly has the right to vote, whether by stock ownership or control, proxy holding, or otherwise, or any combination thereof, more than 25 per centum of the voting rights in a corporation;

"(C) the term 'firm' includes, without limitation on its generality, artificial persons and groups or organizations of persons;

"(D) the term 'investor' and 'borrower' respectively include prospective investors and prospective borrowers;

"(E) the term 'member' includes any institution, any of the deposits, share, or accounts of which have any insurance by the Federal Savings and Loan Insurance Corporation and, to such extent and only to such extent as the Board may provide, includes the Federal Home Loan Mortgage Corporation;

"(F) the term 'person' includes, without limitation on its generality, individuals and artificial persons and groups or organizations of persons;

"(G) the term 'regulate' or any derivative thereof includes prohibition; and

"(H) the term 'services' includes, without limitation on its generality, appraisal or valuation services, legal services, title services, title insurance, hazard insurance, credit insurance, and other insurance, settlement services, escrow services, and trustee services.

"(5) The provisions of subsection (f) of section 5A and of subsections (b) and (c) of Section 5B, all as now in effect, are extended to include this subsection, and for purposes of this sentence the references in said subsections to those sections shall include this subsection, the references in said subsection (f) to provisions of the National Housing Act shall be deemed to be references to those provisions as now in effect, and the references in said subsections (b) and (c) to institutions and nonmember institutions shall include members and shall include affiliated persons. In implementing or carrying out provisions of this subsection the Board may make classifications on the basis of the nature, characteristics, or location of members or affiliated persons or of investors therein or borrowers therefrom or on such other basis or bases as the Board may deem desirable in the public interest."

[From the Congressional Record, Apr. 7, 1971]

Regulation of Conflict of Interest Situations in Insured Savings and Loan Associations

(By Hon. Leonor K. Sullivan, of Missouri, in the House of Representatives, Wednesday, April 7, 1971)

Mrs. Sullivan. Mr. Speaker, following the Easter recess, the House Committee on Banking and Currency will be holding hearings on a broad range of issues involving conflict of interest situations in all types of federally insured

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financial institutions. In anticipation of those hearings, I am today reintroducing as a separate bill a measure which I sponsored last year as an amendment to the housing and urban development bill to clarify and expand the authority of the Federal Home Loan Bank Board to regulate conflict of interest situations in insured savings and loan institutions.

This same proposal was agreed to in the committee last year as an amendment of mine to H.R. 19436, the Housing and Urban Development Act of 1970, but was drastically changed on the House floor and was subsequently dropped in conference after the chairmen of the House and Senate Banking and Currency Committees expressed a willingness and intention to hold hearings in their respective committees in this session on the issues raised by my amendment as originally offered.

GREW OUT OF AD HOC SUBCOMMITTEE INVESTIGATION AND REPORT

My amendment last year on conflict of interest situations involving some savings and loans and their officials was one of a number of legislative proposals resulting from an investigation and report made by an ad hoc subcommittee on home financing practices and procedures created early in the last Congress by the Committee on Banking and Currency following disclosures of widespread victimization and low- and moderate-income families in the District of Columbia in the purchase of homes at terribly inflated prices from speculators, financed to a large degree by one insured savings and loan institution. Several of the legislative recommendations of the ad hoc subcommittee were enacted as part of the Housing and Urban Development Act of 1970, which was signed December 31, 1970, as Public Law 91–009, but the proposal on conflict of interest situations, as I said, was not included in the final version of the bill.

Approximately a month ago, Chairman WRIGHT PATMAN, of the Committee on Banking and Currency, introduced, with eight cosponsors, a bill, H.R. 5700, which would prohibit by law numerous practices engaged in by officials of not only savings and loans but also banks and related institutions which are described in the bill as conflicts of interest. Chairman PATMAN has scheduled hearings on the subject matter of that bill and any similar bills following the Easter recess of the House.

Therefore, in order to have my original proposal formally before the committee for those hearings, I am reintroducing it today as a separate bill. Instead of prohibiting by statute a wide range of conflict-of-interest situations which have arisen in savings and loan management activities, my bill clarifies and expands existing authority of the Federal Home Loan Bank Board to issue regulations covering these activities. This was the general approach taken by the ad hoc subcommittee in its report, which was printed in the CONGRESSIONAL RECORD of July 31, 1970, at pages E7227 through E7236.

DISPOSITION OF AD HOC SUBCOMMITTEE RECOMMENDATIONS

The ad hoc subcommittee in the 91st Congress, of which I was chairman, included the following additional Members: the gentlemen from New York, Representatives JAMES M. HANLEY and FRANK J. BRASCO, and the gentleman from Kansas, Representative CHESTER L. MIZE, and until his resignation from the Committee on Banking and Currency to accept election to the Committee on Armed Services, the gentleman from Maryland, J. GLENN BEALL, Jr. Senator BEALL, participated in our hearings and investigation but not in the drafting of the final report. The report was signed by all of the other Members.

Among concrete legislative results of our study were the adoption by Congress of changes in the law to provide for regulation by the Federal Home Loan Bank Board of all insured savings and loans in the District of Columbia whether or not federally chartered, thus closing a serious loophole in the regulatory machinery; and extending to all insured savings and loans the protection of the criminal code provisions against false claims previously accorded only to federally chartered savings and loans.

A third ad hoc subcommittee proposal, calling for the establishment in the Department of Housing and Urban Development of an office of Special Assistant to the Secretary to advise and assist nonprofit organizations in sponsoring housing projects and programs, was also included in the Housing and Urban Development Act of 1970.

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However, several of our recommendations were not agreed to in the full Committee last year and have therefore not yet been enacted. One would prohibit, except under very limited circumstances, the use of straw parties in residential real estate transactions; others dealt with appraisals, settlement practices, and the disclosure on all deeds in federally related transactions of the actual consideration paid and the interest of the parties thereon. I intend to pursue these issues in connection with housing legislation coming before the Committee in this Congress. I think they are essential reforms.

FEDERAL HOME LOAN BANK BOARD WOULD SET STANDARDS

The bill which I have introduced today, Mr. Speaker, is intended to give to the Federal Home Loan Bank Board the clear statutory authority to carry out, through issuance of appropriate regulations, the following recommendations of the report of the ad hoc Subcommittee on Home Financing Practices and Procedures.

First, expansion of the definition of "conflicts of interest" for directors, officers, and employees of savings and loan associations, regulating their own involvement in the business of real estate for their personal gain through the use of their own or other savings and loan associations;

Second, additional and more realistic limitations on "single borrower" loans. These regulations should set firm limits on the portion of an association's total assets and the number of loans that can be made to single borrowers.

Third, establishment of criteria for the qualification of appraisers and the assignment of responsibility for faulty appraisals.

Fourth, regulation of the interest of directors, officers, and employees of savings and loan associations in title companies, settlement houses, appraisal organizations, and similar institutions who do business with savings and loans.

Mr. Speaker, the language of my bill is technical and legalistic, and has been described as too hard to understand. If it needs improvement on that score, I would certainly have no objection to changes, but not at the expense of destroying the effectiveness of the bill. I asked the technical experts in the Home Loan Bank Board who deal in this field of regulatory law to draft the kind of language necessary to give the Federal Home Loan Bank Board authority it maintained it does not now fully possess to carry out the ad hoc subcommittee recommendations on conflicts of interest. The Board itself did not support this language last year; in fact, it took no position one way or another on this section of H.R. 19436 until after it was amended on the House floor and, in my opinion as well as the Board's opinion, made completely meaningless. While the housing bill was in conference, the Board then came forward with some different language which it said was needed and which it would support, but the conferees decided to postpone the matter until this year.

The Board's belated amendment seemed to me to be much weaker than my original section. Hence, in the forthcoming hearings, I hope the Board will be prepared to tell us in detail why it objects to any specific provisions of my bill which its own version would change. In that way, we can get to the bottom of just what the problems really are in achieving effective regulation to prevent conflict of interest situations which could victimize savers in the association, or those who borrow from it, or the Federal Savings and Loan Insurance Corporation, which is usually the ultimate victim of any serious management abuses in insured institutions.

TEXT OF BILL

Although its language will, I am sure, be virtually incomprehensible to most laymen, I include herewith, for the information of the Members who are interested, the text of the bill I have today introduced on savings and loan conflict-of-interest situation, as follows:

(The text of H.R. 7440 appears on p. 14)

TECHNICAL EXPLANATION OF H.R. 7440

The following technical data on the above bill was given to me, Mr. Speaker, by the experts who drafted this language:

Paragraph (1) provides general authority in the Board to regulate the situations in which conflicts of interest most frequently appear or are likely to ap-

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pear. This regulatory authority clarifies any existing regulatory authority with respect to institutions insured by the Federal Savings and Loan Insurance Corporation and expands such regulatory authority to embrace Federal Home Loan Bank member institutions as well.

The regulatory authority under this paragraph is limited, however, in that it applies only to the relationships and transactions referred to in the paragraph. It does not extend, for example, to relationships or transactions between individuals (such as directors of the same association or a director of one and a director of another) where no member or insured institution is involved.

Under paragraph (5) of the new subsection, which extends to the new subsection certain existing provisions of the Act, the Board would have authority to impose and collect penalties of as much as $100 a day on any member or insured institution, or affiliated person, who violated any rule imposed under paragraph (1).

Subdivision (D) of paragraph (1) is designed to grant clear regulatory authority where services, such as appraisal services, title services, and settlement services, are rendered to member or insured institutions or affiliates thereof, or to investors therein or borrowers therefrom. Paragraph (2) implements this authority by expressly authorizing the Board to regulate the providing of appraisal and other services, including the providing of standards and requirements for such services and for the qualifications and conduct of persons rendering the services. In this connection the Board would be authorized to provide for registers or rosters of eligible persons and for removal of persons therefrom.

Paragraph (3) authorizes the Board to obtain assistance from other agencies or instrumentalities of the United States and to impose user fees or charges. Assistance from other agencies and instrumentalities may especially be needed to make available to the Board the benefit of the expertise of other agencies, such as the Federal Housing Administration and the Veterans Administration, which have had long experience in the field of appraisals and related activities.

Paragraph (4) supplies definitions. Paragraph (5) extends to the new statutory provisions implementing and enforcement provisions already existing in other sections of the Federal Home Loan Bank Act and contains other implementing provisions.

[From the Congressional Record, Dec. 2, 1970]

AMENDMENT OFFERED BY MR. BRASCO TO THE AMENDMENT IN THE NATURE OF A SUBSTITUTE OFFERED BY MR. STEPHENS

Mr. BRASCO. Mr. Chairman, I offer an amendment to the amendment in the nature of a substitute.

The Clerk read as follows:

"Amendment offered by Mr. Brasco to the amendment in the nature of a substitute offered by Mr. Stephens: At page 106, line 11, strike all that follows down through page 111, line 25, and substitute in lieu thereof the following language:

" 'SEC. 913. Section 17 of the Federal Home Loan Bank Act (12 USC § 1437) is amended by adding at the end thereof the following new subsection:

" ' "(c) The Federal Home Loan Bank Board (hereinafter referred to as the Board) is directed, to such extent as it may deem necessary and appropriate to maintain the safety and soundness of any member institution in the conduct of such member institution's business, or for the protection of the Federal Savings and Loan Insurance Corporation, to regulate or prohibit any director, officer, employee of, or attorney or appraiser for, or any other person occupying a fiduciary relationship with, any member institution from engaging or participating in any business or financial transaction conducted on behalf of or involving any such member or other financial institution which would result in a conflict of his own personal financial interests with those of the member institution which he serves, including the authority to use its supervisory agents to examine any member institution with respect to those conflict of interest situations which are not specifically limited or prohibited by regulation and to take appropriate action, when circumstances so warrant, to prevent, circumscribe, or eliminate such situations." ' "

Mr. BRASCO (during the reading). Mr. Chairman, I ask unanimous consent that the amendment be considered as read, and printed in the RECORD.

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The CHAIRMAN. Is there objection to the request of the gentleman from New York?

Mr. BLACKBURN. Mr. Chairman, I object.

The CHAIRMAN. Objection is heard.

The Clerk proceeded to read the amendment.

Mr. BLACKBURN. Mr. Chairman, I withdraw my objection to the request of the gentleman from New York.

The CHAIRMAN. Is there objection to the request of the gentleman from New York?

There was no objection.

Mr. BRASCO. Mr. Chairman, my amendment would substitute language for the language of the so-called Sullivan amendment contained in section 913 of the Stephens substitute, on page 106 beginning with line 11.

Before I begin to explain my amendment, I certainly want to take this opportunity to pay great tribute to the gentlewoman from Missouri, the Honorable Leonor K. Sullivan, with whom I have had the honor to serve on the Committee on Banking and Currency and more specifically in this instance the honor to serve as a member of the Ad Hoc Subcommittee on Home Financing Practices and Procedures, which the gentlewoman chaired.

This ad hoc subcommittee held hearings over several months. The hearings brought to light many nefarious activities which had been and perhaps still are going on concerning the few "bad apples" in the savings and loan association industry. Further, the hearings indicated that these "bad apples" had taken unfair advantage of people's savings in savings and loan associations to the extent that they were making speculative loans the benefits of which accrued to insiders, with the detriment, of course, falling on the unsuspecting home purchaser.

As a result, Mr. Chairman, of the recent inquiry made by this ad hoc subcommittee the gentlewoman from Missouri (Mrs. Sullivan) proposed an amendment, which is the amendment in question, section 913 of the Stephens substitute. It is basically directed at ferreting out conflicts of interest in the savings and loan association industry so that we can put a handle on this unfair practice and get the situation back to normal.

I hasten to add that I certainly join with the gentlewoman from Missouri (Mrs. Sullivan) as indeed do all the other members of the ad hoc subcommittee, in seeking this same resolution of the problem; namely, cutting out conflicts of interest in this area.

When this language was drafted it was generally assumed it would do the job in question. However, I am informed at this time that the language does have very broad implications—broad insofar as they may exceed the legitimate purpose of prohibiting conflict-of-interest situations within the savings and loan industry. For example, the language now contained in section 813 would allow the Home Loan Bank Board to inquire into transactions between a board member of a savings and loan institution and another individual, said transaction having absolutely nothing to do with the board member's activity as a member of a savings and loan institution.

To illustrate more specifically, existing language could be construed to allow the Home Loan Bank Board to secure all books, papers, documents, and records involving transactions between a savings and loan director of a board who happens to be a retail merchant besides, and his relationship as a retail merchant with a supplier of goods to his retail establishment without bringing into play his activities as a board member at all.

Mr. Chairman, I do not believe that it was the author's intent or my intent to give to the Home Loan Bank Board this broad authority. My amendment would do, I believe, exactly what we on the ad hoc subcommittee wanted to do, what Mrs. Sullivan wants to do, and what I understand the full committee wants to do, that is, very simply give to the Federal Home Loan Bank Board, the authority to prohibit any director, officer, employee of or attorney or appraiser from engaging in or participating in any business or financial transaction conducted on behalf of a savings and loan association which would result in a conflict of interest.

The CHAIRMAN. The time of the gentleman has expired.

(By unanimous consent, at the request of Mr. Holifield, Mr. Brasco was allowed to proceed for 5 additional minutes.)

Mr. BRASCO. As I indicated, Mr. Chairman, I believe this amendment, if enacted, would accomplish these purposes.

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I direct the attention of the Members to section 913 on page 106 of the Stephens substitute or in the original bill, page 121, Sec. 911. I would ask them to take a very brief look at that section in terms of its definitions, its broad implications, and the fact that I believe it is not as concise or as intelligible as the language in my amendment, which I believe is concise and simplified and which does exactly what the committee intended it to do.

Mr. DERWINSKI. Will the gentleman yield for a question?

Mr. BRASCO. I certainly do.

Mr. DERWINSKI. May I say in the process of asking the question that I think the gentleman has a very sound amendment and I support it wholeheartedly.

Would the gentleman permit me to say that in effect what he does also is to have the Congress spell out more distinctly the intention of Congress for the officials and agencies to interpret. In effect he has a more precise and workable amendment than the existing language.

Mr. BRASCO. Yes. I tried to indicate that when I indicated I believed that the language as it now exists is too broad and too vague.

Mr. DERWINSKI. I believe the gentleman has a sound amendment and I urge its adoption.

Mr. HOLIFIELD. Will the gentleman yield?

Mr. BRASCO. I certainly do yield.

Mr. HOLIFIELD. I have tried to understand this. I am accustomed to reading bills, and I tried to understand section 911 in the original bill. I tried to get others to explain it to me, also, but I could not get an explanation that made it clear in my mind. I think the gentleman's language clarifies it. It put the responsibility on the Home Loan Bank Board to make the necessary rules and regulations.

I say this with some knowledge, because I was chairman of the subcommittee that investigated the Home Loan Bank Board several years ago, and I served on another committee that the gentleman from California (Mr. Moss) was chairman of. One thing we found out was that the Home Loan Bank Board at that time was far beyond its statutory authority and got into matters which were extraneous and completely without any relationship to the regulatory powers that were given to it. I will say under the present administrator, as far as I know I have had no complaints from the savings and loan people or other people in my district in respect to the present savings and loan administrator of the Home Loan Bank Board.

I commend the gentleman for his amendment and state that I intend to support it.

Mr. BRASCO. I thank the gentleman.

Mr. WIDNALL. Mr. Chairman, will the gentleman yield?

Mr. BRASCO. I shall be happy to yield to the distinguished gentleman from New Jersey.

Mr. WIDNALL. I think this is a very fine amendment. I certainly hope it will be approved by the committee. I believe the minority approves what the gentleman is trying to do. The situation badly needed clarification and it will do exactly the job that was intended in the first place.

Mr. BARRETT. Mr. Chairman, will the gentleman yield?

Mr. BRASCO. I yield to the distinguished chairman of the subcommittee.

Mr. BARRETT. I would certainly like to be for the amendment, but I do think that the distinguished gentlewoman from Missouri (Mrs. Sullivan) has put an awful lot of work into this section 913 and deserves our support. I have not read any language as yet that in my opinion provides better conflict-of-interest protection.

It seems as though the other side here is for it. However, I certainly would like to see this offered at another time when we can analyze it more clearly.

Mr. BRASCO. I do not wish to put words in the mouth of the gentleman, but I think the gentleman from California (Mr. Holifield) said he could not analyze the present language in the bill very clearly. I understood him to say that the language in my amendment was much more concise and understanding.

Mr. HOLIFIELD. Mr. Chairman, will the gentleman yield?

Mr. BRASCO. I yield to the gentleman from California.

Mr. HOLIFIELD. That was the intent I had in mind.

The CHAIRMAN. The question is on the amendment offered by the gentleman from New York (Mr. Brasco) to the amendment in the nature of a substitute offered by the gentleman from Georgia (Mr. Stephens).

The amendment to the amendment in the nature of a substitute was agreed to.

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[Relevant excerpts from letter of Dec. 11, 1970]

FEDERAL HOME LOAN BANK BOARD,
Washington, D.C., December 11, 1970.

Hon. JOHN SPARKMAN,
Chairman, Committee on Banking and Currency,
U.S. Senate.

DEAR MR. CHAIRMAN: This is in response to staff request for the views of the Board regarding the provisions of S. 4368 which affect savings and loan associations.

With regard to Senate-passed S. 4368, the Board favors the enactment of section 1008 thereof, and favors the enactment of section 1007 thereof with an amendment. The text of this amendment is the first attachment to this letter and the reasons for the amendment are discussed below.

With regard to House-passed S. 4368, the Board favors the enactment of sections 809, 810, 811, 813 and 817 thereof. The Board takes no position regarding the enactment of section 821 thereof; the Board suggests a technical amendment to section 821 should the conferees wish to adopt section 821. The Board opposes the enactment of section 814 thereof. The Board opposes the enactment of section 812 as written, but recommends the enactment of a substitute amendment to section 812. The text of this amendment is attached as the second attachment to this letter and the reasons for this amendment are discussed below.

The discussion below relates only to those sections as to which differences exist between the House and Senate versions of S. 4368.

* * * * * * *

Sec. 812. of House version. (Brasco Amendment) Conflicts of Interest and Related Matters. Section 812 is an amendment to section 17 of the Federal Home Loan Bank Act and was offered in place of section 911 of H.R. 19436 as reported (Sullivan Amendment). Section 812 was offered for the stated purpose of providing the Board certain authority over conflicts of interest, but at the same time insuring that such authority was not too broad and was clearly stated, since it was feared that the Sullivan Amendment was too broad and unclear. The Board opposes the enactment of section 812 for the following reasons:

First. Section 812 reaches only "any director, officer, employee of, or any other person occupying a fiduciary relationship with, any member institution". It does not reach the families of those persons or corporations or partnerships in which they have an interest. Nor does section 812 apply to member institutions themselves. Thus, any regulations issued by the Board under this section may be easily evaded.

Second. Section 812 contains no enforcement provisions, and no existing statute would afford adequate enforcement authority with respect to the section. (a) The Board's existing enforcement authority as to *institutions* which are Federal savings and loans associations or FSLIC-insured institutions would not enable the Board to reach the *individuals* which section 812 would authorize the Board to regulate. (b) The existing enforcement provisions with respect to officers and directors of Federal and insured institutions are limited to cases involving personal dishonesty, which is not the thrust of section 812. (c) There are no existing enforcement provisions which would enable the Board to reach individuals connected with Federal Home Loan Bank member institutions that are not Federal savings and loan associations or insured by the FSLIC.

Third. The phrase "to use its supervisory agents" in section 812 implies that the Board's supervisory agents must *personally* conduct the examinations. Any such procedure would be administratively unworkable.

Fourth. The *standard* for the Board's regulatory action is too narrow in that:

(a) Under section 812 the Board may regulate "to maintain the safety and soundness of any member institution in the conduct of such member institution's business, or for the Federal Savings and Loan Insurance Corporation". There is no mention of protection of the interests of savers, investors, or borrowers.

(b) The Board must deem its regulatory action "necessary *and* appropriate". As a technical matter, this phrase, as opposed to "necessary or appropriate", implies excessively close restriction of authority.

Fifth. The range of transactions with which section 812 deals is extremely narrow. These are transactions "which would result in a conflict of his own personal financial interest with those of the member institution". Thus, section 812 would not cover, for example, tie-ins with insurance agencies, building

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supply companies and the like. Here the conflict is between the director's personal financial interest and the interests of the borrower.

While any particular objection of those listed above might not render section 812 unacceptable, the Board believes that their cumulative effect is such that section 812, as written, should not be enacted.

Attached as the second attachment to this letter is an amendment to section 812 which the Board believes will meet the principal objections to the Sullivan amendment and at the same time avoids the problems of the Brasco amendment discussed above. Although the Board's amendment is similar to the Sullivan amendment in a number of respects, there are several differences between them. These differences, which have a substantial cumulative effect, are as follows:

First. Paragraph (1) of the Sullivan amendment authorizes the Board to regulate "to such extent as it may deem necessary or appropriate in the public interest or for the protection of members, investors, or borrowers, or the Federal Savings and Loan Insurance Corporation". The Board's amendment deletes the broad phrase "in the public interest".

Second. Paragraph (1) of the Sullivan amendment authorizes the Board to "regulate relationships, including without limitation on the generality of the foregoing business, financial or other transactions". The Board amendment employs the phrase "business, financial, ownership, or organizational relationships or transactions". This second phrase substitutes a specific statement of the exact transactions and relationships intended to be covered in place of the more general and open-ended statement found in the first phrase.

Third. Paragraph (1) of the Sullivan amendment contains a long and highly technical description of the persons covered by its provisions. The Board's amendment substitutes a much shorter and clearer description. It also eliminates a number of persons from its coverage who are covered in the Sullivan amendment. This restriction in coverage is sufficiently great that the Board may at some future time find it needful to seek further legislation. The Board believes, however, that its proposed amendment covers those major situations which are most likely to require regulation in the near future. The Board would prefer to operate at the present time with a more restricted authority, and to propose extensions of that authority at a later date if experience should demonstrate the need therefor.

Fourth. Paragraph (1) of the Board's amendment employs the phrase "investors or borrowers in their capacity as such investors or borrowers", whereas paragraph (1) of the Sullivan amendment uses the phrase "investors or borrowers" without qualification. The qualifying phrase is intended to emphasize and make clear that the Board's authority under section 812 extends only to those interests of borrowers and investors which relate to them as such.

Fifth. Paragraph (2) of the Sullivan amendment is deleted in its entirety.

Sixth. The elaborate definitional section contained in paragraph (4) of the Sullivan amendment is completely deleted except for three technical definitions considered necessary for precision and the elimination of evasion. The definition of "investors" and "borrowers" as including prospective investors and borrowers appears essential if the Board is to be able, for example, to deal with the situation in which a loan *not yet made* is conditioned upon the purchase of insurance or building materials from specific companies.

Seventh. The final sentence of paragraph (5) of the Sullivan amendment is completely deleted. This sentence reads, "In implementing or carrying out the provisions of this subsection the Board may make classifications on the basis of the nature, characteristics, or location of members or affiliated persons or of investors therein or borrowers therefrom or on such other basis or bases as the Board may deem desirable in the public interest."

Eighth. The remainder of paragraph (5) and all of paragraph (3) of the Sullivan amendment (with minor technical changes) are transferred to the Board's amendment, and appear as new paragraphs (2) and (3), respectively. New paragraph (2) makes provision for enforcement, and new paragraph (3) authorizes the Board to charge user fees for services rendered and to obtain the assistance of other government agencies in implementing the amendment.

The minor technical changes in new paragraph (3) add the word "information" to subdivisions (A) and (C) thereof and the phrase "or in connection with any similar action rendered by the Board to any such agency or instrumentality" to subdivision (B) thereof. The Board believes that these changes are desirable in the interests of clarity and efficiency of its internal administration. These changes are of a housekeeping nature and would have no effect on the savings and loan indsutry.

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Except as to section 812 of S. 4368 as passed by the House, the Board has been informally advised by the Office of Management and Budget that, from the standpoint of the program of the President, there is no objection to the submission of this report. As to said section 812, time does not permit the ascertainment of the relationship of this report or of our suggested substitute amendment to the program of the President.

If the committee of conference has any questions regarding the views of the Board, please do not hesitate to contact us.

Sincerely yours,

PRESTON MARTIN, *Chairman.*

ATTACHMENT NO. 2

Section 812 of S. 4368 as passed by the House is amended to read as follows:

SEC. 812. Section 17 of the Federal Home Loan Bank is amended by adding at the end thereof the following new subsection:

"(c)(1) The Federal Home Loan Bank Board (hereinafter referred to as the Board) is authorized, to such extent as it may deem necessary or appropriate for the protection of members, investors or borrowers in their capacity as such investors or borrowers, or the Federal Savings and Loan Insurance Corporation, to regulate or prohibit business, financial, ownership, or organizational relationships or transactions (A) between (i) a member or affiliated person and (ii) any other member or affiliated person, or (B) between (i) a member or an affiliated person thereof and (ii) an investor in such member or affiliated person, a borrower from such member or affiliated person, or a person from or through which services may be rendered to such affiliated person, investor, or borrower. As used in this subsection, 'affiliated peson' means an affiliated person of any member, 'investor' and 'borrower' include prospective investors and prospective borrowers, and 'member' includes any institution any accounts, deposits, or shares of which have any insurance by said Corporation and includes, but only to such extent as the Board may provide, the Federal Home Loan Mortgage Corporation.

"(2) The provisions of subsection (f) of section 5A and of subsections (b) and (c) of section 5B, all as shown in effect, are extended to include this subsection, and for purposes of this sentence the references in said subsections to those sections shall include this subsection, the references in said subsection (f) to provisions of the National Housing Act shall be deemed to be references to those provisions as now in effect, and the references in said subsections (b) and (c) to institutions and nonmember institutions shall include members and shall include affiliated persons.

"(3) In or in connection with the exercise of any function vested in or exercisable by the Board under this Act or otherwise, the Board (which term as used in this paragraph includes the Federal Savings and Loan Insurance Corporation) is authorized (A) to act through any corporate or other agency or instrumentality of the United States and utilize information services, facilities, and personnel thereof, and any such agency or instrumentality is authorized to provide the same as requested by the Board, (B) to make payment therefor, and any expenses under (A) or (B) hereof or in connection with any similar action rendered by the Board to any such agency or instrumentality shall not be considered as administrative expense, and (C) to impose and collect fees and charges for the provision by the Board of information, services, facilities or personnel to any person, and for purposes of this subsection the references in the last two sentences of subsection (b) of section 5B as now in effect to penalties shall be deemed to be references to such fees and charges. Any such payment or collection may be in advance or by reimbursement or otherwise."

[Excerpt from House Conference Report 91–1781]

(Conference Report on H.R. 19436, Housing and Urban Development Act of 1970)

FEDERAL HOME LOAN BANK BOARD CONFLICT-OF-INTEREST AUTHORITY

The House bill contained a provision not in the Senate amendment clarifying the authority of the Federal Home Loan Bank Board to regulate insured savings and loan associations with respect to situations in which conflicts of interest are likely to appear. No such provision is contained in the conference substitute. The conferees believe the Home Loan Bank Board has considerable authority

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to regulate matters regarding conflict-of-interest situations involving savings and loan associations and agree to postpone consideration of additional authority until next year, when appropriate hearings can be held. The conferees further believe that the Board should more vigorously apply its existing authority.

Mr. WIDNALL. Mr. Chairman.

The CHAIRMAN. Mr. Widnall.

Mr. WIDNALL. This morning we commence hearings on the Banking Reform Act of 1971 and related matters. The bill as it has been presented for consideration is very broad in its coverage and the impression I have at this point is that it would, if enacted in this form, necessitate some massive reorganizations of American business methods both in banking and other industries. There is, of course, the series of staff reports developed over the last few years which suggest that some changes would be desirable. Still I think it is a grave responsibility which we face, for despite the fact that present practices afford opportunities for abuses, and despite the fact we have uncovered a few instances where unscrupulous people have availed themselves of these opportunities, I persevere in my confidence in the American people and question whether all should be restricted as a price for controlling the few. For these reasons I hope we will approach this measure objectively in a sincere effort to find the most appropriate ways of improving on methods of operation which have developed the strongest and most vital economy in the world. These hearings must not degenerate into a forum to castigate the sophisticated leaders of business, nor should we generate any smokescreens to conceal wrongdoing. Differentiating between right and wrong is not a partisan matter and I trust that we can work together, as we have so often in the past to develop a sound bill.

In so doing, I hope our inquiry will develop information which goes beyond the actual context of our bill. I think it will be essential to do so in order for our endeavors to be balanced and complement to the maximum efforts of others. For example, H.R. 5700 proposes Federal standards in some areas which have hitherto been reserved to the States. Before supporting such provisions I would like to know something more than I do about why this is necessary—and whether Federal standards would strengthen or weaken future State efforts at supervision. I am likewise concerned about the implications such action would have on the dual banking concept. Is this a forerunner to full federalization of banking? Would this be desirable? Mr. Chairman, I don't raise these questions idly. They are the kind of questions to which I think we must address ourselves as we consider the means to correct abuses which are proposed in this bill.

There is another aspect of this problem which I think we must consider in all seriousness, namely to what extent are the abuses which have been uncovered already outlawed and as a natural corollary thereto have these abuses occurred as a result of some shortcomings in supervisory functions?

Obviously the answers to these questions will have a direct bearing on the need for, and on the form of, new legislation.

There are 26 provisos in H.R. 5700 and they raise more questions of this type than time permits me to recite at this point. However, I think what I have said will illustrate the broad concerns we must address ourselves to in consideration of this measure.

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Mr. Chairman, should it develop from our inquiries that abuses in our financial institutions are widespread, or even that opportunities for abuses are flagrant, then I think we will all be agreed in our determination to take corrective action. As we commence these hearings I hope that you and the other members share my determination to approach the subject with caution, an open mind, a willingness to consider alternative solutions, and a determination to make this legislation a constructive measure which strengthens the banking and commerce of our Nation.

Mr. WILLIAMS. Will the gentleman yield?

The CHAIRMAN. What is your request?

Mr. WILLIAMS. I would like to have the record show that the statements made by the chairman regarding the necessity for the provisions of H.R. 5700 are not shared by me.

In my opinion, after a very careful study of H.R. 5700, I believe we should entitle this bill not the Banking Reform Act of 1971, but the Banking Destruction Act of 1971.

Thank you.

The CHAIRMAN. There are always honest differences of opinion.

Mr. Wille, you may proceed.

STATEMENT OF HON. FRANK WILLE, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. WILLE. Mr. Chairman, in accordance with the committee's request, I appear today on behalf of the Federal Deposit Insurance Corporation to testify on H.R. 5700, a bill sponsored by you and eight other members of the committee. The Corporation welcomes this opportunity to discuss the bill.

I do not propose at this time to read my prepared statement in full. However, there are approximately four pages at the beginning which are a summary, and I would appreciate the opportunity of reading that summary and turning the microphone over to Mr. Martin.

The CHAIRMAN. Without objection, so ordered.

Mr. WILLE. The Federal Deposit Insurance Corporation supports the concept of increased control over interlocking directorates between competing financial institutions. The potential anticompetitive effects of such interlocks warrant prohibition. But lacking sufficient empirical data on the extent of such interlocks between smaller financial institutions, we prefer that the unequivocal prohibitions of H.R. 5700 not be adopted. Instead, the prohibitions now contained in section 8 of the Clayton Act should be broadened to prohibit such interlocks between banks, savings and loan associations, and similar financial institutions within a defined geographic area—which should approximate more exactly the area of local competition than the present provision—whether or not such institutions are insured by the Federal Deposit Insurance Corporation of the Federal Savings and Loan Insurance Corporation. In addition, if such interlocks were prohibited generally within a statutorily defined geographic area, the three Federal bank regulatory agencies and the Federal Home Loan Bank Board should be given administrative flexibility (a) to extend the prohibition to similar relationships involving a financial institution

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located beyond the defined area, if an agency found that the existence of an interlocking relationship might tend to lessen competition substantially, that is, between banks or other financial institutions which were actual or potential competitors in a national market; and (b) to permit exceptions to the general prohibition, even within the defined area, if the appropriate regulatory agency found that the existence of such an interlocking relationship was the result of common stock ownership or a scarcity of experienced financial talent within the area.

With respect to the provisions of H.R. 5700 prohibiting so-called "equity kickers," the Corporation's limited experience to date with the use of equity participations by insured State nonmember banks indicates no reason why, as a supervisory matter, this financial practice should be banned at the present time. We are aware, however, that other considerations of public policy are involved and that these considerations might well lead to a legislative judgment that equity participations should be prohibited generally. If such a legislative judgment is reached, the coverage of section 14 should in fairness be expanded to include certain other types of lending institutions which compete with those presently listed and specific exceptions for equity participations in small business investment companies and limited profit housing and community development corporations should be included.

We support the committee's efforts to regulate insider loans but feel that the proper vehicle for such regulation exists through the enactment of legislation along the lines proposed by H.R. 7440, introduced by Mrs. Sullivan—or as proposed by the amendment which Mr. Brasco offered to the Housing and Urban Development Act of 1970—that would permit the appropriate regulatory agency to deal with the problem administratively.

As I indicated on March 9 when I testified before this committee, the Corporation supports a statutory prohibition against the receipt of brokered deposits. We continue to believe that violation of the prohibition should not be made a crime; that any civil penalty should be applied to the broker as well as to the financial institution receiving the deposits; and that authority should be given to the appropriate regulatory agency to remove or fine, administratively, anyone receiving or arranging for the receipt of such deposits on behalf of a financial institution.

The Corporation, on the other hand, does not favor the enactment of legislation that would categorically prohibit "giveaways" to attract deposits. Our reasons for that position are explained on pages 18 through 20 of my prepared statement.

Finally, the Corporation wishes to withdraw its past opposition to 100 percent insurance of public funds. Any such change in insurance coverage would raise, however, a number of serious interrelated problems in which Government agencies other than the Corporation—such as the Treasury, the three Federal bank regulatory agencies, and the Federal Home Loan Bank Board at the Federal level and virtually all governmental units at the State and local level—have an interest.

Speaking solely for the Corporation, we interpose no objection to the concept of 100 percent insurance of public funds, but we strongly

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recommend that any statutory mandate include (a) a limitation that such insurance, in the case of States and political subdivisions, extend only to the funds of public units within the State in which the financial institution is located; (b) a requirement that the aggregate amount of public funds that could be deposited in banks or savings and loan associations be limited in relation to such criteria as liquidity, total deposits, and capital and that the Corporation and the Federal Savings and Loan Insurance Corporation prescribe uniform restrictions with respect to such limitations; and (c) a requirement that the maximum rates of interest or dividends payable on comparable deposits be the same for all banks and savings and loan associations.

The Corporation wishes to note that it is now in the process of drafting amendments to the Federal Deposit Insurance Act, most of which are technical in nature. One of these amendments would make more effective the Corporation's present cease-and-desist power by authorizing an administrative proceeding for the prompt removal or fining of any director or officer who violated a cease-and-desist order which had become final or which was the subject of a written agreement between the bank and the Corporation. In view of our belief that such a modification would assist the appropriate regulatory agency in correcting some of the problems with which H.R. 5700 in concerned, the committee may wish to consider including one or more of these amendments in any revised version of H.R. 5700 that may be reported out of committee.

I would also like to state that the Federal Deposit Insurance Corporation has sent to the Chair a letter under date of April 12, opposing for the reasons therein stated, the enactment of H.R. 3287 in its present form. I stand ready to discuss that position in greater detail.

The CHAIRMAN. You asked unanimous request to do that, you want to insert Mr. Gonzalez' letter?

Mr. WILLE. I would appreciate having the Corporation's letter on Mr. Gonzalez' bill appended to my prepared statement, sir.

The CHAIRMAN. All right, sir.

(The complete text of Mr. Wille's prepared statement and the letter referred to follow:)

PREPARED STATEMENT OF HON. FRANK WILLE, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

OPENING SUMMARY

In accordance with the Committee's request, I appear today on behalf of the Federal Deposit Insurance Corporation to testify on H.R. 5700, a bill sponsored by nine of the Committee's members. The Corporation welcomes this opportunity to discuss the bill. Let me begin by summarizing our basic position.

We support the concept of increased control over interlocking directorates between competing financial institutions. The potential anticompetitive effects of such interlocks warrant prohibition. But lacking sufficient empirical data on the extent of such interlocks between smaller financial institutions, we prefer that the unequivocal prohibitions of H.R. 5700 not be adopted. Instead, the prohibitions now contained in section 8 of the Clayton Act should be broadened to prohibit such interlocks between banks, savings and loan associations, and similar financial institutions within a defined geographic area—which should approximate more exactly the area of local competition than the present provision—whether or not such institutions are insured by the Federal Deposit Insurance Corporation or the Federal Savings and Loan Insurance Corporation. In addition, if such interlocks were prohibited generally within a statutorily defined

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geographic area, the three Federal bank regulatory agencies and the Federal Home Loan Bank Board should be given administrative flexibility (a) to extend the prohibition to similar relationships involving a financial institution located beyond the defined area, if an agency found that the existence of an interlocking relationship might tend to lessen competition substantially, e.g., between banks or other financial institutions which were actual or potential competitors in a national market; and (b) to permit exceptions to the general prohibition, even within the defined area, if the appropriate regulatory agency found that the existence of such an interlocking relationship was the result of common stock ownership or a scarcity of experienced financial talent within the area.

With respect to the provisions of H.R. 5700 prohibiting so-called "equity kickers," the Corporation's limited experience to date with the use of equity participations by insured State nonmember banks indicates no reason why, as a supervisory matter, this financial practice should be banned at the present time. We are aware, however, that other considerations of public policy are involved and that these considerations might well lead to a legislative judgment that equity participations should be prohibited generally. If such a legislative judgment is reached, the coverage of section 14 should in fairness be expanded to include certain other types of lending institutions which compete with those presently listed and specific exceptions for equity participations in small business investment companies and limited profit housing and community development corporations should be included.

We support the Committee's efforts to regulate insider loans but feel that the proper vehicle for such regulation exists through the enactment of legislation along the lines proposed by H.R. 7440, introduced by Mrs. Sullivan—or as proposed by the amendment which Mr. Brasco offered to the Housing and Urban Development Act of 1970—that would permit the appropriate regulatory agency to deal with the problem administratively.

As I indicated on March 9 when I testified before this Committee, the Corporation supports a statutory prohibition against the receipt of brokered deposits. We continue to believe that violation of the prohibition should not be made a crime; that any civil penalty should be applied to the broker as well as to the financial institution receiving the deposits; and that authority should be given to the appropriate regulatory agency to remove or fine, administratively, anyone receiving or arranging for the receipt of such deposits on behalf of a financial institution.

The Corporation, on the other hand, does not favor the enactment of legislation that would categorically prohibit "giveaways" to attract deposits.

Finally, the Corporation wishes to withdraw its past opposition to 100 percent insurance of public funds. Any such change in insurance coverage would raise, however, a number of serious and interrelated problems in which Government agencies other than the Corporation have an interest. Speaking solely for the Corporation, we interpose no objection to the concept of 100 percent insurance of public funds, but we strongly recommend that any statutory mandate include (a) a limitation that such insurance, in the case of States and political subdivisions, extend only to the funds of public units within the State in which the financial institution is located; (b) a requirement that the aggregate amount of funds that could be deposited in banks or savings and loan associations be limited in relation to such criteria as liquidity, total deposits, and capital and that the Corporation and the Federal Savings and Loan Insurance Corporation prescribe uniform restrictions with respect to such limitations; and (c) a requirement that the maximum rates of interest or dividends payable on comparable deposits be the same for all banks and savings and loan associations.

Before commenting in greater detail on the bill's provisions, the Corporation wishes to note that it is now in the process of drafting amendments to the Federal Deposit Insurance Act, most of which are technical in nature. One of these amendments would make more effective the Corporation's present cease-and-desist power by authorizing an administrative proceeding for the prompt removal or fining of any director or officer who violated a cease-and-desist order which had become final or which was the subject of a written agreement between the bank and the Corporation. In view of our belief that such a modification would assist the appropriate regulatory agency in correcting some of the problems with which H.R. 5700 is concerned, the Committee may wish to consider including one or more of these amendments in any revised version of H.R. 5700 that may be reported out of Committee.

I would now like to discuss certain of the Corporation's views in greater detail.

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INTERLOCKING RELATIONSHIPS

Turning first to interlocking relationships, sections 2 through 9 of H.R. 5700 contain a variety of proposed prohibitions. None of them would be limited to the geographic area of actual or potential competition; it appears that they would apply nationwide. Moreover, they are broadly written and would apply across the board to all institutions and organizations covered, unless the institutions involved were owned by a registered holding company. We believe that prohibitions of this breadth are unnecessary and inappropriate in many interlock situations.

Insofar as the holding company exemption is concerned, we make two observations. First, because there are 16 States in which holding companies are restricted or prohibited, the exemption would not be available to banks and other financial institutions in those States even if such institutions were subject to similar control through common stock ownership. Second, by proposing to accord an exemption for holding companies, the bill presupposes—and we agree—that not all of the interlocking relationships described are anticompetitive. We hope that to the extent new statutes are enacted which seek to restrict interlocking relationships, a similar exception could be devised for common control situations in which the acquisition of the controlling stock in question was not anticompetitive at the time of acquisition.

Under sections 2, 3, and 4, a person who was a director, trustee, officer, or employee of an insured bank, an insured institution, or a noninsured mutual savings bank would be prohibited from serving at the same time as a director, trustee, officer, or employee of certain other specified financial institutions, of insurance companies, holding companies or subsidiaries thereof, or securities brokers or dealers, or of certain companies engaged in the business of providing title insurance, appraising property, or providing services in connection with the closing of real estate transactions.

While we are concerned about the potential anticompetitive effects of the types of interlocking relationships which sections 2, 3, and 4 would proscribe, we are also concerned about the effect which such prohibitions could have on small financial institutions in small communities.

On balance, we prefer that the prohibitions presently contained in section 8(a) of the Clayton Act be broadened. That section, as you know, does not currently extend to nonmember banks, savings and loan associations, and other financial institutions not federally insured. We would retain the exception in section 8(a) for financial institutions located in a different geographic area, broadening, however, the present geographic coverage to extend to the common area in which such institutions may establish offices, i.e., the area of actual or potential local competition. In addition, we recommend that the appropriate regulatory agency be given authority to proscribe interlocking relationships even beyond such a defined area if the agency found that the existence of such a relationship might tend to lessen competition substantially. We further believe that consideration should be given to the desirability of permitting the appropriate regulatory agency to allow interlocking relationships even within the defined area where the agency found that the existence of such an interlocking relationship was the result of common control through stock ownership or the result of a scarcity of experienced financial talent within the area.

In opting for this more flexible administrative approach, we are not unmindful of the studies on interlocking relationships undertaken by the staff of the Subcommittee on Domestic Finance. Insofar as here pertinent, the first study was concerned with the 300 largest commercial banks in the United States, and the later two with 48 and 49 banks, respectively, in 10 major financial centers. The studies therefore tell us little about the several thousand other and smaller banks not surveyed. The administrative, as opposed to a prohibitory, approach would accord the appropriate regulatory agency with desirable flexibility to deal with particular factual situations that warrant an exception.

Further, on the matter of financial institutions covered by sections 2, 3, and 4, I would like to point out that at least three other types of financial institutions which lend money to the public might logically be included in any list of proscribed interlocks. These would include sales and retail finance companies, factors, and mortgage companies.

Section 9 of the bill would prohibit interlocking relationships with corporations as to which a financial institution has substantial and continuing loan relationships. This again is an area where empirical data, particularly for smaller finan-

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cial institutions, is lacking. The proposed prohibition, however, appears to be too restrictive in light of what we believe to be common banking practice. The problems we have encountered in this area stem not from interlocking relationships as such, but from such items as excessive loans, loans to borrowers with poor credit standing, and loans made on preferential terms. We believe that a more refined tool for regulating loan transactions could be developed by amending our cease-and-desist and removal powers under sections 8(b) and 8(e) of the Federal Deposit Insurance Act along the lines I recommended on March 9. These could then be used to make more effective our general supervisory authority over the lending practices of insured nonmember banks.

Section 8 of the bill would prohibit interlocking relationships between any financial institution and any corporation more than 5 percent of any class of the stock of which was held with power to vote by the financial institution. The potential for violation of this prohibition, even inadvertently, is substantial. For example, a bank holding less than 5 percent of the stock of a particular corporation one day might the next find itself controlling the vote of more than 5 percent by virtue of being named executor of an estate containing such stock. The bank's fiduciary duty to the estate in question might well dictate not disposing of the stock, and it also might well be inappropriate in the circumstances to require the officer, director, or employee involved to resign from or be discharged by the bank. Another situation is one in which a bank acquires more than 5 percent of the stock of a corporation through foreclosure. The provisions of section 8 would require the bank to divest itself of this stock immediately or eliminate the interlocking relationship. Again, this points up the desirability for a more flexible approach than the bill would provide.

Section 10 relates to mutual savings banks' holding stock in other financial institutions. We believe this prohibition should apply only in those cases where interlocking relationships would be similarly prohibited; that is, where there exists a substantial potential for competition between the institutions in question.

EQUITY PARTICIPATIONS PROHIBITED

Section 14 of the bill would prohibit insured banks, institutions insured by the Federal Savings and Loan Insurance Corporation, bank or savings and loan holding companies and their subsidiaries, noninsured mutual savings banks, and insurance companies from accepting so-called "equity kickers" in consideration of the making of loans.

The use of the equity participation, frequently called the "equity kicker," appears to be a comparatively recent phenomenon, at least in the field of banking. The practice has numerous variations, such as percentages of net profits, gross sales, or increases in the market price of the borrower's stock. Those institutions which use it claim that it is a hedge against inflation, that it permits lower interest rates on related loans, and that it provides an appropriate return to the lender where borrowers are not well-capitalized from non-bank sources. It is, moreover, a growing practice for financial institutions, as sponsors, to take an equity participation in small business investment companies and a variety of limited profit housing and community development corporations.

A recent survey of large national banks conducted by the Comptroller of the Currency disclosed that 42 national banks reported "equity kicker" loans totaling $159 million, but that those loans accounted for less than three-tenths of 1 percent of the total loan volume of the 502 banks surveyed.

In an effort to determine the extent to which insured State nonmember banks are or have engaged in the practice and whether the acceptance of equity participations has ever presented a supervisory problem for the Corporation, the Corporation recently surveyed each of its 14 Regional Directors. That survey disclosed that insured State nonmember banks make very limited use of equity participations and that their use has been no cause up to the present time for supervisory concern.

The Corporation recognizes that the indiscriminate acceptance of equity participations by an insured bank could have adverse effects upon the bank's financial condition. The expectation of a share in the anticipated profits of a borrower might influence the attitude of a bank's management toward making such a loan at all and could influence the banks to forsake normal business risks for those of a more speculative nature.

The Corporation's experience to date, however, does not indicate that these potentially adverse effects have occurred. Accordingly, from a purely supervisory

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point of view, there appears to be no reason at the present time for the blanket prohibition contained in H.R. 5700.

The Corporation is aware of the fact that the interest of the bill's sponsors in prohibiting the acceptance of equity participations is prompted by considerations other than those solely related to the financial condition of lenders. They have stated their belief, for example, that lenders should not become involved in the control of nonbanking businesses through the acceptance of equity participations; that equity participations which are to be liquidated through money payments in excess of principal and interest on related loans may lead to the failure of certain borrowers; that equity participations in one borrower's business may lead to decisions not to lend to a competitor of that borrower; and that the acceptance of equity participations runs counter to the philosophy underlying the 1970 amendments to the Bank Holding Company Act of 1956, that banking and commerce should be separated and that potentially anticompetitive practices in the allocation of credit within the Nation's economy should be controlled.

These considerations might well lead to a legislative judgment that equity participations should be prohibited generally. If such a legislative judgment is reached, the coverage of the prohibition should in fairness be expanded to include noninsured commercial banks, building and loan associations, savings and loan associations, homestead associations (including cooperative banks), and other organizations engaged in the business of making or placing loans, all of which compete with the lending institutions already named in section 14.

"INSIDER" LOANS AND DISCLOSURE OF "INSIDER" LOANS

In my testimony before this Committee on March 9, 1971 relating to recent bank closings, I noted the Corporation's experience with problems of bank soundness and safety related to the abuse of "insider" loans and affirmed the Corporation's interest in preventing such abuses.

Directors, officers, and employees frequently promote business for banks by bringing their own business and that of corporations which they influence or control to the bank. Such "insider" loans are not inherently harmful to the bank. H.R. 5700 would nevertheless prohibit loans to those corporations if 5 percent or more of any class of stock was owned, in the aggregate, by directors, trustees, officers, employees, or members of their immediate families.

We have no empirical data that leads us to believe that a significant portion of loans to such corporations is of poor credit quality. Our experience leads us to conclude that most such loans are repaid in a timely manner and benefit both the borrower and lender. From the standpoint of the safety and soundness of the bank, what is important is a careful and thorough credit analysis of the loan application and the ability to deny the loan if the analysis shows the corporation to be a poor credit risk, not the fact that 5 percent or more of the stock is owned by "insiders."

In addition to a thorough credit analysis, the bank should avoid giving preferential terms on a loan to someone simply because he is an "insider." Even if credit quality is good, preferential terms to an "insider" benefit that borrower at the expense of the financial institution and its shareholders. As we read H.R. 5700, preferential terms on loans to "insiders" would not be prohibited.

Since a thorough credit analysis involves a great many interrelated factors, many of which require decisions based on experience and good judgment, and since methods for giving preferential terms are numerous and frequently ingenious, the Corporation feels that a statutory prohibition based on an arbitrary percentage would be inappropriate.

The bill would also require banks to report to the Corporation, and the Corporation to make available to the public, the nature and amount of all loans to directors, officers, employees, and members of their immediate families. The purpose of public disclosure would seem better served by requiring disclosure to be made to the stockholders of the financial institution rather than to Federal regulatory agencies.

As an alternative approach to the problem of "insider" loans proposed by sections 15–18 of the bill, your Committee and the Congress might wish to consider expanding the disclosure requirements of the Securities Exchange Act of 1934 so that they would apply to banks having fewer than 500 shareholders. Pursuant to the provisions of section 12 of that Act, and with respect to pub-

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licly owned State banks registered with this Corporation or the Board of Governors of the Federal Reserve System, regulations prescribed by those two agencies require extensions of credit to bank management to be disclosed publicly unless such extensions are made in the ordinary course of business, are made on substantially the same terms (including interest rates and collateral) as those prevailing at the time for comparable transactions with other persons, at no time exceed the lesser of 10 percent of the equity capital accounts of the bank or $10 million, and do not involve more than the normal risk of collectability or present other unfavorable features.

When I appeared before your Committee on March 9, Mrs. Sullivan requested the Corporation's thoughts on extending to insured banks the provisions of her proposed amendment to the "Housing and Urban Development Act of 1970" which would have provided the Federal Home Loan Bank Board authority to treat administratively the question of "insider" loans in federally insured savings and loan associations. We believe that the approach of Mrs. Sullivan and Mr. Brasco could resolve the problem of "insider" loans without creating additional ancillary problems, and we support their suggestion that administrative authortiy to regulate "insider" loans and other conflicts of interest be given to the three Federal bank regulatory agencies and to the Federal Home Loan Bank Board. We intend to submit to them and to the Committee as soon as possible specific language which in our judgment would provide these agencies with the necessary authority.

BROKERED DEPOSITS PROHIBITED

Sections 19 and 20 of the bill would prohibit any bank insured by the Federal Deposit Insurance Corporation and any institution insured by the Federal Savings and Loan Insurance Corporation (or any officer, director, agent, or substantial stockholder thereof) from accepting so-called "brokered deposits." The Corporation's Board of Directors and the Federal Home Loan Bank Board would be authorized to prescribe such rules and regulations as they might deem necessary to effectuate the purposes of the prohibition and to prevent evasions thereof. Any violation of the prohibition or of regulations issued pursuant thereto would subject the offending bank or institution to a penalty of not more than 10 percent of the amount of the deposit to which the violation related. Moreover, under the terms of section 21 of the bill, whoever knowingly asked, demanded, exacted, solicited, sought, accepted, received, or agreed to receive from any insured bank or institution anything of value for himself or for any other person or entity in return for obtaining or assisting in obtaining funds of another for deposit could be fined not more than $10,000 or imprisoned not more than one year, or both.

Brokered deposits, which the bill proposes to prohibit, are deposits placed in a bank pursuant to an arrangement with a money broker, finder, or other person and for which the depositor receives a premium over and above the interest legally authorized to be paid by the bank on his deposit. Their receipt and misuse by insured banks have posed a continuing supervisory problem to the Corporation.

Nine of the 34 insured banks which failed during the period from January 1, 1960 through December 31, 1968 had brokered deposits of $22,342,500, out of a total deposit liability of $78,205,167. In eight of the 20 bank failures occurring from January 1, 1969 to date, the misuse of brokered deposits was a major contributing factor to the closing of the banks. In all of these cases, the receipt of brokered deposits facilitated improper loans to officers, directors, or owners of the closed banks (or to their affiliated interests) or to borrowers outside the banks' normal lending areas, the collectability of which was sufficiently in question to lead eventually to the closing of the banks.

In some instances, the receipt and misuse of brokered deposits have involved banks in financial difficulties short of closing. In most cases of difficulty, loans are linked to the brokered deposits in the sense that the deposits are placed only if certain loans are made. Brokered deposits, however, since they are not made by the borrower, cannot be used to offset the loan in the event the borrower defaults. Moreover, since most brokered deposits are placed at approximately the same time and are therefore subject to withdrawal on approximately the same date, a bank entering into such a "package" transaction may have to sell other assets in order to meet withdrawals unless it carefully matches deposit and loan maturities. Thus, the bank receiving and misusing brokered deposits may find itself saddled with bad loans or with a liquidity problem, or both, when the

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deposits are withdrawn from the bank. Almost all of these linked-loan transactions, then, contain potentials which can be extremely hazardous to the bank involved, particularly smaller banks. At the same time, because of the speed with which such transactions are entered into, they are difficult to supervise adequately in a timely way.

Last August, in an effort to determine the extent of "money brokering" activities in the Nation's banking system and to learn why banks attempt to obtain brokered deposits, the three Federal bank regulatory agencies transmitted a special questionnaire to all insured banks which called for the reporting of certain activities engaged in as of July 31, 1970. The questionnaire asked, first, whether the banks had brokered deposits as of July 31, 1970 and, second, whether they had made loans linked to these deposits.

Even though our analysis of the answers to the questionnaire disclosed that the number of banks receiving brokered deposits is small in relation to the total number of insured banks and that the dollar amount of brokered deposits appears to be minimal when compared with the total deposit figure for all insured banks in the country, the Corporation is not convinced that any essential banking service is performed through "money brokering" activities that could not be performed in some other way. The difficulties that a bank may experience through the misuse of brokered deposits by a bank management which makes poor loans with those deposits or is insensitive to the needs for matching deposit and loan maturities far outweigh any benefits which might flow from the use of brokered deposits.

For these reasons, the Corporation favors the enactment of legislation along the lines proposed by sections 19 and 20 of the bill that would prohibit the receipt by insured banks and certain other institutions of brokered deposits. We suggest, however, that any proscriptive legislation enacted in this area (a) not make violation of the prohibition a crime, as proposed by section 21 of the bill, since that form of punishment seems to us to be too severe; (b) apply a civil penalty for violation of the prohibition, such as a fine, to the broker as well as to the bank or other institution receiving the deposits, since they are both equally at fault in the misuse of brokered deposits; and (c) authorize an administrative proceeding for the prompt removal or fining of any director, officer, or employee who receives or arranges for the receipt of brokered deposits on behalf of an insured bank or other insured financial institution, since personal responsibility for a bank's deteriorating financial condition is likely to produce a greater degree of self-enforcement.

GIVEAWAYS

Tight-money conditions during recent years have increased competition among financial institutions for funds, encouraging, in turn, the greater use of promotional campaigns. Constrained by interest-rate ceilings, banks have been persuaded to compete for funds through premium offers primarily because withdrawals by a large number of depositors could have impaired their liquidity positions and might have necessitated the sale at depreciated values of bank-owned securities or other assets.

Promotional "giveaways" can serve as an effective means for encouraging thrift. They can also be useful in promoting goodwill among customers and in promoting the opening of new institutions or new branches. Bank and savings and loan association customers seem to like them, although many managements and retailers oppose the practice. Moreover, while numerous "giveaway" campaigns by different institutions in geographic proximity may result in the "churning" of accounts by smaller depositors, we have reason to believe that the dollar retention rate is high enough, nevertheless, to make such campaigns worthwhile to the institutions that engage in the practice.

According to the Corporation's Regional Directors, the use of promotional campaigns by insured banks varies from FDIC Region to FDIC Region. The extent of the practice is limited in most places, but large banks in major metropolitan areas appear to make fairly widespread use of the practice. The survey showed rather unequivocally that the use of "giveaway" campaigns has not resulted in supervisory problems.

Existing regulations of the Corporation now prohibit the payment of interest on demand deposits by insured nonmember banks and prescribe maximum rates of interest or dividends that may be paid on time and savings deposits by

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insured nonmember commercial and mutual savings banks. As a supplement to those regulations, the Corporation adopted a statement of policy, most recently reissued in February 1970, announcing that, in applying those regulations, a premium given to a depositor—whether in the form of merchandise, credit, or cash—will be regarded as an advertising or promotional expense rather than as a payment of interest or dividends if the premium is given to a new depositor, is not given on a recurring basis, and the value of the premium (or in the case of articles of merchandise, the wholesale cost excluding shipping and packaging costs) does not exceed $5.00 except that, if the amount of the deposit is $5,000 or more, the wholesale cost of the premium may be not more than $10.00. This policy is enforced by our review of invoices and by our investigation of the complaints of competitors who call abuses to our attention. The Board of Governors of the Federal Reserve System and the Federal Home Loan Bank Board have adopted similar statements of policy, while the Comptroller of the Currency permits national banks to offer such premiums if they are "nominal" in value.

For all of these reasons, the Corporation opposes the enactment of legislation that would categorically prohibit the types of giveaways now permitted by agency regulation.

FULL DEPOSIT INSURANCE FOR PUBLIC UNITS

Sections 25 and 26 of the bill would amend the Federal Deposit Insurance Act and Title IV of the National Housing Act to require the Corporation and the Federal Savings and Loan Insurance Corporation to insure the deposits and accounts of public units for the full aggregate amount of such deposits or accounts, rather than to the maximum amount of $20,000 currently provided for other depositors. They would permit the two agencies to limit the aggregate amount of funds that could be deposited in insured banks or invested in institutions insured by the Federal Savings and Loan Insurance Corporation.

According to the bill's sponsors, the theory underlying the proposal for full insurance of public deposits or accounts is that, as bank failures have "increased," a number of public units have suffered substantial losses, with the result that Federal, State, and local governments have had to increase taxes to recoup these losses. Without at this point enlisting arguments for or against the proposal, the Corporation wishes only to state that this theory is not supported by the evidence.

The Corporation recently completed a study of public deposits, recoveries, and losses in the 50 banks which closed from January 1, 1960 to December 31, 1970. Those 50 banks had 270 public depositors with a total of $37,224,130.16 on deposit. As of year-end 1970, the public units involved had recovered 98.3 percent, or $36,595,750.84, of such deposits in one way or another. An additional $553,791.63 has been or will be recovered through liquidating dividends paid by the FDIC, thereby resulting in a total recovery of 99.8 percent and an estimated net loss of only $74,587.69 to all public depositors in the 50 banks. We believe this evidence clearly refutes the argument that a number of such public units have suffered substantial losses in cases where deposits were not secured or where the deposits of a closed bank were not assumed 100 percent by another institution. It is possible, of course, that recovery of their deposits was delayed and a source of inconvenience. We have no knowledge, however, that Federal, State or local taxes had to be increased to recoup losses resulting from bank failures.

In reevaluating its position with respect to the enactment of legislation that would provide full insurance protection for public deposits or accounts, the Corporation believes that some of the arguments it had advanced in opposition to such proposals are no longer convincing. There is little evidence, for example, to support the argument that a system of limited insurance causes depositors or share account holders (other than the largest ones) to select their depositories only after considering the management characteristics and capital adequacy of the various financial institutions immediately available to them or to support the argument that such a system imposes disciplinary restraint upon bankers who might otherwise succumb to presumed competitive or economic pressures which might develop as a result of the enactment of legislation providing full protection. Moreover, there may indeed be a basis for differentiating between public depositors and other depositors or share account holders in determining the

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amount of insurance coverage that should be applicable to their deposits, since public deposits represent deposits by the taxpaying public, which has no direct voice in the selection of the depository.

In an effort to determine the impact that full insurance protection for deposits of public units might have upon the FDIC's deposit insurance fund, the Corporation, as a supplement to its recent study of public deposits, recoveries, and losses in the 50 banks which closed during the period from January 1, 1960 to December 31, 1970, estimated the additional disbursements, recoveries, and losses which would have resulted if 100 percent insurance for public deposits had been applicable during that same period. In arriving at our estimates, we assumed that full payments would have been made to all public depositors in the 50 closed banks during the period studied and that the Corporation would have been subrogated to their rights against assets being liquidated. We found that the Corporation would have been required to disburse additional sums totaling $20,546,-534.41, and that total recoveries to the Corporation on account of such disbursements would have amounted to $14,630,782.68. These figures produce an additional net estimated loss to the Corporation of $5,915,751.73 for the 11-year period. The study would tend to indicate that the deposit insurance fund would not be unduly burdened if legislation providing full insurance for deposits of public units were enacted.

In reevaluating its position with respect to the enactment of legislation that would provide full insurance protection for deposits of public units, the Corporation also recognizes that other issues, such as the proposed legislation's potential effect on pledging requirements, deserve careful consideration.

Approximately 30 States require the pledging of securities by banks against State deposits and deposits by political subdivisions. Similarly, Federal statutes require that United States Government deposits in banks be secured by the pledge of Government obligations or certain other securities. In large part, deposits of State and local governments in States requiring the pledging of securities against those deposits are secured by obligations of State and local governments. To the extent that full insurance protection for public deposits might influence some States to repeal their pledging requirements, and to the extent that repealing those requirements might induce some banks—which are by far the largest holders of municipal securities—to dispose of a portion of the municipal securities in their portfolios, the enactment of legislation providing full insurance coverage for public deposits could have a disruption impact on the market for obligations of State and local governments, many of which already are experiencing substantial difficulties in obtaining adequate financing for essential services. It is conceivable, also, that the alternative investments made with the funds freed by the repeal of pledging requirements could run counter to the monetary policy being pursued at the time by the Board of Governors of the Federal Reserve System.

Your Committee and the Congress are also likely to hear arguments that the enactment of legislation providing full insurance for deposits of public units would give savings and loan associations a competitive advantage over banks, since savings and loan associations have generally been permitted to pay higher rates of interest or dividends than banks have been permitted to pay and therefore would be able to attract more public deposits because of the differential. As your Committee knows, however, under their existing flexible interest-rate authority—pursuant to which different rates on different classes of deposits can be prescribed—the Corporation, the Board of Governors of the Federal Reserve System, and the Federal Home Loan Bank Board could act to "equalize" the rates paid by banks and savings and loan associations. Therefore, these arguments would be significant only if that authority were permitted to expire or if the agencies adopted differing regulations.

After reexamining its position and weighing all of these considerations, the Corporation wishes to withdraw its past objection to 100 percent insurance of public funds and to interpose no objection to the enactment of legislation along the lines proposed by sections 25 and 26 of the bill. It strongly recommends, however, that these sections of the bill be amended so as to (a) limit such insurance, in the case of States and political subdivisions, to the funds of public units within the State in which the financial institution is located; (b) require that the aggregate amount of funds that could be deposited in banks or savings and loan associations be limited in relation to such criteria as liquidity, total deposits, and capital and that the Corporation and the Federal Savings and Loan

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Insurance Corporation prescribe uniform restrictions with respect to such limitations; and (c) require that the maximum rates of interest or dividends payable on comparable deposits be the same for all banks and savings and loan associations.

FEDERAL DEPOSIT INSURANCE CORPORATION,
Washington, D.C., April 12, 1971.

Hon. WRIGHT PATMAN,
Chairman, Committee on Banking and Currency,
House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: This is in response to your letter of February 8, 1971, in which you requested the views of the Corporation on H.R. 3287, 92nd Congress, a bill "To prohibit federally insured banks from making loans to provide for the purchase of bank stock, and for other purposes." The bill would amend section 18 of the Federal Deposit Insurance Act (12 U.S.C. 1828) by adding a new subsection "(k)" thereto. The new subsection would prohibit an insured bank from making any loan, discount, or extension of credit to provide for the purchase of stocks, bonds, debentures or other obligations of any bank.

This Corporation, as a result of the exercise of its bank supervisory functions, recognizes the possibilities of abuse that may arise from bank loans to finance the purchase of stock in other banks. We are not convinced, however, that these possible abuses are justification for the enactment of legislation that would entirely preclude insured banks from engaging in bank stock purchase loans.

Were H.R. 3287 to be enacted in its present form, essential and legitimate means of financing bank stock purchases would be foreclosed. Thus, less affluent groups could be denied the financial assistance from an outside bank that might be necessary to organize and maintain their own local community bank. Groups in sparsely populated areas of the country, where the organization and maintenance of a financial institution may be contingent upon the assistance of other established financial institutions, could find such assistance increasingly difficult to obtain.

Enactment of H.R. 3287 would also limit the feasibility of supervisory procedures frequently used in rehabilitating problem banks. Corrective action in such cases often involves the infusion of new capital by existing or new owners, and this new capital can frequently be obtained on short notice only through a loan by another insured bank to purchasers of capital stock or capital debentures issued by the problem bank.

Finally, enactment of H.R. 3287 could limit the application of Section 13(e) of the Federal Deposit Insurance Act which allows this Corporation to assist the assumption of deposits in a closed insured bank by a newly organized insured bank. In some instances the group organizing such a new bank must borrow on one or two days' notice a portion of the amount needed to capitalize the new bank. Borrowing the necessary funds from another insured bank is the usual practice, but this would be prohibited by the language of the pending bill.

In view of these undesirable effects of a complete prohibition on extensions of credit by an insured bank to finance the purchase of stocks, bonds or debentures of another bank, the Corporation believes that it would be preferable for any legislation in this area to address itself to the actual abuses sought to be curbed rather than to a complete prohibition.

To correct abuses that might arise from the speculative aspect of some bank stock purchase loans, remedial legislation might take the form of an authorization for the appropriate banking agency to promulgate regulations with respect to such loans that might, for example, prohibit 100 percent financing of such purchases by insured banks and require the purchaser to provide a significant portion of the funds necessary for the acquisition being considered. Such regulations might also include a prohibition against the extension of credit on terms more favorable than those usually charged for financing the purchase of non-bank securities or on terms which explicitly or implicitly require the deposit of bank funds with the lending institution.

As I indicated to your Committee during the course of my testimony on March 9, 1971, changes in the remedies available to the regulatory agencies when a cease-and-desist order is violated would materially assist the agencies in curbing a variety of unsafe and unsound banking practices, including those that might arise following a change of control financed by bank stock purchase loans extended by another bank. Section 7 of the Federal Deposit Insurance Act, as you know, requires the president or other chief executive officer of an

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insured bank to report a change in control of the bank to the appropriate banking agency promptly after he has knowledge of such a change. Alerted by this report, the bank regulatory agencies review closely, through regular and special examinations, any changes in management policy that might follow. A change in the cease-and-desist remedies available to the agencies could significantly assist the Corporation in taking timely and effective action where changes in management policy indicate that prompt correction is required.

While the Corporation could support legislation along the lines I have suggested, it would oppose the enactment of H.R. 3287 in its present form.

Sincerely,

FRANK WILLE, *Chairman.*

The CHAIRMAN. All right, Mr. Martin.

STATEMENT OF HON. PRESTON MARTIN, CHAIRMAN, FEDERAL HOME LOAN BANK BOARD; ACCOMPANIED BY ARTHUR W. LEIBOLD, JR., GENERAL COUNSEL

Mr. MARTIN. Mr. Chairman and members of the committee, I appreciate the opportunity to appear before you to discuss the many important issues raised by the bills under the committee's consideration.

Mr. Carl Kamp, Jr., and Mr. Thomas Hal Clarke are here. We appreciate the opportunity to discuss the many important issues raised by the bills under the committee's consideration.

May I begin by stating that our Board shares the objectives that are implicit and explicit in H.R. 5700 and the other legislative matters.

To save the committee's time, I will summarize my statement which the committee has on H.R. 5700. I will begin on page 2.

The Board reiterates its previously expressed view that brokered deposits are frequently associated with unsafe and unsound operations and recent experience has confirmed our view. The Board has had for some time a comprehensive regulation, section 563.25 of its rules and regulations for insurance of accounts, which closely regulates the use of these deposits. Although the Board's experience with brokered deposits is more limited than that of the banking agencies, the Board's experience does not justify an absolute prohibition against brokered deposits. Rather, the Board's experience points to two conclusions—that brokered deposits may be useful and proper in some cases and that the use of these deposits must be strictly controlled. The Board would therefore favor legislation which would control these deposits more stringently than at present, but which would not ban them completely. For example, the Board would support a statutory ban on the use of brokered deposits in those cases in which the receipt of the deposit is tied to the granting of a loan.

Sections 22, 23, and 24 of H.R. 5700 deal with the practice of giveaways. It is not entirely clear to the Board whether the intention of these sections is to prohibit only certain types of giveaways. The Board presently has authority to regulate the so-called premiums and has issued regulations on two recent occasions implementing that authority. In one case these regulations were issued jointly with other financial supervisory agencies and more recently a second regulation has been issued—not a regulation, but a memorandum implementing this authority.

It is the view of the Board that its present authority is adequate to control any abuses in this area. The Board coordinates the issuance and modification of its giveaway regulations with the other financial

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agencies. It appears to the Board that the present authority and regulations carry out the intent of sections 22–24 of H.R. 5700. There have been no major problems associated with giveaways.

The Board does not support sections 25 and 26 of H.R. 5700 relating to 100 percent insurance of public funds deposited in insured banks and savings and loan associations. The Board has a very limited experience with this kind of deposit, since it is not possible for them to be placed in saving and loan associations. But we raise the question whether if this legislation pertaining to insurance of public funds is enacted, whether this committee and the Congress will be subjected to strong requests, if not pressures, from other groups who want the same preference for large deposits, for example, charities, nonprofit institutions, pension funds, and the like.

With respect to equity participations, the Board believes that any prohibition of this practice would be undesirable for housing reasons. During a protracted period of tight money, such as we have just been through, the equity participation is simply a device for rationing a very limited supply of funds and can be viewed as an alternative in part to raising interest rates. It appears to us that life insurance companies and other lenders would not have made certain mortgage loans, during the period of tight money without the inducement of equity participations and that many of these institutions would have put an even larger percent of their funds into nonresidential equity outlays.

Thus, the use of equity participation has kept more funds in the housing markets, thereby reducing rents below what they would otherwise have been.

It should be noted that a ban on equity participation in mortgage loans would not automatically mean that more credit would be available for non-participation mortgage loans. It is highly likely that money would simply leave the mortgage market altogether.

The Board takes the view that equity participations in the mortgage area are still relatively new, that experience with them is limited, and that there is no evidence up to now of an adverse impact in their use. The Board intends to observe their use and to keep itself informed on the impact of equity participation in the future. We intend to keep an open mind on the subject and would not hesitate to recommend changes in the Home Owners' Loan Act which presently is interpreted to prevent equity participations by Federal savings and loan associations. We could not ask for such authority at this time. We know these equity participation loans may carry an element of risk. The degree of that element is uncertain to us. We would prefer to meet the question of risk with the write-down powers that we will be asking the Congress for in the Housing Institutions Modernization Act of 1971, section 401 of that act, and these are the so-called write-down powers for assets in which losses can be proved to have occurred.

With respect to interlocking relationships and restrictions on and disclosure regarding loans, the Board suggests a different approach from that embodied in H.R. 5700. This suggestion is borne of the Board's quite extensive experience in these areas and its current activities in adopting regulatory controls applicable to these matters.

The committee will recollect that late last July the Board proposed a comprehensive set of regulations dealing with disclosures and conflicts of interest, subjects which are generally the same as the issues raised in H.R. 5700. These proposals were the subject of an unprece-

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dented volume of public comment. The committee will also recall that these public comments raised a series of extremely difficult and complex technical and administrative problems, totally aside from any underlying questions of policy and philosophy.

In November of last year the Board adopted two of the proposed regulations, substantially modified, and a new statement of policy on conflicts of interest—these went to the selection of the depositor and the conditions for loans by the institutions we supervise—the statement of policy and the new regulation, Mr. Chairman, are attached to the statement. I won't take the committee's time there.

In the last few days, the Board sent to the Federal Register for comment a major portion of the initial proposed regulations as redrafted. A copy of these proposed regulations is attached. The Board believes that, if you will examine these new proposals carefully, you will see the impact in this area. I won't take the committee's time to enumerate the many kinds of transactions and relationships that are covered. They are in the attached proposed regulation.

The regulations show, we believe, the complexity and the difficulty of formulating fair, workable, and absolutely enforcible rules in this area. All of this experience leads the Board to three major conclusions:

(1) It is not possible to deal with this area properly by means of rigid statutory formulae.

(2) If regulation in the area is to be effective, an enforcement mechanism must be set up which is clearly designated and which is sufficiently flexible to cope with all efforts at evasion and avoidance. Furthermore, such regulations must be comprehensive and the statutory authority likewise comprehensive.

In section 203 of the proposed Modernization Act of 1971 we ask for congressional empowerment to reach insured institutions and member institutions in the name of comprehensibility.

(3) If regulation in this area of conflict of interest is to be fair, particularly from the standpoint of preserving competitive equality among financial institutions to which the chairman alluded in his opening statement, it will be necessary to set up a procedure for coordination among the various financial agencies and to require, as nearly as may be possible, uniformity of regulatory standards.

The Board understands that the administration is developing a legislative proposal which would provide the financial supervisory agencies with general regulatory authority to promulgate specific regulations tailored to prevent those interlocking relationships which have proven to be the basis of abuse. The proposal would require consultation among these agencies in the issuance of these regulations.

I want to emphasize that the Board fully concurs in the objectives of these pieces of legislation. Our new proposed regulations indicate that the Board shares many of the concerns that the committee has. They indicate that the Board is actively involved in this area. If there are any differences between the view of the Board and the provisions of H.R. 5700 and the other legislation here, these differences are ones of approach and technique, not of basic purpose.

Section 402 of our proposed Modernization Act is a case in point. Here we ask for authority to examine the affiliates of institutions bearing a 25 percent ownership relationship rather than the present one. I am sure that after the exposure of the ideas which this hearing is designed to accomplish, and the extensive array of witnesses to which

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the chairman has alluded, a concensus can be reached as to how to attack these problems.

We know that, related to this question mergers may tend to create problems as to size, as to competition, as to the boards of directors, and section 404 of our proposed Modernization Act is an effort to get clarifying language so that the board will have authority over—comprehensive authority over—State charter to State charter mergers.

That concludes my statement, Mr. Chairman. I appreciate your courtesy and your presence.

(Mr. Martin's prepared statement follows:)

PREPARED STATEMENT OF PRESTON MARTIN, CHAIRMAN, FEDERAL HOME LOAN BANK BOARD, REGARDING H.R. 5700 AND H.R. 3287

Mr. Chairman and Members of the Committee, I appreciate the opportunity to appear before you to discuss the many important issues raised by the bills under the Committee's consideration.

H.R. 3287 would amend section 18 of the Federal Deposit Insurance Act to prohibit insured banks from making loans to provide for the purchase of securities of any bank.

H.R. 5700 (The "Banking Reform Act of 1971") is designed to accomplish five principal purposes: (1) controlling certain interlocking relationships among financial institutions and between them and other businesses; (2) making certain restrictions and requiring certain disclosures in connection with loans made by financial institutions; (3) prohibiting brokered deposits; (4) controlling giveaways; and (5) expanding insurance coverage on deposits of public funds in insured banks and savings and loan associations to 100 per cent.

Federal savings and loan associations are generally without authority to make the type of loans proscribed by H.R. 3287, since their lending is directed toward housing. The authority of state-chartered savings and loan associations is parallel to the authority of Federal associations in this respect. The Board would therefore defer to the views of the banking agencies on H.R. 3287.

The Board does not support sections 25 and 26 of H.R. 5700 relating to 100 per cent insurance of public funds deposited in insured banks and savings and loan associations.

The Board has previously expressed the view that brokered deposits are frequently associated with unsafe and unsound operations and recent experience has confirmed this view. The Board has had for sometime a comprehensive regulation, section 563.25 of its Rules and Regulations for Insurance of Accounts, which closely regulates the use of these deposits. Although the Board's experience with brokered deposits is more limited than that of the banking agencies, the Board's experience does not justify an absolute prohibition against brokered deposits. Rather, the Board's experience points to two conclusions—that brokered deposits may be useful and proper in some cases and that the use of these deposits must be strictly controlled. The Board would therefore favor legislation which would control these deposits more stringently than at present, but which would not ban them completely. For example, the Board would support a statutory ban on the use of brokered deposits in those cases in which the receipt of the deposit is tied to the granting of a loan.

Sections 22, 23 and 24 of H.R. 5700 deal with the practice of giveaways. It is not entirely clear to the Board whether the intention of these sections is to prohibit completely every form of giveaway or to prohibit only certain types of giveaways. The Board presently has authority to regulate giveaways and has issued regulations implementing that authority. It is the view of the Board that its present authority is adequate to control any abuses in this area. The Board coordinates the issuance and modification of its giveaway regulations with the other financial agencies. It appears to the Board that the present authority and regulations carry out the intent of sections 22–24 of H.R. 5700.

With respect to equity participations, the Board believes that any prohibition of this practice would be undesirable. It is, of course, understandable that the borrower of funds dislikes the insistence of lending institutions on equity participation. However, it is our impression that equity participation reflect economic forces that would be difficult to suppress. One such force is the longer-run trend toward equity participation by many financial institutions in a wide variety of areas. Many financial institutions can, to at least a limited degree, own property, common stock, or bonds that provide equity participation through a conversion

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privilege or through warrants. Financial institutions view such direct or indirect equity holdings as a desirable form of diversification that can raise overall returns in the long-run and provide some hedge against inflation. Given the option of these types of equity participation open to many lenders, it is understandable that they should seek out similar equity opportunities in the mortgage market.

Secondly, during a protracted period of tight money, such as we had through early 1970, the equity participation is simply a device for rationing a very limited supply of funds and can be viewed as an alternative, in part, to raising the interest rate. It appears that life insurance companies would not have made certain mortgage loans during the period of tight money without the inducement of equity participation and would have put an even larger percentage of their funds into non-residential equity outlets. Thus, the use of equity participations has kept some funds in the housing markets, thereby reducing prices and rents below what they would otherwise have been.

It should be noted that a ban on equity participation in mortgage loans would not automatically mean that more credit would be available for straight mortgage loans. It is highly likely that money would simply leave the mortgage market altogether.

The Board takes the view that equity participations in the mortgage area are still relatively new, that experience with them is limited, and that there is no evidence up to now of an adverse impact in their use. The Board intends to observe their use and to keep itself informed on the impact of equity participation in the future. We intend to keep an open mind on the subject and would not hesitate to recommend changes in the Home Owners' Loan Act which presently is interpreted to prevent equity participations by Federal savings and loan associations.

With respect to interlocking relationships and restrictions on and disclosure regarding loans, the Board suggests a different approach from that embodied in H.R. 5700. This suggestion is born of the Board's quite extensive experience in these areas and its current activities in adopting regulatory controls applicable to these matters.

The Committee will recollect that late last July the Board proposed a comprehensive set of regulations dealing with disclosures and conflicts of interest, subjects which are generally the same as the issues raised in H.R. 5700. These proposals were the subject of an unprecedented volume of public comment. The Committee will also recall that these public comments raised a series of extremely difficult and complex technical and administrative problems, totally aside from any underlying questions of policy and philosophy.

In November of last year the Board adopted two of the proposed regulations, substantially modified, and a new Statement of Policy on conflicts of interest. Attached for your information are copies of these regulations and the Statement of Policy, along with a cover letter from me to all insured institutions. You will note from my cover letter that further action on the proposals was promised.

In the last few days, the Board sent to the Federal Register for comment a major portion of the initial proposed regulations as redrafted. A copy of these proposed regulations is attached. The Board believes that, if you will examine these new proposals carefully, you will see the complexity and difficulty of formulating fair, workable, and adequately enforceable rules in these areas. All of this experience leads the Board to three major conclusions:

(1) It is not possible to deal with this area properly by means of rigid statutory formulae and inflexible general prohibitions of the type embodied in H.R. 5700. The underlying reality is too subtle and varied.

(2) If regulation in the area is to be effective, an enforcement mechanism must be set up which is clearly designated and which is sufficiently flexible to cope with all efforts at evasion and avoidance.

(3) If regulation in this area is to be fair, particularly from the standpoint of preserving competitive equality among financial institutions, it will be necessary to set up a procedure for coordination among the various financial agencies and to require, as nearly as may be possible, uniformity of regulatory standards.

The Board understands that the Administration is developing a legislative proposal which would provide the financial supervisory agencies with general regulatory authority to promulgate specific regulations tailored to prevent those interlocking relationships which have proven to form the basis of abuse. The proposal would require consultation among these agencies in the issuance of these regulations.

I should like to conclude by emphasizing that the Board fully concurs in the purposes intended to be achieved by H.R. 5700. The Board's proposed regulations indicate that the Board shares many of the same concerns that this Committee

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has, and that the Board is actively involved in this area. If there are any differences between the views of the Board and the provisions of H.R. 5700 in this regard, these differences are simply ones of approach and technique rather than of basic purpose. I am sure that, after the exposure of ideas which this hearing is designed to accomplish, a common agreement can be reached.

The Office of Management and Budget had advised that, from the standpoint of the program of the President, there is no objection to the submission of this statement.

FEDERAL HOME LOAN BANK BOARD,
Washington, D.C., November 19, 1970.

To: The Management of Each Insured Institution.
Subject: Conflict of Interest Regulations.

Transmitted is a copy of the Board's policy statement on this subject, § 571.7, and final regulation amendments adding new §§ 563.34 and 563.35. These regulation amendments adopted on November 19, 1970 will be effective December 28, 1970. Prior to this effective date, the Office of Examinations and Supervision will issue implementing instructions for these regulations.

The policy expressed in § 571.7 is basic to the continued viability and public acceptance of the industry in contemporary society. The practices and conditions there defined will continue to receive vigorous supervisory attention.

The package of regulation amendments proposed on July 21, 1970 has been the subject of voluminous public comments. These have raised difficult and complex questions and the Board has therefore decided to implement the proposed regulations sequentially. Each stage will occur whenever the Board believes that all the questions relating to a given portion of the July 21 proposals have been resolved to its satisfaction. Hence, you may expect further action by the Board on the July 21 proposals. Unfortunately, timing cannot be predicted now.

Depositary relationships are treated in § 563.34. These relationships, both present and future, will be subject to alteration or disapproval only when harm to the institution, or the realistic possibility of such harm, might arise. If management chooses among banks solely on the basis of objective criteria, § 563.34 will have no effect other than routine reporting.

You will appreciate the objectives that § 563.35 is designed to reach. These are to minimize borrower charges and to maximize his freedom of choice. On the supply side, the regulation should foster the competition among alternative suppliers fundamental to our business system. Some changes in existing business practices are called for but the equities which will result should far outweigh the costs involved.

PRESTON MARTIN.

FEDERAL HOME LOAN BANK BOARD

No. 70-427

Date: November 19,1970.

TITLE 12—BANKS AND BANKING

CHAPTER V—FEDERAL HOME LOAN BANK BOARD

SUBCHAPTER D—FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION

Part 563—Operations

Part 571—Statements of Policy

AMENDMENTS RELATING TO CONFLICTS OF INTEREST

Resolved, That, notice and public procedure having been duly afforded (35 F.R. 12216) and all relevant material presented or available having been considered by it, the Federal Home Loan Bank Board, upon the basis of such consideration, determines that it is advisable to amend Parts 563 and 571 of the Rules and Regulations for Insurance of Accounts (12 CFR Parts 563, 571) for the following purposes: (1) regulating the depositary arrangements of insured institutions; (2) regulating the provisions of certain services to borrowers from insured institutions; and (3) clarifying the policy of the Board regarding conflicts of interest. Accordingly, said Parts 563 and 571 are amended as follows, effective December 28, 1970:

1. Part 563 is amended by adding at the end therof new § § 563.34 and 563.35 (reserving § 563.33 for future use), to read as follows:

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§ 563.34 *Selection of depositary.*

(a) Except with the prior written approval of the Corporation no insured institution may establish a depositary arrangement with a depositary on or after December 28, 1970, of which any officer, director, employee, attorney regularly serving the institution in the capacity of attorney at law, or the spouse of any such officer, director, employee or attorney is an officer, partner, director, or trustee, or owner of 10 percent or more of such depositary's stock. Any such depositary arrangement existing prior to December 28, 1970, may be continued unless disapproved by the Corporation.

(b) Any request for such Corporation approval shall be filed with a Supervisory Agent of the Corporation at the Federal Home Loan Bank of the district in which the institution is located. In taking action with respect to depositary arrangements, including disapproval of existing arrangements, the Corporation will consider the size of the depositary relative to the deposits maintained by the institution, the amount of the deposits relative to the size of the institution, the degree of the interlocking relationships, and any other factor which is or may be detrimental to the institution or investors or depositors therein or borrowers therefrom.

§ 563.35 *Certain conditions prohibited.*

(a) No insured institution or director, officer, or employee thereof may grant any loan or extend any other service of the institution on the prior condition, agreement, or understanding that the borrower contract for any of the following with any specific firm, agency, or person:

(1) insurance (except insurance or a guaranty provided by a government agency);

(2) building materials;

(3) legal services, including title examination, and escrow and abstract services; and

(4) services of a real estate agent or broker.

(b) The prohibition contained in subparagraph (1) of paragraph (a) of this section shall not be construed to prohibit an insured institution from refusing to grant a loan or extend any other service if the borrower wishes to contract, in connection with such loan or service, with a particular company, firm, agency, or person whose services, in such connection, are believed by the insured institution, on reasonable grounds, to afford it insufficient protection.

(c) The prohibition contained in subparagraph (3) of paragraph (a) of this section shall not be construed to prohibit the insured institution from requiring the borrower to pay an initial loan charge to reimburse the institution for legal services rendered to it by an attorney selected by the institution in connection with the processing and closing of a loan.

2. Part 571 is amended by revising § 571.7 to read as follows:

§ 571.7 *Conflicts of interest.*

(a) The Board has a paramount interest in the prevention and elimination of practices and conditions which adversely affect: the interests of members in insured institutions; the soundness of such institutions; the provision of economical home financing for the nation; and the accomplishment of the other purposes of Title IV of the National Housing Act, as amended.

(b) Among the practices and conditions which have such adverse effects are conflicts between the accomplishment of the purposes of Title IV set forth in paragraph (a) and the personal financial interests of directors, officers, and other affiliated persons of insured institutions. Conflicts of this type which have demonstrably resulted in such adverse effects are considered by the Board to be inherently unsafe and unsound practices and conditions. The Board accordingly holds that each director, officer, or other affiliated person of an insured institution has a fundamental duty to avoid placing himself in a position which creates, or which leads to or could lead to, a conflict of interest or appearance of a conflict of interest having such adverse effects.

(c) The Board recognizes that it is impossible to define every practice or condition which falls within the broad concept of objectionable conflict of interest. The Board has nevertheless issued various regulations to limit or prohibit certain conflicts of interest to reflect its conclusion that the conflicts so limited or prohibited are especially inimical to the accomplishment of the purposes of Title IV. However, the omission by the Board to specifically limit or prohibit other conflicts of interest should not be interpreted as tacit approval thereof. The Board or its Supervisory Agents will continue to examine those conflict-of-interest situations which are not specifically limited or prohibited under the

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regulations and will, when circumstances so warrant, take appropriate action to prevent, circumscribe or eliminate such situations.

(Secs. 402, 403, 407, 48 Stat. 1256, 1257, 1260, as amended; 12 U.S.C. 1725, 1726, 1730. Reorg. Plan No. 3 of 1947, 12 F.R. 4981, 3 CFR, 1943–48 Comp., p. 1071)

JACK CARTER, *Secretary.*

[12 CFR Part 563]

FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION

PROPOSED AMENDMENTS RELATING TO CONFLICTS OF INTEREST

Resolved, That the Federal Home Loan Bank Board considers it advisable to amend the Rules and Regulations for Insurance of Accounts (12 CFR Chapter V, Subchapter D) by amending part 563 for the purposes of regulating certain transactions among insured institutions and affiliated persons of such institutions. Accordingly, the Board proposes to amend said Rules and Regulations for Insurance of Accounts as follows:

1. Amend Part 563 by adding, immediately after § 563.32 thereof, new § 563.33 to read as follows:

§ 563.33 *Transaction with affiliated persons.*

(a) *Scope of section.* This section shall apply to all insured institutions, as defined in § 561.1 of this subchapter. However, to the extent that any provision of this section may be inconsistent with any provision of § 584.3 relating to transactions between a subsidiary insured institution of a savings and loan holding company and an "affiliate" (as defined in § 583.15 of this chapter), the provision contained in such § 584.3 shall control.

(b) *Definitions.* For the purposes of this section—

(1) *Affiliated person.* The term "affiliated person" means:

(i) Any director, officer, or employee of an insured institution, any attorney regularly serving the institution in the capacity of attorney at law, or any person who controls an insured institution;

(ii) Any member of the immediate family of any of the persons enumerated in subdivision (i) of this subparagraph;

(iii) Any company which is controlled by any of the persons enumerated in subdivision (i) or (ii) of this subparagraph, *Provided however,* That a service corporation is not an affiliated person except to the extent specifically designated as such.

(2) *Bank.* The term "Bank" means a Federal Home Loan Bank.

(3) *Board.* The term "Board" means the Federal Home Loan Bank Board or one or more of its officials who has been duly authorized by the Federal Home Loan Bank Board to act in its behalf.

(4) *Company.* The term "company" means any corporation, partnership, trust, joint stock company, or similar organization, but does not include (i) the Corporation, (ii) any Bank, or (iii) any company the majority of the shares of which is owned by (*a*) the United States or any State, (*b*) an officer of the United States or any State in his official capacity, or (*c*) or an instrumentality of the United States or any State.

(5) *Control.* A person shall be deemed to have control of

(i) an insured institution if the person directly or indirectly or acting in concert with one or more other persons, owns, controls, or holds with power to vote, or holds proxies representing, more than 10 percent of the voting shares of such insured institutions, or controls in any manner the election of a majority of the directors of such institutions;

(ii) any other company if the person directly or indirectly or acting in concert with one or more other persons, or through one or more subsidiaries, owns, controls, or holds with power to vote, or holds proxies representing, more than 10 percent of the voting shares or rights of such other company, or controls in any manner the election or appointment of a majority of the directors or trustees of such other company, or is a general partner in or has contributed more than 10 percent of the capital of such other company;

(iii) a trust if the person is a trustee thereof: or

(iv) an insured institution or any other company if the Corporation determines that such person directly or indirectly exercises a controlling influence over the management or policies of such institution or other company.

(6) *Corporation.* The term "Corporation" means the Federal Savings and Loan Insurance Corporation.

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(7) *Director.* The term "director" means any director of a corporation or any individual who performs similar functions in respect of any company, including a trustee under a trust.

(8) *Employee.* The term "employee" means any employee other than an officer or director.

(9) *Immediate family.* The term "immediate family" means (i) father, mother, son, daughter, brother or sister (whether by the full or half blood or by way of adoption) and (ii) husband or wife, or the husband or wife of any of the persons enumerated in subdivision (i) of this subparagraph.

(10) *Officer.* The term "officer" means the chairman of the board, president, vice president, treasurer, secretary, or comptroller of any company, or any other person who participates in its major policy decisions.

(11) *Person.* The term "person" means an individual or company.

(12) *Subsidiary.* The term "subsidiary" of a person means any company which is controlled by such person, or by a company which is a subsidiary of such person.

(13) *Supervisory Agent.* The term "Supervisory Agent" means (i) the President of the Bank of the Federal Home Loan Bank district in which the insured institution has its principal office, or (ii) any other person who is specifically authorized by the Corporation to act in its behalf in the administration of this subchapter.

(*c*) *Prohibited transactions.* No insured institution shall directly or indirectly:

(1) Invest any of its funds in the stock, bonds, debentures, notes, or other obligations of any affiliated person;

(2) Accept the stock, bonds, debentures, notes, or other obligations of any affiliated person (including a service corporation) as collateral security for any loan or extension of credit made by such institution;

(3) Purchase securities or other assets or obligations under repurchase agreement from any affiliated person (including a service corporation);

(4) Make any loan, discount, or extension of credit to

(i) Any affiliated person except:

(*a*) in a transaction authorized by subparagraph (8) of this paragraph; or

(*b*) a real estate loan on the security of a first lien on a home (as defined in § 541.10–2 of this chapter) or a combination of home and business property (as defined in § 541.11 of this chapter) owned and occupied by such affiliated person; or

(*c*) a loan for the purpose of alteration, repair, or improvement of a home (as defined in § 541.10–2 of this chapter) or a combination of home and business property (as defined in § 541.11 of this chapter) owned and occupied by such affiliated person; or

(*d*) a loan for the purpose of financing a mobile home (as defined in § 545.7–1 of this chapter), secured by mobile home chattel paper (as defined in § 545.7–1 of this chapter), such mobile home to be owned and occupied by such affiliated person; or

(*e*) a loan secured in full by shares, savings accounts or deposits maintained by such affiliated person in such insured institution; or

(ii) Any third party on the security of any property acquired from any affiliated person, or with knowledge that the proceeds of any such loan, discount, or extension of credit, or any part thereof, are to be paid over to or utilized for the benefit of any affiliated person;

(5) Guarantee the repayment of or maintain any compensating balance for any loan or extension of credit granted to any affiliated person (including a service corporaton) by any third party;

(6) Make to any affiliated person other than an employee any loan at a rate or with terms more favorable than the prevailing market rate or terms;

(7) Pay to an affiliated person (including a service corporation) to enter into any agreement or understanding under which there is reason to believe that such affiliated person is to receive from any other source: (i) any fee or other compensation of any kind in connection with the procuring of any loan from or by such insured institution; or (ii) any discount, rebate, or commission on any initial loan charge paid by a borrower (or any other person) in connection with the making of a loan; and

(8) Except with the prior written approval of the Corporation engage in any transaction with any affiliated person involving the purpose, sale, or lease of property or assets (except participating interests in mortgage loans to the extent authorized in this subchapter, but including any office building or any portion thereof or any land on which to erect an office building).

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(d) *Corporation approval.* (1) *Basis.* The Corporation will not grant approval under subparagraph (8) of paragraph (c) of this section if, in the opinion of the Corporation, the terms of any such transactions by such institution would be detrimental to the interests of its savings accountholders or to the insurance risk of the Corporation with respect to such institution or would constitute an unsafe or unsound practice.

(2) *Approval by Supervisory Agent.* The Supervisory Agent shall have authority to give prior written approval on behalf of the Corporation to any transaction, agreement, or understanding, or payment, requiring such approval under subparagraph (8) of paragraph (c) of this section, and which is not given approval under this section.

(3) *Filing of applications.* Applications for Corporation approval under subparagraph (8) of paragraph (c) of this section shall be in letter form and shall contain a full and complete description of the subject matter of the application, including the consideration to be paid and the basic therefor. Copies of pertinent contracts, agreements, or other documents shall be attached thereto. Applications shall be filed with the Corporation by transmitting the original and one copy to the Supervisory Agent, and one copy to the Director, Office of Examinations and Supervision, Federal Home Loan Bank Board, 101 Indiana Avenue, N.W. 20552.

(Secs. 402, 403, 407, 48 Stat. 1256, 1257, 1260, as amended; 12 U.S.C. 1725, 1726, 1730. Reorg. Plan No. 3 of 1947, 12 F.R. 4981, 3 CFR, 1943–48 Comp., p. 1071)

Resolved further, That interested persons are invited to submit written data, views, and arguments to the Office of the Secretary, Federal Home Loan Bank Board, 101 Indiana Avenue, N.W., Washington, D.C. 20552, by June 18, 1971, as to whether this proposal should be adopted, rejected, or modified. Written material submitted will be available for public inspection at the above address unless confidential treatment is requested or the material would not be made available to the public or otherwise disclosed under § 505.6 of the General Regulations of the Federal Home Loan Bank Board (12 CFR 505.6).

The CHAIRMAN. I would like to ask Mr. Wille a question or two, and then ask Mr. Martin a few questions.

A commercial bank, Mr. Wille, can lend money anywhere in the country. Of course, large commercial banks do lend money to customers all over the country. So do the big insurance companies and the mutual savings banks. Savings and loan associations can now lend money for projects within a 100 miles radius, which can in many cases include several States.

I would like for you to answer this for the record when you get your transcript. I will not take the time to ask for your reply.

How would your proposal work in regard to the many hundreds of competing financial institutions that operate in large regions of the country, even nationwide? I will submit for the record a number of questions which I would like to have answered when you go over your transcript.

Now, Mr. Martin, you bring up the question about more interest through the kicker arrangements and through compensating balances, and you believe that would, of course, encourage more homes to be built and the more homes that are built the less rent is probably charged, because there will be more competition.

But what you are actually saying, if I understand it correctly, is that you believe that people who want to buy homes—that is part of the environmental quality, we will say, that we must have—should pay the same rate of interest that people pay who are compelled to go into the marketplace in competition with everything to get that money. It just happens I do not share your views. I think that the housing industry is entirely in a different category, that the Government should make it clear that money will be available for the construction of residential housing for the purpose that I mentioned, environmental

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quality, and to give people a home—decent, stable home—in which to live.

If we do what you have indicated, we would place a homeowner, the would-be homeowner, in competition with a lot of people that he couldn't compete with in order to get money. We would place him in competition with the huge banks of the country that are not really subject to usury laws, who can pay any amount of interest or they can charge any amount of interest and big corporations can do the same thing, because most usury laws apply to individuals only and not corporations, and where it applies to corporations we can cross a State line very easily in a taxicab and get the contract signed over there. So you are in effect saying, if I am correct, that you want the people who buy homes to get their money in competition with these big concerns that are not restricted by interest, and besides, they get tax deductions if they pay 12 percent for all effective purposes; it costs them less than 6 percent.

So they are in a position of great advantage. They are also in competition with the speculators who can pay high amounts of interest for money, and they are in competition with the high-interest loan companies that can pay any amount of money, and they are in competition with the gambling casinos.

Now, how can you expect homeowners to get an interest rate that will enable them to buy homes in competition with the ones that I have indicated, and remember now that the interest rates have gone down probably about 1 percent, the last year or year and a half on long-term loans. But if a person who goes into the market today to buy a home, a $20,000 home, he must obligate himself not only to pay that $20,000 but also over $30,000 interest on that loan.

In other words, more than $50,000. How do you justify your insistence that the homeowners must be in competition with the gambling casinos and speculators and other people that I named, Mr. Martin?

Mr. MARTIN. Mr. Chairman, I share your concern that the homeowner is not able to compete. The homebuyer is not able to compete with these other demanders of funds in a market.

I do not wish to mislead and indicate that the position of the Federal Home Loan Bank Board is that equity participation associated with homeowner borrowing is a good thing. We are only asking for a consideration of the facts regarding equity participation, and its use during tight money periods.

The use of the equity participation has fallen off very dramatically lately. We note that the equity participation was primarily used by life insurance companies and pension funds in the building of large housing projects during the recent tight money period, and that the use has fallen off.

We simply would hate to see those projects deferred until tight money ends, thus accelerating the contraction in housing during this tight money period. We again are not asking for legislation to permit Federal savings and loans to make this kind of piece of the action lending.

The CHAIRMAN. Just one short question, and then I will yield to Mr. Widnall.

The argument that you make applies not only to so-called equity kickers, but to compensating balances, too, because that is another way of getting more interest as you said awhile ago—you didn't

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say more interest, but the way you had it in your statement was the more money they made the more houses they would build and building more houses, there would be more houses available for rent and thus the price of houses for rent would probably not be as high.

But that same argument could be used for compensating balances too, couldn't it?

Mr. MARTIN. We had no position on compensating balances, since this is more associated with banks than with savings and loans. We defer to you and the banks on that.

The CHAIRMAN. I agree with you, it does relate to banks.

(The following are written questions submitted by Chairman Patman to Mr. Wille, along with Mr. Wille's answers:)

Question 1. "Why not have a bill prohibiting bank loans where:

"(a) An insider is involved;

"(b) There is no payment of principal or final end of the payout of the loan;

"(c) Loans are made at a lower than prevailing interest rate?"

Answer. A bill containing all three of the criteria stated might appear reasonable, but a clarification of terms would be required before such a prohibition against "insider loans" could be effectively enforced. Assuming an appropriate definition of "insider," how would the "prevailing interest rate" in (c) be determined? Could the condition in (b) be satisfied by a relatively insignificant payment at or prior to maturity? For purposes of the same condition. how would formal repayment followed by a new extension of credit be treated? Would the requirement apply regardless of the type or value of any collateral that might be furnished?

The thrust of the prohibition in (b) would raise significant problems for borrowers committed on demand loans or whose method of operation required more-or-less continuous extension of loans for working capital. Moreover, demand loans and loans of short-term maturities permit the bank making them to adjust the rates of interest when market conditions change, even though continuous borrowings are expected and the borrower is completely credit-worthy.

The condition stated in (c), even if "prevailing interest rate" is adequately defined, may already be a violation of State law in some States, or at least a breach of fiduciary duty, if there is no business justification for the lower rate.

For State-chartered banks generally, the suggested prohibition might well raise problems of consistency with any State law that was applicable.

These various considerations suggest further the wisdom of some administrative flexibility in the area of insider loans, rather than the inflexible statutory formula originally contained in H.R. 5700.

Question 2. "While supporting the idea of strengthening provisions of existing law regarding interlocks between various types of financial institutions, you suggest that a defined geographic area be used. How would you define that geographic area?"

Answer. I would define the geographic area as that area of overlap in which the various types of financial institutions named, or holding company affiliates of such institutions, may establish offices under applicable provisions of State or Federal law. For commercial banks and mutual savings banks whose principal officers are in New York City, for example. such a definition would bar interlocking relationships between such institutions and other financial institutions of the types named which are authorized to establish officers either in the city of New York or in the counties of Nassau or Westchester. since New York law permits such banks to branch or merge throughout New York City and to branch, with one or more offices, into the counties of Nassau or Westchester. The bar would apply even if the institutions involved had not actually established such offices. Under this kind of definition. the area in which interlocks were prohibited would obviously vary, depending both upon the provisions of State or Federal branching laws that applied and upon the institutional type named in the prohibitory statue.

For the sake of simplicity, the Corporation would support a *statewide* prohibition barring interlocks between commercial banks. mutual savings banks, savings and loan associations, and similar financial institutions. Federal savings and loan associations are not bound by State laws and can branch statewide to-

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day. One-third of the 50 States, moreover, permit statewide commercial bank branching while a number of additional States permit bank holding companies to operate statewide.

Another alternative, for a more densely populated area, would be to use the Standard Metropolitan Statistical Area as the geographical area in which interlocks between financial institutions of the types named would be barred.

Question 3. "A commercial bank can lend money anywhere in the country and, of course, the large commercial banks do lend money to customers all over the country. So do the big insurance companies and mutual savings banks. Savings and loan associations can now lend money for projects within a 100-mile radius, which can in many cases include several states. How would your proposal work in regard to the many hundreds of competing financial institutions that operate in large regions of the country or even nationwide?"

Answer. The appropriate Federal bank regulatory agency could find that competition might be lessened substantially because of the existence of interlocking relationships between the competing financial institutions named and could administratively extend the general prohibition against interlocks with a statutorily defined geographic area to the institutions so involved in regional or national markets on a case-by-case basis.

The recommendation submitted by the Board of Governors of the Federal Reserve System for prohibiting interlocks between all banks or other financial institutions having over $1 billion in assets, regardless of where they are located, might be an acceptable alternative to the approach I suggested during my testimony before your Committee on April 20, but it would not cover many interlocking relationships between institutions competing in regional, as opposed to national, markets which cross State lines.

Question 4. "Over the years California savings and loan associations have advertised for deposits in the East in competition with financial institutions in the areas in which they advertise. Wouldn't this circumvent any geographic area test you might devise?"

Answer. No. Under that part of the proposal which would authorize the appropriate Federal bank regulatory agency to extend a general prohibition against interlocking relationships within a defined geographic area to similar relationships beyond that area if it found that the existence of such relationships might have a substantial anticompetitive effect, the agency could prohibit interlocking relationships between a California savings and loan association and financial institutions headquartered or doing business in the East if it found that competition for deposits or mortgage loans might be substantially lessened as a result of the existence of an interlocking relationship.

Question 5. "According to a study done a couple of years ago, the Chase Manhattan Bank in New York City had two director interlocks with the Travelers Insurance Company of Hartford, Connecticut. These two institutions are not located in the same geographic area, but both do substantial nationwide business even though headquartered in different geographic area. How would your proposal take care of this kind of problem?"

Answer. Again, the appropriate Federal bank regulatory agency could prohibit the interlocking relationships to which the question refers if it found that their existence might tend to lessen competition substantially in one or more "lines of commerce" within a relevant geographic market.

Question 6. "This same study showed that the Chase Manhattan Bank had two interlocking directorships with the First National Bank of Chicago, that city's second largest bank and one of the ten largest in the United States. Would you consider them competitors?

"How would you handle such a situation legislatively?"

"If so, shouldn't these interlocks be prohibited?

Answer. The Chase Manhattan Bank (National Association) and The First National Bank of Chicago are, of course, substantial competitors for certain types of banking business of many of the same potential customers. Interlocking relationships between two such sizable institutions should therefore be prohibited. Again, the interlocking relationships to which the question addresses itself could be handled, as I suggested during my testimony before your Committee on April 20, by the enactment of legislation that would, in addition to prohibiting such relationships within a statutorily defined geographic area, also prohibit such relationships where the appropriate Federal agency found that the existence of such relationships might tend to lessen competition substantially, as, for example, between banks or other financial institutions which were actual or potential competitors in a national market.

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Should the Congress decide, however, that a flat statutory prohibition against such relationships is desirable, the interlocking relationships between Chase and First National of Chicago could be prohibited by the enactment of legislation, along the lines suggested by the Board of Governors of the Federal Reserve Syetem, that would prohibit interlocks between all banks or other financial institutions having over $1 billion in assets, regardless of where they are located.

Question 7. "In view of the rather substantial resources and income of FDIC, are you presently giving any thought to recommendations for a reduction in deposit insurance premiums or do you think they should be maintained at their present levels?"

Answer. Because of the Corporation's recent loss experience, the net assessment—i.e., the total assessment becoming due less the credits required by statute—increased this past year. Because of this recent loss experience, the Corporation is not currently considering recommending the enactment of legislation that would reduce the net assessment payable by insured banks. The Corporation reviews this question on a regular basis and may, of course, recommend changes in the future in the level of deposit insurance assessments depending on such factors as overall loss experience, the risks presented to the Corporation's insurance fund, and changes in insurance coverage or methods of regulation.

Question 8. "On page 8, you raised certain objections to prohibiting an interlocking directorship where a financial institution holds more than 5 percent of the stock of a corporation with power to vote. It seems to me that your only objection to this provision is that there is a subsanial area for violaion of this provision through various contingencies unforeseen by the financial institutions. An exception could be put into the bill for the types of contingencies you discuss, such as foreclosure on a loan and the receipt of stock by a bank trust department named as executor in an estate. The purpose of this provision is to reduce the possibility that a financial institution would gain control or undue influence over another corporation through a combination of substantial stockholdings and director interlocks. It the problems you raise could be met by certain exemptions in the Act, would you support this provision?"

Answer. Without reviewing the exact language of the proposal suggested, I can express no opinion as to its merit or workability. The question does not indicate, for example, whether the revised proposal would prohibit interlocking relationships during the period of retention of the stock in the two instances cited, subsequent to receipt, or whether the prohibition would apply if the voting of the stock by the financial institution could be directed only by a settlor, donor, beneficiary or a co-fiduciary.

Moreover, while administration of an estate is usually of short duration, many such administrations are not. The question does not indicate how the revised proposal would apply in such instances.

Question 9. "On page 9 of your testimony, you state that there should be a geographic area limitation on the prohibition of mutual savings banks holding of stock in other financial institutions. It is not true that New York State law prohibits mutual savings banks from owning any commercial bank stock regardless of any actual competitive situation between the mutual savings bank and the bank whose stock the mutual savings bank might own? Has this created any serious problems for the investment of funds by mutual savings banks in New York?"

Answer. Section 235(26)(c) of the New York Banking Law specifically prohibits a New York mutual savings bank from investing in the stock of any bank, trust company, national bank, or banking corporation headquartered in New York State. The geographic limitation is derived from the definitions of these terms contained in Section 2 of the New York Banking Law. The prohibition has not, to my knowledge, created any serious problems for the investment of funds by New York mutual savings banks.

Question 10. "Given the large number of securities that the public may invest in, would a prohibition against mutual savings banks owning stock in other financial institutions really be a substantial burden on their investment programs?"

Answer. A prohibition against mutual savings banks' owning stock in other financial institutions is not likely to interfere substantially with their investment programs. Such a prohibition, like others in the bill, raises the gen-

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eral question, however, whether it is appropriate for Federal statutes to restrict the investment powers of mutual savings banks, all of which are State-chartered.

Question 11. "In your discussion of insider loans you state that from the standpoint of safety and soundness, the important thing 'is a careful and thorough credit analysis of the loan application and the ability to deny the loan if the analysis shows the corporation is a poor credit risk, not the fact that 5 percent or more of the stock is owned by insiders.' However, wouldn't 'the ability to deny the loan' be much less likely to exist if officers or directors of the bank had a substantial interest in the firm seeking the loan?"

Answer. The ability to deny a loan would not necessarily be restricted merely because directors or officers of the corporation seeking credit serve also as directors or officers of the bank to which the application for credit is made, since such directors or officers frequently do not participate either in the discussions concerning the extension of credit or in the decision to extend the credit. Such voluntary disqualifications are not uncommon among well-run banks, whose directors and officers are sensitive to possible criticism from shareholders and others.

I trust that my responses to these questions will be helpful to the Committee during its deliberations. If the Corporation can be of further assistance to your Committee in any way, please do not hesitate to call upon me.

(The following are written questions submitted by Chairman Patman to Mr. Martin, along with Mr. Martin's answers:)

Question No. 1. On page 6 of your statement, you say:

"(1) It is not possible to deal with this area [conflict of interest] properly by means of rigid statutory formulae and inflexible and general prohibitions of the type embodied in H.R. 5700. The underlying reality is too subtle and varied.

"(2) If regulation in the area is to be effective, an enforcement mechanism must be set up which is clearly designated and which is sufficiently flexible to cope with all efforts at evasion and avoidance."

Would you consider your proposed conflict-of-interest regulations attached to your statement as a sound approach to the problem of conflict of interest?

Answer. Yes. The Board is convinced that the sound approach is specific regulations promulgated pursuant to general regulatory authority.

Question No. 2. Do you feel these proposals properly treat what you described as an "underlying reality [which] is too subtle and varied"?

Answer. The Board is not entirely convinced that these exact regulatory proposals embody a "proper treatment"; it is for that reason that the proposals have been issued for public comment. Nevertheless, the Board believes that regulations along the lines or of the type proposed would constitute proper treatment.

Question No. 3. If you want to see these proposals adopted as regulations, why then wouldn't you want them to be adopted legislatively?

Answer. This question goes to the very heart of the matter. The Board does not favor embodying in a statute provisions of the type found in its proposed regulations. This is the case for two main reasons.

A. It will be noted that in order to make its regulations equitable the Board has carved out exceptions to various general prohibitions. See, for example, section 563.33(c)(4)(i)(*a*)—(*e*). In addition, the Board has made certain transactions subject to prior approval rather than completely forbidden. See section 563.33(c)(8). Further, the Board has included certain persons within the meaning of the term "affiliated person" who in actual fact are rarely, if ever, the beneficiaries of conflict of interest transactions. The best example of this is the ministerial employee. Nevertheless, it is also true that some employees, such as appraisers, are frequently indispensible parties to improper transactions. The best approach to this problem is for the Board to include employees as a class within the term "affiliated person" and then to except some of them by order, opinion, or further regulatory action.

This kind of highly detailed, carefully tailored rulemaking seems to the Board to be exactly the sort of thing that should be dealt with in regulations and not in statutes. It seems to the Board this is precisely the sort of problem that administrative agencies were set up to handle. "A legislative body is at its best in determining the direction of major policy, and in checking and supervising

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administration. It is ill-suited for handling masses of detail, or applying to shifting and continuing problems the ideas supplied by scientists or other professional advisers. Experience early proved the inability of Congress to prescribe detailed schedules of rates for railroads, or to keep abreast of changing needs concerning the level of import duties. Generally our legislative bodies developed the system of legislating only the main outlines of programs requiring constant attention, and leaving to administrative agencies the tasks of working out subsidiary policies. This system faciliated not merely the promulgation of law through rules and regulations but the correlation of rule making with other necessary activities as adjudication, investigating, prosecuting, and supervising." Davis, *Administrative Law*, section 1.05.

B. Once a detailed statute is enacted, the activities of the persons subject to the statute are altered. Some alternations are for the sake of compliance, some for the sake of evasion. It then becomes necessary to amend the statute since those who evade it mock both the law and those who comply with it. Statutory amendment however, is a lengthy and elaborate process, ill-suited for the continuing surveillance and checking of efforts at evasion. "Although the choice between legislative and administrative enunciation of policy is usually a choice between two complex sets of cooperative arrangements by which many parts of the governmental establishment contribute to policy formulation, the special aptitudes and limitations of Congress and of the agencies bear on the problem. Constant, continuing action can hardly be provided by the legislative process.—The legislative process is especially qualified and the administrative process is especially unfit for the determination of major policies that depend more upon [political questions] than upon investigation, hearing and analysis." Davis, *Administrative Law*, section 2.16.

The board submits that the type of questions dealt with in H.R. 5700, apart from the general policy questions, are classically better suited to determination by administrative regulation rather than legislative enactment.

Question No. 4. On page 3 you say, "With respect to equity participation, the Board believes that any prohibition of this practice would be undersirable."

Do you recognize that the practice of equity participation puts savings and loans associations into non-banking businesses and that in fact the practice is directly counter to the thrust of bank holding company laws?

Answer. As indicated in the Board's testimony, Federal savings and loan associations are without power to employ the device of equity participations. As also indicated in the Board's testimony, the Board does not favor at this time granting this power to savings and loan associations.

Question No. 5. On page 3 you also say, "Financial institutions view such direct or indirect equity holdings as a desirable form of diversification that can raise overall returns in the long run and provide some hedge against inflation."

Don't you recognize that equity participation is itself highly inflationary since it diminishes the owner's return and therefore forces him to increase the price or the rental of the property?

Answer. The Board does not recognize that equity participation is highly inflationary or even inflationary at all. It is true that an equity participation may operate in some cases to increase the price or rental of the property since it increases one of the factor costs in the production of the property. However, these cases are quite rare since in most cases equity participations are on a residual basis and therefore do not enter into the factor cost. On the other hand, the use of the participation enables properties to be produced which would not otherwise be produced. Hence, the participation increases supply and such an increase has the effect of lowering prices, all other things being equal. Equity participations are sufficiently rare, and the data concerning them sufficiently scarce, that it is unknown whether the price decrease due to increased supply is outweighed by the price increase due to the increase in factor costs. Certainly the data do no suggest an inflationary impact of any consequence. This lack of data on which to base an informed legislative judgment is one of the reasons why the Board believes that an absolute prohibition cannot be justified at this time.

Question No. 6. Would you favor legislation which would confine equity participation to the term of the loan? (Since the issue essentially centers on construction loans, equity participation in this case would be of short duration.)

Answer. The meaning of this question is not clear. Since the property produces no income during the construction state, it does not seem that an equity par-

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ticipation could exist at that time. It would appear therefore that the legislation suggested in the question is an indirect method of banning equity partcipations, which the Board has already stated it does not favor.

Question No. 7. On page 4 you say, "It should be noted that a ban on equity participation in mortgage loans would not automatically mean that more credit would be available for straight mortgage loans. It is highly likely that money would simply leave the mortgage market altogether."

Are you saying in effect that market interest rates and down payment arrangements are no longer acceptable to financial institutions and that in fact the effective interest rate on mortgage loans has to be far higher than the rate stated on the loan contract?

Answer. The answer to the question depends on what is meant by the phrases "market interest rates" and "effective interest rates". The effective cost of money to the borrower and the effective return to the lender are based on many factors: The amount of the down payment, the contractual interest rate, discounts, loan fees, charges for services, the extent and frequency with which funds are disbursed, compensating balances and the like.

Under normal economic circumstances, it will be acceptable to the lender to adjustment to the market, that is, to negotiate his effective return, by varying the down payment arrangements, the contract interest rate and the loan fees. Under abnormal circumstances, the lender will adjust by using additional variables. Higher points will be charged, additional fees and charges will be required, disbursements will be less frequent and the like. Of course, the lender could decide not to employ any of these additional variables. In that case, the down payments would increase and the contract interest rate would rise considerably.

Hence, the issue is not whether "interest rates and down payment arrangements are no longer acceptable to financial institutions" and "whether the effective interest rate on mortgage loans has to be far higher than the rate stated on the loan contract". The issue is how many variables the lender will be allowed to use in adjusting to the market. An equity participation is, in essence, another of these variables. It may be that there are peculiar characteristics associated with this variable that may render it unacceptable for use. It remains the view of the Board, however, that such charactertistics have not been demonstrated.

Question No. 8. If you agree that the effective interest rate has to be much higher, what rate do you think reasonable?

Answer. Not applicable in view of the previous answer. The Board does wish to note, however, that it is probably not meaningful to speak of an interest rate as "reasonable" or unreasonable in the abstract. An interest rate either reflects the market or it does not. The Board regards efforts to suppress free market forces in the determination of interest rates as tending to distort the allocation of resources at the expense of housing, which is a low priority investment to diversified lenders.

Question No. 9. The attachments to your statement include a series of proposals prohibiting conflict-of-interest situations among savings and loan associations. The proposals are similar to provisions of H.R. 5700, but unlike the bill, the proposals would achieve reform through expanded regulatory authority rather than setting the changes in law.

The proposed restrictions are presented on page 4 of the Proposed Amendments Relating to Conflicts of Interest.

The overriding question here is whether you would endorse putting the proposed conflict of interest regulations in legislative form. Stated briefly, the proposals would:

1. Prohibit savings and loan associations from investing in the obligations of an affilitaed person (including members of their immediate families) or accepting such obligations as collateral for a loan.

2. Prohibit any loan or extension of credit to affiliated persons except with the written approval of the FSLIC. That approval can be given only if the terms of the loan, in the opinion of the FSLIC, are not detrimental to the interests of depositors or does not constitute an unsound insurance risk.

3. Prohibit affiliated persons from receiving any compensation in connection with the granting of a loan by a savings and loan association.

4. Prohibit savings and loan associations from guaranteeing the repayment of a loan or maintaining compensating balances to or for affiliated persons.

The proposals in some respects are far more restrictive than the provisions of H.R. 5700 that go to loans to affiliated persons or members of their immediate

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families. The bill would prevent banking institutions, including savings and loan associations, from making loans to corporations where 5 percent or more of any class of stock of the corporation is owned in the aggregate by the directors, trustees, officers or employees or members of their immediate families.

It also requires the public disclosure of loans but does not prevent loans being made to affiliated persons or members of their immediate families.

For all intents and purposes, section 11 of H.R. 5700 is identical with the Federal Home Loan Board proposals prohibiting affiliated persons from receiving compensation in connection with the procuring of any loan.

Why wouldn't you want to see these proposals adopted in legislative form?

Answer. See answer to Question No. 3.

Question No. 10. On page 2 of your statement you say: "The Board would therefore favor legislation which would control these [brokered] deposits more stringently than at present, but which would not ban them completely. For example, the Board would support a statutory ban on the use of brokered deposits in those cases in which the receipt of the deposit is tied to the granting of a loan."

Would you favor amending H.R. 5700 to ban only those types of brokered deposits?

Answer. As indicated, the Board would favor a ban on the link-financing type of arrangement. The Board believes that in the drafting of such a ban the phrase "directly or indirectly" should be employed in order to control efforts at evasion. The answer to Question No. 11 indicates that the Board would consider additional controls as well.

Question No. 11. What specific control do you want for other types of brokered deposits?

Answer. As indicated in the oral testimony on April 20, the Board believes that most of the problems with brokered deposits (aside from the link-financing aspect) would be eliminated if the deposits took only the form of longer term certificate deposits. As also indicated in the oral testimony, such a requirement would tend to eliminate the "churning" or brokered deposits. The Board does not necessarily "want" such a limitation but would not seriously object to it.

Question No. 12. If you acknowledge the need for more stringent control of brokered deposits, why hasn't the Federal Home Loan Bank Board and/or the FSLIC exercised it?

Answer. As indicated in the Board's testimony, brokered deposits as such have not caused any serious supervisory problems in the savings and loan industry. Hence, the Board does not "acknowledge the need for more stringent control of brokered deposits" with respect to the savings and loan industry. The Board's support for more stringent control is based on its observation of the experience of the bank supervisory agencies.

Question No. 13. If the Federal Home Loan Bank Board and/or the FSLIC lacks needed authority, why haven't they requested it long ago?

Answer. The Board does not believe that it lacks needed authority in this area. The Board believes that its existing regulations have proven sufficient to control abuses of brokered deposits within the savings and loan industry.

Question No. 14. There is nothing in your proposed conflict-of-interest regulations which goes to interlocking directorships among financial institutions. The Federal Home Loan Bank Board's own investigation conducted by Irwin Friend of the University of Pennsylvania leaves no doubt that such relationships are anti-competitive by their very nature. The "Friend Report" states:

In 1965 approximately two out of three savings and loan associations had at least one interlock with another financial institution, and one of the three had at least one officer affiliated with another financial institution. . . .

A small Federal association in Louisiana is dominated by the control group of a bank located across the street. . . . They run the association as if it were a branch operation of the bank.

In a small town in Mississippi, four of the seven directors of a Federal association are officers and/or directors of the two local insured commercial banks. . . . The association, which began operations in 1934, had total assets of less than $3 million in June, 1968. . . . Its rate of growth was 0.25 percent as compared with a 7 percent rate for all insured associations Mississippi.

In [a] Texas association in which the loan committee was dominated by a group of directors primarily interested in the local commercial bank, there is evidence supporting the assertion of an examiner that these bank representatives

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'used the association as a receptacle for the bank's bad real estate loans.'
The report goes on to site other examples, all of which clearly indicate that interlocking directorships among financial institutions should be eliminated. Do you agree?

Answer. No. The Board does not agree that all interlocking directorships among financial institutions should be eliminated. The Board's basic position on this subject is as follows:

A. As a general rule, the Board believes that management interlocks should be eliminated as to financial institutions which compete with one another, especially for savings.

B. Generally speaking, such interlocks will be found within certain geographic or product markets.

C. However, within those markets it will be found that in certain communities the existing pool of financial talent is sufficiently small that exceptions will have to be made in order not to do damage to the institutions and their customers.

D. The defining of the relevant geographic and product markets with respect to each type and size of institution is a task of considerable difficulty. The same is true regarding the definition of the communities whose existing pool of financial talent is too small.

E. Hence, the Board believes, as it stated in the testimony on April 20, that the control of interlocks can be accomplished best by administrative action operating within general guidelines layed down by the Congress.

F. For the same reasons, as the Board also stated in the April 20 testimony, the Board believes that the administration mechanism for the control of interlocks must include provision for prior consultation among the financial supervisory agencies.

G. Finally, the Board believes that, even in those communities where the existing pool of financial talent is scarce, is abuses can be shown, supervisory action to terminate the interlocks is in order.

Question No. 15. Do you insist that financial talent is so rare as to be confined to a small, select group in many communities?

Answer. Yes.

Question No. 16. If you insist there's not enough financial talent to go around and that the officers and directors of financial institutions in small and medium size communities must be mutually shared, then you are admitting that these financial institutions in many instances will continue to be a long way from fully competing with each other.

Answer. The Board does not admit that these financial institutions will be "a long way" from competing fully with one another. It must be acknowledged, however, that the level of competition will not be as high as it otherwise might be in all cases.

As indicated in the answer to Question 14, the Board believes that, even in those communities where the existing pool of financial talent is scarce, if abuses can be shown, supervisory action to terminate the interlocks is in order. At the present time the Board's Office of Examinations and Supervision is developing an expanded program of surveillance of interlocks among financial institutions, including interlocks in these communities. This program is designed, among other reasons, to implement section 563.34 of the Board's regulations, a copy of which was attached to the Board's April 20 testimony. Again, the Board believes that this kind of administrative action is best suited to conrol in this area.

Question No. 17. On page 5 of your statement, you say: "In November of last year the Board adopted two of the proposed regulations substantially modified, and a new statement of policy on conflicts of interest. Attached for your information are copies of these regulations. . . ."

The regulation goes to conflict of interest [*and*] *deals with depositories and insider loans. Under the new regulations, savings and loans and affiliated persons are prohibited from granting loans on the prior condition that the borrower contract for insurance, legal or real estate services or the puchase of building materials with any specific firm or person.*

How is it to be determined that a prior contract exists?

Answer. Initially, it should be noted that it is not necessary for the Board, in order to prove a violation of section 563.35, to show that a prior *contract* exists. It is only necessary to show an agreement or understanding, orally or in writing. It should also be noted that section 563.35 deals with tying arrangements, the loan being the "tying product" and the insurance, legal services, etc. being the "tied

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product". Tying arrangements are *per se* violations of the anti-trust laws. See *International Salt Co., Inc.* v. *U.S.*, 332 U.S. 392,, 68 S. Ct. 12, 92 L. Fd. 20 (1947); *Northern Pacific Railway Co.* v. *U.S.*, 356 U.S. 1, 78 S. Ct. 514, 2 L. Ed. 2d 514 (1958). Hence, in enforcing section 563.35, the Board faces the same type of evidentiary and investigative problems that the Antitrust Division faces in dealing with other tying arrangements.

Perhaps the two most common methods of determining that a tying arrangement exists are as follows: First, a borrower who has been coerced complains to the Board. Second, the Board's examiners will note during the course of an examination that a very high percentage of the hazard insurance on the properties securing loans made by the association has been written by a certain agency or company; or that a high percentage of the association's files on construction loans show disbursements to certain suppliers of building materials; and so forth. Thereafter, statistical evidence is collected and affidavits are obtained. Depending on the resourcefulness of the investigator, and the investigative resources available the resulting case can be quite overwhelming.

Question No. 18 In lieu of documentation, how can anyone really tell whether a prior contract exists?

Answer. See previous answer.

Question No. 19. Aren't you really saying that this practice exists among persons who are affiliated with savings and loans and operate real estate, legal and building material firms? Savings and loan directors, for instance.

Answer. Yes.

Question No. 20. If it is bad to have prior contracts under these conditions, isn't it also equally unacceptable to have post contracts with persons affiliated with savings and loans and other businesses?

Answer. It is not clear what the term "post contracts" means. It is assumed that the term is intended to refer to contracts and other dealings between the association and its officers and directors and businesses owned by them. Such dealings are of course frequently improper and dangerous and are forbidden or restricted by state and Federal law and regulation. It will be noted that the Board's proposed conflict of interest regulations are directed at these insider transactions. It is not possible, and is probably not very useful or meaningful, to attempt to decide whether tying arrangements are equally or more or less unacceptable than other types of insider transactions. In any event, the Board clearly looks with disfavor on all such transactions and is actively engaged in subjecting them to tighter regulatory control.

Question No. 21. On page 885 of the "Friend Report", the following statement is made:

"The most striking fact about the ancillary financial connections of savings and loan management groups is their extraordinary degree of interlocking relationship with commercial banks. While the banking business had long opposed various forms of legislative assistance to the savings and loan industry, many individual banks have quietly followed the alternative route, suggested by the famous dictum: 'If you can't beat 'em, join 'em.' A significant segment of the savings and loan industry (conservatively, 20 pereent) is under common control with commercial banking interests, and a substantial number of individual relationships suggest bank dominance in the partnership. The business performance of many bank-affiliated associations, often burdened with part-time management, has been below average; in a number of cases it is deficient in ways that we would expect to result from capture by a competitor (high levels of cash holdings, slow growth, unaggressive competitive efforts). Beyond this, the anticompetitive implications of savings and loan interlocks and common control with commercial banks are so clear that a sizable number of such linkages would appear vulnerable to antitrust attack on structural grounds alone. Regulation has been seriously inadequate in this area and is in need of drastic overhauling."

Do you agree with this observation and if so what are you doing about it?

Answer. The Board agrees that management interlocks among competing financial institutions can have serious anti-competitive effects. On November 19, 1970, the Board adopted finally a regulation (section 563.34) dealing with interlocks between banks and savings and loan associations. A copy of this regulation was appended to the Board's testimony on April 20. In a letter dated December 11, 1970 and addressed to the Committee of Conference on the Housing and Urban Development Act of 1970 the Board supported legislation which would have enabled the Board to further control management interlocks. Section 203 of

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the Board's proposed Modernization Act would also convey authority which could be employed to restrict management interlocks. In the Board's testimony on April 20. the Chairman noted that on the subject of interlocks the position of the Board differed from the position expressed in H.R. 5700 only as to approach and technique not as to basic purpose.

The CHAIRMAN. Mr. Widnall.

Mr. WIDNALL. Thank you, Mr. Chairman.

Mr. Wille, on pages 16 and 17 of your statement you referred to a questionnaire mailed last year to all insured banks which called for the reporting of certain activities engaged in as of July 31, 1970. The questionnaire asked, first, whether the banks had brokered deposits as of July 31, 1970, and, second, whether they had made loans linked to these deposits. Unfortunately, you don't give us the results.

It would be most helpful to the committee if you would give us these results. Can you do that this morning?

Mr. WILLE. These results were given in my testimony on March 9 with respect to closed banks. I will summarize them to the best of my recollection this morning.

There were 264 banks, regardless of charter—that is national banks, State member banks, and State nonmember banks—out of approximately 14,000 banks in the country that reported some type of brokered funds in their deposit structure. The total amount that was involved was approximately $260 million out of a total deposit figure for all insured banks in the country of some $532 billion. Those figures will give you a feel for the limited use of brokered funds in the Nation's banking system at the present time.

Of course, the impact of these brokered funds varies with individual institutions.

Mr. WIDNALL. Did you find any instances where you felt that there had been an unwise practice in the operation of the institution because of the receipt of brokered deposits?

Mr. WILLE. Yes, sir; I think we have. Some of the banks that accepted deposits have either become "problem" banks or failed, say, in the last 2 years or more. As a matter of fact, in the hearing on closed banks. I indicated that eight banks out of the 20 that have failed since January 1, 1969, had misused brokered deposits. If you go back further, there are other instances in which the misuse of brokered deposits has been a major contributing factor in a bank failure.

This does not include banks that have developed problems because of the misuse of brokered funds, i.e., banks which have not failed but which are on the "problem" list.

Mr. WIDNALL. What would be the number of banks that have used brokered deposits without any indication of problems?

Mr. WILLE. Our analysis of the figures we got as of last July disclosed that approximately 20 percent of the 264 banks reporting brokered deposits did develop some serious problems but that 80 percent of that number knew how or were able to handle the risks that were involved in brokered deposits.

I might say that most of the difficulties came in the smaller institutions around the country.

Mr. WIDNALL. On page 2 of your testimony you said that the "corporation's limited experience to date with the use of equity participations by insured State nonmember banks indicates no reason why"—

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and I emphasize that—"as a supervisory matter, this financial practice should be banned at the present time."

Do you feel that you have gone into it enough to warrant an absolute statement on that?

Mr. WILLE. I think with regard to your question that the differing jurisdiction of the three different Federal bank regulatory agencies is relevant. The Comptroller regulates national banks, the Federal Reserve Board regulates the State-chartered banks that are members of the System, and the Federal Deposit Insurance Corp. regulates those remaining State banks that are not members of the Federal Reserve System. By and large, it is our belief that equity participations have been used more extensively by national banks and by State member banks than by the State nonmember banks with which we are familiar which are a good deal smaller.

But even if that is the case, the Comptroller's survey conducted last year indicated that very few national banks actually had equity participations, and that they accounted for less than 0.3 percent of all their loans outstanding.

Mr. WIDNALL. Could you tell me what choice the institution would have for their loans if they hadn't gone into equity participations? What would they use that money for? What would they have been forced to participate in in order to get some income for their own institutions?

Mr. WILLE. This goes to the question of why institutions seek "equity kickers." Bankers who have discussed this indicate that they believe that equity participations do provide them a hedge against inflation, and that, in fact, where businesses are very thinly capitalized from nonbank sources and the bank is the primary party financing these businesses, equity participations provide the bank an appropriate return where very little money of the entrepreneurs themselves is at stake.

It is, some of them claim, a means of rationing credit in a very tight-money period, such as we have had over the last 3 years until about last July. The claim is made that were it not for equity participations, interest rates stated in the loans would have been higher. That is only repeating the comments that I think participating banks have made.

The CHAIRMAN. Mr. Barrett.

Mr. BARRETT. Thank you, Mr. Chairman.

Mr. Wille, on the bottom of page 4 you say, "Turning first to interlocking relationships, sections 2 through 9 of H.R. 5700 contain a variety of proposed prohibitions." You are talking about the interlocking director relationships. You have suggested broadening the geographic coverage with a prohibition of interlocking relationships to the common area within which such institutions may be established or may establish their offices, namely, the area of actual or potential local competition.

This seems to me an extremely narrow definition for geographic coverage. Since the big banks in San Francisco compete with the banks in Chicago, and New York and elsewhere, to allow such interlocking relationships between the largest financial institutions which together control the vast majority of lendable and investable assets; how do you justify this?

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Mr. WILLE. Well, I think this goes to the purpose of the prohibition on the interlocks. If the purpose is to maintain a more competitive market which might otherwise not be the case if the interlock exists, you have a question then as to what is the relevant market. If you are dealing in terms of the smaller community, the area generally for a bank is an area somewhat around its offices, particularly for deposit functions.

Now, granted that loan functions for the major, largest banks in the country are nationwide, and you will note that my suggestion as to this provision would permit the relevant banking agency to extend the prohibition that you have suggested to major institutions in the national market which might be substantial, actual, or potential competitors in that market.

Mr. BARRETT. Well, I think you would rather use the word "require to extend it" rather than "permit it to extend it"; wouldn't you?

Mr. WILLE. I believe the problem here is one of determining whether particular institutions are in competition in a given market. I think that if that finding is made, yes, I would agree that interlocks should be prohibited.

Mr. BARRETT. You further state in your statement that there should be a geographic area limitation on the prohibition of mutual savings banks holding of stock in other financial institutions. Is it not true that New York State law prohibits mutual savings banks from owning any commercial bank stock regardless of any actual competitive situation between a mutual savings bank and stock the mutual savings bank might own? Has this created any serious problems in the investment funds by mutual savings banks in New York?

Mr. WILLE. I might say that your comment raises a problem that Mr. Widnall alluded to in his very early remarks, that is, that some of the Federal banking agencies, particularly the Federal Reserve Board and ourselves, are the second regulator for many of these banks, that is, those that are State-chartered banks subject to State law. It is true that in New York there is a prohibition against the ownership by mutual savings banks of stocks in commercial banks.

I would point out, however, that commercial banks, at least through the holding company device in New York, and with appropriate regulatory approvals at both the State level and the Federal Reserve Board level, can have affiliates statewide and therefore, I don't think there is anything inconsistent in the statement before you.

Mr. BARRETT. That is all, Mr. Chairman.

The CHAIRMAN. Mr. Johnson.

Mr. JOHNSON. Thank you.

Mr. Wille, I am going to direct my questions to Mr. Martin because I cross-examined you, if you recall, when you were here last.

I am interested in your statement, Mr. Martin, about brokerage deposits, that they are not bad per se, and I take it that you feel that a brokered deposit, even though a broker gets a commission for getting a bank, let's say, $100,000 deposit, there is nothing wrong in that transaction of the bank paying a broker a little fee for a deposit, providing that there is nothing sinister about the transaction; isn't that just about what you have said in your statement?

Mr. MARTIN. Yes. We are absolutely against any kind of tie-in, or, as you say, any sinister or below the surface kind of arrangement. We

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note that brokers are turning to the placement of funds in certificate form which is of a longer term, 1 or more years. This seems to us to remove another possibility for difficulties of a supervisory nature.

Mr. JOHNSON. The reason I am asking this question is because the last time Mr. Wille was here I believe he stated he would favor eliminating the practice entirely. But it seems to me that there is nothing inherently wrong with the broker deposit providing it is properly regulated; there is no reason why we can't permit brokered deposits, yet lay down certain guidelines that if there is a tie-in it has to be on record in the bank, or if there is a tie-in that money can't be withdrawn while the tie-in exists, or some other protective device.

There are certain safeguards, it seems to me, that can be written into the law rather than destroy a business which is probably relatively lucrative to, let's say, people who are in the brokerage business. I take it that is the way you feel about it?

Mr. MARTIN. Yes. I take it our position is a little stronger in that we would certainly accede to and support, should Congress decide on absolute prohibition of brokerage funds, where there is any direct or indirect tie-in on loans or other such transactions.

Mr. JOHNSON. Now, turning to another subject, I notice the attempt here to do away with kickbacks or equity participation demands by lenders. I notice that the bill covers insurance companies.

Now, I don't recall—since I have been on this committee—any attempts on the part of this committee to extend our jurisdiction to insurance companies. When I was in law school the case of *Paul* v. *Virginia*, decided way before the turn of the century, said insurance was not commerce, but the Supreme Court has since overturned that and said insurance is commerce.

But we on this committee generally legislate within the realm of national banks or within the realm of federally insured banks. That seems to be our jurisdiction.

Do you feel that this committee has jurisdiction to start regulating insurance companies in their lending activities?

Mr. MARTIN. I don't know that I am capable of answering your question, Mr. Johnson. I would comment on it, though, if the chairman thinks it is appropriate, that since insurance companies have used the equity participation more than any class of institutions, I would think that might be the reason why they were so included.

The CHAIRMAN. I think they originated it. Of course, this is attached to the cost of money, interest rates.

We did have flood insurance, and we had crime insurance. We dealt with insurance in many different ways. But it is not a part of the jurisdiction that we have assumed as such. But where it relates to something like interest rates, why I think it is within our jurisdiction.

Mr. JOHNSON. Well, that is debatable, Mr. Chairman. Of course, if we can regulate insurance companies, they are the greatest offenders in the conglomerate field and have billions of dollars controlling industries all over the country. Maybe we are opening up a new can of worms which we are to get into.

The CHAIRMAN. I suggest if the gentleman will present a bill we will get right into it.

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Mr. JOHNSON. Mr. Martin, I notice you say if we destroy the rights of these lending institutions to engage in equity participation plans that you might see mortgage money market dry up entirely. I notice you have said that in your statement.

Do you want to embellish that a little?

Mr. MARTIN. I certainly would, Mr. Johnson. I am afraid I gave a needlessly restricted impression.

I only mean that it has been our observation that there were a number of housing projects announced in the tight money period which we feel would not have been financed by life companies and the pension funds without the equity participation, because equities were very attractive to these institutions and they were accumulating equities at the same time. They were not buying mortgage loans. They were not without equities. They were completely out of the residential, single-family residential market. We just hate to see big project financing not occur in the next tight money period.

Mr. JOHNSON. I thank you very much.

The CHAIRMAN. Mrs. Sullivan.

Mrs. SULLIVAN. Thank you, Mr. Chairman. I have questions for both Mr. Martin and Mr. Wille. In order to get my questions asked, I would appreciate it if you would just be brief now and then enlarge upon your answers later, as you correct your testimony in the transcript.

Mr. Wille, I noticed your endorsement of the approach taken in my bill of allowing wide administration discretion in regulating conflicts of interest. My bill, as you know, applies only to the insured savings and loans. Are you saying that we need a similar extension of power to the FDIC to deal with conflict of interest situations in insured banks, or do you now have all the power already which H.R. 7440 would give to Chairman Martin's agency?

Mr. WILLE. As I indicated on March 9, Mrs. Sullivan, our position is that we do not have the authority at the present time. We believe that proper regulatory authority would be beneficial and helpful in this area, and of course it should be applicable as well to the Federal Reserve Board which also regulates State banks.

Mrs. SULLIVAN. Thank you.

Mr. Martin, I understand from your testimony that you favor legislation giving stronger regulatory authority to the Home Loan Bank Board rather than specifically prohibiting by law the things which could be regulated by stronger authority; is that correct?

Mr. MARTIN. Yes. In several of the sections of our proposed Modernization Act we have asked for additional authority over certain classes of institutions so that the impact of regulation would fall equally across the board on those institutions operating in various forms which compete with each other across the country.

Mrs. SULLIVAN. Thank you.

Is there any question in your mind that the Home Loan Bank Board needs additional authority by law to deal with and regulate, the kinds of conflicts of interest which the ad hoc subcommittee of this committee described in our report?

Mr. MARTIN. We feel that the move we have made in the regulatory area are in the direction of correcting the abuses that the ad hoc subcommittee on home financing practices brought out last year. We

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have been greatly guided by the testimony and the committee recommendations there.

Our request is for legislation, as I say, which would balance the impact of regulation rather than, for example, new expansive conflict of interest powers over several institutions.

So I believe that there is a great deal of overlap between what we have done since the committee report and since I testified here and the transactions and relationships which the committee very properly called our attention to.

(At the request of Mrs. Sullivan to expand his remarks, Mr. Martin submitted the following supplemental information to the above question:)

There is no question in my mind on this point; the Board needs additional authority. In order to explain why this is so, it is necessary to describe briefly the Board's existing authority in this area. This authority is seen most clearly if one distinguishes among three types of savings and loan associations.

A. *Federally Chartered Associations*: Section 5(a) of the Home Owner's Loan Act of 1933, as amended (HOLA), grants the Board plenary regulatory authority over federally chartered associations. It follows therefore that, with respect to these associations, the Board has the full authority to issue any regulations dealing with conflicts of interest or any other subject which are reasonable in the Constitutional sense. It also follows that neither the July 28 draft, nor the December 11 draft, nor section 203 of the Board's proposed "Modernization Act" would add anything to the scope of the Board's regulatory authority with respect to Federally chartered associations.

B. *State-Chartered Insured Associations*: The Board's authority over state-chartered insured associations stems from various provisions in Title IV of the National Housing Act, as amended (NHA). The exact extent of the Board's authority over state-chartered insured associations is the subject of some debate. It is conceded on all sides that (1) the Board has some authority, stemming from specific provisions of the National Housing Act, over state-chartered associations and (2) that this authority is not as extensive as it is with respect to federally chartered associations. Examples of these specific provisions are various subsections of section 404 of the NHA authorizing the Board to promulgate regulations governing the payment of insurance premiums and establishment of reserves by state-chartered insured associations.

The point on which there is not unanimity is the extent of the Board's regulatory authority over state-chartered insured associations. The position of the Board on this point is that the Board now has the authority to regulate state-chartered insured associations with respect to matters which affect (1) the soundness of the FSLIC, (2) the safety of insured institutions, (3) the interests of depositors in insured institutions, (4) the provision of economical home financing for the nation, and (5) the accomplishment of any of the other purposes of Title IV of the NHA. In connection with this position several points need to be stressed:

1. This regulatory authority is not as "general" as the Board's general regulatory authority over federally chartered associations, but is limited to matters having a reasonably direct and demonstrable relationship to one or more of the five factors mentioned above.

2. There is no *clear* and *explicit* grant in Title IV of the NHA of this regulatory authority over state-chartered insured institutions. This grant of regulatory authority is implied by reading together a number of provisions in Title IV and consideration of the legislative history and purposes of the title, both as enacted and amended from time to time. In addition, the scope of this regulatory authority is not clearly stated in Title IV; no more explicit statutory guidance is furnished to the Board than the five factors mentioned above. The basic reason for the lack of clarity in the grant and scope of the Board's regulatory authority over state-chartered insured institutions is the great haste in which Title IV was enacted. The National Housing Act was a piece of emergency legislation requested by President Roosevelt in 1934 and the entire Act (including Title IV) was drafted, heard before committees of both Houses, debated, passed and enacted in less than a few months.

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3. The lack of clarity and precision regarding the Board's authority over state-chartered insured institutions has a number of effects:

(*a*) It is a potential source of litigation.

(*b*) It has a dampening effect on the Board's exercise of its statutory responsibilities, since it is reluctant to act in areas where its authority in unclear.

(*c*) The outcome of any litigation in this area is unpredictable. The arguments regarding the extent of the Board's regulatory authority over state-chartered insured institutions are very complex and sophisticated. Although the Board feels confident that its position is correct, it would be turning its back to reality if it did not acknowledge that a court which is highly conservative or lacking in familiarity with financial regulatory matters might accept a contrary position. The Board cannot, of course, select the forum in which the question might be litigated, and it is reluctant to commit a major portion of its functions to such a degree of uncertainty.

C. *Member Institutions*: The Board also has some regulatory authority over state-chartered *uninsured* institutions which are members of the twelve Federal Home Loan Banks. This authority stems from certain provisions of the Federal Home Loan Bank Act. For example, the Board may regulate these institutions with respect to the maximum rate of return they may pass on savings accounts, and with respect to required holdings of liquid assets.

In considering the question of aditional authority another distinction must be kept clearly in mind: The distinction between the *scope* or applicability of the Board's authority and its *enforceability*. Although the scope of the Board's regulatory authority over Federal associations is greater than over insured institutions, its enforcement authority is virtually identical with respect to the two classes of institutions. In the case of plain members, the Board has no enforcement powers, except the removal of a member from the System or the denal of advances. Both of these are drastic, and in most cases probably fatal, tools which are unsuitable for enforcement against relatively minor civil transgressions.

This discussion suggests two conclusions to the Board:

1. There must be a greater equalization of the treatment of the three types of institutions from the standpoint of both regulatory applicability and enforcement. My oral testimony on April 20 was directed to this point.

2. The authority of the Board with respect to state-chartered insured institutions must be clarified by explicit provisions.

Mrs. SULLIVAN. Do you feel you have carried your present legal authority as far as it can go in this respect?

Mr. MARTIN. No. We have now issued three sets of regulations, one in July, one in November and one very recently for comment. We will continue to review both the findings of the ad hoc committee on practices, and the volume of responses to the initial issuance of our proposed regulations. We will continue to review the experience we have in supervisory cases. I don't believe we have issued our last regulation.

(At the request of Mrs. Sullivan to expand his remarks, Mr. Martin submitted the following supplemental information to the above question:)

My response during the oral testimony on April 20 was flatly "No". As I said on that occasion, "I don't believe we have issued our last regulation."

Nevertheless, because of the factors discussed above, it is simply impossible, if the Board were to exercise its present authority to the maximum, for the resulting regulatory scheme to be equitable. Differing classes of institutions would be subject to substantially different standards. It is therefore the view of the Board that the question of whether the Board has stretched its present authority to the limit is largely irrelevant, and a suggestion that the Board do so is a recommendaion for an unequal and hence unworkable system.

Mrs. SULLIVAN. But you are doing that under the authority you now have. This is why I asked whether you feel that authority as it now

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exists is strong enough to allow you to meet the problem. I know you have issued some regulations on conflicts of interest, but you had said at one time that you do not have enough authority to issue stronger regulation.

Mr. MARTIN. Yes, the Congresswoman is quite right, and again as she pointed out in the introduction of H.R. 7440, the Home Loan Bank Board is grateful for the additional authority embodied in legislation as to amendments of the Housing Act last year, which we have also implemented in areas such as Washington, D.C. savings and loans, the very savings and loans which the subcommittee examined in some detail as to certain classes of transactions.

I didn't mention that we have also moved into that area, thanks to the legislation passed last year.

Mrs. SULLIVAN. I admit I was terribly disappointed last year when the Board declined to take any position, one way or another, on the conflict of interest amendment which I had offered and which was incorporated in the committee's bill. What was the reason, if you can tell me, why the Board was unable to reach a policy decision on that legislation at that time?

Mr. MARTIN. Well, Congresswoman, we worked on this very complex issue of relationships and transactions, both economic and noneconomic, involving savers, borrowers, in some cases even certain kinds of institutions, stockholders, suppliers of services to institutions, the so-called infrastructure with which the institutions deal, and all the other matters that your subcommittee brought out. We found repeatedly that Federal moves in this line would cut across what the States were doing. These States have, as the gentlewoman knows, a myriad and mosaic of approaches to the subject. It was as much as anything the great difficulty in two areas which caused us to be late in our recommendations to the committee. The recommendations were forthcoming when we worked out as much as we could of the problems.

The two main areas, No. 1, that the State laws not be unduly transgressed or interfered or set aside for all the reasons the committee is so familiar with; and second, that the issuance of regulations and/or the request for legislation and the granting of legislation would not unduly cut back the flows of mortgage funds, particularly to moderate- and low-income people who are grappling. But the needs sometimes are contradictory, accelerating the flows of mortgage funds to low- and medium-income people, on the one hand, and correcting abuses which are a conflict of interest, on the other hand. These are extremely complex questions on which I respectfully suggest we are making substantial progress.

(At the request of Mrs. Sullivan to expand his remarks, Mr. Martin submitted the following supplemental information to the above question:)

The best way to answer this question is to begin by briefly sketching in the background on this matter.

In the latter part of May of last year the Board's staff received a request for a drafting service from a member of the Committee's staff, Mr. Holstein. The request was that the Board staff supply, at the earliest possible date, legislative language which would implement the 9 specific recommendations of the Ad Hoc Subcommittee on House Financing Practices and Procedures, except recommendations 6, 7 and 9. As the Board's staff understood the request, it was for general language—general in the sense that it would cover all types

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of institutions (Federals, state-chartered insured, and plain members)—general in the sense that it would cover not only the practices mentioned in the report and recommendations of the subcommittee but also similar practices and variations on them—and general in the sense that the Board's enforcement remedies would range from the lightest to the most severe.

As the Board's staff began the drafting, it soon discovered that, regardless of whether the request was for general or specific language, only general language could meet the request because of the variety of the recommendations and the complexity of each.

On July 28 the Board's staff gave Mr. Holstein draft language dated the same day along with a brief explanation of the language. The staff had informed the Board of the request when it was received, and sent copies of the language to the Board after the drafting had been completed. The Board did not, however, review and approve the language. The Board thought it inappropriate to do so, since review and approval would have made the staff's draft into a formal legislative recommendation and the Board was not prepared at that point to make a legislative recommendation in this broad and complex area without additional time for study.

The July 28 draft was added (as section 911) to the Housing and Urban Development Act of 1970 (H.R. 19436), as reported by the House Banking and Currency Committee. Section 911 became known popularly as the "Sullivan Amendment". On December 3 the House passed H.R. 19436 and substituted the so-called "Brasco Amendment" (as section 912) for section 911. In the few days prior to the floor action on December 3 the Board received repeated and insistent requests from various sources to take one or another positions with respect to the "Sullivan Amendment", the "Brasco Amendment", and various modifications of them. The Board declined to do so and finally communicated its formal recommendation to the Committee of Conference in a letter to Chairman Patman, dated December 11, 1970.

The third question is basically why the Board declined to take a position on or prior to December 3, but did take a position on December 11. The simple answer is that as of December 3 the Board had not yet been able to resolve the many difficult issues raised by the various proposals. It will be recalled that throughout the second half of 1970 the Board had been continually wrestling with the subject of conflicts of interest. On July 21 the Board sent to the Federal Register a substantial package of proposed regulations on this subject and during August, September and October received an unprecedented volume of public comment. In my oral reply to this third question I made reference to two of the more difficult issues raised by these comments: The impact on state law and the disruption of badly needed mortgage lending that might result from regulatory action which was too severe or too quick. Other equally difficult issues were also presented. On November 19 the Board adopted finally a part of the original July proposal.

With this regulatory background—and therefore with a full appreciation of the great difficulty of the problems in this area—the Board turned in late November to a consideration of the various legislative proposals. An examination of the Board's files indicates that by December 3 the Board had not yet been able to resolve to its satisfaction all of the issues presented. Indeed, the Board's files indicate that substantial presentations of data and alternatives were being made to the Board by the staff as late as the morning of December 11.

Mrs. SULLIVAN. Mr. Martin, my time has expired, and I have five more questions to ask you. They deal with H.R. 7440 and its predecessor last year on which the Board took no position, and with the proposed amendment that the Board did recommend to the conferees on December 11, and then with the provisions in a new bill that I believe you are recommending this year. I want to know about its weaknesses and its strengths and so forth. So I am going to submit these five other questions to the reporter and I would like to have your answers to them in detail, because that will give me a clearer view of what you really want; right now I am not sure.

The CHAIRMAN. Without objection. it is so ordered.

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(The following are written questions submitted by Mrs. Sullivan to Mr. Martin, along with Mr. Martin's answers:)

1. Do you feel that the new bill you are offering is stronger or weaker than H.R. 7440 in meeting the conflict of interest problem?

Answer. H.R. 7440 is, as you know, identical to the July 28 draft prepared by the Board's staff. There is no question that section 203 of the "Housing Institutions Modernization Act of 1971" is weaker than H.R. 7440 in meeting the conflict of interest problem. There are, however, good reasons for this in the Board's view. These reasons will be discussed in detail below.

2. I am certainly no expert legislative draftsman, but I wonder why the section of your new bill which deals with conflicts of interest reads almost verbatim—at least the first part of it—to the substitute language adopted on the House floor last year. Why is this language better than the language I have or which the Board itself submitted to the conferees?

Answer. This question is, in effect, a request for a comparison of all the various proposals on this subject to date. Such a comparison could be so technical and lengthy that it would obfuscate rather than elucidate. What follows will therefore be confined to the essentials.

Analytically it is best to group H.R. 7440 with the December 11 draft to the Conferees and to group the "Brasco Amendment" with section 203. The former would convey on the Board general regulatory authority with respect to all *transactions* and *relationships* among the persons named therein. Such transactions and relationships *may or may not* involve a conflict of interest. The latter are limited specifically to conflicts of interest and to *transactions*.

A. H.R. 7440 and December 11 Draft

The principal difference between H.R. 7440 and the December 11 draft relates to the type of transactions and relationships covered. The main objection which was voiced to H.R. 7440 was that it could be construed to cover transactions and relationships among the affiliates which were of a purely private nature and had no bearing on the affairs of the institution. It was not the intent of the staff members who drafted H.R. 7440 that such transactions be covered. The December 11 draft represents an effort to eliminate the possibility of such a construction.

In addition, the December 11 draft eliminates from regulatory coverage transactions and relationships among a number of persons covered by H.R. 7440. For example, H.R. 7440 covers transactions among borrowers from and investors in affiliated persons of different members. The December 11 draft does not cover these transactions and relationships. The Board concluded, during the lengthy deliberations mentioned earlier, that these relationships and transactions were relatively peripheral to its concerns and that no firm case could be made that these relationships and transactions caused harm to associations, or their borrowers or investors in practice.

Further, the December 11 draft eliminated the second paragraph of H.R. 7440. This paragraph contains two sentences. The first sentence makes clear that the authority conveyed in the first paragraph includes authority to set appraisal and appraiser standards. The second sentence authorized the Board to establish rosters of appraisers and to remove persons from those rosters involuntarily. The first sentence was eliminated as superfluous. The second sentence was eliminated because the Board concluded that the authority which would be granted by it was excessive. The Board believed that such authority would have caused the Board to enter unnecessarily an area traditionally regulated by the States since the other authority in the appraisal area which H.R. 7440 would have granted was sufficient.

Finally, the December 11 draft eliminated the phrase "in the public interest". This matter is discussed below under Question No. 8

The other differences between H.R. 7440 and the December 11 draft are insubstantial.

B. The "Brasco Amendment" and section 203

The Board's several objections to the Brasco Amendment are specified in the Board's December 11 letter to the Conferees (pp. 3–4). Section 203 is drafted to eliminate all of these objections and contains a substantial grant of meaningful and workable regulatory authority. Nevertheless, section 203 is relatively narrow in scope as compared to H.R. 7440 and the December 11 draft.

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This narrowing is, frankly, the result of a decision made on practical and policy grounds. It is the Board's judgment that a proposal having the scope of the December 11 draft probably does not command at this time sufficient general Congressional acceptance to secure its passage. The Board prefers some provision in this area to no provision, and has carefully drafted section 203 to grant the fundamental authority required but to avoid any substantial criticism regarding an excessive grant of authority.

It should be emphasized that it is the Board's view that any substantial narrowing of section 203 would render it largely ineffective and that the Board is firmly opposed to any such action.

3. How does your bill treat appraisers and appraisals compared to H.R. 7440?

Answer. Basically, H.R. 7440 would grant the Board authority to make and the regulations governing all transactions and relationships among appraisers and the persons specified in subdivision (D) of paragraph (1) of the subsection (c) intended to be added to secton 17 of the Federal Home Loan Bank Act. The Board could enforce these regulations by means of the powers which would be conveyed by paragraph (5). Paragraph (2) specifically mentions that the regulatory power in paragraph (1) includes authority to establish appraiser and appriasal standards. Paragraph (2) also provides authority to establish rosters and to remove appraisers from the rosters involuntarily.

Section 203 covers appraisers performing services for a member institution. This coverage would include appraisers who are employees of the member or independent contractors. It would also cover appraisers rendering services to the service corporation of a member because of the identity of interest between the member and its service corporation. However, the member and its service corporation is a substantially narrower group than the persons specified in subdivision (D) referred to above.

Under section 203 the Board could establish appraiser and appraisal standards since such standards are reasonable regulatory methods of preventing conflict of interest situations. Under section 203, the appraisal practices would have to result in a conflict of the appraiser's "financial interests with those of the member." This criterion is met since faulty appraisals are contrary to the financial interests of the member and since in the typical improper situation, the appraiser would not have been hired unless it was agreed or understood that he would misappraise the property.

4. Is there any difference between your proposed new bill, my bill, and the bill which you submitted to the Conferees last December in the matter of enforcement powers?

Answer. No, except that H.R. 7440 authorizes the establishment of rosters and the involuntary removal of persons therefrom. The other proposals would not authorize this.

5. H.R. 7440 makes, as one of the purposes of the regulations to be adopted by the Board, in dealing with conflict of interest situations, the necessity to do something or other "in the public interest." It says the Board is directed "to such extent as it may deem necessary or appropriate in the public interest or for the protection of members, investors, or borrowers," or the FSLIC and so on. Your bill leaves out the public interest aspect. Is there any reason to leave out the public interest aspect, or—if we were to take your bill would you object to the inclusion of the words "in the public interest?" I ask this because a savings and loan may operate in such a way that it doesn't hurt its investors or borrowers, but the conflict of interest situation may be very much against the public interest. Isn't that true?

Answer. As noted, the addition of the phrase "in the public interest" would strengthen those proposals from which it is omitted. Whether the phrase should be added is, in the Board's view, a tactical judgment.

The CHAIRMAN. Mr. Stanton.

Mr. STANTON. Thank you, Mr. Chairman.

Gentlemen, I want to ask you both the same question. First, Mr. Martin.

I read your testimony last night and basically you agree in principle that we are all against conflict of interest and we are for increased competition and so forth.

My first question is that while you agree in principle with H.R. 5700, you are opposed to the legislation that is now proposed?

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Mr. MARTIN. I would say that with regard to the conflict-of-interest section we are, sir, yes.

Mr. STANTON. Would you further state that you honestly feel, and in answer to Mrs. Sullivan's question that you have the authority now within your organization to accomplish many of the goals of H.R. 5700 and therefore that new legislation might not be necessary.

Mr. MARTIN. I would say that we have much of the authority we need. However, in sections 203 and 404 of the proposed Housing Institutions Modernization Act of 1971, we have asked for authority, as I have stated before, in order to make a home equitable impact by our regulations on different classes of institutions.

Mr. STANTON. Thank you.

Mr. Wille, would you say that—maybe the wrong word is "oppose," but do you find this legislation necessary?

Mr. WILLE. We have a somewhat different situation at the Corporation than does the Federal Home Loan Bank Board. We are, as I pointed out, the second regulator of the banks that we regularly examine, that is, State banks that are not members of the Federal Reserve System. There are, as Chairman Martin has pointed out, a myriad of State law provisions that apply to these State-chartered institutions.

We do not have a general rulemaking authority over this conflict-of-interest area as the Federal Home Loan Bank Board apparently does have with regard to federally chartered savings and loan associations and may have as far as the insured State associations are concerned.

I think that the Board's experience in this area is most revealing, that is, that this area is very complex. You really are dealing in individual judgments of people and their ethics and the way they conduct their business, and to draft in a statute all of the ramifications and possibilities of which individuals are capable would be very difficult. That is why I think both he and I would agree that this is an area for regulatory power rather than statutory mandates.

Mr. STANTON. Well, I certainly want to agree with you there in principle, Mr. Wille, because when you get into the general subject, especially of interlocking directorships of financial institutions, and when you consider the medium and the small-sized towns and banks in this particular country, and when fundamentally in principle you look to a director of a bank—at least I always have—first of all as being an outstanding individual in that community, one who is financially probably considerably well off, highly respected, and a leader in community activities.

Mr. BARRETT. If the gentlemen would yield to me for a very quick statement——

Mr. STANTON. Sure.

Mr. BARRETT. I was asking Mrs. Sullivan before she terminated her questioning whether she wouldn't ask you another question, to furnish some of the information on the abuses of conflicts of interest in making loans to low and moderate income families. Would you be kind enough?

Mr. MARTIN. We would be glad to, Mr. Barrett.

Mr. BARRETT. Thank you.

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Mr. STANTON. Mr. Wille, seeing you this morning brings to mind that in my State of Ohio two situations have come to my attention over the years. A bank receives its charter and builds a building and is ready to open its doors, and then they don't have FDIC approval. In one case the bank waited several weeks and this came at a time when the board wasn't meeting or something and there was a real inconvenience. The other case is where they issued a charter to another institution and they were ready to open their doors and the FDIC, and rightfully so, wanted to ask some further questions and check into this situation further. It seemed to me that in both cases the FDIC was under pressure. The organizations were formed and they were ready to open their doors, and you are more or less under a time pressure in which to approve these applications.

I was wondering if in these particular instances it would not have been better if you had FDIC approval as a condition to the granting of a charter rather than have it come after?

Mr. WILLE I know something of the situations to which you refer, and I must say that fortunately they are rare. A State bank cannot open, as you know, without the authority of its State supervisor, whether or not it has FDIC insurance. It can open uninsured, of course. In most States, the State supervisor requires as a condition of opening that there be Federal insurance before the opening. That kind of condition might have avoided some of the questions and problems to which you refer.

Mr. STANTON. This would be a State matter, then? They could remedy the situation and change the law?

Mr. WILLE. Yes; but I think in fairness I should point out that the State supervisor himself was under a certain amount of pressure in those cases.

The CHAIRMAN. Mr. Reuss.

Mr. REUSS. I thank you, Mr. Chairman.

Let us talk about giveaways. Under existing law, banks can't pay higher than zero interest on demand deposits, and whatever the going rate is on time deposits, and savings and loans are similarly restricted. I have always had some question in my mind about the justification of this whole interest ceiling business, but until that is resolved the law is as I have stated it.

That being so, I can't quite understand the willingness of you gentlemen to allow institutions to add on to the ceiling rate a small ham, large hams, ballpoint pens, clocks, or whatever nonsense they engage in. How do you justify that? Why are you willing to permit giveaways which in a sense violate the ceilings? If you want to attack the ceilings directly, I will certainly listen to you, but it seems to me rather odd to permit their violation. Who is first on the list?

Mr. WILLE. I think that is the reason that the Federal regulatory agencies have tried to keep to a nominal amount any type of premium that might be given away.

Mr. REUSS. Why permit a little pregnancy? You either have a ceiling or you don't and if you don't it seems to me that——

Mr. WILLE. I think we are trying very hard to separate "giveaways" from additional and illegal extra interest in the belief that there are some legitimate uses for a "giveaway." The legitimate uses are to en-

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courage thrift and to get an office going, if you like. I am not about to say the use of "giveaways" should be a continuous, year-round practice or should involve items of substantial value.

Mr. REUSS. Would it not encourgage thrift to pay 6 percent interest on demand deposits or 12 percent on time deposits?

Mr. WILLE. You are probably saying there are better incentives to encourage thrift, and I wouldn't disagree with that.

Mr. REUSS. Yes.

Mr. WILLE. On the other hand, the banks that have engaged in these programs with premiums having valuves of relatively nominal amounts find them to be attractive and the public does find them to be something of an incentive to open an account and keep it there.

Mr. REUSS. It seems to me "giveaways" violate the philosophy which caused Congress to impose the zero ceiling on demand deposits and the other ceilings on time deposits in the various institutions. Maybe Congress is all wet in doing that. It seems to me we are just kidding ourselves by imposing these ceilings, including the zero ceiling on demand deposits, and then letting the institutions lure customers by these "giveaways". In short, why shouldn't they stick to banking and savings and loan and forget about the schlock?

Mr. WILLE. I think any bank supervisor would be concerned if they were to get into a general merchandising operation. In fact, there is case law to the effect that that is not the business of banking. It has a bearing on the "giveaway" regulation the agencies have promulgated. I think as a technical matter you will agree it isn't interest because the value of the usual "giveaway" is not related to the amount of the deposit or its duration.

Mr. REUSS. It is, however, a method of allowing one institution to compete with another institution in attracting depositors?

Mr. WILLE. I think there is no doubt about that, and it is related to the presence of interest rate ceilings.

Mr. REUSS. Maybe you can pursuade me, Mr. Martin.

Mr. MARTIN. I am not that egotistical, but I may be able to give you some information about our constant struggle.

From a supervisor's point of view it is a headache, nuisance and irritant. But from the point of view of competing for funds, we find there are hundreds of institutions which are not paying the ceiling rates but which are using giveaways.

Mr. REUSS. May I say that wouldn't bother me. If a depositor would sooner get schlock than money, he should have that right. But when the interest goes up to the ceilings, I just don't follow your logic, or Mr. Wille's logic, in insisting that we ought to let people evade the ceiling. If the ceiling is valid, it shouldn't be evaded. If it is invalid, we should do away with it, which I sometimes think we should do.

Mr. MARTIN. What I am trying to say, in the analysis of marketing practices in the savings and loan industry as well as in the analysis of those interest rate financial monetary inducements for savings, we have found in many cases these are the alternative means of bringing in funds, that the small institution, particularly in the middle west and the border south areas may use giveaways, although they are not even contemplating paying the ceiling rate, and other institutions

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when they advertise do not associate that in their advertising with rates. It seems to me an alternative way of attracting savings.

Mr. REUSS. As long as the interest rate charge is below the ceiling, is it not the business of Government to tell consumers whether they should get paid in money or in goods, but when it hits the ceiling I frankly don't understand your respective arguments that we should allow evasion of the ceiling by the giving away of goods. That is your position?

Mr. MARTIN. Yes, it is. I think it is an element of de minimis here. A ballpoint pen or a $5 value item as to an average balance of $3,700 or something of that sort, is separable from the question of interest. But we see that thing differently, I believe.

Mr. REUSS. If it is all that different I shouldn't think it should bother anybody to excise the de minimis.

The CHAIRMAN. Would you yield?

Mr. REUSS. I am through anyway.

The CHAIRMAN. In regard to not paying the ceiling, of course there is not much argument there if they wanted to give enough to where it would be the ceiling, but it would apply in all cases of demand deposits, because when the FDIC law came in and when a majority of the Members of the House signed a petition that they would not adjourn until the FDIC Act was passed into law, why then of course it was insisted that that phrase be put in there that it should be unlawful to pay interest on demand deposits, no penalty or anything else, just unlawful. Then when a large depositor mentioned to his banker I hear you are paying interest on these deposits, he said yes, that is time deposits. Yours is demand.

Therefore, that is where that started and of course it didn't mean anything hardly then. But now it amounts to billions of dollars a year.

So, I just wanted to suggest that the reason given by you gentlemen about the time deposits being the deposits that they are allowed to pay up to a certain amount of interest as long as they do no give premiums that would make that excessive in the amount. Of course, there is no argument on time deposits. But on demand deposits there is an argument from the beginning. I don't see how you can justify even a match or a lead pencil or anything else if it is a violation of the law. I agree with Mr. Reuss on that.

Mr. WIDNALL. Would the gentleman yield to me?

The CHAIRMAN. Yes, his time has expired. Then I think Mr. Williams is next.

Mr. WIDNALL. Do you have any kind of a cost accounting figure on the quoted price of a giveaway as compared to the cost of the giveaway? I notice that most of these items, while supposedly $5 items, will cost the institution $1.25 or $1.75 or something like that. I would just like to know what is actually being given away, from cost.

Mr. MARTIN. I think this depends on the degree of competition for savings in a given market. I think in New York City, and Mr. Wille can speak better to this than I, the mutual savings banks having some difficulties with that market, competing against the huge banks in Manhattan, have given away some things where the wholesale or manufacturers' price may have been used, as is appropriate under the joint regulations that the various agencies have issued. But much that is

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given away, of course, is nominal in value, and we would certainly hate to see those kinds of nominal matters which are a type of good will and public relations be stopped by any language adopted.

Mr. WIDNALL. Thank you.

Mr. CHAIRMAN. Mr. Williams.

Mr. WILLIAMS. I want to thank Mr. Wille and Mr. Martin for appearing here this morning.

We have had some talk about equity participation or equity kickers, which are sometimes called a piece of the action. You have stated that the reason for this practice is tight money. On the other hand, I believe there is additional reason, and that is the fact that any savings and loan or any commercial bank that makes a loan, say in 1968, and with continued inflation caused by continuing deficit spending, the dollars which are paid back to that financial institution, say in 1973 are worth perhaps 70 percent of the dollar that was originally loaned to them. Don't you agree this is one thing that has driven financial institutions into equity participation?

Mr. WILLE. The statement that I presented to the committee does include that point, that many bankers engaged in the practice consider it to be a hedge against continued——

Mr. WILLIAMS. What has happened, the policies of the Federal Government in deficit spending has produced a national debt of over $400 billion with an annual interest rate payment today of $26½ billion annually, and it is going up from there. This has been the main cause for inflation, and this has forced our financial institutions into seeking to protect themselves by engaging in equity participation.

Going on to these giveaways, actually in the title of this bill we state we are trying to encourage competition in the banking industry. We have had a lot of talk here this morning about giveaways. As I understand it, by regulation you are limited as to the value of these giveaways.

Now, we can call them schlok, and we can say all corporations should stop schlok advertising to sell their products and things of this nature. Don't you agree that as long as we put a limit on the value of these giveaways, or actually permit these financial institutions to give away things of a certain value, nominal value, we are encouraging people to develop the habit of thrift saving?

Mr. MARTIN. Yes; I think they definitely have that effect.

Mr. WILLIAMS. Now, on the subject of public funds, Mr. Wille, in your statement on page 3 you state that "approximately 30 States require the pledging of securities by banks against State deposits and deposits by political subdivisions." You go on to state in most cases these financial institutions are pledging State or municipal securities or bonds. You further state that by doing away with this practice, in these 30 States that are fully protecting public deposits, this could have an adverse or disruptive impact in a market for municipal bonds which are already in some difficulty.

So wouldn't it be much more logical for other States to take the same steps that the 30 States have taken rather than just rule out this practice altogether?

Mr. WILLE. That is certainly an alternative and one to which more States are turning: either to impose pledging requirements where they are not imposed or some substitute arrangement.

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Mr. WILLIAMS. That would be a better solution to the problem.

I think incidentally, as far as the Sharpstown Bank failure was concerned, which we discussed during your last appearance, that actually it was weak State laws that played an important part in the failure of that bank.

Mr. WILLE. Texas is one of the States that is not included in this list of 30.

Mr. WILLIAMS. All right.

Mr. Martin, your statement indicates that you disagree with virtually every section of H.R. 5700 as it is presently written. I agree with that position.

On page 5 of your statement you do say "with respect to interlocking relationships and restrictions on disclosure regarding loans, your Board suggests a different approach," and on page 6, item one, you further state "it is not possible to deal with this area properly by means of rigid statutory formulas." Then you state that this should be done by regulation which can be somewhat more flexible. This is your position, is it not?

Mr. MARTIN. Yes, sir.

Mr. WILLIAMS. And also, Mr. Martin, in your proposed legislation is there any connection between, one, your recommendation in your proposed draft on conflicts and supervisory legislation; and two, your recommendation regarding stock, Federal savings and loans?

Mr. MARTIN. Well, Mr. Williams, section 101 in our proposed Modernization Act deals with the issue involving a new kind of charter, a Federal stock charter. The connection with conflict of interest is simply this; under the present situation many times managers of mutual institutions find they are located in a growth urban area, that their level of salary compensation becomes with that growth quite restrictive to them, and yet they have no way, however successfully they manage the institution, to have any of the kinds of normal incentives that are accorded managers of commercial banks or other institutions. I would think that the pressure to engage practices, insurance and other matters, that have been characterized as conflicts of interest, would be removed if the normal incentives accorded managers of stock institutions could be carried over to savings and loan associations.

Mr. WILLIAMS. Thank you, Mr. Martin.

Mr. BARRETT. Mr. Moorhead?

Mr. MOORHEAD. Thank you, Mr. Chairman.

Mr. Wille, it has been customary to insist that an officer become a member of the board of directors of the borrowing institution on the theory that this gives the bank some information about the borrower that would be difficult to obtain otherwise. Do you think this is a good and valid practice or do dangers inherent in this practice outweigh the advantages? I would think that a bank could get sufficient information from a borrower without actually having a man on the board of directors.

Mr. WILLE. I don't know that the facts are as you state them exactly in your question, Mr. Moorhead. But I would say that in a particularly small or family-held, closely-held business, this might be a way of gaining information. I would think it less likely as a source of information in the publicly held corporations.

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Mr. MOORHEAD. On page 7 and 8 you seem to oppose section 9 of the bill which would prohibit interlocking relationships where there is a borrower-lending relationship, is that correct?

Mr. WILLE. Yes, because I think it goes much further than probably the evil to which it is addressed. As we know, many banking institutions when they are started seek to get a board of directors that has a community involvement and that will bring business to a newly chartered bank. Frequently, it is their own business that they are bringing to a bank or the business of their family companies or what have you. I think that to look at this solely from the point of view of the bank being in existence and then getting involved in the business of its directors is misleading. It frequently happens the other way around. A bank director frequently is involved in the business first and then becomes a bank director. The election of such businessmen to a bank's board is encouraged by the regulatory agencies so the bank may get the best qualified boards it can in a local community.

I would say certainly we cannot consider this by itself, the substantial and continuing loan relationship, to be sufficient to prohibit the interlock to which this is addressed.

What is a source of concern is improper analysis of the credit worthiness of a director's company after the bank comes into existence and is asked for a loan.

Mr. MOORHEAD. Then, are you saying that this is only a new bank problem?

Mr. WILLE. No; what I am saying is that the prohibition in the bill is broad enough to apply obviously to both situations, and from that point it is too broad in our judgment and should not take the form of a flat prohibition.

Mr. MOORHEAD. To return to this matter of the giveaways, I understand that the banking authorities—I am talking about the Federal banking authorities—have adopted "statements of policy." My question is, one, are they uniform; and two, are they binding on the institutions and have they been effective?

Mr. WILLE. These regulations are uniform among the three agencies that prescribe interest-rate ceilings. They are the Federal Reserve Board, the FDIC, and the Federal Home Loan Bank Board. The Comptroller, who regulates national banks, has a somewhat different regulation limiting "giveaways" to those that are nominal in value, and there is a certain administrative discretion in the interpretaton of the word "nominal." It is my understanding that his office takes publicly the position that it is interpreting the word "nominal" in the same way as the other three agencies. If so, there would be uniform regulation.

Mr. MOORHEAD. Is there a regulation with respect to giveaways in connection with demand deposits?

Mr. WILLE. As other members of the committee have pointed out, any interest on a demand deposit is prohibited by law. The "giveaway" regulation of the three agencies is limited to savings deposits, and therefore the use of "giveaways" to attract demand deposits wouldn't run afoul of that regulation in any event.

Mr. MOORHEAD. I am not sure I understand. You can have giveaways without regulation on demand deposits or the other way around?

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Mr. WILLE. No, the three agencies have adopted in these policy statements limitations which would permit "giveaways" of nominal value, but only in connection with savings deposits, not checking accounts.

Mr. MOORHEAD. So that is prohibited, the giveaways with checking accounts?

Mr. WILLE. It would certainly raise a question without that kind of regulatory agency statement, because of the complete prohibition on interest on demand deposits.

Mr. MOORHEAD. On the question of brokered loans, I understand that you, Mr. Wille, oppose it but you, Mr. Martin, do not oppose brokered loans. Is there anything with respect to the institutions that you regulate that would indicate that brokered loans are all right for those institutions but would not be all right for banks? Are you suggesting a double standard, or do you believe that——

Mr. WILLE. If I could take that one first, it would seem to me that the motivations of the two agencies here represented are exactly the same, that we want to see a practice in which brokered funds are tied into poor loans stopped or eliminated. The question of technique or how you reach this problem is the one that divides us in our conclusion.

Our experience has been that a loan which is tied into a given deposit can be a very difficult thing to prove. One of the purposes of our survey last summer was to find out whether or not banking institutions had legitimate reasons other than tied-in loans to attract deposits through a broker. We did not find such reasons from that survey, and we did try to track down that question.

The experience of the Federal Home Loan Bank Board might have led them to quite a different conclusion.

Mr. MOORHEAD. Do you care to comment?

Mr. MARTIN. I think our experience has been different. Savings and loan associations, as Chairman Patman pointed out, have a much narrower geographic reach. While it is quite true that deposits tend to be clustered around commercial bank offices, the ability to operate nationwide in lending leads to compensating balances from other kinds of deposits also, particularly the demand deposit.

Second, we have not had the impact upon failing institutions of the tie-in loans associated with brokered funds that has been true in banking, about which testimony has been rendered. So our experience has been different. However, it does not take away our concern about the abuses that can arise in brokered loans—pardon me, in brokered funds. In obtaining savings via brokers we are still very concerned. We feel it should be regulated very carefully. And we would support a flat prohibition and strong language which would put the burden of proof on management rather than upon the regulatory agency.

Mr. MOORHEAD. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. The time of the gentleman has expired. Mr. Wylie.

Mr. WYLIE. Thank you, Mr. Chairman.

Mr. Martin, I would like to pursue that for just a moment.

On page 2 of your statement you indicate that the Board's experience does not justify an absolute prohibition against deposits. Then you say the Board would favor legislation which would control these deposits more stringently than at present.

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I have a copy of the letter which you have sent to the Speaker of the House which transmitted the proposed legislation. Does this proposed legislation mention specific proposals with respect to brokered deposits?

Mr. MARTIN. No, the specific provisions of the Modernization Act go to broaden investment and lending powers, go to the need to write down certain assets, not governments but other kinds of assets. It goes to, in some sections, the examination of affiliates of institutions. It has a conflict-of-interest section, as I have already indicated. It goes to a number of matters with regard to the Federal Home Loan Mortgage Corporation, which we found, in 7 months of operation of that Corporation, to be unduly restricted in certain ways.

But specifically, brokered funds, no. We are asking for the kind of verification of our authority that the bank supervisory agencies have as a matter of parity so that when there are losses, under section 401 of our proposed bill, we could take a banker supervisor-like approach.

Mr. WYLIE. Well, what you are saying is that it wouldn't require additional specific legislation, it would require a continuation of the rulemaking authority that you now have?

Mr. MARTIN. With regard just to brokered funds?

Mr. WYLIE. Yes, sir.

Mr. MARTIN. I think our present authority on brokered funds is adequate at this time. But we are again trying to recognize that: one, there is a problem in such funds; and two, the kinds of problems the bank regulatory authorities have testified to here are real and we recognize them and would not oppose legislation, let us say, in the interest of their supervision.

Mr. WYLIE. I see, but you are not in a position to recommend any specific legislation or you haven't addressed yourself to that?

Mr. MARTIN. Not on that particular topic, because we don't have the abuses to base——

Mr. WYLIE. You have mentioned that brokered deposits might be useful in certain cases. Could you give me an example or two where they might be useful or proper?

Mr. MARTIN. Yes; in our economy today there are great changes in economic base. For example, an area may have a giant Government contract awarded. Large contracts are awarded in certain sections of the country and there is a need to accommodate housing in those sections. I am thinking of Mississippi and the award to Litton of a giant contract for certain kinds of naval vessels. Now, that part of the country happens to be one in which we have in the immediate area only one small savings and loan association. There are a couple of branches of other institutions some distance away. Carefully and properly done, the bringing in of certificate funds of, let us say, up to 5 years in staggered maturities in nature by that small institution will enable it to accommodate the housing needs of the immediate area. That is an example of the type we are thinking about, and we have had experience in this.

Mr. WYLIE. Thank you very much.

Mr. Wille, the general tone of your statement, I think it is fair to say, indicates a desire on the part of your corporation to maintain

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a great deal of flexibility in handling potential abuses, interlocks, broker deposits and giveaways; is that a fair statement?

Mr. WILLE. Yes; I thing that is a fair statement.

Mr. WYLIE. These hearings are allegedly being conducted because of widespread abuses in these areas. Are you aware of any widespread abuses?

Mr. WILLE. We have at hand, of course, the three studies prepared by the Subcommittee on Domestic Finance of this committee. We point out in our statement that these are actually limited to the 300 largest banks in the country. We would say with regard to institutions subject to FDIC jurisdiction that where we notice a reason for legislative action would be primarily in the area of competition between financial institutions in a given area, and that is one reason why I have stated in our prepared statement here that we would recommend a broadening of section 8 of the Clayton Act which does get at interlocks between financial institutions in a relatively limited market.

Mr. WYLIE. I think the crux of my question is really do you feel that the present level of scrutiny which you have to administer is adequate?

Mr. WILLE. With regard to the area of examination and factfinding, I don't think that there is any inhibition on our ability to get facts that would lead to certain conclusions in the area of conflicts of interest or the effects of interlocks.

Regulatory authority to deal with some of these problems, however, is more limited and that is why we are seeking a broader authority and a more refined tool to deal with these things that our examination might find as facts.

Mr. WYLIE. I see my time has expired.

I want to thank you both for an outstanding and articulate statement.

Mr. BARRETT (presiding). Thank you, Mr. Wylie.

Mr. Stephens.

Mr. STEPHENS. Thank you, Mr. Chairman.

I have studied the two statements, and I appreciate the criticisms that have been made in these two statements. I agree with the facts that you have found about the statute that is proposed. That is the reason I didn't cosponsor it because I thought it was making too many minute judgments that we should not make in this committee. For example, as I read the proposed statute we would make it a matter of law that an interlocking directorate was in itself a conflict of interest. I believe that same proposal was made by the Federal Home Loan Bank Board directly to the industry of a savings and loan.

You came up after several conferences and a lot of letters with the fact that you would prefer, and it would be infinitely preferred in the industry, to say that interlocking directorates may be a conflict of interest but let each one stand on its own merits. I feel that is the criticism that I gather is coming from the two statements here by and large, that you would prefer for Congress not to sav as a matter of policy that this is wrong and that there is no flexibility whatsoever.

I would appreciate the criticism bringing forth that idea, because I have opposed a categorical classification of this as a conflict of interest because somebody says it is. I think each item should stand on its own.

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As Mr. Wille points out, the study made of the banking industry that was done under the supervision of this committee only covered about 300 of the largest banks, and we are trying to put them all in the same boot or make all fit the same shoe. When you say an interlocking directorate by itself is a conflict of interest or that this business of giveaways is wrong completely, then you are leaving no discretion to the advisory boards and maybe we don't need any advisory boards if we are going to pass on everything. That would mean all you have to do is find out whether somebody does have an interlocking directorate.

I prefer you find out if there is a conflict of interest, because we can get so detailed in the committee that we forget people have to make a living, they have to make profit and they have to supply the purposes savings and loans were created for. We forget the whole purpose of it is to help people to get homes and encourage thrift. The same over control principal is true of the commercial banks. We tend to want to regulate too much.

Thank you. I didn't have any questions. I guess I had answers, didn't I?

Thank you.

Mr. BARRETT. Thank you, Mr. Stephens.

Mr. Rousselot.

Mr. ROUSSELOT. Thank you, Mr. Chairman.

I notice we received ahead of time a letter directed to Speaker Carl Albert and a bill proposed by Mr. Martin. I wonder, without objection, if we can have this inserted in the record?

Mr. BARRETT. That may be done also, and so ordered.

(The documents referred to follow:)

PREPARED STATEMENT OF HON. PRESTON MARTIN, CHAIRMAN, FEDERAL HOME LOAN BANK BOARD

DISCUSSION OF HOUSING INSTITUTIONS MODERNIZATION ACT OF 1971

In the "Housing Institutions Modernization Act of 1971" the Federal Home Loan Bank Board is proposing a series of measures designed to modernize the structure and powers of this nation's major housing credit institutions. These include savings and loan associations under Federal jurisdiction, the Federal Home Loan Bank System, and the Federal Home Loan Mortgage Corporation.

The savings and loan industry, with backstops of the Federal Home Loan Bank System and the Federal Home Loan Mortgage Corporation, is playing a crucial role in meeting the ambitious housing goals mandated by the Housing and Urban Development Act of 1968. By law and practice, savings and loan associations remain the only set of financial institutions almost totally committed to serving housing. During 1970, savings and loan associations accounted for 50 percent of the net acquisition of all residential mortgages and 57 percent of home mortgages as other large lenders withdrew from or reduced their contribution to the financing of housing.

This demonstrates, in the Board's opinion, that the long-run fulfillment of housing goals depends upon the continued availability of funds for housing through the savings and loan industry. This in turn requires that savings and loan associations have a full range of tools for competing effectively in the market place and that they have the power to raise and to lend money commensurate with their role.

Let me turn now to an analysis of the bill beginning with Title I.

Section 101 makes two amendments that broaden the sources of funds, especially in the form of capital, available to Federal associations. One change would authorize the issuance of capital stock by Federal associations and, thus,

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make it possible for Federal associations to operate under the stock form as is now possible for state-chartered associations in many states. The Board would be given the authority to provide adequate regulation of the use of this method of operation. In the case of conversion from the mutual to the stock form, the Board would impose conditions that would fully protect the legal rights of account holders to issuance of stock arising from conversion. This is extremely important, of course, since the stock issued as a result of conversion from the mutual to the stock form has a monetary value. The account holders retain the full value of their existing accounts as well as receiving stock incident to conversion.

The right to issue capital stock can provide an important additional source of funds to associations in capital deficit areas. Professors Brigham and Pettit in their monograph on the "Effect of Structure on Performance in the Savings and Loan Industry" show that even though little new equity capital is raised by stock associations in the aggregate, it is primarily raised by associations located in capital deficit areas from investors located in capital surplus areas. This is a way of distributing funds across the country in an efficient manner to provide housing.

In this industry, equity capital is very critical because of the leverage it provides for an increased deposit base. In 1969 the ratio of reserves and capital to savings was 8.5 percent. This means that one dollar in new capital can support about $12 in new deposits. Since new capital cannot be raised by mutual associations to support new savings, these capital dollars must be retained out of profits. In periods of the greatest housing needs, retained earnings often tend to be low and the amount of deposits that can be supported is limited. This creates a vicious cycle.

If Federal associations had the option of operating under the stock form, then in periods when savings growth was low and individuals were interested in equities, these associations could sell common stock and compete in the equity markets with other corporations. When interest rates came down, and savings were increasing, they would have the capital base to support these savings regardless of their current retained earnings.

The stock method of raising capital is especially important in forestalling supervisory action. One of the principal reasons for the weakness of associations and the need for supervisory action is the inadequacy of net worth to absorb writedowns of bad loans and foreclosed real estate. Low net worth has two effects. It discourages associations from taking a more aggressive leadership position in housing finance, and it decreases the flexibility and timing of corrective action between loss on loans and resulting default on savings accounts. The ability of associations, through conversion from mutual to stock, to sell debentures, participation certificates and new equity is directly related to their ability to serve housing and savings needs. This Board intends to see that stock associations use their power to raise money through stock issues as a means of maintaining a strong net worth position commensurate with the risks that they take.

The Board believes that the ability of Federal associations to choose to operate in the stock form will facilitate the merger of many smaller associations that are uneconomic but have built up an especially large net worth position as a result of conservative practices and cannot realize their full equity in a merger involving mutual associations. At the present time there are many small associations in certain areas of the country well in excess of the number that the market can effectively support and much greater than required for competition. The merger of such associations would promote the effectiveness of the savings and loan industry in serving the needs of housing and in competing with other financial institutions.

The Board's position on stock associations has been influenced by a number of considerations. One is that the Board now has in effect a moratorium on conversions of mutual to state-chartered stock associations. However, one of the recommendations of the "Study of the Savings and Loan Industry," directed by Professor Irwin Friend, is that this moratorium be ended and that regulations be issued setting forth procedures to ensure that account holders receive their full legal rights to conversion profits and that insiders do not benefit at their expense. If the Board follows this recommendation, the lack of authority for Federal associations to operate under the stock form would result in a rapid diminution in the number of Federally chartered savings and loan associations, with adverse impact on the dual supervisory system.

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The second consideration is the intensive study of the comparative performance of stock and mutual associations by Professors Brigham and Pettit in the monograph cited above. This study indicated that the differences between the two types of organization are not that great but that stock associations appear to exhibit a faster rate of growth, are somewhat more profitable over the long run, possibly have slightly lower cost ratios when other factors are held constant, but show up as somewhat riskier than mutuals although factors other than form of organization are far more important in determining risk. On balance, the Board believes that these differences viewed as a whole argue that both mutual and stock associations have a role to play.

I would like to conclude the discussion on stock associations by noting that the Board believes that both mutual and stock associations make vital contributions to serving the housing market. Both have their own strengths and will undoubtedly play varying roles in different areas of the country.

I would like to refer briefly to the second amendment under Section 101 of this Act. This would permit the issuance of securities and accounts that could have lesser priority upon liquidation than savings accounts. This would be necessary to implement the authority above to issue capital stock and would provide greater flexibility to associations in the type and variety of accounts that they offer. This change would also supplement the statutory authority which empowers the Board to allow Federal associations to issue notes, bonds, and debentures and would put savings and loan associations on a competitive footing with commercial banks.

I would like to turn now to Sections 102 through 105 of the Act. These would broaden the lending and investment powers of savings and loan associations.

The Board believes that the savings and loan industry can make a maximum contribution to housing goals only if it has broad powers to serve the full spectrum of housing needs as they exist today. The Board has already made many regulatory changes in lending powers of associations under existing statutes, but they go only part of the way in meeting today's needs, which include large urban renewal projects, new communities, and more tools for rehabilitating and improving the present housing stock.

In part, some of these proposed changes reflect the philosophy of the Friend Study. Professor Friend advocated the need for further diversification in portfolio powers of savings and loan associations if they are to earn an adequate return and be effective competitors for funds. The Federal Home Loan Bank Board would prefer to emphasize diversification within the area of housing, broadening the range of housing credit powers and permitting some modest degree of investment in real property within prudent limits and where justified by social needs. In the Board's view the savings and loan industry should remain committed to serving housing, and statutory changes in portfolio powers at this time should emphasize a broader and more effective participation in housing needs.

Under Section 102 Federal associations would have broader powers with respect to areas in which they can invest so as to promote urban renewal. The Board would not have to follow the highly technical definitional provisions of Section 110(c) of the Housing Act of 1949 with respect to urban renewal areas. The Board would designate HUD urban renewal projects, locally designated community development projects and additional eligible areas in order to promote investment by Federal associations that would forestall urban blight. Section 102 would raise from 5 percent to 10 percent of assets the investment that a Federal association could make in these areas in real property, interests in real property, and obligations secured by first liens on such property. Section 102 would not change the 2 percent of asset limitation under this section applicable to real property and interests in real property located in these areas.

Section 103 would raise from $5,000 to $10,000 the limitation on the maximum dollar amount of property improvement loans. This recognizes the impact of inflation on such loans and broadens the role that associations can play in maintaining and improving the quality of the housing stock. It is far more economical in the long-run to promote continued upkeep of existing housing than to replace housing after it has become substandard.

Section 104 authorizes Federal associations to invest up to 3 percent of assets directly in real property provided that it is located within one hundred miles of the association's home office or in the State in which such home office is located and is primarily for residential usage. Federal associations would also be auth-

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orized to warehouse land for development so as to facilitate projects such as new communities.

In the Board's opinion these expanded investment powers are reasonably prudent, reflect the needs of today's housing markets, and serve important social objectives. They provide opportunities for improving the rate of return on association portfolios in forms of investment that may have a fairly short turnover period, and are an ideal complement to the traditional long-term mortgage.

Investment in real property and the warehousing of land development within prudent limits would provide increased incentive to associations to participate in large projects, including new communities. These are playing an increasingly important role in total housing production because of the efficiency of providing housing on a mass scale, the superior planning afforded by such projects, which result in better amenities and facilities, and the contribution that such projects can make toward providing housing for a broad range of economic groups.

Section 105 would amend the powers of associations to make package loans for acquisition, development and improvement of land. This would permit associations to combine loans for the construction of housing as part of loans for the acquisition and development of land, thus providing a single package loan with uniform terms. In addition, such loans could be made up to 10 percent of assets rather than as presently up to 5 percent of withdrawable accounts. This would be another important tool to permit savings and loan associations to play an adequate role in the larger scale projects that are now becoming increasingly important

At this point I want to recognize explicitly that some of the new powers above can increase the risk exposure of savings and loan associations although they will also contribute to a higher portfolio yield. This is one reason why I put so much stress in my discussion of Section 101 on the need for new sources of capital to strengthen the net worth of savings and loan associations. In addition, two other provisions of this bill have a bearing on the Board's ability to monitor risks assumed by associations, and I will mention them out of sequence here.

Thus, Section 401 of Title IV would provide explicit power to the Federal Savings and Loan Insurance Corporation to require such adjournments as it deems necessary or appropriate in the amounts appearing in the books and records of insured institutions in order that their financial condition and operations may be fairly stated. It has long been the position of the Board that the Federal Savings and Loan Insurance Corporation already possesses the authority intended to be conveyed by Section 401 and the Board has long had a regulation implementing that authority. The Board believes, in views of the expansion of lending authority intended to be accomplished by Title I of the proposed legislation, that the possibility of challenge should be clearly foreclosed.

In addition, Section 402 in Title IV would allow for examination of affiliates of insured institutions defined as involving 25 percent control by the insured institution rather, than as presently, 50 percent. This would be comparable to the 25 percent requirement in the Savings and Loan Holding Company Act provisions relating to control and would recognize the reality of control that exists at an ownership share well below 50 percent. This change takes on special importance because the effective use of the new lending and investment authority above commonly involves activity by affiliated persons and businesses. To insure that this proposed lending and investment authority will be used safely, the Board believes the expansion of its regulatory authority over affiliated persons and businesses is desirable.

Let me turn now to Title II of the bill, which encompasses a variety of provisions. Section 201 would raise the number of members of the Federal Savings and Loan Advisory Council, appointed by the Board, from six to nine so as to bring in new members who could advise the Board on areas of responsibilities assigned in recent years to the Federal Home Loan Bank Board. Section 202 would give jurisdiction over legal suits involving Federal Home Loan Banks to the Federal courts, comparable to the jurisdiction of the Federal courts with respect to the Federal Savings and Loan Insurance Corporation, Federal Home Loan Mortgage Corporation, and Federal Reserve Banks.

Section 203 has three provisions that would (1) clarify the authority of the Board to regulate conflicts of interest involving insured institutions and would extend this authority over member institutions, (2) provide for enforcement by making available the remedies under other acts administered by the Board,

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and (3) authorize the Board to charge user fees and to utilize and to make payments for services of other agencies.

As you may be aware, the Friend Study contained a very comprehensive analysis of conflicts of interest, and the Board has already enacted regulations to deal with these. However, the Board's ability to deal with conflicts of interest depends very much on a clarification of its authority with respect to insured state-chartered institutions and the extension of this authority to all member institutions.

Section 204 would remedy the defects in Section 916 of the Housing and Urban Development Act of 1970. Section 916 states that "Unpledged deposits in the Bank for Savings and Loan Associations, Chicago, Ill., maintained by an institution which is a member of a Federal Home Loan Bank or is an insured institution as defined in Section 401(a) of the National Housing Act, shall be considered assets for purposes of meeting the liquidity requirements of Section 5A(b) of the Federal Home Loan Bank Act. . . ." In commenting on an earlier version of this, contained in Section 913 of the House bill, the Board stated its objections. These included the following:

The liquidity resources of the Bank for Savings and Loan Associations cannot be compared with those of Federal Home Loan Banks. It could not borrow from the Treasury, its obligations are not eligible for open-market purchase by the Federal Reserve Banks or as security for advances by those banks as obligations of the Federal Home Loan Banks are, and there is no provisions of statute by which fiduciary, trust, or public funds under the control of the United States could be invested in its obligations . . . The lack of deposit insurance and Federal Reserve membership means that the Bank for Savings and Loan Associations is not under effective supervisory, regulatory, or enforcement authority of any Federal agency. If it got into difficulties the Federal Deposit Insurance Corporation could not render with respect to it the financial assistance by loans or purchases of assets which that corporation is authorized to render as to insured banks . . . The provisions of the Board's regulation as to time deposits in insured banks are designed to restrain undue concentration of deposits and to assure ready availability. Section 913 of H.R. 19436 is obviously intended to escape those safeguards in the case of the Bank for Savings and Loan Associations.

Section 204 has two paragraphs. One, would limit the applicability of Section 916 to members located in the State of Illinois, thus eliminating imbalances in the distribution of mortgage funds that would result if member institutions in other states made deposits in the Bank for Savings and Loan Associations. The second paragraph would enable the Board to insure the full liquidity of the reserves of institutions under its supervision.

Section 205 would allow Federal Home Loan Banks to have advances outstanding to a member institution up to twenty times the capital stock paid in by that member institution. Currently, the ratio is limited to 12 to 1. The Board believes, on the basis of experience, that the 12-to-1 ratio acts as an excessive restriction on the Board's power to provide adequate funds for mortgages under certain conditions and that the 20-to-1 ratio is justified on the basis of the financial soundness of the Federal Home Loan Bank System.

Let me turn now to Title III of the bill having to do with the Federal Home Loan Mortgage Corporation. As you know, the Federal Home Loan Mortgage Corporation was created under the Emergency Home Finance Act of 1970 to provide secondary mortgage market facilities and was capitalized with funds from the twelve Federal Home Loan Banks. The proposals here reflect the experience of the Corporation to date. They would improve the effectiveness of the Corporation in its secondary market operations and, thus, further its mission to provide greater liquidity to mortgages, enhance the flow of funds into mortgages, and promote the flow of funds from capital surplus to capital deficit areas.

Section 301 would permit the Corporation to purchase an interest in a whole mortgage which it had sold and to purchase the whole of a mortgage where it had sold an interest in it.

Section 302 would raise to 25 percent the 10 percent limitation contained in the following paragraph "The Corporation may purchase a conventional mortgage which was originated more than one year prior to the purchase date only if the seller is currently engaged in mortgage lending or investing activities and if, as a result thereof, the cumulative aggregate of the principal balances of all con-

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ventional mortgages purchased by the Corporation which were originated more than one year prior to the date of purchase does not exceed 10 percentum of the cumulative aggregate of the principal balances of all conventional mortgages purchased by the Corporation." The increase in the limitation from 10 to 25 percent would improve the flexibility of the Corporation's secondary market operations in conventional mortgages and would enhance the liquidity of conventional mortgages.

Section 303 would allow the Corporation generally to purchase conventional mortgages if the outstanding principal balance of the mortgage at the time of purchase is no greater than 80 percent of the value of the property securing the mortgage. The customary maximum limit on conventional home mortgages, under statutes and regulations quite generally in effect, is 80 percent rather than the 75 percent specified in the current wording of the statute. The Corporation could continue to purchase mortgages with loan-to-value ratios in excess of 80 percent only under certain specified circumstances.

Section 304 would, in effect, authorize the Corporation to make forward commitments on participations on mortgages. The Board believes that the ban on such forward commitments serves no purpose and hinders the Corporation's effectiveness.

Section 305 would provide that, subject to regulatory authority otherwise applicable, obligations of the Corporation, except its stock shall be lawful investments and security for fiduciary, trust, and public funds whose investment or deposit is under the control of the United States or its possessions, or under the control of corporations incorporated under the laws of the United States or such possessions. This provides for a treatment of Corporation securities comparable to that afforded securities of the Federal Home Loan Banks.

Section 306 would provide that authority comparable to that contained in sections 301–305 will be given to the Federal National Mortgage Association.

Finally, I would like to turn now to Title IV of the bill. I have already commented earlier on Sections 401 and 402.

Section 403 makes certain minor technical and clarifying changes with respect to the Savings and Loan Holding Company Act provisions.

Section 404 is an important provision that clarifies and codifies the powers of the Federal Home Loan Bank Board with respect to approval of savings and loan mergers and provides for procedures comparable to that in the Bank Merger Act for passing upon antitrust aspects of proposed mergers.

Mergers between savings and loan associations are presently subject to direct challenge under antitrust laws without any consideration of the convenience and needs of the community to be served as is presently permitted in the case of bank mergers under the Bank Merger Act. This is a serious lack of symmetry in treatment between the two major types of depository institutions.

This section would remedy such asymmetry by providing for language similar to that in the Bank Merger Act. The precise language would be that the Corporation shall not approve—

"(1) any proposed merger transaction which would result in a monopoly, or which would be in furtherance of any combination or conspiracy to monopolize or to attempt to monopolize any type of business in which insured institutions engage in any part of the United States, or

"(2) any other proposed merger transaction whose effect in any section of the country may be substantially to lessen competition, or to tend to create a monopoly, or which in any other manner would be in restraint of trade, unless it finds that the anti-competitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served.

In every case, the Corporation shall take into consideration the financial and managerial resources and future prospects of the existing and proposed institutions, and the convenience and needs of the community to be served."

It is the intention of the Board, as it is now doing under its present Statements of Policy on Mergers, to evaluate the possible anti-competitive impact of each merger in both savings and mortgage markets and to take into account close competitors of savings and loan associations in each of these markets.

This section will provide for a report on the competitive factors involved from the Attorney General and provide that the Attorney General be notified immediately in the case of approval. The merger shall not be consummated until 30

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days after approval except in the existence of an emergency. This serves the objectives of antitrust and, at the same time, provides assurance to savings and loan associations that, once a merger is consummated, a Department of Justice suit would not subject it to the extremely complex process of unscrambling.

Turning to Section 405, this would clarify and amend provisions relating to the Federal Savings and Loan Insurance Corporation. It would restate more precisely the present rights of the Corporation and uninsured account holders as a result of insurance settlement payments incident to the default in an insured association.

This section would delete all reference to the Corporation paying the valid creditor obligations of the defaulted association. The deleted language is both ambiguous and superfluous since the Corporation in any event would be obligated to pay all credits obligations of the defaulted association, out of such institution's assets, when it acts as a liquidating receiver.

This section also would add a sentence designed to avoid in the future unnecessary litigation of the type involved in past receiverships. This sentence is also intended to make clear that the obligation to pay interest to the Corporation becomes a continuing liability of the insured association upon its default even though the interest is not payable until payment or provision for payment has been made with respect to the specified expenses and other creditor claims. In order to achieve uniformity and consistency in the event of receiverships in different States, such interest is to be paid to the Corporation at the rate based on the average market yield on the Corporation's investment in obligations of, or guaranteed as to principal and interest by, the United States.

This completes the analysis of the various provisions of the bill. Some of the provisions are technical or involve relatively minor matters. However, many of the provisions are obviously quite important in their impact on the structure and operations of savings and loan associations, the Federal Home Loan Bank System, and the Federal Home Loan Mortgage Corporation. Taken as a whole, they represent continued progress in improving the structure of the housing credit mechanism and in providing additional assurance that this nation's housing goals can be met.

FEDERAL HOME LOAN BANK BOARD,
Washington, D.C., April 17, 1971.

Hon. CARL ALBERT,
Speaker of the House of Representatives,
Washington, D.C.

DEAR MR. SPEAKER: I transmit herewith on behalf of the Federal Home Loan Bank Board a draft of a proposed bill, "To amend laws relating to savings and loan associations, to broaden their mortgage credit powers, and for other purposes," which has been tentatively entitled the "Housing Institutions Modernization Act of 1971."

Savings and loan associations supply the great majority of the credit required to meet the Nation's housing needs. These private institutions are assisted in the achievement of this enorous and vital social endeavor by this agency and the public and quasi-public institutions under its supervision, namely, the Federal Home Loan Banks and the Federal Savings and Loan Insurance Corporation. They are also assisted by the Federal Home Loan Mortgage Corporation, a private, Federally chartered corporation whose board of directors consists of the board members of this agency.

The Board has learned from the experience of the housing crisis from which the Nation is now beginning to emerge that there are many needed improvements in the authority and functioning of these private, public, and quasi-public institutions. The industry needs enhanced capabilities of raising equity capital to sustain growth. It is the purpose of the proposed bill to accomplish these improvements.

Title I would enable Federal savings and loan associations to provide additional funds to the housing markets by authorizing them to sell capital stock. This title would also adjust the asset structure of Federal savings and loan associations by enabling them to make additional types of loans and investments. These adjustments would have the effect of stimulating the housing sector and providing financial stability to associations during economic downturns.

Title II of the bill would clarify and expand the authority of the Board to

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control certain undesirable practices and would make certain institutional changes.

Title III would enable the Federal Home Loan Mortgage Corporation to provide a broader, deeper, and more flexible secondary market in mortgages, and would grant to the Federal National Mortgage Association the same new powers which would be conferred on the Federal Home Loan Mortgage Corporation.

Title IV would add to the stability of savings and loan associations by expanding the examination authority of the Board and by restating the Board's authority over mergers involving insured savings and loan associations so that it would be comparable to the authority now granted to the banking agencies over mergers involving insured banks. Finally, title IV would make a number of clarifying and technical amendments.

It would be appreciated if you would lay the proposed bill before the House of Representatives. An identical bill has been transmitted to the President of the Senate.

The Office of Management and Budget advises that there is no objection to the transmittal of this legislation and that its enactment would be consistent with the objectives of the Administration.

Sincerely,

PRESTON MARTIN, *Chairman.*

A BILL To amend laws relating to savings and loan associations, to broaden their mortgage credit powers, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Housing Institutions Modernization Act of 1971".

TITLE I—FEDERAL SAVINGS AND LOAN ASSOCIATIONS

ISSUANCE OF CAPITAL STOCK

SEC. 101. Section 5 of the Home Owners' Loan Act of 1933 is amended (1) by striking out in paragraph (1) of subsection (b) "and all of which shall have the same priority upon liquidation", and (2) by changing "except capital stock" to "including capital stock" in paragraph (2) of subsection (b).

FINANCING IN URBAN AREAS

SEC. 102. The twelfth sentence of section 5(c) of the Home Owners' Loan Act of 1933 is amended (1) by striking out "in subsection (a) of section 110 of the Housing Act of 1949" and substituting therefor "by the Board"; and (2) by striking out the figure "5" and inserting in lieu thereof the figure "10".

PROPERTY IMPROVEMENT LOANS

SEC. 103. Section 5(c) of the Home Owners' Loan Act of 1933 is amended by striking out the figure "$5,000" in the fourth and sixth sentences thereof and inserting in lieu thereof the figure at each such place "$10,000".

REAL PROPERTY

SEC. 104. Subsection (c) of section 5 of the Home Owners' Loan Act of 1933 is amended by adding to said subsection, immediately before the last paragraph thereof, the following paragraph: "Without regard to any other provision of this subsection, but subject to such prohibitions, limitations, conditions, and restrictions as the Board may prescribe, an association may invest in real property, including interests in real property, located within one hundred miles of its home office or within the State in which such home office is located, for the purpose of acquiring, developing, and/or improving such property or interests therein for primarily residential usage, and may hold, sell or otherwise dispose of, lease, improve, and operate any such property or any interest therein, but an association shall not make any investment under this sentence in the acquisition of real property or any interest therein if its aggregate outstanding investment

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under this sentence (determined as prescribed by the Board), exclusive of any investment which is or at the time of its making was otherwise authorized, would thereupon exceed 3 per centum of its assets."

LOANS FOR CONSTRUCTION

SEC. 105. The paragraph added to subsection (c) of section 5 of the Home Owners' Loan Act of 1933 by section 805(c) of the Housing Act of 1959 is amended (1) by substituting "10 per centum of assets" for "5 per centum of such withdrawable accounts", and (2) by substituting ", development, and/or improvement of land or interests therein" for "and development of land".

TITLE II—FEDERAL HOME LOAN BANK BOARD

FEDERAL SAVINGS AND LOAN ADVISORY COUNCIL

SEC. 201. Section 8a of the Federal Home Loan Bank Act is amended by substituting "nine" for "six".

SUITS INVOLVING FEDERAL HOME LOAN BANKS

SEC. 202. Section 12 of the Federal Home Loan Bank Act is amended by adding at the end thereof a new subsection (c) as follows:

"(c) Notwithstanding section 1349 of title 28 of the United States Code or any other provision of law, (1) each Federal Home Loan Bank shall be deemed to be an agency included in sections 1345 and 1442 and the first sentence of section 2408 of said title 28; (2) all civil actions to which a Federal Home Loan Bank is a party shall be deemed to arise under the laws of the United States, and the district courts of the United States shall have original jurisdiction of all such actions, without regard to amount or value; and (3) any civil or other action, case, or controversy in a court of a State, or in any court other than a district court of the United States, to which a Federal Home Loan Bank is a party, may at any time before the trial thereof be removed by such Bank, without the giving of any bond or security, to the district court of the United States for the district (and the division, if any) embracing the place where the same is pending, or, if there is no such district court, to the district court of the United States for the district (and the division, if any) in which the principal office of such Bank is located, by following any procedure for removal of causes in effect at the time of such removal. No attachment or execution shall be issued against a Federal Home Loan Bank or any of its property before final judgment in any State, Federal, or other court."

CONFLICTS OF INTEREST AND RELATED MATTERS

SEC. 203. Section 17 of the Federal Home Loan Bank Act is amended by adding thereto the following new subsection:

"(c)(1) The Federal Home Loan Bank Board is authorized, to such extent as it may deem necessary or appropriate to prevent materially adverse effects as to any member, or for the protection of the Federal Savings and Loan Insurance Corporation, to regulate or prohibit any member (which term as used in this subseection shall include any insured institution as defined in section 5A) or any director, officer, controlling person, or employee of, or any attorney or appraiser for, or any person occupying a fiduciary relationship with, or any other affiliated person of, any member from engaging or participating in any business or financial transaction conducted on behalf of or involving any member or other financial institution which would result directly or indirectly in a conflict of his or its financial interests with those of the member.

"(2) The provisions of subsection (f) of section 5A and of subsections (b) and (c) of section 5B, all as now in effect, are extended to include this subsection, and for purposes of this sentence the references in said subsections to those sections shall include this subsection, the references in said subsection (f) to provisions of the National Housing Act shall be deemed to be references to those provisions as now in effect, and the references in said subsections (b) and (c) to institutions and nonmember institutions shall include members and shall include affiliated persons.

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"(3) In or in connection with the exercise of any function vested in or exercisable by the Board under this Act or otherwise, the Board (which term as used in this paragraph includes the Federal Savings and Loan Insurance Corporation) is authorized (A) to act through any corporate or other agency or instrumentality of the United States and utilize information, services, facilities, and personnel thereof, and any such agency or instrumentality is authorized to provide the same as requested by the Board, (B) to make payment therefor, and any expense under (A) or (B) hereof or in connection with any similar action rendered by the Board to any such agency or instrumentality shall not be considered as administrative expense, and (C) to impose and collect fees and charges for the provision by the Board of information, services, facilities or personnel to any person, and for purposes of this subsection the references in the last two sentences of subsection (b) of section 5B as now in effect to penalties shall be deemed to be references to such fees and charges. Any such payment or collection may be in advance or by reimbursement or otherwise."

ILLINOIS BANK FOR SAVINGS AND LOAN ASSOCIATIONS

SEC. 204. Section 916 of the Housing and Urban Development Act of 1970 is amended by adding the following immediately before the period at the end thereof: ": *Provided,* That after the date of enactment of this proviso, no deposits in such bank shall be considered assets for such purposes at any time when (1) such member or insured institution does not have its principal office in the State of Illinois (except that this requirement shall not apply to any deposits held on such date by an institution which on such date is a member or an insured institution as defined in this sentence, as long as such deposits are held by such institution and no addition is made thereto), or (2) there is outstanding a determination by the Federal Home Loan Bank Board (A) that the facilities or condition of such bank are not consistent with the liquidity of deposits in such bank, or (B) that it does not possess sufficient information to make the determination specified in clause (A) above".

ADVANCES

SEC. 205. The Federal Home Loan Bank Act is amended by substituting "twenty" for "twelve" in section 6(c)(2)(ii) thereof and in the first place that it appears in section 10(c) thereof.

TITLE III—FEDERAL HOME LOAN MORTGAGE CORPORATION

REPURCHASE OF MORTGAGES

SEC. 301. Paragraph (1) of subsection (a) of section 305 of the Federal Home Loan Mortgage Corporation Act is amended by inserting after the period at the end of the first sentence thereof, a new sentence as follows: "Where a mortgage or an interest therein is sold by the Corporation, the Corporation may thereafter purchase such mortgage or an interest therein from any holder or owner."

PERCENTAGE LIMITATION ON 1 YEAR MORTGAGES

SEC. 302. Paragraph (2) of subsection (a) of section 305 of the Federal Home Loan Mortgage Corporation Act is amended by striking out the figure "10" in the third sentence thereof and inserting in lieu thereof the figure "25".

LOAN-TO-VALUE RATIO

SEC. 303. Paragraph (2) of subsection (a) of section 305 of the Federal Home Loan Mortgage Corporation Act is amended by striking out the figure "75" in the first sentence thereof in each place that it appears therein and by inserting in lieu thereof the figure "80" in each such place.

COMMITMENTS

SEC. 304. Paragraph (2) of subsection (a) of section 305 of the Federal Home Loan Mortgage Corporation Act is amended by deleting the second sentence thereof.

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ELIGIBILITY AS PUBLIC INVESTMENTS

SEC. 305. Section 303 of the Federal Home Loan Mortgage Corporation Act is amended by adding a new subsection (f) at the end thereof as follows:

"(f) Subject to any regulatory authority otherwise applicable, obligations of the Corporation and (to such extent as the Corporation may prescribe) other securities of the Corporation except stock shall be lawful investments, and may be accepted as security, for all fiduciary, trust, and public, private, or other funds the investment or deposit of which shall be under the authority or control of the United States, the District of Columbia, the Commonwealth of Puerto Rico, or any territory or possession of the United States, any public, private, or other corporation incorporated by or under any law of any of the foregoing, any county or municipality of any of the foregoing, any political subdivision of any of the aforesaid, any court or any corporate or other agency or instrumentality of any of the preceding, or any officer or officers, employee or employees, or agent or agents of any of the above."

FEDERAL NATIONAL MORTGAGE ASSOCIATION

SEC. 306. Section 302(b)(2) of the National Housing Act is amended—

(1) by inserting after the period at the end of the first sentence thereof, a new sentence as follows: "Where a mortgage or interest therein is sold by the corporation, the corporation may thereafter purchase such mortgage or an interest therein from any holder or owner.";

(2) by striking out the figure "10" in the fourth sentence thereof and inserting in lieu thereof the figure "25";

(3) by striking out the figure "75" in the second sentence thereof in each place that it appears therein and by inserting in lieu thereof the figure "80" in each such place; and

(4) by deleting the third sentence thereof.

TITLE IV—FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION

ADJUSTMENTS IN ASSETS

SEC. 401. Section 403(b) of title IV of the National Housing Act is amended by adding at the end thereof the following sentence: "The Corporation shall have power to require such adjustments as it deems necessary or appropriate in the amounts appearing in the books, records, reports, or other documents of insured institutions in order that their financial condition or operations may be fairly stated."

DEFINITION OF AFFILIATE

SEC. 402. Section 407(m)(1) of title IV of the National Housing Act is amended by deleting the last sentence thereof and by adding the following sentence at the end thereof: "For purposes of this subsection, the term 'affiliate' shall have the same meaning given to it in section 408(a) of this title."

SAVINGS AND LOAN HOLDING COMPANIES

SEC. 403. Section 408(d)(4) of the National Housing Act, as amended, is further amended by striking out all which follows "(2)" and substituting therefor, the following: "property previously owned, legally or beneficially, by any savings and loan holding company or affiliate thereof, other than the parent holding company of such service corporation or any affiliate of such holding company."

MERGERS

SEC. 404. Title IV of the National Housing Act is amended by adding at the end thereof a new section as follows:

"SEC. 412. (a) Except with the prior written approval of the Corporation, no insured institution shall—

"(1) merge or consolidate with any other institution;

"(2) assume liability to pay any deposits, share accounts, or similar liabilities of any other institution;

"(3) transfer assets to any other institution in consideration of the assumption of liabilities for any portion of the deposits, share accounts, or similar liabilities of such insured institution.

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"(b) Notice of any proposed transaction for which approval is required under subsection (a) (referred to hereafter in this section as a 'merger transaction') shall, unless the Corporation finds that it must act immediately in order to prevent the probable failure of one of the institutions involved, be published—

"(1) in a form approved by the Corporation,

"(2) in a form approved by the Corporation,

"(3) at appropriate intervals during a period at least as long as the period allowed for furnishing a report under subsection (c) of this section, and

"(4) in a newspaper of general circulation in the community or communities where the main offices of the institutions involved are located, or, if there is no such newspaper in any such community, then in the newspaper of general circulation published nearest thereto.

"(c) In the interests of uniform standards, before acting on any application for approval of a merger transaction, the Corporation, unless it finds that it must act immediately in order to prevent the probable failure of one of the institutions involved, shall request a report on the competitive factors involved from the Attorney General. The report, or in the alternative a notification indicating that no report will be submitted, shall be furnished within thirty calendar days of the date on which the report is requested, or within ten calendar days of such date if the Corporation advises the Attorney General that an emergency exists requiring expeditious action.

"(d) The Corporation shall not approve—

"(1) any proposed merger transaction which would result in a monopoly, or which would be in furtherance of any combination or conspiracy to monopolize or to attempt to monopolize any type of business in which insured institutions engage in any part of the United States, or

"(2) any other proposed merger transaction whose effect in any section of the country may be substantially to lessen competition, or to tend to create a monopoly, or which in any other manner would be in restraint of trade, unless it finds that the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served.

In every case, the Corporation shall take into consideration the financial and managerial resources and future prospects of the existing and proposed institutions, and the convenience and needs of the community to be served.

"(e) The Corporation shall immediately notify the Attorney General of any approval by it pursuant to this subsection of a proposed merger transaction. If the Corporation has found that it must act immediately to prevent the probable failure of one of the institutions involved and the report on the competitive factors has been dispensed with, the transaction may be consummated immediately upon approval by the Corporation. If the Corporation has advised the Attorney General of the existence of an emergency requiring expeditious action and has requested the report on the competitive factors within ten days, the transaction may not be consummated before the fifth calendar day after the date of approval by the Corporation. In all other cases, the transaction may not b consummated before the thirtieth calendar day after the date of approval by the Corporation.

'(f)(1) Any action brought under the antitrust laws arising out of a merger transaction shall be commenced prior to the earliest time under subsection (e) at which a merger transaction approved under subsection (d) might be consummated. The commencement of such an action shall stay the effectiveness of the Corporation's approval unless the court shall otherwise specifically order. In any such action, the court shall review de novo the issues presented.

"(2) In any judicial proceeding attacking a merger transaction approved under subsection (d) on the ground that the merger transaction alone and of itself constituted a violation of any antitrust laws other than section 2 of the Act of July 2, 1890 (section 2 of the Sherman Antitrust Act, 15 U.S.C. 2), the standards applied by the court shall be identical with those that the Corporation is directed to apply under subsection (d).

"(3) Upon the consummation of a merger transaction in compliance with this section and after the termination of any antitrust litigation commenced within the period prescribed in this subsection, or upon the termination of such period if no such litigation is commenced therein, the transaction may not thereafter be attacked in any judicial proceeding on the ground that it alone and of itself

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constituted a violation of any antitrust laws other than section 2 of the Act of July 2, 1890 (section 2 of the Sherman Antitrust Act, 15 U.S.C. 2), but nothing in this section shall exempt any institution resulting from a merger transaction from complying with the antitrust laws after the consummation of such transaction.

"(4) In any action brought under the antitrust laws arising out of a merger transaction approved by the Corporation pursuant to this section, the Corporation, and any State supervisory agency having jurisdiction within the State involved, may appear as a party of its own motion and as of right, and be represented by its counsel.

"(g) The Corporation may make such rules and regulations as it may deem necessary or appropriate for the purpose of carrying out the provisions of this section.

"(h) For purposes of this section, the term 'antitrust laws' means the Act of July 2, 1890 (the Sherman Antitrust Act, 15 U.S.C. 1–7), the Act of October 15, 1914 (the Clayton Act, 15 U.S.C. 12–27), and any other statutory provisions in pari materia therewith."

PAYMENT OF INSURANCE

SEC. 405. Title IV of the National Housing Act is amended—

(1) by adding the following two sentences at the end of section 405(b) thereof:

"The surrender and transfer to the Corporation of an insured account in any institution in default shall subrogate the Corporation with respect to such insured account and all rights incident thereto, and the insured member shall retain only those rights incident to any uninsured portion of his account. Upon the payment of insurance by the Corporation to the insured members of the institution in default, the Corporation shall become entitled to interest on the withdrawable or repurchasable amount of the accounts surrendered and transferred to it, computed at a rate determined by the Federal Savings and Loan Insurance Corporation, as of the date of default, based upon the average market yield on the Federal Savings and Loan Insurance Corporation's investments in obligtions of, or guaranteed as to principal and interest by, the United States, commencing upon the date of default and continuing until the date or dates on which the Corporation's claim for the aggregate withdrawable or repurchasable amount of all such accounth is paid in full by the conservator, receiver, or other legal custodian of such institution: Provided, That such rate shall not be less than the rate determined by the Secretary of the Treasury taking into consideration the current average market yield on outstanding marketable obligations of the United States of comparable maturity, adjusted to the nearest one-eighth of one per centum: and provided further, That no such interest shall be payable to the Corporation until payment or provision for payment has been made with respect to the expenses of administering the institution in default, including tax liability, and all creditor claims against such institution, including the full withdrawable or repurchasable amount of all account claims."

(2) By inserting a period after the words "Section 405" in section 406(b) thereof and deleting the remainder of said section 406(b) following said period.

SECTION-BY-SECTION ANALYSIS

TITLE I

PROPOSED "HOUSING INSTITUTIONS MODERNIZATION ACT OF 1971

Section 101—Issuance of Capital Stock

Section 101 makes two amendments to section 5 of the Home Owners' Loan Act of 1933.

Amendment (1) would amend the first sentence of paragraph (1) of subsection (b) of said section 5. That sentence provides that a Federal savings and loan association may raise capital in the form of "such savings deposits, shares, or other accounts, for fixed, minimum, or indefinite periods of time (all of which are referred to in this section as savings accounts and all of which shall have the same priority upon liquidation)" as are authorized by its charter or by regulations of the Federal Home Loan Bank Board as therein set forth.

The language "all of which shall have the same priority upon liquidation"

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constitutes a serious limitation on the flexibility and workability of the provision. It prevents, for example, the providing of liquidation priority for deposits over shares, or for deposits of public funds over other deposits, and it equally prevents the issuance, for example to institutional investors, of accounts having deferred status upon liquidation. Accordingly, amendment (1) would delete the quoted language "all of which shall have the same priority upon liquidation".

Amendment (2) would amend paragraph (2) of subsection (b) aforesaid, which now provides: "To such extent as the Board may authorize by regulation or advice in writing, an association may borrow, may give security, and may issue such notes, bonds, debentures, or other obligations, or other securities (except capital stock) as the Board may so authorize."

The parenthetical language "except capital stock" prevents the adoption for Federal savings and loan associations of the more modern method of operation known in various jurisdictions as the permanent-stock, guaranty-stock, or reserve-stock method, under which the savers are protected by the issuance of capital stock which typically is nonwithdrawable and is, upon liquidation, deferred to the claims of the holders of savings accounts. Amendment (2) would change this parenthetical language to "including capital stock", thus making this more modern method available to Federal savings and loan associations.

If this amendment were enacted, the Federal Home Loan Bank Board would have complete and effective regulatory authority as to the extent and manner of the use of this method of operation under existing provisions of subsection (a) of section 5 of the Act, which authorizes the Board, under such rules and regulations as it may prescribe, to provide (among other things) for the organization, operation, and regulation of Federal savings and loan associations. This regulatory authority would include, but would not be limited to, the required amounts of capital stock, the terms on which it could be issued, and the conversion of existing associations to the new type of operation, including the assurance of adequate protection to existing savings-account holders in the event of such conversion.

Federal savings and loan associations have no outstanding ownership equities except those represented by deposits. There are no shares of stock. The Charters of these institutions provide that in the very unlikely event of a liquidation of the institution, the excess funds, remaining after the payment of deposits, of interest, and of other obligations, will be distributed to the depositors who are customers of the association in which respect they resemble consumers.

The Bank Board must have authority to assure that the rights of the depositors to these benefits which are over and above the amount of deposits and interest, are preserved. That authority should be sufficiently flexible so that the full proceeds of the sale of stock representing ownership go to the depositors, and to protect against mass last minute deposits by insiders and other devices to water down or take away benefits that belong to the depositor. Present statutes are not adequate for this purpose. Amendment is urgently necessary.

If the savings and loan industry is to provide the housing financing needs of the country as they have in the past, and survive in a highly competitive savings market, they must benefit from all economies of scale. Since these economies do exist, it is advantageous and necessary for mergers of small associations to occur. These mergers would be greatly facilitated if the associations were in stock form prior to the merger.

Highly related to the question of providing financing needs is the question of obtaining capital in times of rising interest rates and in areas which traditionally are capital short. Even through little new equity capital is raised by stock associations in the aggregate, it is primarily raised by associations located in capital short areas from investors located in capital surplus areas. This is definitely a way of distributing funds across the country in an efficient manner to provide housing.

Section 102—Financing in Urban Areas

The twelfth sentence of section 5(c) of the Home Owners' Loan Act of 1933 authorizes a Federal association to invest not more than 5 percent of its assets (1) in *real property* located within urban renewal areas designated as such by the Secretary of Housing and Urban Development under section 110(a) of the Housing Act of 1949 (42 U.S.C. 1460(a)); (2) in *interests* in such property; and (3) in *obligations* secured by first liens on such property. The twelfth sentence also restricts investment in such *real property* and such *interests* to 2 percent of assets.

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Section 102 would make two amendments. First, it would raise the 5 percent limitation to 10 percent. Second, it would permit the Board to define areas for the purposes of investment by Federal associations under the twelfth sentence.

This second amendment would make the twelfth sentence more workable and flexible since, under section 110(a) of the Housing Act of 1949, the Secretary's authority to designate an area as an urban renewal area is limited to approving the area as appropriate for an "urban renewal project", which latter term is itself subject to the complicated definitional provisions of section 110(c) of that act. While those provisions may be appropriate for determining the eligibility for loan and grant contracts under title I of the Housing Act of 1949 (42 U.S.C. 1451 *et seq.*) we believe they are not needed for the purpose of enabling Federal savings and loan associations to make loans to assist in rehabilitation operations.

Investment by Federal savings and loan associations in redevelopable and rehabilitatable real estate outside urban renewal project areas would enable these institutions to forestall urban blight and conserve the existing housing stock prior to its decay. The FHLBB would of course continue to support HUD projects by designating all such areas following the Secretary's designation. The intent of the Sec. 102 amendment is to complement HUD efforts and to utilize the comparative advantage of savings and loan associations, many of whom have large volumes of outstandinng loans and thus experience in "gray areas" proximate to HUD-designated project areas.

Section 103—Property Improvement Loans

Section 103 would raise to $10,000 the $5,000 limitation on the maximum dollar amount of property improvement loans contained in the fourth and sixth sentences of section 5(c) of the Home Owners' Loan Act. This dollar limitation has been successively raised over the years; in 1954 from $1,500 to $2,500; in 1956 from $2,500 to $3,500; and in 1964 from $3,500 to $5,000. Changed economic circumstances have made the 1964 figure increasing unrealistic.

In order to avoid wasteful and time-consuming piecemeal legislation, and in view of the natural limits placed on such loans by reasonable lenders and homeowners, a good case could be made for eliminating the dollar limitation entirely. It is believed, however, that a fixed $10,000 dollar figure will serve to check occasional excess and should render further amendatory legislation unnecessary for the indefinite future.

Section 104—Real Property

Under present law, Federal associations may invest directly in real property only to the extent permitted under the twelfth sentence of section 5(c) of the Home Owners' Loan Act (discussed above under § 102). In a number of states, notably California, state-chartered associations may invest in real property up to some percentage of assets or some similar base or limitation. Section 104 would correct this competitive inequality by authorizing Federal associations to invest no more than 3 percent of their assets directly in real property. In addition to this percentage-of-assets limitation, section 104 would impose limitations as to the location of the property and the purpose of the investment in the property. The location of the property must be within one hundred miles of the association's home office or in the State in which such home office is located, and the purpose of the investment must be "for primarily residential usage".

Section 104 would also authorize Federal savings and loan associations to "warehouse" land for development with small percentage of assets and would facilitate housing production, including "New Towns".

Section 105—Loans For Acquisition, Development and Improvement of Land

Section 105 makes two amendments to the paragraph added to section 5(c) of the Home Owners' Loan Act of 1933 by section 805(c) of the Housing Act of 1959.

That paragraph now provides that, without regard to any other provision of subsection (c) of section 5 of the Act except the area restriction, any Federal savings and loan association with general reserves, surplus, and undivided profits in excess of 5 percent of its withdrawable accounts may invest not exceeding at any one time 5 percent of such withdrawable accounts in loans to finance the acquisition and development of land for primarily residential usage, subject to such rules and regulations as the Board may prescribe.

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The object of the paragraph, as set forth (at p. 628) in the House Housing Subcommittee hearings on the Housing Act of 1959, was to provide for the development of housing sites. The term "development" is defined in section 545.6–14(d) of the Board's regulations. Loans for the construction of the housing must be made under other authority and subject to different percentage and other limitations. This fragmentation is unduly complex, prevents the paragraph from being as effective a tool for housing finance as is desirable, and is largely the result of the process of piecemeal amendment which has produced the present text of section 5(c).

Section 105 of the bill would eliminate this fragmentation by permitting loans to be made under the paragraph for the improvement of the property as well as for its acquisition and development, or any combination thereof. The section would also change the percentage limitation on such loans from 5 percent of withdrawable accounts to 10 percent of the association's assets. This would make a reasonable increase in the permitted amount of loans under the paragraph and bring this paragraph in line with the other lending limitations in section 5(c), which are based on percentages of assets rather than percentages of withdrawable accounts.

TITLE II

Section 201—Federal Savings and Loan Advisory Council

Section 8a of the Federal Home Loan Bank Act (12 U.S.C. 1428a) establishes a Federal Savings and Loan Advisory Council to consist of one member elected by the Board of Directors of each Federal Home Loan Bank (currently 12) and six members appointed by the Board. Section 201 would raise the number of appointed members to nine. It has been apparent to the Board for some time, but especially since the creation of the Federal Home Loan Mortgage Corporation, that the Council needs to be expanded to provide representation to industry groups which do not now have an institutional voice on the Council.

Section 202—Suits Involving Federal Home Loan Banks

Under existing law, the Federal Courts have original jurisdiction over suits involving the Federal Savings and Loan Insurance Corporation (12 U.S.C. 1730(k)(1)), the Federal Home Loan Mortgage Corporation (§ 303(e), P.L. 91–351), and the Federal Reserve Banks (12 U.S.C. 632). The purpose of these provisions, and similar provisions involving other Federal instrumentalities, is to insure uniformity and consistency of treatment. Section 102 would give the Federal courts comparable jurisdiction over suits involving Federal Home Loan banks.

Section 203—Conflicts of Interest and Related Matters

Section 203 would add a new subsection (c), consisting of three paragraphs, to section 17 of the Federal Home Loan Bank Act (12 U.S.C. 1437). Paragraph (1) of the new subsection would clarify the authority of the Board to regulate conflicts of interest involving insured institutions and would extend this authority to conflicts of interest involving member institutions. Paragraph (2) would provide for enforcement by extending to this subsection the remedies available to the Board under other acts which it administers. Paragraph (3) would authorize the Board to charge user fees and to utilize and to make payment for services of other agencies in the implementation of this subsection and other statutory provisions administered by the Board.

Section 204—Illinois Bank for Savings and Loan Associations

Section 913 of the Housing and Urban Development Act of 1970, as reported by the House (H.R. 19436), reads as follows:

"SEC. 913. The provision numbered (2) in the first sentence of subsection (b) of section 5A of the Federal Home Loan Bank Act (12 U.S.C. 1425a) is amended to read as follows: '(2) unpledged deposits in a Federal Home Loan Bank or in a State bank performing similar functions and in operation on February 6, 1970, and to such extent as the Board may approve for the purposes of this section, time and savings deposits in commercial banks, and'."

In a letter to the Chairman of the House Committee on Banking and Currency the Board stated its objections to the enactment of section 913 in the following terms:

"*Sec. 913, H.R. 19436, Liquidity of institutions.* Section 5A of the Federal Home Loan Bank Act, as amended in 1968, requires each institution which is a mem-

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ber of a Federal Home Loan Bank or insured by the Federal Savings and Loan Insurance Corporation to maintain certain types of assets in amounts fixed by the Board, but not less than 4% nor more than 10% of its withdrawable accounts and short-term borrowings as therein set forth or, in the case of institutions which are insurance companies, such other base or bases as the Board may determine to be comparable.

Under the statute, these assets include cash and, to such extent as the Board may approve, time and savings deposits in Federal Home Loan Banks and commercial banks. By section 523.10 of the Regulations for the Federal Home Loan Bank System (12 CFR 523.10), the Board has limited eligible deposits to demand and time deposits in a Federal Home Loan Bank and demand and time deposits in an 'insured bank', defined as a bank insured by the Federal Deposit Insurance Corporation which is not under the control or in the possession of a supervisory authority. However, time deposits in an insured bank are eligible under the regulation only if (1) the total of the member's time deposits in the same bank does not exceed the greater of (a) one-fourth of 1% of the total deposits of the bank (calculated as therein set forth) or (b) $20,000, (2) no consideration other than discounting to a current market rate of interest is received by the member from a third party in connection with its making or acquisition of the deposit, and (3) the deposit is negotiable and not over one year in remaining maturity or, if not withdrawable without notice, the notice period does not exceed 90 days.

In the administrative proceedings prior to the issuance of the regulation, an Illinois corporation known as the Bank for Savings and Loan Associations, incorporated in 1966 under the general banking laws of Illinois and not a member of the Federal Reserve System or insured by the Federal Deposit Insurance Corporation, but all of whose capital stock was owned by Illinois savings and loan associations, took the position that demand and time deposits made in it should be eligible on the same basis as those in a Federal Home Loan Bank. It indicated that its ends would not be served if it were placed on the same basis as that proposed for insured banks, asserting that the provision limiting the total time deposits of a member in the same insured bank to one-fourth of 1% of the total deposits would have serious effects on it.

The Board did not grant the requested relief, and the same result is now apparently being sought directly by statute, through section 913 of H.R. 19436. The Federal Home Loan Bank Board objects to that section, for reasons briefly summarized below.

First. For a bank to qualify under section 913, it must be, *and must continue to be,* a State bank "performing similar functions" to a Federal Home Loan Bank. It is not clear how institutions making or acquiring deposits in the Bank for Savings and Loan Associations, or the Board and its examiners and other staff members, could obtain current, dependable information as to what functions that Bank was performing at any time or from time to time.

Second. The liquidity resources of the Bank for Savings and Loan Associations cannot be compared with those of Federal Home Loan Banks. It could not borrow from the Treasury, its obligations are not eligible for open-market purchase by the Federal Reserve Banks or as security for advances by those banks as obligations of the Federal Home Loan Banks are, and there is no provision of statute by which fiduciary, trust, or public funds under the control of the United States could be invested in its obligations.

Third. The lack of deposit insurance and Federal Reserve membership means that the Bank for Savings and Loan Associations is not under effective supervisory, regulatory, or enforcement authority of any Federal agency. If it got into difficulties the Federal Deposit Insurance Corporation could not render with respect to it the financial assistance by loans or purchases of assets which that corporation is authorized to render as to insured banks.

Fourth. The provisions of the Board's regulation as to time deposits in insured banks are designed to restrain undue concentration of deposits and to assure ready availability. Section 913 of H.R. 19436 is obviously intended to escape those safeguards in the case of the Bank for Savings and Loan Associations. There is even danger that in other States (or in Illinois itself) State banks which were in operation on February 6, 1970, might claim that they were performing similar functions to a Federal Home Loan Bank and were entitled to the same treatment as the Bank for Savings and Loan Associations.

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Finally, we note that the word "unpledged", which now appears in the regulation but not in the statute, would be carried into the statute by section 913 of the bill. We believe that situations might later develop in which it would be desirable to permit some pledged deposits to be counted as eligible, and we consider it unwise to incorporate that word in the statute.

In light of the foregoing, the Board opposes the provisions of section 913 of H.R. 19436."

The following section 916 was adopted in conference, and ultimately by the Congress, in lieu of section 913:

"SEC. 916. Unpledged deposits in the Bank for Savings and Loan Associations, Chicago, Illinois, maintained by any institution which is a member of a Federal Home Loan Bank or is an insured institution as defined in section 401(a) of the National Housing Act, shall be considered assets for purposes of meeting the liquidity requirements of section 5A(b) of the Federal Home Loan Bank Act (12 U.S.C. 1425a(b))."

This section 916, while an improvement over section 913, still suffers from the fundamental defects in section 913. Section 204 of the proposed bill is an effort to remedy two of these defects.

The first paragraph of section 204 would limit the applicability of section 916 to members located in the State of Illinois. This would eliminate the serious imbalances in distribution of mortgage funds which would result if capital from the rest of the States continued to flow into one State. The second paragraph would enable the Board to insure the full liquidity of the reserves of institutions under its supervision.

Section 205—Advances

Section 10 of the Federal Home Loan Bank Act, which provides for advances by the Federal Home Loan Banks to their members on the security of home mortgages or obligations of or fully guaranteed by the United States, provides in subsection (c) that at no time shall the aggregate outstanding advances made by any Bank to a member exceed twelve times the amounts paid in by the member for outstanding capital stock held by it. Section 6(c)(2)(ii) provides in effect that the Federal Home Loan Bank stock held by a member shall not be reduced if the effect would be to cause the aggregate outstanding advances, within the meaning of this provision of section 10(c) or within the meaning of Board regulations defining that term for the purposes of the provision, to exceed twelve times the amounts so paid in by the member. It has been the Board's experience that the 12-to-1 ratio acts as an excessive restriction on the Board's power to assure stability in the housing sector during periods of economic downturn. The Board believes that a 20-to-1 ratio is fully justified, and section 205 of the proposed bill would so provide.

TITLE III

Section 301—Repurchases of Mortgages

The alteration made by section 301 in the authority of the Federal Home Loan Mortgage Corporation to conduct secondary mortgage market operations is indicated fairly plainly by the text of the section. One point is worthy of note, however. The added language means that the Corporation could purchase an interest in a whole mortgage which it had sold, and could purchase the whole of a mortgage where it had sold an interest in that mortgage. This authority is in addition to the obvious authority for the Corporation to purchase a whole mortgage where it had sold that whole mortgage, and to purchase an interest in a mortgage where it had sold that interest.

Section 302—Percentage Limitation on 1-Year Mortgages

The third sentence of section 305(a)(2) of the Federal Home Loan Mortgage Act provides:

"The Corporation may purchase a conventional mortgage which was originated more than one year prior to the purchase date only if the seller is currently engaged in mortgage lending or investing activities and if, as a result thereof, the cumulative aggregate of the principal balances of all conventional mortgages purchased by the Corporation which were originated more than one year prior to the date of purchase does not exceed 10 per centum of the cumulative aggregate of the principal balances of all conventional mortgages purchased by the Corporation."

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Section 302 would raise the 10-percent limitation to 25 percent and would thereby increase the flexibility of Corporation's secondary-market operations in conventional mortgages.

Section 303—Loan-to-Value Ratio

Section 305(a)(2) of the Federal Home Loan Mortgage Corporation Act prohibits the Corporation, except under certain specified circumstances, from purchasing a conventional mortgage under that section "if the outstanding principal balance of the mortgage at the time of purchase exceeds 75 per centum of the value of the property securing the mortgage". The customary maximum limit on conventional home mortgages, under statutes and regulations quite generally in effect, is 80% rather than 75%, and section 303 of the proposed legislation would accordingly raise this loan-to-value ratio in the Federal Home Loan Mortgage Corporation Act to 80 percent.

Section 304—Commitments

The first and second sentences of section 305(a)(2) of the Federal Home Loan Mortgage Corporation Act provide:

"No conventional mortgage shall be purchased under this section if the outstanding principal balance of the mortgage at the time of purchase exceeds 75 per centum of the value of the property securing the mortgage, unless (A) the seller retains a participation of not less than 10 per centum in the mortgage; (B) for such period and under such circumstances as the Corporation may require, the seller agrees to repurchase or replace the mortgage upon demand of the Corporation in the event that the mortgage is in default; or (C) that portion of the unpaid principal balance of the mortgage which is in excess of such 75 per centum is guaranteed or insured by a qualified private insurer as determined by the Corporation. The Corporation shall not issue a commitment to purchase a conventional mortgage prior to the date the mortgage is originated, if such mortgage is eligible for purchase under the preceding sentence only by reason of compliance with the requirements of clause (A) of such sentence."

The effect of the second sentence is to prevent the Corporation from making forward commitments for participations. The Board believes that this restriction, while perhaps arguably justifiable on grounds of caution at the inception of the Corporation's existence, no longer serves any good purpose. The removal of the restriction would enable the Corporation to achieve greater stability and predictability in its secondary-market prices.

Section 305—Eligibility as Public Investments

Section 305 of the proposed bill would add a new subsection (f) to section 303 of the Federal Home Loan Mortgage Corporation Act. The new subsection (f) would provide that, subject to regulatory authority otherwise applicable, obligations and securities of the Corporation except its stock shall be lawful investments and security for fiduciary, trust, and public or other funds whose investment or deposit is under the control of the United States or its possessions, or under the control of corporations incorporated under the laws of the United States or such possessions.

There are ample precedents for this type of legislation.

One such precedent is section 15 of the Federal Home Loan Bank Act, which provides that obligations of the Federal Home Loan Banks, and it may be noted that those are not guaranteed by the United States, shall be lawful investments and security for fiduciary, trust, and public funds whose investment or deposit is under the authority or control of the United States or any officer thereof.

Another precedent is section 409 of the National Housing Act. That section provides that savings and share accounts of institutions insured by the Federal Savings and Loan Insurance Corporation shall to the extent they are so insured be lawful investments and security for public funds of the United States, fiduciary and trust funds under its control, and the funds of all corporations organized under the laws of the United States, subject to any regulatory authority otherwise applicable.

Still another precedent is section 311 of the National Housing Act which provides that all obligations, participations, or other instruments issued by either the Government National Mortgage Association or the Federal National Mortgage Association—and the latter's securities are not guaranteed by the United States except in the special case of those which are GNMA-guaranteed—shall be lawful investments and security for fiduciary, trust, and public funds whose

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investment or deposit is under the authority and control of the United States or any officer or officers thereof.

Section 306—Federal National Mortgage Association

Section 306 of the proposed bill would amend section 302 of the National Housing Act to grant to the Federal National Mortgage Association the same new powers which would be conferred on the Federal Home Loan Mortgage Corporation by sections 301–304 of Title III of the proposed bill.

Title IV

Section 401—Adjustments in Assets

Section 401 would add the following sentence to section 403(b) of Title IV of the National Housing Act: "The Corporation shall have power to require such adjustments as it deems necessary or appropriate in the amounts appearing in the books, records, reports, or other documents of insured institutions in order that their financial condition and operations may be fairly stated." It has long been the position of the Board that the Federal Savings and Loan Insurance Corporation already possesses the authority intended to be conveyed by section 401 and the Board has long had a regulation (12 CFR 563.17–2) implementing that authority. However, this position represents a construction of general langage found in various places in Title IV and the validity of this construction is open to possible challenge.

The Board believes, especially in view of the expansion of lending authority intended to be accomplished by Title I of the proposed legislation, that the possibility of challenge should be clearly foreclosed.

Section 402—Definition of Affiliate

Section 407(m) of Title IV of the National Housing Act provides for the examination of affiliates of insured institutions. The last sentence of section 407(m)(1) defines "affiliate" as follows:

"For purposes of this subsection, the term 'affiliate' shall have the same meaning as where used in section 2(b) of the Banking Act of 1933 (12 U.S.C. 221a(b)), except that the term 'member bank' in said section 2(b) shall be deemed to refer to an insured institution."

Section 2(b) of the Banking Act of 1933 provides:

"(b) Except where otherwise specifically provided, the term 'affiliate' shall include any corporation, business trust, association, or other similar organization—

(1) Of which a member bank, directly or indirectly, owns or controls either a majority of the voting shares or more than 50 per centum of the number of shares voted for the election of its directors, trustees, or other persons exercising similar functions at the preceding election, or controls in any manner the election of a majority of its directors, trustees, or other persons exercising similar functions; or

(2) Of which control is held, directly or indirectly, through stock ownership or in any other manner, by the shareholders of a member bank who own or control either a majority of the shares of such bank or more than 50 per centum of the number of shares voted for the election of directors of such bank at the preceding election, or by trustees for the benefit of the shareholders of any such bank; or

(3) Of which a majority of its directors, trustees, or other persons exercising similar functions are directors of any one member bank; or

(4) Which owns or controls, directly or indirectly, either a majority of the shares of capital stock of a member bank or more than 50 per centum of the number of shares voted for the election of directors of a member bank at the preceding election, or controls in any manner the election of a majority of the directors of a member bank, or for the benefit of whose shareholders or members all or substantially all the capital stock of a member bank is held by trustees."

The essential effect of section 402 of the proposed bill is to substitute for the 50 percent requirement in section 2(b) the 25 percent requirement found in the Savings and Loan Holding Company Act provisions relating to affiliation. It is the experience of the Board that effective control, and therefore affiliation in fact, frequently exists in cases of less than 50 percent control. Hence, section 402 would bring the Board's supervisory authority over affiliates of insured institutions more into line with corporate reality.

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Effective use of the lending and investment authority of the sort intended to be conveyed in Title I of the proposed bill commonly involves activity by affiliated persons and businesses. The Board believes that expansion of its regulatory authority over such persons and businesses is desirable to insure that this proposed lending and investment authority will be used safely and wisely.

Section 403—Savings and Loan Holding Companies

Section 403 would make certain minor technical and clarifying changes to section 408(d) (4) of Title IV of the National Housing Act.

Section 404—Mergers

Section 404 of the proposed bill would add a new section 412 to Title IV of the National Housing Act. New section 412 would clarify the authority of the Board regarding mergers, consolidations, and similar transactions involving insured institutions and would provide procedures for the exercise of that authority which would be comparable to those applicable in the field of commercial banks.

The proposed section 412 is modeled very closely upon the Bank Merger Act, as amended (12 U.S.C. 1828(c)(1)). Under the section, insured savings and loan associations would have available to them all the protections available to banking institutions under the Bank Merger Act, and at the same time, comparable standards and procedures, particularly in the antitrust area, would be established for all financial institutions.

It will be noted that new section 412 does not contain provisions comparable to 12 U.S.C. 1828(c)(9) relating to inclusion of a description of each merger transaction in the responsible agency's annual report. Comparable provisions would duplicate in large measure the existing annual report requirements specified in the second to last sentence of section 17(b) of the Federal Home Loan Bank Act under which the Board now describes merger transactions in its annual report to the Congress.

Section 405—Payment of Insurance

Both section 405(b), which applies to Federal and State savings and loan associations, and section 406(b), which applies only to Federal associations, of Title IV of the National Housing Act envision that the Federal Savings and Loan Insurance Corporation, upon its insurance settlement payments incident to the default of an insured association, shall become the owner of, and succeed to all the rights in, the insured portion of the accounts of the insured members of the association in default, and that the insured members shall retain only those rights relating to the uninsured portion of their accounts. However, the present sections 405(b) and 406(b) use different terminology to describe such result. In order to achieve uniformity, section 405 of this bill would amend sections 405(b) and 406(b) of Title IV of the National Housing Act by deleting the subject provision with respect to the Corporation's insurance payments from said section 406(b) and by adding a new sentence to section 405(b) restating more precisely the present rights of the Corporation and the uninsured account holders, as follows:

"The surrender and transfer to the Corporation of an insured account in any institution in default shall subrogate the Corporation with respect to such insured account and all rights incident thereto, and the insured member shall retain only those rights incident to any uninsured portion of his account."

Section 405 of the bill also would amend the present section 406(b) of Title IV of the National Housing Act by deleting all reference to the Corporation paying the valid creditor obligations of the defaulted association. The deleted language is both ambiguous and superfluous since the Corporation in any event would be obligated to pay all creditor obligations of the defaulted association, out of such institution's assets, when it acts as a liquidating receiver; however, the Corporation would not necessarily pay such obligations if it merges the association in default with another existing association or with a newly organized Federal association.

Section 405 also would add the following sentence to the end of section 405(b) of Title IV of the National Housing Act:

"Upon the payment of insurance by the Corporation to the insured members of the institution in default, the Corporation shall became entitled to interest on the withdrawable or repurchasable amount of the accounts surrendered and transferred to it, computed at a rate determined by the Federal Savings and

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Loan Insurance Corporation, as of the date of default, based upon the average market yield on the Federal Savings and Loan Insurance Corporation's investments in obligations of, or guaranteed as to principal and interest by, the United States, commencing upon the date of default and continuing until the date or dates on which the Corporation's claim for the aggregate withdrawable or repurchasable amount of all such accounts is paid in full by the conservator, receiver, or other legal custodian of such institution: Provided, That such rate shall not be less than the rate determined by the Secretary of the Treasury taking into consideration the current average market yield on outstanding marketable obligations of the United States of comparable maturity, adjusted to the nearest one-eighth of one per centum: and provided further, That no such interest shall be payable to the Corporation until payment or provision for payment has been made with respect to the expenses of administering the institution in default, including tax liability, and all creditor claims against such institution, including the full withdrawable or repurchasable amount of all account claims."

This provision is declaratory of the present law but the inclusion thereof in Title IV of the National Housing Act is deemed advisable in order to avoid in the future unnecessary litigation concerning the matter of the type involved in past receiverships. Said provision also is intended to make clear that the obligation to pay such interest to the Corporation becomes a continuing liability of the insured association upon its default even though the interest is not payable until payment or provision for payment has been made with respect to the specified expenses and other creditor claims. In order to achieve uniformity and consistency in the event of receiverships in diffierent States, such interest is to be paid to the Corporation in accordance with the formulae stated in the last quoted sentence. These formulae are consistent with OMB Circular A-70 and are commonly employed in other Federal statutes. In the event of a surplus, other creditors of the association in default, including the holders of its uninsured accounts, also would receive interest on their claims, but at the rate or rates allowable by governing law or regulation.

Mr. Rousselot. Mr. Wille, you mentioned in your statement on page 23 and commented already on the some 30 States that already pledged securities against State deposits and mentioned that one alternative to this bill would be if the various States that do not now have laws would maybe improve the criteria and upgrade their laws. I wonder if another alternative might be to exempt in this bill, should it go through, those States that have adequate laws requiring backing to this kind of security.

In other words, States like California, for instance, have a very stringent requirement.

Mr. Wille. Even if this proposal were to be passed in the language of sections 25 and 26, the States would be able to control the repeal of any pledging requirements that are now on their books, because what you are talking about is public deposits of the State and local governments within that State.

Mr. Rousselot. But another alternative would be to exempt those States that have a higher criteria.

Mr. Wille. Such an exemption might be difficult to draft since many of the State laws imposing pledging requirements apply only to the extent such deposits are not covered by Federal deposit insurance.

Mr. Rousselot. Thank you. I have no more questions.

Mr. Barrett. Mr. St Germain.

Mr. St Germain. The Home Loan Bank Board has issued regulations on its own on conflict of interest, some of which seem to be a little more stringent than what is proposed in H.R. 5700.

Incidentally, I am a cosponsor, not that I agree with each and every section of the act, but I cosponsored it so that we could have the hearings and delve into this.

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In view of the fact that you have propounded these regulations, would you have any objection to these regulations being considered as amendments to H.R. 5700, your particular regulation on the conflict of interest?

Mr. MARTIN. Mr. St Germain, if you will indulge me, I would like to refer back to previous testimony with regard to the great amount of time that the staff and the Board and our institution have spent on the subject in the last 2 years.

We have considered that the present regulations are the best job we can do at the moment, although not the last such issuance, but we have not had time to observe the administration of and implementation of these regulations in the field.

I would respectfully ask for some period of time to check out and to test how they apply. It is the best job we can do, but it may not be, even so, an adequate job.

Mr. ST GERMAIN. Under your new regulations on conflict of interest there is a regulation prohibiting affiliated persons from granting loans on prior condition, to wit, the borrower contract for interest, legal or real estate services and what have you, prior to—with particular firms as a condition prior to the granting of the loan.

Mr. MARTIN. As a condition of that loan, yes.

Mr. ST GERMAIN. How can we prove that this prior condition existed? Wouldn't it be better in essence to say that any such activities are prohibited, both before as a prior condition, or after the loan is granted or approved, thereby saving you the almost impossible task of proving that a prior condition existed?

Mr. MARTIN. In some cases this is a contractual matter in which the proof lies in the terms of a contract, so-called conditional commitment.

Mr. ST GERMAIN. Unless you've got actual documentation—for instance, how can you prove that on insurance? You can't insure a house before you buy it, right?

Mr. MARTIN. Our general counsel, Arthur Leibold, is here. Could I refer your question to him?

Mr. LEIBOLD. Congressman, as a practical matter there has to be an agreement ahead of time in order for us to bar or ban the situation. If someone voluntarily comes in after a commitment and takes out a policy of insurance, that should not be barred, that would not be a tie-in under any Federal or State statute.

Mr. ST GERMAIN. That makes sense, but by the same token how can you document there was a condition prior to issuance of the loan? As I say, you cannot insure the house before you own it, correct?

Mr. LEIBOLD. But, you can in many States. You should take out a policy of insurance before you sign the agreement of sale.

Mr. ST GERMAIN. On the date that you pass the title?

Mr. LEIBOLD. No; the day you sign the agreement of sale. In some States, you have an interest the moment you sign the agreement of sale, and typically the agreement of sale may be conditioned on whether or not you get a commitment for a mortgage. So you then go to your lending institution after you sign the agreement of sale.

Congressman, you are merely talking about the difficulties of proof which we always have in these matters.

Mr. ST GERMAIN. Could you give us some examples of how you could document that a prior condition existed?

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Mr. Leibold. Well, the typical case would be someone admitting it, some individual who seeks to borrow money advising the Bank Board or its examiner that in fact he was required to take out a policy of insurance from an affiliate of a particular savings and loan. That would be the typical way.

Or, when we determine that a large percentage of borrowers have insurance from the affiliate, we will send out an examiner and a lawyer-investigator to talk to the applicants, the borrowers, and find out if there was, in fact, coercion used.

Mr. St Germain. Right. There is a preponderance that would lead one to believe that there is a possibility of this condition.

Mr. Leibold. That is correct.

Mr. St Germain. All right.

Mr. Martin, in the Emergency Home Finance Act there was language adopted by the House to prohibit securities for funds. You this morning stated you are against the 100-percent requirement, and this has been alluded to by many of the previous members and you have discussed this. But at that time your Office of General Counsel assured the conferees that you had the authority to issue the required regulation that this would be done and the conferees in their report directed you to do so. Have these regulations in fact been issued?

Mr. Leibold. Congressman, the regulations have not been issued. The Office of General Counsel of the board has issued an opinion that pledging of collateral or security for public deposits is appropriate. But the difficulty is you run into the laws of the 50 States which do not allow public deposits in savings and loans, even though pledging of collateral is authorized. They typically allow those deposits to be made in commercial banks or in institutions up to the insured amount.

In neither situation would our regulation be of any utility whatsoever.

Furthermore, there are other complications. If there has to be collateral, then those funds which are pledged are not additional funds that go into housing. So you merely have a $100,000 deposit, for example, coming in but the pledging of collateral in the equal amount which doesn't give $1 more to housing.

Mr. St Germain. This will be directed to both of you and you can answer it in writing afterward.

It seems to me historically that the function of lending institutions and banks is to take money from depositors and place that money in sound investments for as good a return as possible.

Now we get into the new twist which is the equity position, more popularly known as a piece of the action. Develop from that, No. 1 step, a sound investment for a good return. Then the next thing was that the lending institution requires that they participate in some of the profit so they not only get the interest on the loan but, in addition, they get a profit.

I am thinking primarily of large office buildings, shopping centers, and what have you. Then when we get into tight money, lo and behold, no longer is it merely a piece of the action as originally we understood it, but the new twist is that the end of the term of the mortgage the lender then owns the entire property, whether it be the office building, the commercial property, or the shopping center.

60-299—71—pt. 1——8

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We say to oneself we have strayed too far afield from the original purpose of the bank. To take in deposits and to lend money, because here the lending institutions are in a great position. They lend the money, they get the interest. They get a part of the profit as an equity position. At the end of the term, if it is a sound investment and sound loan, the mortgage is paid off and they own it.

I would ask you to address yourself to this in your written replies, and unanimous consent—I am wondering if we will all have an opportunity to file additional questions with these gentlemen?

Mr. BARRETT. I think that was stated earlier. You will answer questions.

Mr. ST GERMAIN. Well, I will ask that in case it wasn't asked, Mr. Chairman.

Mr. BARRETT. That will be done, and I am sure the witnesses will agree to answer any written question by any members of the committee.

(The following are written questions submitted by Mr. St Germain to Mr. Wille, along with Mr. Wille's answers:)

Question A. Where giveaways are employed, would you agree that to protect the depositor:

(1) The fair market value of the giveaway item should be disclosed?

(2) The annualized interest rate for the additional amount of deposit should be disclosed?

For example, if a fry pan of $20 in value is given for new accounts of $500 minimum or $500 additions to existing accounts, this would be 4%/year if the money were required to be deposited for one year, but less than 2% compounded annually if the amount were required to be deposited for 2 years.

Answer. We would answer "no" to both parts of this question.

With respect to (1), if "fair market value" means retail price, this varies extensively on each item and a bank might well find it impossible to state a single price for an item which represented all fair market values. This is one of the reasons the Corporation uses wholesale costs in its regulations which limit giveaways to merchandise, the wholesale cost of which is under $5 if the deposit is less than $5,000 and $10 if the deposit is $5,000 or more.

With respect to (2), the Corporation does not believe that merchandise of nominal value should be considered interest and would not support legislation which would translate the cost or value of such merchandise into annualized interest terms.

Question B. Would you favor "truth in depositing" legislation along the lines of truth in lending or truth in packaging?

Answer. The Corporation would favor full disclosure to each depositor of all terms of a deposit, including the interest rate and the circumstances under which such rate can be changed after deposit.

Question C. Do you feel that the deposits which financial institutions obtain from giveaways outweigh the disadvantages of possible quick withdrawal from the institution when another (competing) financial institution offers a more attractive giveaway? In short, funds attracted by giveaways may actually be leading the bank into a false sense of liquidity.

Answer. We have no supervisory evidence which indicates that any significant share of the deposits attracted by giveaways jumps from bank to bank as additional giveaways are offered by competing banks. We also have no evidence that any bank has failed or become a supervisory problem because it has given away merchandise of nominal value to attract deposits.

Mr. BARRETT. Mrs. Heckler, you have been called out and we don't desire to have a beautiful woman of this committee to not ask questions. I am sure Mr. McKinney won't mind. We will recognize you now.

Mrs. HECKLER. Thank you very much, Mr. Chairman. You are very kind.

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Mr. Wille, I want to be sure I understand your position in regard to interlocking directorates. Is it your position we shouldn't adopt a complete prohibition, as in H.R. 5700, but limit them among institutions in specific geographic localities where institutions would be in competition; is that a correct statement of your position?

Mr. WILLE. I think it is too brief a statement of the position of the corporation, Mrs. Heckler. Right now, in statute law on the Federal books, section 8 of the Clayton Act does prohibit certain interlocks involving member banks of the Federal Reserve System.

We believe that possible abuses in the competitive arena between competing financial institutions do warrant a statutory prohibition, and that is the reason we are recommending changes and a broadening of section 8 of the Clayton Act.

With regard to other types of interlocks which H.R. 5700 also covers, involving nonfinancial institutions, we would recommend that there be an administrative authority to deal with these matters on the part of the three Federal bank regulatory agencies and the Federal Home Loan Bank Board. This would allow us to take into account variations in particular conditions or situations where perhaps the outright prohibition now in H.R. 5700 would have otherwise applied.

Mrs. HECKLER. You referred to possible abuses. Have you in your experience seen any actual abuses?

Mr. WILLE. As I indicated in an answer to an earlier question, the facts that we have where there may have been some abuses are limited to two situations: Where there are interlocks between competing financial institutions and in some cases where a particular director of a bank is also a borrower of the bank and loans have been made or are made on certain terms not justified by the credit standing of the borrowing company.

We think the latter can be handled by regulation, but that the former is susceptible to a general statutory prohibition along the lines of section 8 of the Clayton Act.

Mrs. HECKLER. I wondered about the actual application of the prohibition against interlocks between financial institutions and business. It would seem rather difficult in small communities to have competent members of the board of a bank chosen if all businessmen are excluded by virtue of the board prohibitions of this particular act. Would you give your judgment on this?

Mr. WILLE. In some communities, we believe that could easily be the case where there is such a scarcity of talented management for these directors' spots. That is why we recommend some limited administrative discretion in allowing exceptions to a more general statutory prohibition.

On the other hand, we are mindful that particularly in smaller communities there can be the most adverse effects of interlocks, in restricting competition, because the customer doesn't have a wide choice of facilities for banking services or financial services. It is a question of weighing those two out and we would recommend that that be done by an administrative approach rather than by the outright prohibition now in H.R. 5700.

Mrs. HECKLER. Mr. Martin, would you care to comment on that last question?

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Mr. MARTIN. Yes. We would join with the corporation in our recommendation and position that the matter of interlocking directorates be one of regulation. We recognize, as the Congresswoman has indicated, that in the smallest communities there may be a positive value to be obtained from savings and loans directors or commercial bank directors serving on another class of institution's board of directors.

Mrs. HECKLER. Thank you, Mr. Chairman.

Mr. BARRETT. Thank you, Mrs. Heckler.

Would the gentleman from Texas desire to be heard or ask some questions?

Mr. GONZALEZ. I appreciate this opportunity, Mr. Chairman, if I may have it.

Mr. BARRETT. You may do so.

Mr. GONZALEZ. Thank you, sir.

Mr. Wille, with respect to the bill introduced, known as H.R. 3287, the main intent being to prohibit the acquisition of bank interest or shares through the hypothecation of other bank shares or related transactions, I notice that in your reply to Chairman Patman, who asked for an opinion on the bill, your reply was 100 percent negative as has been most of the reaction from many of the banking interests, particularly those in States that permit chain banking and the like.

Now, I can understand the rather severe language of my bill. It is simple, but it is to the point. Of course, I know better than to think that there is such a thing as a perfect bill. But I can't understand a total negative reaction or attitude to what I consider to be an area of dire need for reform or some measure of control. For example, in reply to the request made by two members of this committee during the time you testified the last time, one was a request to outline the type of management practices that were common characteristics in the 19 bank failures, and your answer to that was characteristic of bold management with respect to the Sharpstown State Bank, included self-serving transactions through extension of a large volume of questionable loans which exceeded reasonable amounts to related interest, liberal loan policies, ineffective collection practices, disregard for requirements and regulations, the maintenance of unsound investment policies, and so forth.

But then a request was made relating to the history of the regulatory agencies' experience with respect to the Sharpstown State Bank, on March 23, 1968, with concurrent State authority examination. The response was that conditions improved; but information obtained after that report was that banks were accepting brokerage certificates of deposits and related loans, and that loans of about $22 million were granted to finance almost the entire purchase price of three other banks, leading to the continuation of "other problems" status.

Then 2 months later, May 7, 1968, FDIC examiner visited the bank to investigate the above-mentioned loans and other loans and another loan for $850,000 to finance the acquisition of majority interest in a bank in Illinois.

Now, Mr. Wille, don't you feel that those of us interested in this type of legislation are entitled to some constructive suggestion about regulating this practice of acquisition of a bank by another bank, which is definitely something with which this committee and the Con-

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gress has been charged with since at least 1964 as a real problem area?

Mr. WILLE. Mr. Gonzalez, I think that we should go back to the actual wording of your proposed bill which would prohibit any insured bank from making any loan to provide for the purchase of stock in another bank. It is an outright prohibition and isn't limited to this area of acquisition of the controlling block of stock of an existing bank.

I pointed out in my letter that the broad terms of the prohibition are such that, even in your home State of Texas, it would very severely limit the chartering of new banks—banks being organized to serve the convenience and needs of the people in Texas. There is no doubt about it but that when bank loans are made for the acquisition of existing companies, whether they are banks or anything else, there are going to be certain people, particularly incumbent management, that are very unhappy with this particular development.

We recognize that there is an area of abuse here where bank loans are made for the purpose of allowing some "insider"—as was the case in Sharpstown, for example—to acquire control of other corporations and to use banks' funds for personal gain. We believe that these are more susceptible to specific administrative reaction with individual institutions than the blanket prohibition you have suggested in your bill, H.R. 3287. It isn't that we are unsympathetic to the problem of misuse of bank funds for acquisition loans which end up to the personal gain of an "insider." I think where we part company is this question of the broadness of the prohibition contained in the language that you propose.

Mr. GONZALEZ. Well, this is what I am interested in learning. What would be the alternative? How would the language be refined here?

Mr. WILLE. My letter to the chairman included several suggestions in lieu of a complete prohibition. In pertinent part, for example, it stated that:

> To correct abuses that might arise from the speculative aspect of some bank stock purchase loans, remedial legislation might take the form of an authorization for the appropriate banking agency to promulgate regulations with respect to such loans that might, for example, prohibit 100 percent financing of such purchases by insured banks and require the purchaser to provide a significant portion of the funds necessary for the acquisition being considered. Such regulations might also include a prohibition against the extension of credit on terms more favorable than those usually charged for financing the purchase of non-bank securities or on terms which explicitly or implicitly require the deposit of bank funds with the lending institution.
>
> As I indicated to your Committee during the course of my testimony on March 9, 1971, changes in the remedies available to the regulatory agencies when a cease-and-desist order is violated would materially assist the agencies in curbing a variety of unsafe and unsound banking practices, including those that might arise following a change of control financed by bank stock purchase loans extended by another bank. Section 7 of the Federal Deposit Insurance Act, as you know, requires the president or other chief executive officer of an insured bank to report a change in control of the bank to the appropriate banking agency promptly after he has knowledge of such a change. Alerted by this report, the bank regulatory agencies review closely, through regular and special examinations, any changes in management policy that might follow. A change in the cease-and-desist remedies available to the agencies could significantly assist the Corporation in taking timely and effective action where changes in management policy indicate that prompt correction is required.

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I have tried to indicate, however, that this is a very difficult area for a statutory prohibition. I think it is more susceptible to regulatory reaction on specific loans and specific lending policies of a given institution. I think specific corrective action should be left to the regulatory agency.

Mr. GONZALEZ. Let me interrupt you right there. Here is a bank that obviously was in trouble, according to the history of the regulatory agency, and here is a $22 million item involving loans from that bank for acquisition purposes of three other banks. Now, what could the regulatory agency have done there that it didn't do, but would have done if it would have sufficient statutory authority or regulatory authority; and if it did have the authority and didn't invoke it, well, that is something else. But if it doesn't have it, what is the responsibility of the Congress to see to it that you get it? I know this is a very difficult theory, and I am not interested in over regulating anybody. But I think the whole approach philosophically has been from both the congressional and regulatory standpoint to look upon this as being for the convenience and protection of bankers and banking, whereas really it is the public interest that we should be serving, not the banking industry. We are not here to serve the purposes of the banking industry. We are not here to do it. We are here to serve the people.

What I want to know is why not, if the regulatory authorities didn't have the authority, why not and what can we do about it?

Mr. WILLE. Mr. Gonzalez, I will be glad to elaborate on the particular problems of the Sharpstown State Bank, as I did in the March 9 hearing. The most significant bank stock loans to which you refer, however, were repaid well before the bank closed. It was my understanding that your bill arose out of the Gross National Bank situation, not Sharpstown.

Mr. GONZALEZ. Not necessarily. Let me explain my position on that one. I don't know whether the acquisition practices or pattern of the people buying or attempting to buy is good, bad, or indifferent. There we are charged with knowledge. Here I have it in my own backyard, and I had constituents come in and saying you are a member of this committee, we fear this, we fear that. I have not come to take the position that it is good, bad, or indifferent. The protestors, if you want to call them that, brought out some history involving one of the men who was attempting to get on the board, and there again we refer to the proper regulatory authorities. But we are charged with knowledge that an institution that has been chartered for more than a hundred years and is a national bank. I guess, at least a century, is about to be taken over through the use of resources from a large bank in a neighboring large city of Houston, and we think we have a continuing responsibility to make sure that the same thing doesn't happen here in this acquisition that will destroy the basic intention of the charter given to Groos National Bank to begin with. If that is the case then we ought to stop chartering. Let's just get new banks through acquisition tactics. Why have chartering? Why go that route?

If we are going to have the purpose of chartering serve the statutory intentions, then I think it is our clear duty to define how we are going to regulate these practices that we think we are on notice as being inherently dangerous, potentially dangerous to the main reason why a bank has been chartered.

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Mr. BARRETT. The time of the gentleman has expired.

Mr. GONZALEZ. Well, I will ask for the same privilege as my colleague, Mr. St Germain, and ask unanimous consent that we submit questions in writing and offer a chance for Mr. Wille to answer more fully.

Mr. BARRETT. That may be done, and I think the witness have agreed to answer those in writing. Mr. Rees.

Mr. REES. Yes. I would like to ask several questions on the bill.

I don't see too many problems with section 2 as regards banks, because most escrow companies and such can be owned by virtue of the one bank holding company, and the one bank holding company exception is in the bill.

But when you come to the savings and loan associations, I think what this would do would be to treat mutuals in one manner and to treat stock companies in another manner, because a stock company can have a holding company and through the holding company you can have all these financial operations such as appraisal, escrow, and insurance. I think if we passed the restrictions on mutuals that it would put stock companies in a far superior position to the mutual companies.

Now, Mr. Martin, in your bill, Housing Institutions Modernization Act of 1971, do you have a proposal for conversion of Federal mutuals into stock companies. ?

Mr. MARTIN. Yes, we have the provision in section 101 of the act to which the Congressman alludes, both the statutory language which would permit new chartering of Federal stock institutions and the conversion into a Federal stock form from a Federal mutual form.

Mr. REES. Then it is my opinion if we are to approve section 2 that we would probably do best to amend into H.R. 5700 at least part of the Housing Institution Modernization Act of 1971 which would allow conversion so that a Federal institution could then have the advantage of a holding company so as to hold escrow appraisal and insurance companies within the group.

Mr. MARTIN. I think it would have that effect, yes, sir.

Mr. REES. Let me ask another question.

The bill reads that if a person is a member of a board of directors of a company and the bank has more than 5 percent of that company's stock, which could be in a trust, that that would be a conflict and a member of the board of directors would have to resign. This is my interpretation of section 8. Isn't this rather difficult? Wouldn't you find in certain situations for example, if a bank controlled as trustee a major stock portfolio of a company, don't you think it might be a good idea if that company might have some type of representation on that bank's board? It seems that a person is not allowed to protect their interest as to what the bank might be doing. I just bring that up as a point.

There is another amendment in section 9 which says you can't have a member of a bank on the board of directors of another company where substantial financial relationship exists. I can see the situation of where a bank might loan $50 million to Lockheed Aircraft and they would not be able to have a member of that bank on the Lockheed Aircraft board. Now, I think the bank has a substantial interest to protect if they have a big piece of the financing of a company.

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Don't you think the bank has the right to protect the investment? The banker approves the initial loan, but I think there is the problem of what happens to that money and how it is spent.

Mr. WILLE. I think you have articulated, Mr. Rees, the precise reasons why we oppose the blanket prohibition in section 8 and section 9 of the bill.

Mr. REES. Another question.

I don't like to see the use of equity kickers. I know the building contractors were very unhappy in my district. They couldn't borrow money so they went to insurance companies and insurance companies took a big bite out of their operation.

But in the way that the restriction is written in section 14 it would not prohibit an insurance company or a bank or anybody else from forming an SBIC, for example, or real estate investment trust and each of these entities could engage in equity financing. Does section 14 really prohibit equity kickers? Doesn't it mean the lawyers just get a little more money for setting up a subsidiary corporation?

There is a section that prohibits a bank from controlling more than 10 percent of the stock in any company. Control means generally that the bank is acting as a trustee. So let's say that XYZ corporation, in order to take care of the problems of an estate, takes 80 percent of its stock which is owned by a family and has a bank administer that stock as trustee.

Under this it would mean they would have to go to eight different banks and give them 10 percent of the company and say okay, you run this as a trustee. here is your 10 percent. The trustee fees could well eat up that estate. Isn't this a problem again that exists in this bill?

Mr. WILLE. Yes, it does.

Mr. REES. These are just a few minor items I noticed in reading the legislation. I think that if we make these outright prohibitions that there are going to be problems while not really solving the inequities, because you can of course, always go around the barn by forming another type of company, or you go to a convenience of spreading your action around which really might be against the best interest of the estate that is being administered by the bank.

I would hope that when we are dealing with this bill, Mr. Chairman, that we might also deal with the Housing Institution Modernization Act of 1971, because I think that one needs the other if we are going to make this a good bill if there is too much of a differentiation between the mutuals and the State stock companies, I think it is going to hurt the Federals in terms of their competitive position.

Let me ask just one last short question.

Why are the arguments against full interest of public funds? In California a bank has to have full collateralization. If they have California school district bonds, for example, $1 million worth, that means the bank must have $1 million of collateral behind that. If we have full insurance doesn't that mean that the bank will then be able to use that $1 million for lending in other areas?

Mr. WILLE. That would be the effect of it if the State of California, subsequent to the passage of this kind of legislation were to repeal its pledging requirements, or it is conceivable that their present law is written in such a way that it only applies to the amount of the deposit

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not covered by FDIC insurance. It is true that this would have the effect in some States of freeing up a significant amount of bank assets for other investments.

Mr. REES. Well, don't you think this would be good? This would free that collateral money. It wouldn't just be a statute.

Mr. WILLE. The Federal Reserve Board might have a different view on that.

Mr. REES. Thank you.

Mr. BARRETT. Thank you, Mr. Rees.

All time has expired.

Mr. Wille and Mr. Martin have been two very fine witnesses, very edifying this morning, and did a splendid job.

This committee will now stand in recess until 10 a.m. tomorrow morning.

(The following additional letters were received for inclusion in the record:)

APRIL 5, 1971.

Hon. WRIGHT PATMAN,
House of Representatives,
Washington, D.C.

DEAR CONGRESSMAN PATMAN: Enclosed is a copy of a letter which I have received from Commissioner Eric E. Wohlforth, Department of Revenue, State of Alaska, in which he supports your bill to provide for 100% FDIC insurance of public fund deposits. Please note that Commissioner Wohlforth is willing and able to participate in any hearings which you may call on this bill.

I, too, am in support of your legislation, and I would appreciate your keeping me informed of progress on this bill.

With best wishes.

Sincerely,

NICK BEGICH, *Member of Congress.*

STATE OF ALASKA,
DEPARTMENT OF REVENUE,
Juneau, March 30, 1971.

Hon. NICK BEGICH,
Congressman for Alaska,
Longworth House Office Building,
Washington, D.C.

DEAR MR. BEGICH: We note with great interest the introduction of a bill by House Banking Committee Chairman Wright Patman (D-Texas) which apparently provides for one hundred per cent F.D.I.C. insurance of public fund deposits.

The Department wholeheartedly supports the concept of such insurance. As you know, the State has over one hundred million dollars on deposit with Alaska banks constituting by far the highest percentage of State deposits to total deposits of any state banking system in the Union. The requirement of collateral in the form of United States Government securities, United States Agency securities, or state or local government bonds has to date, inhibited the banking system from lending the funds represented by State deposits generally and in many areas of critical need, such as FHA and VA mobile home loans.

Full FDIC insurance of public deposits would remove the necessity of requiring State collateral and would be of tremendous benefit to the State.

I would appreciate a copy of the bill introduced by Representative Wright Patman and periodic indications of its progress. This matter is of such vital concern to this department that we would stand ready to testify at any committee hearing on short notice.

Very truly yours,

ERIC E. WOHLFORTH, *Commissioner.*

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April 9, 1971.

Hon. Wright Patman, *Chairman, House Banking and Currency Committee, Rayburn Building, Washington, D.C.*

Dear Mr. Patman: Reference is made to H.R. 5700, which is now under consideration by the Banking and Currency Committee. Specifically, I wish to comment on those sections of the bill which provide for the Federal insurance of public deposits in both banking and savings and loan institutions.

Officials of the Alaska State government and members of the financial community of Alaska have been nearly unanimous in their support of the above mentioned provisions. As a state which has an extremely high percentage of public deposits within total state deposits, Alaska will benefit greatly from the liberalized insurance and public deposit provisions. It will mean the termination of collateral requirements to insure deposits, and will free financial institutions to make loans in areas of great social need, such as housing and small business development.

It is my understanding that representatives of the Alaska State government will be sending more detailed documents of support to your committee, and I hope they will be persuasive in supporting this legislation. If I can be of any further help in obtaining information, I would be pleased to do so.

Sincerely,

Nick Begich, *Member of Congress.*

State of Alaska,
Department of Administration,
April 13, 1971.

Hon. Wright Patman, *Chairman, House Banking and Currency Committee, U.S. House of Representatives, Washington, D.C.*

Dear Representative Patman: It is my understanding that you will begin hearings on April 19, 1971 regarding House Resolution 5700 which, among other things, provides for Federal Deposit Insurance Corporation coverage of public deposits in banks and savings and loan associations. We in the State of Alaska are exceedingly anxious to have public deposits covered by insurance in order to dissolve the need for collateral which idles large sums which could be better used in the economy. Please be assured of our full support in passage of this important legislative change.

Sincerely yours,

Joseph R. Henri, *Commissioner.*

Matanuska Valley Bank,
Anchorage, Alaska, May 10, 1971.

Hon. Wright Patman,
House Banking Committee Chairman,
Washington, D.C.

Dear Mr. Patman: The Matanuska Valley Bank has reviewed HR 5700 and particularly sections 25 and 26 on insuring public fund deposits by the FDIC.

Banks in Alaska have a larger percentage of public funds deposited with them than almost any other state. By the FDIC taking over the insuring of all public fund deposits it will relieve the banks of the collateral requirements presently restricting these deposits. This bill will enable the banks to more readily handle the larger volume of loan demand and thereby further the development of the whole economic structure of Alaska.

We strongly urge the passage of HR 5700.

Sincerely yours,

A. C. Swalling, *President.*

Alaska State Bank,
Anchorage, Alaska, May 11, 1971.

Hon. Wright Patman,
Chairman, House Committee on Banking and Currency,
Washington, D.C.

Dear Mr. Patman: We are not large by comparison to other banks in the U.S. but wish to express our concurrence with the recommendation of Frank Wille. Chairman, Federal Deposit Insurance Corporation of House Representative 5700 concerning insurance for public units.

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The meaningful recommendation pertains to Sections 25 and 26 of the bill which Mr. Wille recommends be amended so as to (a) limit such insurance, in the case of States and political subdivisions, to the funds of public units within the State in which the financial institution is located; (b) require that the aggregate amount of funds that could be deposited in banks or savings and loan associations be limited in relation to such criteria as liquidity, total deposts, and capital and that the Corporation and the Federal Savings and Loan Insurance Corporation prescribe uniform restrictions with respect to such limitations; and (c) require that the maximum rates of interest or dividends payable on comparable deposits be the same for all banks and savings and loan associations.

Such legislation simplifies the bookkeeping for the Public Treasurer which is a savings to the taxpayer and the insurance offers the protection needed.

The Treasurers of Alaska watch their dollars very closely and I can assure you they negotiate a very tight bargain as far as any profits for the banks.

Very truly yours,

KENNETH C. HUME, *President.*

(Whereupon, at 12:40 p.m., the committee recessed, to reconvene at 10 a.m., Wednesday, April 21, 1971.)

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THE BANKING REFORM ACT OF 1971

WEDNESDAY, APRIL 21, 1971

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
Washington, D.C.

The committee met, pursuant to recess, at 10 a.m., in room 2128, Rayburn House Office Building, Hon. Wright Patman (chairman) presiding.

Present: Representatives Patman, Barrett, Sullivan, Reuss, Moorhead, Stephens, St Germain, Gonzalez, Minish, Gettys, Annunzio, Bevill, Griffin, Hanley, Brasco, Chappell, Koch, Johnson, Stanton, Blackburn, Williams, Crane, Rousselot, McKinney, and Archer.

The CHAIRMAN. The committee will please come to order.

This morning, in continuing our hearings on H.R. 5700, 3287, and 7440, the committee is to hear from Commissioner Richard B. Smith of the Securities and Exchange Commission, the Honorable William B. Camp, Comptroller of the Currency, and Mr. Alan S. Ward, Director of the Bureau of Competition, Federal Trade Commission.

Commissioner Smith has been involved over the last 2 years or so with a voluminous study carried on by the Securities and Exchange Commission into the institutional investor. This study, which literally runs into thousands of pages, was released just a few weeks ago, and it has been impossible for a complete analysis to be done of this important study prior to these hearings.

However, some of the more relevant chapters, such as chapter V on bank trust departments and chapter XV, which deals with institutional investors and the companies in which they invest, has some very interesting things to say about commercial banks as institutional investors. Much of the study confirms the findings of studies that this committee has carried on in recent years concerning bank trust departments. Without going into detail at this point, the institutional investor study states in summarizing some of its findings that "a relatively high incidence of interlocking personnel and business relationships may reinforce any institutional power conferred by shareholdings, multiply possible conflicts of interest, increase the opportunities for use of inside information, and—if concentrated among relatively few large institutions and companies—produce anticompetitive effects."

This, it would appear, is an extremely important finding in connection with the legislation before us.

I am sure that all of these gentlemen will contribute significantly to the committee's consideration of this legislation. Let us first hear from Commissioner Smith of the SEC, then Comptroller of the Currency Camp and then from Mr. Ward of the Federal Trade Commission.

You may proceed in that order. Mr. Smith, you are recognized.

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STATEMENT OF RICHARD B. SMITH, COMMISSIONER, SECURITIES AND EXCHANGE COMMISSION, ACCOMPANIED BY PROF. DONALD E. FARRAR, UNIVERSITY OF PENNSYLVANIA; AND PHILIP A. LOOMIS, GENERAL COUNSEL, SEC

Mr. SMITH. Thank you, Mr. Chairman.

It is an honor for a representative of the Securities and Exchange Commission to appear before this committee. As you know our parent committee in the House is the Interstate and Foreign Commerce Committee, and we don't usually have the opportunity of being before you.

The CHAIRMAN. May I ask that if you could summarize your statement in 15 minutes, it would be appreciated, and then we will get to all three of you, and each of the members of the committee will have an opportunity to ask questions. Your testimony has been made available to them, and it will surprise you to know how they look it over before they attempt to interrogate you. This morning we have a Democratic caucus at 10 o'clock, and we are in somewhat of a bind. But we are going to continue the hearings as long as we can.

Mr. SMITH. I will make an attempt to do so, Mr. Chairman.

While this legislation relates primarily to banks, which are generally not within the jurisdiction of the Commission, your letter of March 18 suggested that several aspects of this bill relate to matters treated in the Commission's institutional investor study. I am currently appearing in place of Chairman Casey at his request, because Mr. Casey did not take office until after the institutional investor study had been completed and transmitted to the Congress, while I have had some contact with the study during most of its conduct.

I am accompanied here, Mr. Chairman, by Prof. Donald E. Farrar, of the University of Pennsylvania, who was director of the study through its completion. The study was primarily an economic study, and since Dr. Farrar, unlike myself, is an economist, I thought he might be better able to answer any questions with respect to the economic aspects of the study. And he is here for that purpose.

I am also accompanied by the Commission's general counsel, Mr. Philip A. Loomis.

The scope of the institutional investor study embraced banks, and particularly the operations of the bank trust departments were studied in some detail. As the entire text of the study only became available last week, as you indicated, the Commission has not yet consulted with Federal bank regulatory agencies concerning those portions of the report that relate to banks. We feel that until such consultations, our conclusions in this area, which are initial, must necessarily be considered preliminary.

Turning now first to H.R. 3287, this bill prohibits banks from making loans for the purpose of purchasing their own stocks or stocks of any other banks. While banking policies may justify these prohibitions, I only mention in passing that this legislation would modify the regulatory scheme adopted by the Board of Governors of the Federal Reserve System pursuant to section 7 of the Securities and Exchange Act of 1934.

H.R. 3287 would in effect prohibit an investor from purchasing the securities of any bank on margin by a loan from the bank, although under the Board's regulations the investor could purchase securities of

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any other type of corporation. The bill apparently would not prohibit an investor from purchasing securities of banks on margin if the loan were from a broker-dealer instead of a bank. And as you know, most broker-dealer loans in that respect as hypothecated with banks.

With respect to H.R. 5700, I would first note generally that this bill's definition of financial institution includes most banks, insurance companies, and registered broker-dealers. But it excludes registered investment advisers and registered investment companies, two of the most important types of financial institutions in terms of equity investing.

While at this time legislation might be considered with respect to one type of institution, the Commission in its letter of transmittal accompanying the study indicated that presently the burden of disclosure at least falls very unevenly on institutions. The problem of institutional investors are not unique to a single type of institution. It may prove more desirable to develop at the outset a consistent regulatory approach applicable to all institutions deemed appropriate.

I do not propose to discuss the matter of insurance coverage on deposits of public funds in insured banks, which does not fall within our Commission's jurisdiction, nor was it examined by the study.

The study did not deal specifically with personnel interlocks among financial institutions, the area addressed in sections 2 through 5 of H.R. 5700. Sections 7, 8, and 9 of H.R. 5700 deal with a different type of interlock, that is, vertical relationships between certain enumerated classes of institutions and corporations for which the financial institution manages an employee pension or welfare plan or owns 5 percent or more of the voting stock of the corporation, or where the financial institution has a substantial and continuing relationship with the corporation with respect to loans or extensions of credit.

The study focused principally on the incidence of multiple shareholdings, personal and business relationships between institutions and companies. I did not deal with the lateral relationships such as common director ties between banks.

Data was analyzed on shareholdings, personnel ties, employee benefit plan management, loans and bank deposits, concerning the 50 largest banks, the 21 largest property and liability insurance companies, the 26 largest life companies, and the 70 or so largest investment advisory complexes.

Two initial conclusions emerge. First, that banks do have a greater number of personnel and business ties with portfolio companies in absolute terms than do either insurance companies or investment advisory complexes.

Second, it appears unlikely that the observed incidents of multiple relationships in the case of banks occur entirely by chance. Banks are historically more likely to have more than one relationship with any particular company. The relationship between bank deposits and bank loans was found to be particularly strong, although the study data provides no basis for concluding that any one relationship caused the other.

The multiple relationships exhibited by banks is perhaps not surprising in view of the fact that perhaps more so than any other insti-

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tution, banks are engaged in providing a variety of financial services both on the investment side and the commercial side.

Neither the study nor the Commission concluded that the existence of the multiple relationships was undesirable per se. Indeed, specific restrictions to curb possible abuses flowing from multiple relationships such as the Commission's rule 10b-5 can and have been devised.

Our attention has been directed to an aspect of section 8 of H.R. 5700 which may create unintended difficulties.

As noted, that section prohibits any officer, director, or employee of any one of the seven types of financial institutions enumerated in that section from serving as an officer or director of any other corporation if the financial institution he serves holds more than 5 percent of the voting stock of such corporation.

There is an exception in section 8(b) for persons holding positions within a group of companies which are part of a bank holding company system or a savings and loan holding company system. There is no comparable exceptions for companies which are subsidiaries of either insurance companies or registered broker-dealers in securities, both of whom are treated as financial institutions for the purposes of section 8.

A specific case called to our attention, and which is not uncommon, we believe, is the situation where a broker-dealer has a wholly owned subsidiary which is engaged in either managing or underwriting mutual fund shares, or in providing investment advice or furnishing other similar services. Taken literally, section 8(a) would prohibit an officer, director, or employee of a registered broker-dealer from serving as an officer or director of any wholly owned subsidiary of that broker-dealer which engages in the activities above mentioned.

While we are not experts in the insurance industry, we also understand that it is also not uncommon for insurance companies to have subsidiaries engaged in various activities such as offering and selling insurance policies or distributing shares of variable annuities sponsored by the insurance company.

We understand that section 8 was designed, in part, to limit concentrations of power by restricting personnel interlocks between financial institutions and independent corporations in which they have a stock interest and that it was not intended to restrict parent-subsidiary relationships. Section 8(a)(4) in connection with section 8(b) so indicates, but do not resolve the problem as to parent-subsidiary relationships in the case of groups of related financial companies other than those in bank holding company systems or in savings and loan holding company systems. It is our feeling that this result was probably not intended and that the committee may wish to correct it.

Section 12 of H.R. 5700 would require insured banks annually to report their holdings of particular securities under investment management to the Federal Deposit Insurance Corporation. The Commission's Institutional Investor Study concluded that there were significant shortcomings in existing patterns of institutional reporting of security holdings and security transactions, such as duplicative reporting to different agencies, lack of uniformity in reporting requirements, and failure to require reports concerning holding of and transactions in securities of specific companies.

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The scope of H.R. 5700 disclosure would be considerably more narrow than those deemed appropriate by the Commission. First, H.R. 5700 would require only annual reports of holdings, while Commission proposals would encompass transactions in securities as well.

Second, H.R. 5700 is limited to disclosures by federally insured banks, though there is no logical reason why expanded disclosures would not be extended to all types of institutional investors.

Third, R.H. 5700 contemplates filings only with the FDIC, while Commission proposals envision the SEC functioning as a central depository for information about security holdings and security transactions by all types of institutions.

Finally, while H.R. 5700 would require disclosure of the reporting banks' voting rights with respect to securities under management, and the manner in which proxies are exercised, if at all, the Commission has proposed further that institutions state their policies on involvement in corporate affairs. In this way both portfolio companies and institutional beneficiaries might be informed of this important aspect of institutional investment management.

I think it important to point out, Mr. Chairman, that the Commission is proposing general rulemaking authority in this area to eliminate possible burdens, de minimis considerations, and the problems that are created by inflexible statutory requirements where they serve no appropriate purpose, and where other systems of reporting could achieve that purpose and could be adopted with the flexibility of rulemaking power.

Section 13 of the bill would prohibit any federally insured bank from holding under investment management more than 10 percent of any class of stock for which a registration statement has been filed under the Securities Act of 1933, and from holding its own stock or the stock of its parent company.

Data from the study show that banks may have potential economic power to exercise significant influence over some of the companies whose securities comprise their portfolios. Aggregate holdings of bank trust departments constitute often more than 20 or 30 percent of the outstanding shares of many large companies, that is bank trust departments in the aggregate. However, the study has also found that it is relatively rare that a single bank will hold a very substantial position in any one company, and in fact most banks surveyed have self-imposed limitations on the amount of such holdings.

The study found that as a group institutions generally voted with management. Banks voted negatively and deliberately abstained from voting more ferquently, however, than did other types of institutions, although not to any great extent. In addition, the study found evidence of widespread institutional participation in corporate takeovers.

The Commission plans to deal with these latter problems through the use of its existing rulemaking powers.

The Commission has not reached any decision as yet on recommending generalized restrictions on the size of institutional holdings. We do not see any basis at this time for generalized restrictions on the volume of institutional trading or the size of institutional transactions.

There do appear to be several reasons weighing against flat percentage limitations on institutional holdings. For one thing, institutions, particularly banks, may "inherit" large blocks of securities to

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manage, and the compelled diversification of such holdings may be both difficult and harmful to beneficiaries as well as other shareholders.

Second, percentage limitations may work to the disadvantage of beneficiaries by forcing purchases of less desirable stock or undesirable dispositions of securities.

Third, it is questionable whether a percentage limitation is needed where the institution maintains a rigid separation between its trust department and its commercial operations, and there is no intent or effort to exercise control over portfolio companies.

Should nevertheless, limitations of the type set forth in section 13 of H.R. 5700 be imposed, we question whether the stock encompassed should be those "for which a registration statement has been filed." Registration statements under the Securities Act of 1933 are not filed with respect to a class of stock, but rather are limited only to the particular securities being offered and sold pursuant to the statement. Many publicly held companies do not have registration statements under the 1933 act in effect at all times.

Accordingly, a more appropriate reference may be made to all companies whose equity securities are registered with the Commission under section 12 of the Securities Exchange Act of 1934, or companies required to file reports with the Commission pursuant to section 15(d) of that act.

While my prepared statement covers additional matters, in view of the time, Mr. Chairman, I will conclude my summary testimony at this point in order to permit time for questioning and for the other witnesses to testify.

The CHAIRMAN. Thank you, sir. And your written statement will appear as it is in the record. And then if in the questioning all the points are not covered you may extend your remarks in the record.

Mr. SMITH. Thank you.

(The prepared statement of Mr. Smith follows:)

PREPARED STATEMENT OF RICHARD B. SMITH, COMMISSIONER, SECURITIES AND EXCHANGE COMMISSION

Mr. Chairman, members of the committee, my name is Richard B. Smith, and I am a Commissioner of the Securities and Exchange Commission. I am here in response to your letters of March 18 and April 5 requesting that a representative of the Commission appear at these hearings on H.R. 5700 and H.R. 3287. While this legislation relates primarily to banks which are generally not within the jurisdiction of the Commission, the Chairman's letter of March 18 suggested that several aspects of this bill relate to matters treated in the Commission's Institutional Investor Study. I am, accordingly, appearing in place of Chairman Casey at his request because Mr. Casey did not take office until after the Institutional Investor Study had been completed and transmitted to the Congress, while I have had some contact with that Study during most of its conduct. I am accompanied by Professor Donald E. Farrar of the University of Pennsylvania who was Director of the Study through to its completion. The Study was primarily an economic study and, since Dr. Farrar unlike myself is an economist, I thought that he might be better able to answer any questions with respect to economic aspects of the Study. I am also accompanied by the Commission's General Counsel, Mr. Philip A. Loomis, Jr.

The Committee has requested the views of the Securities and Exchange Commission on two bills which would impose additional regulatory and disclosure requirements on federally insured banks and certain other types of financial institutions. H.R. 5700, introduced by the Chairman of the Committee, would among other things, prohibit certain personnel interlocks; it would require disclosure by insured banks of their holdings of particular securities; it would place

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restrictions on securities holdings and loans by insured banks; and it would prohibit "brokered" deposits. H.R. 3287, introduced by Representative Gonzalez, would prohibit insured banks from making loans for the purchase of securities issued by banks.

I should emphasize at the outset that most of the matters with which these bills deal are not within the specific jurisdiction or expertise of the Securities and Exchange Commission. I understand that the Committee is particularly interested in the Commission's views insofar as they may reflect the results of its recently completed Institutional Investor Study. The Study Report, submitted to the Congress on March 10, 1971, included the Commission's initial conclusions and recommendations. Some of these conclusions and recommendations, as well as the underlying analyses upon which they are based, have a bearing on the proposed legislation now before your Committee. On the other hand, some aspects of the legislation—particularly those dealing with deposit insurance—were not the subject of the Institutional Investor Study nor have they otherwise invoked the Commission's authority or concern. Accordingly, I shall limit most of my remarks today at a discussion of those provisions of the proposed legislation which relate to problems considered by the Institutional Investor Study. The Commission has determined to take no position at this time on the legislation as a whole. We are happy, however, to provide analyses conducted by the Institutional Investor Study to the extent they are useful in your Committee's deliberations.

It should be noted that the bills relate primarily to the conduct of insured banks, insured savings and loan associations and mutual savings banks and the activities of their managements and their employees. Although most of these institutions are regulated by other Federal agencies and not by the Commission, the scope of the Institutional Investor Study, as envisioned by the Congress, necessarily embraced banks, in particular, and the operations of bank trust departments were studied in some detail. Certain of the conclusions and recommendations of the Commission relate to banks. We have not so far, however, had the opportunity to consult with the Federal bank regulatory agencies concerning these matters since the complete text of the Institutional Investor Study just became available last week from the Government Printing Office. We expect to initiate such discussions promptly but until we have done so, our conclusions with respect to banks must necessarily be preliminary.

BACKGROUND AND DESIGN OF INSTITUTIONAL INVESTOR STUDY

I would like to begin with a few remarks about the background and design of the Study. The Institutional Investor Study was authorized by Joint Resolution of the Congress and approved by the President as Public Law 90-438 on July 29, 1968. The Commission was authorized to make "a study and investigation of the purchase, sale, and holding of securities by institutional investors of all types . . . in order to determine the effect of such purchases, sales, and holdings upon . . . the maintenance of fair and orderly securities markets . . . the stability of such markets . . . the interests of the issuers of such securities and . . . the interests of the public, in order that the Congress may determine what measures, if any, may be necessary and appropriate in the public interest and for the protection of investors."

One of the most important types of institutions examined by the Study was the banking industry. The data collected by the Study encompasses equity holdings of and trading by the 50 largest bank trust departments in the United States. These banks also provided certain information on their relationships with companies in the capacity of creditor, depository and employee benefit plan manager.

Chapter 5 of the Study focuses on operational characteristics of the bank trust departments surveyed. It includes analyses of the types of accounts and assets administered, costs, turnover and activity rates, performance, and compensation. Chapter 9 includes data of concentrations of holdings in particular securities by various categories of institutions including bank trust departments. Chapter 15 of the Study examines the impact of institutions, including bank trust departments, on portfolio companies—that is, companies whose equity securities comprise institutional portfolios. The chapter includes data indicating the extent to which institutions in the Study's sample hold varying percentages of the outstanding shares of a broad sample of publicly held companies. There is also an analysis of intercorrelations among shareholdings and certain types of personnel and business relationships linking institutions and companies.

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INITIAL CONCLUSIONS AND RECOMMENDATIONS OF THE COMMISSION

In its letter of transmittal submitting the Study to the Congress, the Commission made several proposals among other things designed to improve the flow of information to Government agencies and to the public about the securities holdings of and trading by institutions. Throughout the letter the Commission stresses the need not only for improved reporting by and regulation of institutions, but for comparable treatment of all types of institutions. For example, in discussing the need for better disclosures by institutions of their holdings of and transactions in the securities of specific companies, the Commission noted that "the burdens of disclosure fall unevenly on institutional respondents."

While we recognize that your Committee is primarily concerned with the activities of banks, the problems dealt with in the proposed legislation are not entirely limited to this one type of institution. H.R. 5700 defines "financial institution" for various purposes as encompassing most banks, insurance companies and registered brokers and dealers. This definition excludes registered investment advisers and registered investment companies—two of the most important types of financial institutions, particularly in terms of equity investment. It is, of course, possible to legislate with respect to one type of institution at this time, reserving consideration of appropriate treatment of other types of institutions. On the other hand, it may prove more desirable to develop at the outset a consistent regulatory approach to the problems of institutional investment where those problems are not unique to a single type of institution.

One of the primary benefits we hope will flow from the Institutional Investor Study is a more encompassing perspective on the role of institutions of all types and a delineation of the extent to which the regulatory requirements applicable to each of them, at least as to their portfolio management, should be uniform.

In his letter of March 18 to the Commission, Chairman Patman stated that H.R. 5700 covers the following five basic areas:

1. Certain interlocking relationships among financial institutions, and between them and other corporations;
2. Certain restrictions and disclosures in connection with loans made by financial institutions;
3. The problem of brokered deposits, which has caused a number of bank failures in recent years;
4. The practice of offering gifts to potential depositors by financial institutions in order to attract deposits; and
5. Expanding insurance coverage on the deposits of public funds in insured banks and savings and loan associations by 100 percent.

The last item, that is, expanding the insurance coverage on deposits of public funds, not only does not come within the jurisdiction of the Commission but was not examined in the course of the Institutional Study and, accordingly, with your permission, I do not propose to discuss it.

With respect to the third item, the question of brokered deposits, this likewise is not within our regulatory jurisdiction but certain perhaps related problems involving bank deposits by securities brokers were considered by the Institutional Study and I will later mention these. I would like to note here, however, that in the course of general enforcement of the antifraud provisions of the securities laws, we have recently come across situations which indicate that brokered deposits may create a situation dangerous to banks and their depositors. This may be particularly true where brokered deposits are procured by persons wishing to borrow money from a bank and unable to otherwise provide the desired compensating balances.

Chairman Patman also referred to H.R. 3287, a bill which prohibits banks from making loans for the purpose of purchasing their own stock or stock of any other bank. I believe that in this connection, I should mention the fact that Section 7 of the Securities Exchange Act grants to the Board of Governors of the Federal Reserve System authority to regulate the extension of credit for the purchase or carrying of securities, including securities of banks, and the Board of Governors under this authority has promulgated Regulation U regarding the use of bank credit for the purpose of purchasing or carrying securities. This section, as amended by Public Law 91–437, applies to the securities not only of those banks which are listed on national securities exchanges but also to the securities of the larger banks which are traded in the over-the-counter market. H.R. 3287, if enacted, would modify the regulatory scheme provided in Section 7 of the Securities Exchange Act. It would, in effect, prohibit an investor from purchasing the securities of any bank on margin by a loan from a bank

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although he could so purchase securities of any other type of corporation if he complied with the regulations of the Federal Reserve Board. This bill might not, however, prohibit an investor from purchasing securities of banks on margin by a loan from a broker-dealer. There may be reasons of banking policy which justify the prohibitions contained in H.R. 3287. As to this, I express no opinion but I did think it proper to advise the Committee of the impact which this legislation would have on the regulatory scheme adopted by the Board of Governors of the Federal Reserve System pursuant to Section 7 of the Securities Exchange Act.

I will now turn to the first two areas referred to in Chairman Patman's letter as to portions of which the Institutional Study may provide pertinent data.

INTERLOCKING RELATIONS

Sections 2 through 5 of H.R. 5700 deal, in effect, with personnel interlocks between insured banks, insured savings and loan associations and mutual savings banks with other financial institutions of the same type or of other enumerated classes such as insurance companies, bank holding companies and registered broker-dealers. The Institutional Study did not deal specifically with personnel interlocks among financial institutions although it did consider a larger phenomenon, the trend to integrate various types of financial services in one institution or a group of related institutions. I might note, however, that Section 10 of the Investment Company Act of 1940 restricts certain personnel interlocks between registered investment companies and commercial banks, investment bankers and securities brokers who serve as regular brokers to the investment company. Section 6(c) of the Investment Company Act, however, authorizes the Commission to grant exceptions from these and other prohibitions, if and to the extent it is appropriate in the public interest and consistent with the protection of investors and the purposes and policy of the Act. Whether or not any similar flexibility would be in order in connection with H.R. 5700 is a matter which this Committee may wish to consider.

Sections 7, 8 and 9 of H.R. 5700 deal with a different type of interlock or relationship—that is, a "vertical" relationship between enumerated types of financial institutions and corporations for which the financial institution manages an employee pension or welfare plan or owns 5 per cent or more of the voting stock of the corporation or where the financial institution has a substantial and continuing relationship with the corporation with respect to loans or extensions of credit. The Institutional Study did deal with relationships between financial institutions and corporations with which they had various types of business relationships particularly securities holdings.

The Institutional Investor Study examined the incidence of personnel and business relationships between institutions and companies, including companies whose equity securities were held and managed by the institution. As noted in Chapter 15 of the Study Report, "a relatively high incidence of interlocking personnel and business relationships may reinforce any institutional power conferred by stockholdings, multiply possible conflicts of interest, increase the opportunities for use of inside [corporate] information and—if concentrated among relatively few large institutions and companies—produce anticompetitive effects."

While recognizing that possibly undesirable consequences might flow from the existence of multiple shareholding, personnel and business relationships between institutions and companies, the Study focused principally on the incidence of these relationships rather than on the possible consequences themselves—which obviously do not lend themselves to statistical analysis. The Study was not concerned with "lateral" relationships between institutions—such as common director ties between two banks. Therefore, its data do not relate to those provisions of H.R. 5700 which would place limitations upon such ties. The data do bear on the question of whether there is a systematic intercorrelation between various types of relationships linking institutions and companies.

The institutions surveyed included the 50 largest banks, 21 largest property and liability insurance companies, 26 largest life insurance companies and 70 largest investment advisers, including advisers to registered investment companies. Data were collected on shareholdings, various types of personnel ties, employee benefit plan management (which includes pension plans), loans and bank deposits.

The initial conclusions which emerged from analysis of this data are twofold. First, banks have a greater number of personnel and business ties with port-

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folio companies in absolute terms than do either insurance companies or investment advisers. Second, it appears unlikely that the observed incidences of multiple shareholding, personnel and business relationships in the case of banks occur entirely by chance. In other words, the Study concluded that unlike insurance companies and investment advisers, banks are historically more likely to have more than one relationship with any particular company. The relationship between bank deposits and bank loans was found to be particularly strong. This conclusion cannot be interpreted as implying that one type of relationship necessarily causes or is the result of another relationship—for example, that stock holdings lead to loans or vice-versa. It merely establishes the fact that banks are likely to establish additional types of relationships with companies they already "know" through one relationship.

Neither the Study nor the Commission concluded that the existence of multiple relationships between institutions and companies were on their face undesirable. While the potential problems to which I have already referred are an inevitable aspect of such relationships, it must be recognized that these problems are in part a result of the fact that banks, more so than other institutions, are engaged in providing a variety of financial services, both investment services and commercial banking services. Thus, it is not surprising to find that when banks hold stock in a company, they are more likely also to have a director on the company's board, to have a creditor relationship with the company, to serve as depository for the company's funds and to manage the company's employee benefit plan.

Specific restrictions designed to curb possible abuses flowing from multiple relationships can be and have been devised. For example, the Commission's Rule 10b-5 under the Securities Exchange Act would prohibit a bank receiving non-public, material information about a company in its capacity as creditor from purchasing or selling the company's securities on the basis of that information.

Our attention has been directed to an aspect of Section 8 of H.R. 5700 which may create unintended difficulties. As noted, that section prohibits any officer, director, or employee of any one of the seven types of financial institutions enumerated in that section from serving as an officer or director of any other corporation if the financial institution he serves holds more than five percent of the voting stock of such corporation. There is an exception in Section 8(b) for persons holding positions within a group of companies which are part of a bank holding company system or a savings and loan holding company system. There is no comparable exception for companies which are subsidiaries of either insurance companies or registered broker-dealers, both of whom are treated as financial institutions for purposes of Section 8.

A specific case called to our attention, which is not uncommon, is the situation where a broker-dealer has a wholly-owned subsidiary which is engaged in either managing or underwriting mutual fund shares, or in providing investment advice or furnishing other similar services. Taken literally, Section 8(a) would prohibit an officer, director or employee of a registered broker-dealer from serving as an officer or director of any wholly-owned subsidiary of that broker-dealer which engages in the activities above mentioned. While we are not experts in the insurance industry, we also understand that it is also not uncommon for insurance companies to have subsidiaries engaged in various activities such as offering and selling insurance policies or distributing shares of mutual funds or variable annuities sponsored by the insurance company.

We understand that Section 8 was designed, in part, to limit concentrations of power by restricting personnel interlocks between financial institutions and independent corporations in which they have a stock interest and that it was not intended to restrict parent-subsidiary relationships. Section 8(a)(4) in conjunction with Section 8(b) so indicate, but do not resolve the problem as to parent-subsidiary relationships in the case of groups of related financial companies other than those in bank holding company systems or in savings and loan holding company systems. It is our feeling that this result was probably not intended and that the Committee may wish to correct it.

DISCLOSURE OF INSTITUTIONAL HOLDINGS

Section 12 of H.R. 5700 would require insured banks to report annually to the Federal Deposit Insurance Corporation their "fiduciary" holdings of particular securities. These reports, which would be available for public inspection,

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would include information on the voting authority of the bank with respect to each security and on the manner in which the bank exercised proxies.

One of the principal conclusions emerging from the Commission's Institutional Investor Study was that there are significant shortcomings in existing patterns of institutional reporting. As the Commission noted in its transmittal letter to the Congress:

"The scope of information reported often is limited, particularly with respect to holdings of and transactions in the securities of specific companies; information often is supplied to more than one agency, resulting in unnecessary and costly duplicative efforts; and in some cases data is supplied only on a voluntary or confidential basis, limiting both the comprehensiveness and usefulness of the data supplied."

The Commission also noted that some institutional investors were subject to more extensive reporting requirements than others. It stated:

"Extensive reports currently are provided by registered investment companies and most large insurance companies; banks, investment advisers and self-administered foundations, endowments and employee benefit funds, however, do not now for the most part provide information on holdings and trading in particular securities to any public agency."

The Commission recommended that gaps in information flows about the scope and impact of institutional investing be eliminated by amendment of the Securities Exchange Act of 1934 to provide the Commission with general rule-making authority to require reports and disclosures of security holdings and transactions from all types of institutional investors, including banks, as to which the institution has beneficial or investment management discretion. As the Commission noted:

"Such authorization would permit the Commission . . . to obtain continuing data for public disclosure and for the production of statistical data or aggregates, to the extent that it deems such data necessary or appropriate."

As a less preferable alternative to general legislative authority to promulgate reporting rules for institutions, the Commission recommended modification of existing reporting requirements in the Exchange Act to encompass institutional holdings and transactions involving securities as to which the institution had either beneficial ownership—the present test—or investment management authority.

Section 12 of H.R. 5700 appears to be designed to accomplish some of the purposes embodied in the Commission's recommendations for improved institutional reporting. However, the scope of H.R. 5700 disclosures would be considerably more narrow than those deemed appropriate by the Commission. H.R. 5700 would require only annual reports of holdings, while the Commission's proposals would encompass transactions in securities—purchases and sales—as well. Perhaps more significant is the fact that H.R. 5700 is limited to disclosures by federally insured banks. There is no logical reason why expanded disclosures should not be extended to all types of institutions.

Furthermore, H.R. 5700 contemplates filings only with the FDIC. We appreciate that the FDIC, as well as other federal and state banking agencies, may require information on bank holdings in order to fulfill its regulatory responsibilities. However, the Institutional Investor Study found that there is already considerable overlap in reports filed by institutions with various federal and state agencies. Thus, the Commission's recommendations contemplated that the SEC, as the agency charged by Congress with the broadest regulatory responsibilities over the public securities markets, would serve as a central depository for information about sec累tiies holdings of and transactions by all types of institutions. The Commission recognized in its transmittal letter accompanying the Study that it would be necessary to "consult with other regulatory bodies and interested persons on the form, frequency and content of reports to be required, and arrangements by which all affected regulatory bodies can share the data reported."

Thus, under the Commission's proposals, all types of institutions, including banks, would report to the SEC, pursuant to rules adopted by the Commission after opportunity for public comment. The data reported would then be available for use by all other regulatory agencies and, to the extent appropriate, by the public. As an agency already receiving thousands of reports regarding securities holdings and transactions from individuals and corporations as well as institutions, the SEC would appear to be the logical focal point for adoption, receipt and dissemination of broader institutional disclosures.

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H.R. 5700 would require disclosure not only of securities holdings, but also of the reporting bank's voting rights with respect to the securities under management and of the manner in which proxies are exercised, if at all. The Commission's transmittal letter accompanying the Institutional Investor Study recognizes that these types of disclosures are appropriate for all types of institutions which manage investments for others. However, the Commission in most respects recommended more extensive disclosures than those prescribed by H.R. 5700. Institutions would, under the Comimssion's proposals, state their policies on involvement in corporate affairs so that both portfolio companies and institutional beneficiaries might be informed of this important aspect of institutional investment management. The disclosures would encompass, for example, procedures for considering proxy materials, any general policy regarding supporting corporate management, any general policy of abstaining from voting, any general policy on voting for or against (or not voting on) certain types of proposals, any general policy of participating or not participating in corporate takeover situations, and any policies regarding business relationships, personnel relationships and informal participation or consultation with portfolio companies in corporate affairs. As the Commission stated:

"This type of public disclosure would focus the obligation of institutions to act in the interest of their beneficiaries and lead to their setting up procedures for systematic attention to questions of stockholder voting."

Thus, the Commission concurs in principle with the disclosure philosophy embodied in Section 12 of H.R. 5700, but would prefer that the reporting mechanisms suggested both be made more flexible by giving the SEC rule-making authority and be amplified. They should be extended to all types of institutions, which would make these disclosures available to other agencies and where appropriate to require them to be made available to the public.

RESTRICTIONS ON INSTITUTIONAL HOLDINGS

Section 13 of H.R. 5700 would prohibit any federally insured bank from holding under investment management more than 10 percent of any class of stock "for which a registration statement has been filed under the Securities Act of 1933" and from holding its own stock or the stock of its parent company. The apparent purpose of these restrictions is to prevent banks from obtaining a position of control in any portfolio company and to preclude bank managements from perpetuating control through purchases of the bank's own stock.

The Institutional Investor Study did not consider the question of institutional holdings of their own securities as a means of perpetuating control. The Study did examine the holdings of the 50 largest bank trust departments—as well as the holdings of other large institutions—in an effort to determine whether those holdings constituted sufficiently large percentages of the outstanding shares of various companies to create a potential element of economic power. The Study found that the banks surveyed were the largest institutional holders of its sample of 800 publicly-held companies, with about $69 billion of the $115 billion worth of stocks of such companies held by all institutions surveyed as of September 30, 1969. All institutions as a group held about 30 per cent of the value of all of the sample companies. Therefore, based on this sample, one should not be surprised to find that about one-third of the outstanding shares of any company are held by institutions. Considering bank holdings separately, one would expect that, on average, all banks as a group would hold about 18 to 20 per cent of the outstanding shares of a company. However, the Study found that banks—as well as other types of institutions—tend to concentrate their portfolios in relatively few stocks. At the same time, the stocks in which bank portfolios are concentrated tend to be the stocks of larger companies. The result is that the holdings of bank trust departments taken together constitute a substantial percentage—often much more than 20 or even 30 per cent—of the outstanding shares of many companies, particularly large companies. The same is true, although to a lesser extent, when only bank holdings coupled with voting authority are considered.

While banks may have the potential economic power to exert significant influence over some of the companies whose securities comprise their portfolios, the Study found that ordinarily it is necessary to aggregate the holdings of several banks before those holdings constitute a substantial percentage of any company's outstanding shares. It is relatively rare that a single bank trust department will hold a very substantial position in any one company. Many institutions, including banks, have self-imposed policy limitations on the amount of stock they will hold in any one company; 22 of the 50 banks surveyed by the

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Study maintained such limitations, none exceeding 10 percent. As the Study points out in Chapter 15, it cannot be assumed that merely because a group of banks together have a substantial percentage of a company's stock that those banks will in fact act in concert to influence corporate policy.

In an effort to determine whether institutions, including banks, do attempt to influence corporate policy and decision-making through their shareholdings, the Study gathered data on institutional voting and informal participation in corporate affairs. While the Study was not satisfied that its efforts produced reliable statistical evidence of the extent of institutional participation other than through voting, some general conclusions emerged from the body of data collected and from Study interviews with institutional and corporate officials.

The Study found that institutions as a group generally voted with management on matters submitted to shareholder vote. Banks voted negatively and deliberately abstained from voting more frequently than did other types of institutions, although not to any great extent. Banks also appear to have more formalized procedures for reviewing proxy materials. Some institutions believed that informal participation in corporate affairs, such as direct contacts with corporate management, might be necessary and appropriate under certain circumstances: for example, when the company requests advice or when the institution is "locked in" to its holdings because the shares are restricted, as when the amount of shares held is very large and difficult to dispose of, or sale of the shares might generate unfavorable tax consequences. In general, however, unless the institution feels that it has no alternative but to attempt to influence corporate policy, it appears to regard its role as primarily that of investment manager and will dispose of the company's shares if corporate management pursues policies with which the institution disagrees. These institutional attitudes appear influenced in part by the concern that participation in corporate affairs may be deemed inappropriate by governmental authorities, exposing the institutions involved to additional regulation or litigation.

In the area of transfer of corporate control—or "takeovers"—the Study found evidence of widespread institutional participation. Here, unlike ordinary corporate decision-making, the possible benefits to institutional participants may appear to them more clear and certain. The Study found that institutions were in some cases able to obtain premium prices and other advantages—including advance notice of an impending takeover bid—that were not made available to other corporate investors. The Commission proposes to deal with the problems created by institutional participation in corporate takeovers through the use of its existing rulemaking powers.

The data and analyses developed by the Institutional Investor Study have not resulted in the Commission recommending generalized restrictions on the volume of institutional trading or the size of institutional transactions or in any decision on a general limitation on the amount of institutional holdings. We note, however, that in considering a possible flat percentage limitation on institutional holdings there are several reasons which weigh rather heavily against it.

First, institutions, particularly banks, may "inherit" large blocks of securities to manage; for example, the estate of a corporate officer who during his lifetime held a large position in his employer company, or a foundation created by the former owner of a now publicly-held corporation or an employee benefit plan which purchases the shares of the founding or sponsoring company. It may not be feasible or desirable to diversify such a portfolio very quickly. The impact of large sales of the securities might harm not only the portfolio beneficiary, but also other shareholders.

Second, percentage limitations may inadvertently cause hardship to institutional beneficiaries and generate conflicts of interest on the part of institutional financial managers. This may occur when the financial manager is barred from acquiring a particular stock for trust or other account under management, or is required to dispose of shares out of one or more managed accounts, solely because of the overall percentage limitations on the amount of that companies stock that may be held. If the institutional manager otherwise considers the stock a desirable investment, the result may be to disadvantage the beneficiary by forcing purchase of a less desirable stock. Undesirable tax consequences may also result if shares must be disposed of.

In addition, the financial manager may be forced to choose among accounts under management in making purchases and sales of stocks potentially subject to the percentage limitation. The limitation might be especially harsh in a case

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where holdings had been under 10 percent, but exceeded that limit because of events beyond the control of the financial manager—such as a repurchase by the company of its own shares.

Third, it is questionable whether a percentage limitation is needed where the institution maintains a rigid separation between its trust department and its commercial operations and there is no intent or effort to exercise control or influence over the portfolio company.

The Commission recognizes that the question of institutional power over portfolio companies has no simple solution. On the one hand, it is generally desirable that institutions concern themselves as shareholders with the affairs of portfolio companies, at least to the extent of voting intelligently on matters presented to them in proxies. If a financial manager disregards such matters, it may fail to fulfill the obligation it owes to its beneficiaries to conduct their affairs with diligence and skill. On the other hand, there are potential problems stemming from concentrated economic power that are inherent in an environment consisting of large institutions holding substantial positions in large corporations. The Bank Holding Company Act Amendments of last year recognized that limitations should be placed upon the acquisition by banks of operating control of non-banking entities. The question remains whether it is likely that the trust departments of banks might be used as a means of attaining such control through the use of savings entrusted to such banks by thousands of public investors seeking professional investment management.

In the event that your Committee believes it appropriate to impose limitations of the type set forth in Section 13 of H.R. 5700, we question whether the stocks encompassed should be those "for which a registration statement has been filed under the Securities Act of 1933." For one thing, registration statements under the Securities Act are not filed with respect to a class of stock, but rather are limited to the particular securities which are being offered and sold pursuant to the registration statement. Therefore, the existing language in the bill might be construed merely as prohibiting a bank from acquiring more than 10 percent of a particular registered public offering of securities, rather than 10 percent of the outstanding shares of any class of stock. We are not sure that this is intended. Second, there are many companies which, while publicly held, do not have registration statements under the Securities Act in effect at all times. In fact, there are some publicly held companies which have never had an effective Securities Act registration—such as companies which sold their shares publicly before 1933 or under one of the exemptions from registration.

Accordingly, if it is intended to refer to a category of companies subject to the federal securities laws, the appropriate reference would be to all companies whose equity securities are registered with the Commission under Section 12 of the Securities Exchange Act of 1934 or which are required to file reports with the Commission pursuant to Section 15(d) of that Act. This would include all companies whose securities are listed on any national securities exchange as well as most companies having 500 shareholders and over $1 million in assets. It should be recognized, however, that some classes of companies have been exempted from these requirements, notably unlisted insurance companies in most cases.

The third topic referred to in Chairman Patman's letter describing H.R. 5700 was the problem of brokered deposits and the fourth topic was the practice of offering gifts to attract deposits. For purposes of our brief comment we deal with these two subjects together.

BROKERED DEPOSITS AND GIFTS FOR DEPOSITS

Sections 19 through 24 of H.R. 5700 deal with the practice on the part of insured banks and insured savings and loan associations paying brokerage or other compensation to persons for obtaining deposits in such banks or associations and also with the practice of some banks and savings and loan associations giving merchandise or other things as an inducement to persons who make a deposit. The Commission has no comment on these practices as such. These sections are, however, related to some degree to a matter which was examined in considerable detail by the Institutional Study. This involved the relationship between deposits made by securities brokers in banks and the allocation by banks of securities commission business among brokers. The Study found that there was a strong relationship between broker's deposits in banks and commissions received by brokers from such banks. This raises an initial question as to whether or not the allocation of brokerage commissions to brokers by a bank in relationship to

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the deposits of the broker in the bank would fall within the prohibition of Section 19 of H.R. 5700. Beyond this, both the brokered deposits referred to in H.R. 5700 and the practices of banks concerning broker's commissions may be symptoms of the same fundamental economic forces. When an institution obtains something of value, as a deposit is to a bank, but does not pay any charge therefor by reason of applicable regulatory restrictions, there exists an incentive on the part of such an institution to pay indirectly for the value received. Conversely from the viewpoint of the securities broker, when he receives compensation for his services which by reason of applicable regulation is in excess of that which he requires to induce him to perform the services, in this case the execution of orders from the bank for purchase or sale of securities, he has an incentive to obtain this business by, for example, maintaining deposits in banks giving him such brokerage orders.

While the Commission noted this situation in its letter of transmittal for the Institutional Study it did not recommend any direct action except the initiation of steps to introduce competitive commission rates for large brokerage transactions executed on exchanges. Consideration of this question from the viewpoint of bank acquisition of deposits from brokers through the use of brokerage commissions was deferred pending consultation with the banking authorities since the Commission believed that significant questions of banking policy and bank regulation were involved on which it was not in a position to express an informed judgment. The Commission believes, however, that it is possible that the situations sought to be dealt with by Sections 19 through 24 of H.R. 5700 represent another example of the basic economic factors noted in the Institutional Study as referred to above.

Section 14 of H.R. 5700 prohibits lenders there specified from accepting equity participations in the making of loans. The Institutional Study did not examine into this matter specifically although data in Chapter 14 of the Study show that most such type of financing in private placements has been done by insurance companies. We have some question, however, as to whether a blanket prohibition of this nature will not inhibit flexibility and innovation in the financing of American industry. A stated reason of this prohibition was to prevent lenders from acquiring control of non-banking companies through the use of such equity participations. It would seem, however, that less drastic prohibitions might accomplish this objective particularly in view of the existing restrictions on banks and their holding companies from acquiring or controlling non-banking businesses.

CONFLICT OF INTEREST

Sections 15 through 18 of H.R. 5700 seek to deal with the conflicts of interest which may be present where an insured bank, an insured savings and loan association or a mutual savings bank makes loans either to its directors, officers or employees or to a corporation in which they have a significant interest. The Institutional Study did not deal in any detail with questions of this kind which did not appear to fall within the scope of such an economic study. The Commission has, however, encountered similar questions under the regulatory statutes which it administers. Thus, Sections 15, 16 and 17 of H.R. 5700 would require disclosure by the financial institutions therein referred to of loans made to directors, trustees, officers, or employees of such institutions. The Commission also requires disclosure in proxy statements under the Securities Exchange Act and in registration statements under the Securities Act of all transactions by the issuer in which directors, officers, and members of their families have a material interest. The Commission's requirements in this regard are at the same time somewhat broader and somewhat narrower than those proposed in H.R. 5700. The Commission's disclosure requirements do not extend to transactions in which employees, as distinct from officers and directors, have an interest nor do they extend to transactions in which the amount involved is less than $30,000. On the other hand, the Commission's disclosure requirements do not extend not only to loans but to any other transaction of any kind, subject to specified exceptions, in which directors and officers have a material interest.

The provisions of Sections 15, 16, and 18 of H.R. 5700 prohibiting loans to corporations in which officers, directors, or employees of the specified financial institutions have an interest find some parallel in the provisions of Section 17(a)(3) of the Investment Company Act of 1940 which prohibits affiliated persons of an investment company, which includes all officers, directors, or em-

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ployees of such a company, together with any corporation in which any such person owns 5 percent of the voting securities, from borrowing money from the investment company or any company controlled by it unless the Commission, upon application, determines that the transaction is reasonable and fair and does not involve overreaching on the part of any person concerned. We suggest the possibility that rather than a direct unconditional prohibition such as that found in Sections 15, 16, and 18 of H.R. 5700, it might be appropriate to permit exceptions to be made by the appropriate regulatory authorities upon application and after notice and opportunity for hearing if it determines that the transaction is fair and involves no overreaching.

Since this bill pertains in an important degree to disclosure by banks, I would like to take the occasion to refer briefly to what the Commission believes may be a shortcoming in the existing disclosure patterns as applied to banks. Securities of banks are presently exempt from registration under the Securities Act of 1933. This means that banks may offer and sell their securities to public investors without affording them the protection of the full and fair disclosure which Congress over thirty-seven years ago found necessary for investors to whom securities are offered by almost all other corporations.

The reasons for the bank exemption are somewhat obscure. The House Report indicates reliance on the supervision of banks by the Comptroller of the Currency. While the Comptroller has taken some commendable steps with respect to offerings of bank securities, he does not have direct statutory authority, let alone a mandate from Congress, nor are these disclosures backed up by the civil liabilities provided for by the Securities Act.

Whatever the reasons for exempting bank stock and other bank securities in the 30's, we have questions that they are any longer valid. It is true that banks are a regulated industry but so also are electric and gas utilities, telephone companies, television and radio stations, and airlines, yet none of these are exempt from registration under the Securities Act. This, of course, would give us no economic regulatory power over banks, any more than disclosure requirements have given us any such regulatory power over utilities or airlines, which they have not. We do not believe that subjecting bank stocks and other securities to registration under the Securities Act would create any serious problems.

It used to be that financial statements of banks were rarely audited by independent public accountants as the Securities Act requires, but this practice appears to be changing and such audited financial statements by banks have become farly common. Moreover, Congress did not exempt from registration under the Securities Act securities of bank holding companies, including one-bank holding companies, and many of these have registered with the Commission without difficulty. In the case of a one-bank holding company the required disclosure pertains primarily to the business of the bank whose stock is held by the holding company, so that in substance we obtain the equivalent of registration of new offerings of securities evidencing what is essentially an ownership interest in any bank which constitutes the principal asset of a one-bank holding company. We see no adequate reason why similar protection should not be provided for investors in the stock of banks which are not owned by such a holding company.

While there may be justification for a limited exemption from the Securities Act of 1933 for certain types of short term obligations and for certificates of deposits, the Commission believes that equities and long term obligations issued by banks and publicly offered and sold should be subject to the registration requirements of the Securities Act. The Commission, accordingly, is giving serious consideration to seeking the removal of the existing statutory exemption for such securities, just as we intend to do for securities issued by companies regulated by the Interstate Commerce Commission, the only other category of private companies most of whose securities are so exempted. This exemption also appears to be an anachronism and we are now having discussions with the ICC concerning it.

CONCLUSION

It has not, of course, been possible for me to review in detail the analyses, findings and conclusions of the Study in areas of interest to the Committee. Needless to say, the Commission and its staff stand ready to assist the Committee further in its evaluation of the Study, and we welcome the Committee's interest in implementing legislative solutions to some of the problems with which the Study deals. At the same time, we wish to emphasize that institutional investors and their impacts on the securities markets, on corporate issuers and on

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the public interest are subjects that require a comprehensive overview and, to the extent feasible, comparable treatment. As I have noted, the Commission intends to consult with other regulatory agencies on the findings of the Study and on the Commission's initial recommendations as they affect financial institutions under their jurisdiction. We may well make additional recommendations after such consultations.

The CHAIRMAN. Mr. Camp, you are welcome to the committee. We are glad to have the Comptroller of the Currency before us, and we will have your testimony.

STATEMENT OF HON. WILLIAM B. CAMP, COMPTROLLER OF THE CURRENCY

Mr. CAMP. Thank you, Mr. Chairman. It is a pleasure to be here today.

I do have with me the members of my staff. We have made studies of certain areas contemplated by this legislation. And with your permission, later on I would like to have them ——

The CHAIRMAN. If you would like to file them for the record, you may.

Mr. CAMP. We have submitted to the committee a rather detailed statement, which I won't bother to read.

But I have a very short statment which I would like to read.

The CHAIRMAN. That will be satisfactory.

Mr. CAMP. I do appreciate the opportunity to present the views of the Office of the Comptroller of the Currency on this legislation. In order to conserve the time of the committee, the following is a summary of our position on the principal provisions.

With respect to interlocking directorates, our detailed statment expresses the view that the prohibitions of H.R. 5700 are too drastic and would unduly disrupt accepted business practices. We agree that the provisions of law are inadequate in that they only cover commercial banks and do not regulate interlocks between commercial banks, savings and loan associations, and other types of financial institutions. We favor an approach which would prevent interlocks between institutions in actual competition with each other and at the same time preserve regulatory flexibility necessary to prevent hardship and unnecessary restriction.

It appears to us that the bill provisions against commercial bank interlocks with customers and competitors are designed to prevent three categories of possible abuse:

(1) The abuse of the competitive process;

(2) Unfair use of insider information; and

(3) Conflicts of interest.

It is our feeling that with the suggested expansion of the law on interlocking directorates, that there would be sufficient existing statutory controls on all three areas of abuse. Our statement lists the existing Federal statutes which we believe are effective to control abuse of insider information and conflicts of interest.

We are strongly opposed to the restrictions on bank trust departments, contained in sections 12 and 13. We feel that their effect would be to unfairly handicap bank fiduciaries in their competition with other types of trustees. We believe that the cost and administrative

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burdens of complying with the disclosure proposals would outweigh the benefits to be derived therefrom.

Our statement opposes the flat prohibitions of equity participation loans, premiums for deposits and bank stock loans. While recognizing that there are some possibilities for abuse in each of these areas, we feel that there is ample existing law and regulatory authority to effectively control them.

A survey of a representative sample of national banks revealed very little use of the equity "kicker" loan by national banks. However, we feel that commercial loan rates should be left to competitive forces and not subject to Federal control in the absence of compelling necessity. Also, the bill would unfairly leave some types of commercial lenders free of its control.

With respect to the complete prohibition of loans to insider interests, we feel that any problems in this area are best dealt with on a case-by-case basis. In many cases, unexceptionable loan opportunities come to a bank through its directors. We think that the emphasis in regulating such loans should be on credit factors and lack of preferential treatment, rather than solely on the relationship between the borrower and the bank.

We do not favor extending 100 percent deposit insurance to public deposits mainly because of the disruption to the market for municipal bonds which would be caused by the elimination of the present pledging requirements. We also feel that excepting one class of depositors would inevitably lead to pressures to extend similar treatment to other classes.

We do not support H.R. 3287 because it would prohibit even the most experienced and desirable purchasers from obtaining bank financing to acquire control of a bank.

Further details covering our position on the above and other provisions are contained in our prepared statement.

Thank you, Mr. Chairman.

The CHAIRMAN. We will place your statement in the record as is, Mr. Camp. And if at the conclusion of the hearing every point has not been covered to your satisfaction, you may extend your remarks and cover them.

Mr. CAMP. Thank you, sir.

(The prepared statement of Mr. Camp follows:)

PREPARED STATEMENT OF HON. WILLIAM B. CAMP, COMPTROLLER OF THE CURRENCY

Sections 2 through 9. Interlocking Relationships. The bill would amend the Federal Deposit Insurance Corporation Act (and other banking law sections) to prohibit the following: (1) any officer, director or employee of eight types of financial institutions from serving in a similar capacity with any other such institution; (2) any officer, director or employee of such financial institution from serving in similar capacities with a corporation which does substantial and continuing loan or pension trust business with the financial institution; (3) commercial banks, savings and loan associations and mutual savings banks from controlling or having interlocking relationships with a title company, property appraisal firm, or other company which offers services in connection with the closing of real estate transactions; (4) service as an officer or director or employee of a commercial bank or savings institution, by any lawyer who performs legal services for a customer of the institution in connection with transactions with it; and (5) any interlocking relationship between any of the eight types of financial institutions and any corporation in which the institution has voting control of five percent or more of the stock.

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The present federal law (section 8 of the Clayton Act, 15 U.S.C. 19) prohibits interlocking relationships between a member bank of the Federal Reserve System and any other bank located in the same city with such member bank or in any city, town, or village contiguous or adjacent thereto. There are presently no statutory prohibitions against interlocks between the other seven types of institutions listed in the bill or against interlocks between institutions more geographically separated than adjoining towns.

We agree that some strengthening of the present law on interlocking directorates is desirable. The administration presently is developing a proposal which would correct the existing deficiencies without disrupting legitimate business relationships. Under this approach, the regulatory agencies would be given authority to regulate interlocks with a mandate to protect the public from anicompetitive situations or other abuses.

We have not seen documented examples of practices against the public interest sufficient to justify the sweeping dislocation of accepted business practices which would be caused by the adoption of the other prohibitions in Sections 2 through 9. On the contrary, we think it would be most detrimental to the public interest to curtail the use of scarce executive management talent in this way.

We see no possible justification for prohibiting, for example, a New York City banker who maintains a winter home in Florida or some other section of the country from contributing his banking knowledge to a small local bank in the latter community. Similarly we see no reason why a large commercial bank specializing in making loans to the chemical, furniture, or some other industry, should not be able to have on its board a business executive skilled in such field. It is no answer to say that such an executive could be found in a corporation doing no business with a particular bank. Service on a bank's board of directors, is not an unmixed privilege. There is substantial risk of liability involved in serving on the board of directors of any corporation, especially a bank, and, unless a financially responsible person has some good reason, such as a continuing business relationship, he will not assume such responsibility.

The possible abuses which Sections 2 through 9 appear designed to prevent, fall into three main categories: (1) abuses of the competitive process; (2) unfair use of insider information to the detriment of the general investing public; and (3) untenable conflicts of interest created by a single individual occupying positions of fiduciary responsibility to different sets of beneficiaries.

It is our opinion that there is sufficient federal law on the books to deal with problems (2) and (3) and that the proposal I have just outlined would adequately take care of problem (1).

(1) I do not think it is necessary to take the time of the committee to detail the elaborate set of statutory, judicial and administrative apparatus which exists to control abuses of the competitive process. Although, as the committee knows, we do not always agree with the views of the Antitrust Division of the Department of Justice, we do not think that anyone, least of all our office, could fault them for lack of zeal or conscientiousness in pursuing their statutory assignment.

(2) The abuse of insider information is also specifically outlawed by existing federal statutes, supplemented by strict judicial interpretations. I refer to the provisions of law administered by the Securities and Exchange Commission as interpreted by the *Texas Gulf Sulphur decision.*

(3) With respect to conflicts of interest, there are many legal tools presently available. The common and statutory law of corporate and fiduciary responsibility provide effective civil remedies to aggrieved stockholders. In addition to this potential civil liability, questionable or improper action of any bank director are subject to scrutiny, control and effective sanctions by the bank supervisory agencies.

In addition, Section 22 of the Federal Reserve Act (12 U.S.C. 375, 375A) and Regulation O issued thereunder controls loans to executive officers.

A powerful deterrent to self-dealing practices in institutions with more than 500 shareholders is the public disclosure requirements imposed by the Securities Acts Amendments of 1964. The hand of the federal banking agencies in controlling conflicts of interest was greatly strengthened in 1966 by the passage of the Financial Institutions Supervisory Act. (12 U.S.C. 1818(b)). That Act empowered the agencies to issue a cease and desist order against any practice deemed detrimental to sound banking.

The philosophy underlying Sections 2 through 9 appears to be one of suspicion of the integrity of the average businessman and banker. My over thirty-four years of service with the office of the Comptroller of the Currency has not led

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me to any such conclusion. My experience has been to the contrary—that with few exceptions, bankers and businessmen conduct their lives and affairs with integrity. We think that present law if amended in accordance with the suggestion above would be adequate to take care of the exceptions as they may arise.

§ 10. Mutual Savings' Bank Stockholdings in Other Financial Institutions.

Section 10 would completely eliminate the present practice of some mutual savings banks of owning shares of commercial banks, insurance companies, savings and loan associations, bank and S&L holding companies and brokerage firms.

We believe that a better approach would be to prohibit such ownership only in those cases where interlocking relationships would be similarly prohibited.

§ 11. Commercial Bribery.

Section 11 would amend the Federal Criminal Code to make it a criminal offense for a financial institution to offer or give a bribe to an employee of any customer or potential customer of the bank.

This office is not aware of any instance in which a national bank has sought to obtain business or influence a customer's conduct, by bribing the customer's agent or employee. In the absence of such instances, it is not apparent to us why federal legislation is necessary. Some states now make commercial bribery a crime, and we know of no legal reason why such state laws would not be available for use against a financial institution.

Of course, if the committee has evidence of or reason to believe that banks, S&Ls and the other types of institutions listed in Section 11 have been guilty of abuses in this area, we would have no objection to the adoption of Section 11.

§§ 12 and 13. Trust Department Stockholdings.

Section 12 of the bill would require every insured bank to file with the FDIC a list of the aggregate holdings in a fiduciary capacity of all securities, other than government securities. Specifically, it would require filing information as to the name, class, value, number held, and voting rights of the bank, and how the shares were voted by the bank in the previous year. This list would be available for public inspection.

We do not believe that the benefits to be achieved from this proposal justify the costs which it will involve, both to the government and to the banks. This information would constitute a vast mass of statistics, requiring large storage areas and numbers of housekeeping personnel at the FDIC. Its very size would pose a severe limitation upon its utility. In addition, we question the usefulness, from a standpoint of most governmental policies, of such a listing. It presumably will reflect holdings as of a given date and have no transactional information. We believe that information with respect to specific holdings and transactions, obtained from specific banks as of specific times, is more relevant to the responsibilities of the various government agencies having an interest in bank trust departments. Sufficient power to obtain such information presently exists in these agencies, in our opinion. If deficiencies exist, correction should be considered in the context of specific policy areas and agency needs. The accumulation of a vast storehouse of abstract data of this nature called for by Section 12 will not be of material aid in detecting or bringing appropriate corrective action in cases of abuse. Its primary utility, in our opinion, would be the facilitation of broad-scale policy studies, such as the recently completed Institutional Investors Study of the S.E.C. We do not believe that the ready availability of this information for such inquiries, which appear to be best conducted at periodic intervals, furnishes sufficient justification for the cost involved.

This requirement would also be extremely burdensome upon the banks. Compilation of the information would require many man hours of work on the part of bank personnel, and many hours of machine time in automated departments. In smaller banks, the cost involved could represent the difference between a profit and a loss in the operation of their trust departments. Thus, it would greatly increase the cost of operation as a corporate fiduciary and have the tendency to drive smaller competitors from the field and concentrate the business in the hands of the larger institutions. This effect is manifestly undesirable.

Section 13 would prohibit insured banks from holding in the aggregate in their trust departments more than 10% of any class of stock in any corporation for which a registration statement has been filed under the Securities Act of

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1933. In addition, it would forbid the holding of any stock, which has been issued by the bank or its parent company, in the bank's trust department.

These limitations would, we believe, be of questionable benefit. They would eliminate certain conflicts of interest and limit the potential for concentrations of control of corporations by banks through their trust departments. However, in so doing, they would cripple the effectiveness of professional corporate fiduciaries. A person planning the administration of his estate would have no assurance that the trust department of his selection would be able to accept his account, because some of his holdings might push the trust department aggregate over the 10% limit in a particular security. These considerations would become particularly acute in the case of family-owned corporations. If the stock were registered under the Securities Act of 1933, the use of a corporate fiduciary would not be available to the family for estate planning purposes.

The flat prohibitions upon holding stock of the bank or its holding company poses even greater problems for the person planning his estate. If he holds stock of a bank, he would simply have to utilize the services of a different bank or an individual. Large holdings of stock of a bank or bank holding company on the part of an individual reflects great confidence on his part in the management of that bank. It is natural that such a person would also have great confidence in such bank's ability to manage his estate. This provision might deprive him of his constitutional freedom of choice and even drive his holdings into the hands of a competitor bank. Even if the alternative institution were not a competitor, the implications from an anti-trust standpoint, of encouraging the flow of blocs of stock of one bank to the trust department of another bank, are serious.

Finally, we believe that the net effect of this section would be to drive trust and estate business into the hands of individuals. Because of their mortality, frequent lack of expertise, and virtually complete freedom from governmental supervision, we do not regard this as a desirable result. We believe that the desirable ends sought to be achieved by this section are now being obtained through banking supervision. If it is felt that increased statutory safeguards are required, the bank supervisors can readily implement them. For example, Section 61 of Title 12 presently imposes a most effective restriction on the voting of national bank stock held in a trust department, in the election of directors of the fiduciary bank. This provision might well be extended to all insured banks.

§ 14. Equity Participation Loans.

Section 14 would make it a federal crime for any insured bank, insured S&L holding company, mutual savings bank or insurance company to take as consideration for any loan, a share in the ownership or profits of the borrower.

This office, in August of 1970, made a survey relating to equity participation loans by national banks. A sample of 502 national banks was surveyed, including all 149 national banks with deposits of $225 million or more. The remaining 353 banks in the sample were selected to provide representative coverage of geographic areas and bank size.

The results indicate that equity participation loans are relatively insignificant in the National Banking System. The sample banks reported only 112 such loans, totalling $159 million as of August 31, 1970. This amount represented only .27 of one percent of the $58 billion volume of outstanding commercial and industrial loans on the books of the sample banks. Only 42 of the 502 banks in the sample reported any equity participation loans.

The volume of such loans by affiliates of banks in the sample was also small. Fourteen banks in the sample reported one affiliate each with equity participation loans. In all, 117 loans by these 14 affiliates totalled $28 million.

It is apparent from our sample that national banks are not making equity participation loans to any significant degree. We have no reason to believe that the attitude and practice of state member banks is different in this regard. Given this small amount of activity, it could be argued that no great harm or inconvenience would be caused (at least to banks) by the enactment of the prohibition of § 14. However, we believe that the stronger considerations and arguments are to the contrary.

First, the enactment of § 14 would represent a marked departure from the approach of past Congresses to the field of law commonly referred to as the usury statutes. Substantive regulation in this area has almost without exception been left to the states. In the absence of compelling necessity, we do not think it

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advisable to take what might become the first step toward a general federal usury law.

Secondly, we believe strongly in the principle that markets should be left free of any forms of price control, in the absence of compelling necessity. The traditional approach to the regulation of loan interest has been to impose only such controls necessary to protect the unsophisticated consumer. Interest rates on commercial loans have been left to find their natural level based on competition. The commercial loan segment of our free market has always been one of the most sensitive to changing money supply and general economic conditions.

Thirdly, the restriction of § 14 would apply only to banks, S&L's, their holding companies and insurance companies. The omission of mortgage companies, pension funds and other possible sources of construction and commercial loans. would give such lenders an obvious and unfair competitive advantage.

§§ 15, 16, 17, and 18. Insider Loans.

Section 15 would amend the Federal Deposit Insurance Act to require the following of insured banks:

(1) A report to the FDIC [for the purpose of placement in a public file] of the nature and amount of any loan to a director, officer or employee of the bank or any member of such person's immediate family.

(2) No loan to be made to any person acting as agent for another, except on condition that the bank be informed of the identity of the person receiving the beneficial interest of the loan.

(3) No loan to be made to any corporation of which 5% or more of the outstanding stock is owned in the aggregate by directors, officers or employees of the bank.

We believe that the statutory tools presently available to the supervisory agencies to combat self-dealing are adequate. These tools are described in our earlier discussion of Sections 2 through 9. The existing tools provide for more flexibility and fairness than the flat prohibition contained in the bill.

Also the interaction of the proposed public disclosure provision in Section 17(b) with the prohibition contained in Section 18 would result in an undue invasion of privacy of many bank employees and needless public disclosure of many harmless transactions. Section 22(g) of the Federal Reserve Act (12 U.S.C. 375A) as amended in 1967 expressly permits a member bank to make certain types of loans to its own executive officers. The permitted loans include a residential mortgage loan of up to $30,000; a children's education loan of up to $10,000 and a general purpose loan of not more than $5,000. We see no supervisory purpose to be served by requiring such loans to be made a matter of public record as does proposed Section 17(b).

§§ 19, 20, and 21. Brokered Deposits.

Sections 19 and 20 prohibit any insured bank or S&L from making any payment to anyone as compensation for obtaining a deposit for the bank or S&L. A payment made by a person other than the bank or S&L for the purpose of obtaining a deposit for the bank or S&L is deemed to have been made by the bank or S&L if it had or reasonably should have had knowledge of the payment when it accepted the deposit.

The acceptance of deposits and loans placed through money brokers has been a significant contributing factor to several bank failures in the past few years. All of the federal banking agencies now have outstanding directives designed to curb the practice.

We also support the principle of outlawing the troublesome aspects of brokered deposits by statute. In the national banks, the trouble causing aspect has been the acceptance of questionable out-of-territory loans from the money broker as a condition of his obtaining deposits for the bank. However, we understand that the FDIC has found other types of brokerage abuses in some closed state banks.

We therefore support in principle a prohibition of brokered deposits. We think it important, however, that the charter supervisor, or some other banking agency, be given exemptive and regulatory authority to define the terms used in the statute. There are a few compensated deposit gathering services which are unobjectionable and even essential in certain markets.

§ 22. Gifts to Attract Deposits.

This section would prohibit the practice of offering merchandise or other premiums to depositors as an inducement to make or add to any deposit.

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The use of merchandise premiums promoting retail deposits is presently closely limited by rulings of all the federal banking agencies. The banking agencies Coordinating Committee agreed some time ago to restrict the value of such premiums to a wholesome cost of $5 in connection with deposits of under $5,000 and $10 if the deposit is $5,000 or more.

It is our view that the existing regulatory approach to the giveaway problem is preferable to a flat prohibition since it provides a measure of flexibility to permit at least minimal competition to the benefit of the small depositor who at present is restricted to a much smaller percentage of interest than are depositors possessing over $100,000.

§§ 25, 26, and 27. Deposit Insurance for Public Units.

Sections would extend 100% insurance for deposits of federal, state and local governments in insured banks and S&Ls.

Exempting public depositors from the $20,000 limit on insurance would appear to conflict with the objective under existing law of providing protection for the savings of individual families of moderate income who frequently lack the technical ability to appraise accurately the soundness of available outlets for their funds, while maintaining the incentive to holders of large accounts to investigate institutions before placing deposits in them. Moreover, exempting one class of depositors from the limitation on insurance coverage could lead to pressures to extend the exception to other classes.

Local law now requires in almost all cases that public deposits be secured in full by the depositor pledging federal state or municipal bonds. Some states kill two birds with one stone by specifying that only home state bonds shall be eligible collateral for this purpose.

Adoption of Section 25 would eliminate any need for pledging and probably would have a substantial negative effect on the demand for municipal bonds, a market which already suffers from serious structural problems.

For these reasons we do not favor the adoption of Section 25.

H.R. 3287. Bank Stock Loans.

The bill flatly prohibits any insured bank from making a loan, the proceeds of which are used to buy any stock or bonds of any bank.

We understand the purpose of H.R. 3287 to be to stop the practice of one bank financing the take-over of control of another bank. However, the language of the bill goes much further and apparently prohibits any bank loan for the purpose of purchasing even one share of bank stock. This would make unlawful many, many routine loans for investment purposes. We know of no reason why an investor should not be able to purchase bank stock on margin in accordance with the prevailing margin requirements, in the same way as any other security.

Even if the bill were amended to prohibit only take-over loans, we feel that it would be still inadvisable for the following reasons:

(1) Our office, and we are sure other bank supervisors, have had occasion to call on a financially strong institution to finance the purchase of control of a faltering one. This bill would take away that supervisory tool.

(2) One of the principal problems inherent in take-over loans, is the almost inevitable sequel of some of the taken-over bank's liquid funds being transferred to the lending bank as an inter-bank deposit. This inter-bank deposit is often a prearranged condition of the take-over loan. The Department of Justice in a letter to the Banking Agencies has taken the position that the use of an inter-bank deposit as a compensating balance for a loan to controlling persons of the depositing bank, may constitute a misapplication of the depositing bank's funds. This position was made known to all banks by the federal banking agencies in a circular letter in October 1970.

We believe that the distribution of the Justice letter has been effective in minimizing one of the most troublesome aspects inherent in take-over loans.

We understand another concern behind H.R. 3287 to be the prevention of bank take-overs in general by undesirable persons through the use of funds borrowed from other banks.

This is a laudable purpose with which we as bank supervisors could not agree more. However, the bill draws no distinction between the desirable and undesirable purchaser-borrower. We fear that the effect of cutting off prospective desirable bidders for banks from the conventional source of financing might be to promote one of the very things the bill is designed to prevent—the use of underworld money by undesirable elements.

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It has been our experience that the great majority of bankers would never knowingly finance the take-over of another bank by dishonest persons. This is not to say that misjudgments have not and cannot occur. When one does occur, we feel that the tools presently available are sufficient to take care of the situation. Under the provisions of the Barr Bill, (12 U.S.C. 1817(i)(1)) passed in 1966, a bank which makes a take-over loan must notify the supervisory agency of the take-over bank. This serves to alert the agency to watch out for possible changes in management competence.

For the above reasons, we do not favor the adoption of H.R. 3287.

The CHAIRMAN. Mr. Ward, we shall be glad to hear from you. And you may proceed in your own way.

STATEMENT OF ALAN S. WARD, DIRECTOR, BUREAU OF COMPETITION, FEDERAL TRADE COMMISSION

Mr. WARD. Thank you, Mr. Chairman.

Mr. Chairman and members of the committee, it is a privilege for me to participate in these important and timely hearings, and to communicate to you the statement of the Federal Trade Commission on H.R. 5700 and H.R. 3287.

The Commission, as you know, has no jurisdiction in connection with the proposed bills, nor does it have any jurisdiction over banking generally. Section 5 of the Federal Trade Commission Act specifically excludes coverage of banks. And the Clayton Act's grant to the Federal Trade Commission of enforcement responsibility for the interlocking directorate prohibitions embodied in section 8 of that act also excepts banking and other regulated industry interlocks.

First, I would like to briefly read a short statement by the Commission stating its position on this legislation. The letter is from Chairman Kirkpatrick of the Federal Trade Commission, addressed to Chairman Patman:

Dear Mr. Chairman:

Thank you for your invitation to appear before the Committee on Banking and Currency to present the Commission's views on H.R. 5700, the Banking Reform Act of 1971, and H.R. 3287, a bill to prohibit federally insured banks from making loans to provide for the purchase of bank stock and for other purposes.

These proposals, amending three organic acts, deal primarily with banks and other financial institutions. As you know, none of these acts, nor banking in general, falls directly within the Commission's jurisdiction.

The Commission is interested, nonetheless, in the provisions in H.R. 5700 which are designed to control a number of business practices contributing to the trend toward concentration in our economy. I refer, principally, to the prohibition of interlocking relationships among financial institutions and between them and the business community in general.

The Commission has responsibility under the paragraph of section 8 of the Clayton Act which prohibits interlocking directories between competing corporations. This paragraph applies only to limited types of situations and, in the past, it has not proved easy to enforce. Commission orders have, in some instances, been circumvented by the employment of equivalent techniques, such as interlocking management personnel. Such techniques are not prohibited by section 8 of the Clayton Act.

Therefore, the Commission has previously recommended expansion of the section to embrace all significant management officials, indirect as well as direct interlocks, and vertical as well as horizontal ties.

The Federal Trade Commission considers that remedial legislation in the area dealt with by H.R. 5700 is in the public interest to the extent noted above, but withholds comment on the merits of any particular bill in view of the

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statutory exclusion of banks from the operation of the Federal Trade Commission Act.

By direction of the Commission.

MILES W. KIRKPATRICK, *Chairman.*

I thought it would be helpful, in addition to transmitting this view of the Federal Trade Commission on the particular bills, to comment generally on the Commission's experience in carrying out its responsibilities to enforce section 8 of the Clayton Act dealing with corporate interlocks.

The Clayton Act, as you know, was passed in 1914. It prohibited certain conduct which might tend to eliminate or suppress competition. Section 8 of the Clayton Act dealt specifically with interlocks, and prohibit interlocking directorates between competing companies engaged in interstate commerce.

Generally speaking, the concern behind section 8 was about the concentration of control of a large part of the American economy in a few hands. There was in addition concern about conflicts of interest. And there was also the feeling expressed that if interlocks were prohibited, there would be an infusion of new talent and new views into the management of the Nation's business.

Section 8 as drafted, however, did not give the broad mandate that was envisioned by the proponents of the legislation. It is generally conceded, I think, that insofar as industrial and commercial interlocks are concerned, section 8 has not accomplished its sponsors' objectives.

According to a staff report prepared by the House Judiciary Committee in 1965, enforcement of section 8 by both the Federal Trade Commission and the Department of Justice has been irregular and feeble. A major reason for the ineffective enforcement, as Chairman Kirkpatrick's letter indicated, is the presence of certain technical deficiencies in the statute itself.

First, it deals only with direct horizontal interlocks, that is, between directors of competing companies. It does not affect management interlocks, and thus it is relatively easy to avoid the statute's applicability. And where an investigation may be maintained by either the Commission or the Justice Department, a resignation usually is enough to blunt the investigation.

Second, section 8 as it now exists does not deal with vertical interlocks, that is, interlocks between buyers and sellers, even though such directorships may have an important influence on competition. For example, as I am sure you will recall, the Supreme Court held in 1957 that the DuPont Company's ownership of some General Motor's stock violated section 7 of the Clayton Act. An interlocking directorship between those two corporations—if it existed today, and we hasten to assure you it does not—probably would not violate section 8.

Third, the statute does not deal with indirect interlocks, that is, where an intermediate such as a bank or insurance company has directors on the boards of competing corporations.

Whether or not the law should completely prohibit management, vertical, or indirect interlocks may be subject to question. But the failure of section 8 to deal with such interlocks in any way has unrealistically limited the statute's coverage.

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In 1950, after a thorough study, the Federal Trade Commission submitted to the Congress a report on the extent and nature of corporate interlocks in the United States. The report's major conclusions were that interlocks were common among U.S. industrial corporations, and that they probably had some significant anticompetitive effects. They may have prevented companies engaged in parallel lines of production from invading one another's markets, for example. And there seems to be the possibility that such interlocks created communities of interest among corporations in different lines of endeavor.

Finally, and of particular interest to this committee, the commission concluded that interlocking relationships between manufacturing corporations and financial institutions constituted the most important series of interlocking relationships found, and also gave rise to the most extensive and apparently significant of the networks of interlocking relations.

The Commission then, and several times since then, has recommended that section 8 be amended. Most recently this was done in 1969 by the staff in connection with its study on conglomerate mergers.

It is unnecessary, of course to even mention to this committee how vital access to credit is to industrial and commercial competition. As a Federal Trade Commission economist testified before this committee in 1959:

> Banking, of course, is a critical part of our economy, and access to capital is one of the most crucial problems to all of industry. Any major intermingling of banking and industry surely poses serious problems for competition.

In my view, remedial legislation of the type posed here is in the public interest. I have no specific comments on the provisions of these bills; however, since they involve competitive issues in a market context where the Bureau of Competition is neither involved nor particularly experienced. I understand that officials of the banking agencies will testify on these aspects of the pending legislation.

Finally, one additional comment I would like to make. Despite the limited coverage of section 8, our broader jurisdiction under the FTC Act would permit challenge to interlocks under certain circumstances, but those circumstances would not include direct involvement of banks.

Thank you.

The CHAIRMAN. Thank you, sir. You may insert your entire statement at this point in the record, sir.

(The prepared statement of Mr. Ward follows:)

PREPARED STATEMENT OF ALAN S. WARD, DIRECTOR BUREAU OF COMPETITION, FEDERAL TRADE COMMISSION

Mr. Chairman and members of the Committee, it is a privilege for me to participate in these important and timely hearings, and to communicate to you the statement of the Federal Trade Commission on H.R. 5700 and H.R. 3287.

The Federal Trade Commission, as you know, has no jurisdiction in connection with the proposed legislation nor does it have jurisdiction over banking generally. Section 5 of the Federal Trade Commission Act specifically excludes coverage of banks. The Clayton Act's grant to FTC of enforcement responsibility for the interlocking directorate prohibitions embodied in Section 8 of that Act also excepts banking and other regulated industry interlocks. Enforcement of Section 8's banking provisions is lodged with the Federal Reserve.

The Commission, on the other hand, has had extensive experience with interlocking director problems, and my brief comments this morning will relate to that experience which may be of interest to the Committee in connection with the pending bills.

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First, let me insert into the record a letter from Miles W. Kirkpatrick, Chairman of the Federal Trade Commission, addressed to Chairman Patman, stating the Commission's position on the proposed bills. (The letter referred to appears at the end of this statement.)

Second, let me very briefly summarize some of the significant elements of the Commission's experience in enforcing Section 8 of the Clayton Act. The Clayton Act, as you know, was enacted in 1914 to deal specifically with conduct which did not violate the Sherman Act but which tended to restrain competition and lead to monopoly or monopolistic behavior. The Act specifically prohibited, among other things, price discrimination, exclusive dealing contracts, and acquisition of stock in competing corporations, where such practices might result in a substantial lessening of competition. Section 8 of the Clayton Act contained provisions prohibiting interlocking directorates between competing companies engaged in interstate commerce. The first paragraphs of Section 8 dealt with banking interlocks; commercial and industrial interlocks were dealt with in subsequent paragraphs of the Section.

Generally speaking, the prime concern behind Section 8 has been that interlocking directorates may tend to concentrate control over significant parts of United States commerce in the hands of a few individuals, and that such power inevitably would have anticompetitive effects. In addition, interlocks can raise conflict of interest problems. In 1913, Mr. Brandeis argued for this legislation to embody the fundamental law that "no man can serve two masters."[1] President Wilson, under whose leadership the Clayton Act and FTC Act were passed, foresaw that Section 8 would "bring new men, new energies, a new spirit of initiative, new blood, into the management of our great business enterpirses.[2]

Section 8, as drafted, did not give the broad mandate envisioned by Mr. Brandeis or fulfill President Wilson's lofty concept. Quite the opposite. It is generally conceded, I think, that insofar as industrial and commercial interlocks are concerned, Section 8 has not accomplished its sponsors' objectives. According to a staff report prepared for the House Judiciary Committee in 1965, "enforcement of Section 8 by both the Federal Trade Commission and the Department of Justice has been irregular and feeble."[3] A major reason for ineffective enforcement, I would point out, is the presence of certain technical deficiencies in the statute itself.

First, Section 8 deals only with direct horizontal interlocks, that is, common directors of competing companies. But it does not affect management interlocks of *any* sort—that is, where a management official rather than a director serves on the board of another corporation. Thus, it is relatively easy to avoid the statute's applicability.

Second, it does not deal with vertical interlocks, that is, interlocks between buyers and sellers, even though such directorships may have an important influence on competition. For example, as I am sure you will recall, the Supreme Court held in 1957 that the DuPont Company's ownership of some General Motors' stock violated Section 7 of the Clayton Act. But an interlocking directorship between those two corporations—if it existed today, as it does not—probably would not violate Section 8.

Third, the statute does not deal with indirect interlocks, that is, where an intermediate such as a bank or insurance company has directors on the boards of competing corporations. This, by the way, is not an unusual circumstance; indirect interlocks have been common even among dominant corporations in concentrated industries.

Whether or not the law should completely prohibit management, vertical, or indirect interlocks may be subject to question. But the failure of Section 8 to deal with such interlocks in any way, has unrealistically limited the statute's coverage.

The Federal Trade Commission submitted to Congress in 1950 a thorough and careful study of the extent and nature of corporate interlocks in the United States and of the limitations of Section 8 enforcement. The report's major conclusions were that interlocks were common among United States industrial corporations, and that interlocks probably had some significant anticompetitive effects, for instance, by preventing companies engaged in parallel lines of

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[1] Brandeis, *The Endless Chain,* Harpers Weekly, December 6, 1913.
[2] 51 Cong. Rec. 14,222 (1914).
[3] *Interlocks in Corporate Management,* Staff Report to Antitrust Subcommittee of the House Judiciary Committee (March 12, 1965), at p. 57.

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production from invading one another's markets, and by creating communities of interest among corporations in different lines of endeavor. Moreover, the Commission found that vertical interlocks may have created integrated groups of companies and tended to tie some manufacturers to specific outlets for their products. Finally, and of particular interest to this Committee, the Commission concluded that interlocking relations between "manufacturing corporations and financial institutions * * * constituted the most important series of interlocking relations found and also gave rise to the most extensive and apparently significant of the networks of indirect interlocking relations." [4]

The Commission then and subsequently has recommended amendment of Section 8. Most recently, in the 1969 *Staff Economic Report on Corporate Mergers* prepared by the Federal Trade Commission's Bureau of Economics, the Commission's staff urged that there should be new interlocking directorate legislation to amend Section 8 of the Clayton Act to deal with:

(1) Interlocks between competitors achieved by means of:

(a) Directors of one company acting as officers of another, and

(b) Directors of one company being large stockholders in another;

(2) Interlocks between potential competitors;

(3) Vertical interlocks between buyers and sellers, including industrial firms and various kinds of financial institutions providing lending or investment services;

(4) Indirect interlocks achieved through third party organizations of any form—whether partnerships, proprietorships, associations or corporations.

This Committee, of course, well knows how vital access to credit is to industrial and commercial competition. As a Commission Economist testified before this Committee in 1969:

Banking, of course, is a critical part of our economy and access to capital is one of the most crucial problems to all of industry. Any major intermingling of banking and industry surely poses serious problems for competition * * * [5]

In my view, remedial legislation of the type proposed here is in the public interest. I have no comments on the specific provisions of these bills, however, since they involve competitive issues in a market content where the Bureau of Competition is neither involved nor particularly experienced. I understand that officials of the banking agencies will testify on these aspects of the pending bills.

Finally, it should be noted that despite the limited coverage of Section 8, our broader jurisdiction under the FTC Act would permit challenge to interlocks under certain circumstances—not directly involving banks, however.

The CHAIRMAN. Is it correct, Commissioner Smith, that the SEC favors regulation requiring certain disclosures of investment and trading by financial institutions, including bank trust departments, on a regular basis?

Mr. SMITH. We do, sir.

The CHAIRMAN. Now, what percent of the New York Stock Exchange transactions would be covered by the institutional investors? I have heard different estimates, 50, 60, 70 percent. What would you say?

Mr. SMITH. It is in the area of two-thirds.

The CHAIRMAN. In the area of two-thirds.

What would you say, Mr. Camp?

Mr. CAMP. I think that is correct, sir.

The CHAIRMAN. What would you say, Mr. Ward?

Mr. WARD. I do not know.

The CHAIRMAN. Now, then, is it not true that there is public disclosure of some kinds of investments, of insurance companies, of mutual funds, but there is no disclosure at the present time of the largest

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[4] *Report of the Federal Trade Commission on Interlocking Directorates* (1951), at 27.

[5] Statement of Harrison F. Houghton, Chief, Division of Economic Evidence, Bureau of Economics, Federal Trade Commission, "Bank Holding Act Amendments," Hearings before the Committee on Banking and Currency, House of Representatives, Ninety-First Congress, First Session, Part 1, April 1969, p. 349.

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category of institutional investors, bank trust departments, there is no disclosure of that?

Mr. SMITH. There is no required public disclosure.

The CHAIRMAN. No requirement.

And we had an investigation 2 years ago and disclosed that there was about $253 billion of assets in bank trust departments, and fewer than 50 banks had over half of that. A recent disclosure indicates that the bank trust departments have more than $280 billion, and 19 banks have a majority of that. Were you aware of those figures, Mr. Smith?

Mr. SMITH. Yes, sir. The banks clearly are the most dominant institutional investors. I can't recite and confirm the specific figures you gave me, but there is no question that there is a higher degree of concentration among bank trust departments, and that they are dominant among the institutional investors.

The CHAIRMAN. Mr. Camp, you state that adequate bank supervision has prevented abuses of banks controlling large blocks of their own stock in their trust departments, and in preventing self perpetuation of management. If this is true, how do we have such notorious cases as the Cleveland Trust situation, where the management of the bank controls 35 percent of its own stock?

Mr. CAMP. Sir, I would like Mr. Miller to respond to that. But I think you are overlooking the fact, possibly, that most of the stock, own bank stock in trust departments of banks, is inherited through wills or other forms from individuals, it is not stock that is gathered in the open market.

The CHAIRMAN. You mean the banks inherited it?

Mr. CAMP. Yes, sir.

The CHAIRMAN. Isn't that rather unusual?

Mr. CAMP. I don't think it is unusual at all.

The CHAIRMAN. What percentage of it?

Mr. CAMP. I don't know the percentage, but I think there is nothing unusual; if a person has been dealing with a bank for many, many years, and has had a very fine relationship with them, and names that bank as trustee when he dies, I see nothing unusual about this. And if a person happens to have bank stock among the assets of his estate, I see nothing unusual about that.

The CHAIRMAN. I can see where a person connected with a bank would have an affectionate feeling towards the institution. But in the case of the customer generally I don't think that would hold true.

Mr. CAMP. I would not see why not. They have all the expertise, they have the legal background, the real estate background, and the investment background. Who would you suggest that he leave it to?

The CHAIRMAN. Maybe we haven't gotten our definitions straight. You indicate there in your last statement that they are just putting it in trust. That is entirely different.

Mr. CAMP. That is correct, sir.

The CHAIRMAN. The way I understood you to say it first is that the estate was left to the bank.

Mr. CAMP. No, sir. What I understood you to be questioning me about was whether a bank invested in the open market through its trust department in its own stock.

The CHAIRMAN. I am afraid we misunderstood each other, so we will not pursue that further at this point.

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Now, there seems to be a difference of opinion between the SEC and the Comptroller over the need for disclosure of certain stock holding and stock trading transactions by a financial institution including a bank trust department. The SEC feels that we need such disclosures on a regular basis, while the Comptroller would leave such disclosures to special studies such as the recently completed Institutional Investors Study. Is that a fair statement of the divergent views, Mr. Camp?

Mr. CAMP. I believe it is, although I would like Mr. Miller to speak to that.

The CHAIRMAN. I don't have time. We are restricting ourselves to 5 minutes on the first go-round. After that we will have plenty of time.

Mr. CAMP. All right.

The CHAIRMAN. Now, then, I want to ask just one question of Commissioner Smith. On page 17 of your statement you say: "It is relatively rare that a single bank trust department will hold a very substantial portion in any one company."

Yet your study pointed out the following percentage holdings in some of the Nation's largest companies by one bank trust department: Xerox, 5 percent; Gulf Oil, 15 percent; Ford Motor, 5 percent; Avon, 5 percent; Burroughs, 5 percent; International Paper, 10 percent; S. & H. Co., 10 percent; TWA, 10 percent; Texaco, 20 percent. How do you define substantial? Couldn't a 5 percent holding be substantial in many instances where the remainder of the stock is widely diffused?

Mr. SMITH. To answer the last part of your question first, yes, in a widely held security 5 percent can be a substantial holding.

As to the first question, what is "relatively rare," when we were looking at the some 800 stocks on which data were collected and not simply at banks but a number of other financial institutions, we characterized the incidence as relatively rare. And in some few cases that we inquired into there were situations such as Mr. Camp described as being "inherited," in the sense that they were family estates being administered by banks named as trustees under a will. And we do share the concern about mandatory disposition, given that set of circumstances. Indeed, that is one of the primary reasons why in our view we would propose at this point in time a general rulemaking authority on the part of the Commission to require disclosure, until we get some better feel of the impact of mandatory prohibitions.

The CHAIRMAN. Thank you, sir.

Now, then, I yield to Mr. Johnson.

Mr. JOHNSON. Thank you, Mr. Chairman.

I think we are honored by having these three brilliant gentlemen here this morning.

I want to go into this question of trust departments of banks. And I will start with you, Mr. Camp.

In all my career, both in school, college, and elsewhere, and as a lawyer, I have been taught that the only safe thing for a testator to do, where he has large holdings, and has maybe a closely held family business, or has stock in a company that he wants to perpetuate in his family, is to create a trust and name a banking institution trustee, because they have more longevity, they go into perpetuity, and all

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the safeguards that you as a testator want for your estate are reposed in a bank.

Now, isn't that pretty generally true, Mr. Camp?

Mr. CAMP. Absolutely, sir.

Mr. JOHNSON. And isn't that the reason that we have banks operating trust departments today?

Mr. CAMP. Yes, sir. I think if you eliminated that choice, a bank or bank trust department, you would be eliminating something which is very popular today, and quite in the news, and that is the "freedom of choice" of an individual.

Mr. JOHNSON. That is to say, he can name any bank he wants to be his trustee?

Mr. CAMP. Or anybody else.

Mr. JOHNSON. Or anybody else. An individual if he wants to?

Mr. CAMP. Even a lawyer.

Mr. JOHNSON. Now, another point. When you establish a trust the rule against perpetuity, of course, says that you can only establish a trust during life or lives in being and 21 years and 9 months, which includes the period of gestation, which has to be, of course. So trusts are for that reason terminating every day throughout the banks in this country; are they not?

Mr. CAMP. Absolutely.

Mr. JOHNSON. As a result of this inducement and this safeguard to a testator to name a bank as his trustee, have you in the Office of the Comptroller received, let us say, widespread abuses by banks in voting stock as the Chairman of this committee infers?

Mr. CAMP. No, sir. We are very careful about that. As a matter of fact, there is a statutory prohibition against it.

Mr. Patman mentioned the Cleveland Trust Company, which is not a national bank. And we have found no significant abuses involving the voting of its own stock in its own trust department by the national banks, it is prohibited by statute, it is spelled out there.

Mr. JOHNSON. This act says that if the stock has been previously registered by the SEC—I believe the rule is that any issue above $300,000 has to be registered, so this ruling would cover practically every company of any size in this country that has to go before the SEC before they issued their stock. It would be a pretty far-reaching rule, would it not?

Mr. CAMP. I think it would be too far-reaching, sir.

Mr. JOHNSON. The statute says that if the trust department had 10 percent of the stock of a company that previously had registered with the SEC, they couldn't, let's say, vote the stock.

Mr. CAMP. They couldn't even accept the trust, as I understand it.

Mr. JOHNSON. Now, what would people do, then, that have family owned corporations, or have stock in the companies which they don't want to see divided among improvident children, let's say, what would they do if this law would prevail, if this passes, sir?

Mr. CAMP. It would be very burdensome, sir. It would certainly eliminate their freedom of choice, and one of the accepted means of establishing a trust.

Mr. JOHNSON. It would turn the business to the corporation trust companies and companies which are not banking institutions but which are fiduciaries, is that correct?

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Mr. CAMP. That is correct.

Mr. JOHNSON. So you would have the same trouble with that type of ownership or fiduciary relationship?

Mr. CAMP. That is right. As I understand it, if a bank had an aggregate in its trust department of 9 percent of a stock subject to this statute, and I as an individual had dealt with that bank over many years, and established a very close relationship with them, and wanted to name the bank trustee under my will, and I happened to have 2 percent of that stock which I had accumulated over time, the bank would have to say that they could not accept my account. This would seem to me to be almost unconstitutional.

Mr. JOHNSON. Thank you. My time has expired.

The CHAIRMAN. Mr. GONZALEZ?

Mr. GONZALEZ. Thank you.

This is a question for Commissioner Smith. In studying all of the various interlocking relationships, the SEC report concluded by saying "that the likelihood that these functional interrelationships between banks and portfolio companies will occur entirely by chance is extremely remote." Now, the Domestic Finance Subcommittee of this committee, in its report on bank trust departments, indicated that the Mellon National Bank has four interlocking directorates with Gulf Oil Company, as well as managing 10 pension funds of that company, when the trust department held over 15 percent of the common stock of Gulf Oil. It also shows that Morgan Guaranty having one interlocking director, and managing one pension fund of Texas Gulf Sulfur, while holding 10 percent of their common stock. Is it your opinion that these examples are illustrative of this lack of coincidence?

Mr. SMITH. I don't know whether those particular examples and the percentages that you indicated are typical. Certainly the general phenomenon of existence of multiple relationships where a single banking institution performs these many different functions does exist, and exists in a very consistent way.

Mr. GONZALEZ. In chapter 15 of your report you indicate that only 10 bank trust departments hold between 10 and 15 percent in companies worth $19 million. The report goes on to say that the data portrays the potential dominance of a relatively small group of large banks over portfolio companies. In view of their potential dominance, why does the report then conclude and say "It does not follow that the institutions will necessarily act together or that the influence of one institution will be augmented through concerted activities"? Is there any real basic statistical predicate for that statement?

Mr. SMITH. There is an absence of a statistical predicate for stating the contrary. In the case of a single institution such as the examples you gave, such interrelationships may exists. There are also questions, of course, of who dominates the financial institution; the flow of power as between industrial companies and financial institutions is not altogether clear in many instances. The statistical corelationships that the study developed do not indicate causative factors. And I think that was what we were attempting to say, that the extent of the analysis to which the study proceeded was simply the establishing of statistical correlations, and we did not go through to the establishing of causative factors.

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Mr. GONZALEZ. I see.

So while there may be a tendency to conclude one way, actually statistically—you don't have statistics to prove it either way?

Mr. SMITH. There is a limitation as to what statistical evidence can prove or disprove. It is my own view that this kind of analysis helps to focus the problem, but it does not necessarily represent the solution to it.

Mr. GONZALEZ. In your institutional report you recommend the full disclosure?

Mr. SMITH. Yes, sir.

Mr. GONZALEZ. How often would you suggest?

Mr. SMITH. That can vary. This, of course, was the Commission's first effort at systematically collecting data from banks and from other financial institutions with which we have had no prior contact. Our experience in developing that data, collecting that data, was a difficult one, because we have been accustomed to the kinds of data that investment companies provided to us. Their forms of record-keeping, aggregations of data, were different from other institutions. So that it is not a simple process to dictate what kind of data should be provided, how often, and in what way. Our primary concern here is the impact of institutional investors on equity markets and the information to these markets. That would, I think, indicate that we would like to see more, probably like to see more frequent reporting than annual. We require investment companies to report this kind of information on a quarterly basis.

Now, given the very heterogeneous mix of funds which banks administer, personal trusts, corporate trusts, pension funds, and trusts with many different characteristics in terms of the authority of the trustee to manage—they are very individualized instruments—it is not a very simple task to require, with reasonable regard to the burden on the reporting institution, how often and in what form such reports should be made. We are quite sure in our own mind that such reports should be made. But we would like to have the general rulemaking authority to take account of the heterogeneous accounts that particularly banks have.

Mr. GONZALEZ. I believe your answer does explain the difficulty of precisely fixing the specific frequency of reporting, and all.

I am sure you are familiar with the Texas developments with respect to the SEC proceedings and the insurance companies.

Mr. SMITH. Yes, sir.

Mr. GONZALEZ. There is a common saying in Texas, as a result of all of that, that if you had the same strict requirements with respect to these interpersonnel director dealings that the SEC governs with respect to corporations in the issuance of stock and securities, with respect to bank transactions, you wouldn't have had some of these developments such as the closing of the Sharpstown Bank, and so forth; is that true? Is there any substance to that?

Mr. SMITH. I would like to respond to that. I think first, Mr. Gonzalez, you appreciate that this is a litigative situation. So I feel myself precluded from discussing that particular situation here.

In general, it is not a fair description to say that the Securities and Exchange Commission regulates loans to affiliates generally with

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corporations that are registered with us. Our general regime is simply one of disclosure, and through the means of registration statements and periodic reports and proxy statements, we require disclosure of material transactions with affiliates.

With respect to investment companies, our powers go beyond that of disclosure. There are prohibitive and regulative provisions in the Investment Company Act which the Commission administers with respect to that one type of financial institution. And there are provisions there generally prohibiting transactions among affiliates except where the Commission finds that it does not involve overreaching or unfair transactions with respect to the financial institution.

As I understand, the testimony that was given yesterday—and I have not had an opportunity to read it, so I am basing this on newspaper reports—the views of the banking authorities who testified then sounded to me comparable to the kind of control, but with the flexibility of administrative treatment, that the Commission has with respect to investment companies.

Mr. GONZALEZ. One little followup question. That is exactly what I was trying to get to.

Now, in your field do you have discretionary authority in supervising these disclosures with respect to acquisition and the like, or do you have total power of prohibition?

Mr. SMITH. With respect to noninvestment companies and nonpublic utility holding companies, our powers relate only to disclosure. We also do have antifraud enforcement powers; obviously if there is a fraud involved in our securities transactions, that comes within our enforcement powers. But in terms of prohibiton, we have no such powers, except with respect to investment companies and the public utility holding companies. And there the general statutory format has been in essence to prohibit such conflicting transactions, except to the extent that the Commission finds, under general standards, that they do not in any way impair the operations of that financial institution, or are unfair or against the public interest.

Mr. GONZALEZ. Suppose then instead of a bank it were an insurance company, and the insurance company diverted a substantial percentage of its capitalization for the acquisition of some other corporations, and from a good management standpoint, and from a Securities Exchange Commission standpoint, it would look like a dubious thing, what would you do about that, if anything?

Mr. SMITH. Absent fraud on investors only require disclosure with respect to insurance companies, some of which are exempt from certain parts of our statutes.

Mr. GONZALEZ. Thank you very much.

Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Stanton?

Mr. STANTON. Thank you, Mr. Chairman.

The CHAIRMAN. Let's try to restrict the time to 5 minutes so that all of us can be given an opportunity to question.

Mr. STANTON. That is a good idea.

Mr. Smith, in your colloquy with the Chairman you seemed quite emphatic when you made the statement that bank trust departments are the largest institutional investors, which is a fact. Do you believe this is wrong?

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Mr. Smith. No, I don't believe it is "wrong." There are many kinds of concentrations in American business generally. And given the existence of very large businesses, one would expect very large financial institutions. I would not say that it is wrong. There are certain aspects of that concentration that we would like to explore with the banking authorities, because we are quite conscious of our limited knowledge and expertise in the policies behind the banking system, which is a very complex mechanism.

There are some things which are a little difficult for us to understand, such as, at least in some States, the requirement that a trust company, a corporation that wants to engage in trust operations, must also engage in comercial banking operations, and vice versa. Those we are not quite sure we understand at this point. And we do plan to have some discussions with banking authorities in some of these areas where perhaps it is a matter of our being better informed, but where we have initial questions.

Mr. Stanton. You know, in this numbers world in which we live, somebody is always first and somebody is always the largest. Would you rather see some other type of an organization the largest institutional investor?

Mr. Smith. No, I can't say that I have preferences one way or the other. The commission's role is not to determine those kinds of allocations, but simply to try to preserve to the degree possible the fairness of the securities market. I think, generally speaking, that the more, different decision centers there are with respect to security markets, the stronger these markets are.

Mr. Stanton. Do you have within the Commission the authority to go into the trust departments of banks to find out any information that you wish to ascertain?

Mr. Smith. We have no inspection or examination powers with respect to banks, which are administered by the various bank regulatory agencies. We do have subpena powers in connection with enforcement actions involving securities frauds or manipulations and, so that we do have——

Mr. Stanton. Have you ever been turned down by a financial institution on a request for information you desired?

Mr. Smith. Oftentimes a financial institution will feel that a confidential relationship exists with its customer and will not voluntarily provide information to us. And they might quite properly at that point ask to be given a subpena so that they will be under a legal mandate to provide the information.

Mr. Stanton. They do the same thing with the Banking and Currency Committee.

Mr. Camp, I want to compliment you on your statement. One thing that you do for the committee members which is of great value is, to make a section-by-section analysis. And I like to see that in the statements that we get.

Will it be a fair statement to say that—and I have not read your complete statement here this morning—that you feel that 80 or 90 percent of the bill before us, H.R. 5700, is either unnecessary or is covered now by the regulatory agencies having the authority?

Mr. Camp. Yes, that is a fair statement, sir.

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Mr. STANTON. I believe you said that it is section 11 of the Federal Criminal Code which makes it a criminal offense for a financial institution to offer or give a bribe to any employee of a customer or potential customer of a bank. And you went on to state that you don't think this is necessary, and in all your years you have never heard of it being used.

Mr. Chairman, I think it would be appropriate to put it in the record at this time if the committee has any evidence or reason to believe that banks, savings and loans or other types of institutions have been guilty of abuses in this area.

Mr. Smith, you disagreed with Mr. Camp when it comes to the subject of trust department reporting. Mr. Camp makes the general statement that the accumulation of additional information would be cumbersome and very expensive, especially for the small banking institutions. H.R. 5700 covers only a yearly report, and you would want it more frequently than that.

Do you think that there is some basis for Mr. Camp's objection to this that it would be too expensive?

Mr. SMITH. I am sure Mr. Camp has a good basis for any position he takes. But we may disagree about some things with respect to reporting. I assume Mr. Camp obtains all the information he needs for the regulatory responsibility he has. The Commission's concern is one of making sure the securities markets and public investors have such information as they may need. And perhaps that is a somewhat different focus, bias if you will, perspective that the Commission has with respect to reporting that may not strike the bank regulatory agencies as being in their particular field.

Mr. STANTON. Mr. Ward, I was just wondering, once again getting to your statement, about section 8 of the Clayton Act. As I understand, it, only national banks are affected under section 8 at the present time on interlocks in communities in which the banks are located, intracommunities. My question is, if it is true, has the Federal Trade Commission ever recommended to Congress that other financial institutions are covered under this act?

Mr. WARD. Even as to the banks that are covered, the Federal Trade Commission has no jurisdiction under the first part of section 8 of the Clayton Act which deals with banks. The only part of section 8 of the Clayton Act that the Federal Trade Commission deals with is the part that deals with corporate interlocks, which is a subsequent paragraph. We have nothing to do with the banking interlocks.

Mr. STANTON. Thank you, Mr. Chairman.

The CHAIRMAN. May I state in reply to your question as to whether or not the committee had any evidence along the lines of the bribery matter that was decided that there was a situation which came to our attention during the investigation of the Penn Central matter which has been regarded as a commercial bribery case. It involved obvious preferencial treatment by a major New York bank in connection with a loan, a loan to Penn Central officials. There is evidence to show that this highly professional treatment was granted in order to keep Penn Central business in the banks. Of course, it is a highly lucrative oper-

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ation to the banks, and I don't blame them for wanting the deposits, and especially the free deposits. According to your statement, Mr. Camp, in the last 2 years the banks have had about $225 billion of the free use of money through demand deposits. And therefore this is a very important matter. It is our understanding that New York law enforcement officials are investigating their action as a possible violation of its commercial bribery statutes.

This would seem to me good evidence that the Federal statute covering interstate transactions should be seriously considered.

Mr. STANTON. Mr. Chairman, I am interested in that bribery case. Was it a case where a bank was soliciting business, or attempting to keep the customers away?

The CHAIRMAN. We are in no position to take the time of the other members at this point. But we shall be very glad to document it. We assure you that the Penn Central case was a terrible case, and it leads to lots of things that should be stopped.

Mr. WILLIAMS. Mr. Chairman, I should like to make the observation that there is already a law against what the Penn Central and the New York banks were reputed to have done.

The CHAIRMAN. Mr. Gettys.

Mr. GETTYS. Thank you, Mr. Chairman.

Mr. Ward and Mr. Smith, following up some of the previous interrogation, would you put restraints upon a testator or a trustor in naming a banking institution or other financial institution as a trustee?

Mr. CAMP. I didn't get your question.

Mr. GETTYS. Would you put any restraints on a testator or a trustor in naming a bank or other financial institution as a trustee?

Mr. CAMP. No, sir, I would not. I think that would be depriving a person of his constitutional freedom of choice.

Mr. GETTYS. Would you put any limitation on the amount of trust property that a bank or other financial institution could represent?

Mr. CAMP. No, sir, I would not. I think you have come to a very basic question here, and that is, are our holdings, our large holdings, in and of themselves an abuse strictly because of concentrations?

Now, when we find abuses in this fashion, where we detect them we report them to the proper agents.

Mr. GETTYS. We have some serious questions in the Congress. If I were a banker, which I am not, would I have conflict of interest in serving on the Banking and Currency Committee?

If I am a lawyer, which I am, would I have a conflict of interest in serving on the Judiciary Committee? If I were a farmer, which I am, would I have a conflict of interest in serving on the Agriculture Committee?

There are very serious questions inside and outside the Congress. Would you place any restrictions on a bank trustee taking commissions in dealing with the trust estate property of its own stock; that is, of the bank stock?

Mr. CAMP. Yes, I would.

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Mr. GETTYS. Would you not permit the trustee to take a commission on dealings with the bank stock which you sell to the trust?

Mr. CAMP. They are prohibited by statute in dealing with their own stock. The only way that the bank can have its own stock in any manner is for a debt previously contracted, or to be the recipient in kind through a trust estate.

Mr. GETTYS. But do not State laws in most instances restrict your dealings with the banks?

Mr. CAMP. That is right, although I am quite surprised that a number of States allow banks within their States to purchase directly stock of other banks. Pennsylvania is one. And Louisiana is another. And there are others.

Mr. GETTYS. I appreciate the fact that you would even let a lawyer be a trustee. But there again, State law covers that. But would it be proper, do you think, for a trustee who is a lawyer to practice law for the trust?

Mr. CAMP. One who is a trustee for other parties outside the ——

Mr. GETTYS. No. Suppose that a trustee is a lawyer, should that laywer represent that trust estate?

Mr. CAMP. I see no reason to preclude that.

Mr. GETTYS. For a commission or a fee?

Mr. CAMP. Outside the bank?

Mr. GETTYS. Yes.

Mr. CAMP. I see no reason to preclude that. I think most lawyers are honest people.

Mr. GETTYS. What I am worried about in this—and there are many things, Mr. Chairman, in this bill that I have no objection to, and which I think would lend themselves to proper regulation of banks and other institutions—but the presumption is that everybody is crooked. Wouldn't it be better to presume that everybody is honest and go from that standpoint?

Mr. CAMP. That is correct, sir.

And I think one thing that has failed to be pointed out here is that as far as investments of banks are concerned through their trust departments, there is set out actually in the trust indenture itself, the type of investments that banks through their trust departments can acquire. And it is not the bank in any case going helter-skelter. We require that they follow the terms of the trust instrument very carefully. And in most States there is a so-called list of legal investments for trust accounts.

Mr. GETTYS. Thank you, sir. My time has expired.

The CHAIRMAN. Thank you.

Mr. Blackburn.

Mr. BLACKBURN. Thank you, Mr. Chairman.

Mr. Smith, I am sure that you are aware that existing State laws generally require full disclosure by fiduciaries as to their holdings and their activities each year. You are aware of that, are you not?

Mr. SMITH. By the fiduciary?

Mr. BLACKBURN. Yes.

Mr. SMITH. Yes.

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Mr. Blackburn. And so before we enact legislation which would require extensive and very expensive burdens on banking institutions and anyone else who might be dealing with stocks, wouldn't it be advisable to have the SEC make a study as to existing reporting laws and whether or not they might be adequate for your purposes?

Mr. Smith. We have such a survey, Mr. Blackburn. The appendix to chapter 1 of "The Institutional Investor Study" does reflect such a survey. And chapter 5 has a rundown of the State requirements in this area. One of our purposes, in fact, is to reduce the duplicative burden that a number of financial institutions have in reporting to various regulatory authorities.

There is always a cost-benefit equation with respect to disclosure. Any disclosure system costs some money. And the question is: Is the public benefit great enough to justify it? We have reached a conclusion that the benefit of increased reporting, increased disclosure, by the largest financial institutions, including banks, justifies the cost.

The inflexibility of trying to do this by statute, it seems to me, might tilt that equation to the extent of making it more costly than beneficial, and that is why we have proposed that the Commission be given rulemaking authority to require disclosures. Our interest is in informing public investors about it. And to the extent that reporting to the Commission could be incorporated with the bank or regulatory authorities who may want more information in certain areas, we would make every attempt to do that in the exercise of our rulemaking authority, with a very conscious effort to reduce duplicative reporting.

Mr. Blackburn. As I interpret your response, then, this bill, in your opinion, would go further than you think is necessary at this time?

Mr. Smith. It goes further in some respects in the rigidity of the requirements. It does not go as far in other respects, in that we would like such reporting by financial institutions in addition to banks, and we would like the flexibility, perhaps, to require the reporting with respect to transactions, and perhaps more frequently than annually.

Mr. Blackburn. I think that directs my next question to Mr. Ward.

As I recall your testimony, Mr. Ward, you feel that section 8 of the Clayton Act may need some change. Now, aren't we really dealing with the question of jurisdiction right now? If we are going to enact the present law, the one that is before the committee, we are extending the jurisdiction of the FDIC very broadly into perhaps the antitrust area. In your opinion, don't you think it would be more manageable and more applicable to extend the authority of section 8 and extend the jurisdiction of the Federal Trade Commission, rather than inject a new agency into antitrust legislation?

Mr. Ward. Insofar as the interlocking provisions of section 8 that deal with banks, I think the Commission—I am not positive about that, but I doubt that the Federal Trade Commission has taken a position that it should be given jurisdiction over interlocks among banks such as covered by this bill. The only reason I went in on our experience under section 8 is that I think it does reveal that there are certain troublesome aspects of dealing with this on a flat prohibition basis, unless it is fairly broad.

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Mr. BLACKBURN. But don't you think it would be more manageable to allow the FTC to manage such an area rather than thrust the FDIC into this new role?

Mr. WARD. Now, I really don't have a position on that. I don't know what it would mean for FDIC to get into this area, because they certainly will not have any jurisdiction of matters that the Federal Trade Commission has.

Mr. BLACKBURN. Mr. Camp, as I interpret your statement—and I am in agreement with Mr. Stanton here—we shouldn't scratch a place that doesn't itch. Your testimony points out that perhaps we are creating some strawmen as evils in the banking institution, where really the evils don't exist when you look at the actual operation of the institutions. Am I right in that interpretation?

Mr. CAMP. Absolutely, sir.

Mr. BLACKBURN. My time has expired.

The CHAIRMAN. Mr. Annunzio?

Mr. ANNUNZIO. I have no questions. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Williams.

Mr. WILLIAMS. Thank you, Mr. Chairman.

I want to compliment all three of you gentlemen for your testimony, and I want to thank you for being here.

I think that your statement, Mr. Camp, has been a very comprehensive statement. You have put your finger on some of the things which are really wrong with H.R. 5700. On page 2 of your testimony, where you are commenting on interlocking directorates, you say that rather than handle things in the manner in which this bill suggests, you think it would be most detrimental to the public interest to curtail the use of scarce executive management talent in the way prescribed by H.R. 5700. Would you care to elaborate on that, sir?

Mr. CAMP. Yes, sir. I think if this bill is carried to its ultimate, if it prevails, what you would have in banking would be an in-house board of directors. And I think that the banks are entitled to have the expertise of the outstanding men in their communities representing all segments of the economic life of their communities on their boards of directors. I don't think they should be deprived of that. If they are in a cattle area, I think they ought to have cattlemen on the board. If they are in an agricultural area, they ought to have the agricultural people. Or the automobile dealers, and any outstanding men. And I presume—and I have found it almost always true that when a man goes on a board of directors, he is an honest man.

Mr. WILLIAMS. On page 7 of your testimony you state that the accumulation of a vast storehouse of abstract data of this nature called for by section 12 will not be of material aid in detecting or bringing appropriate corrective action in case of abuse. I certainly am inclined to agree with your viewpoint. I think that the cost, as you stated in your statement, could not possibly, be justified.

Mr. Smith, when a bank buys stock for a trust account, is the bank buying the stock to exercise control over a company or a corporation,

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or is it buying the stock for investment purposes for the benefit of the trust account?

Mr. SMITH. I assume that the general purpose would be the latter. It is not always a simple matter to break a question such as that down. We have found institutional involvement in transfers of control to be fairly considerable, not necessarily for the purpose of a bank assuming control, but participating in transfers of control to somebody else, and therefore assisting in the control transfer effort. But as a general matter, certainly any investment fiduciary should be buying for investment purposes.

Mr. WILLIAMS. Mr. Smith, section 14 prohibits insured banks, insured savings and loan associations, mutual savings banks, bank or savings and loan holding companies and insurance companies from obtaining any equity participation for making a loan.

Use of debt securtities convertible into stock or with warrants for purchase of stock has long been accepted as a useful form of corporate finance typically resulting in lower interest costs to the borrower.

For instance, about a month ago I noticed an ad for new offerings of debt securities by Pennzoil United, Inc. The company offered $75 million of 25-year debentures at 100¼ with an interest rate of 8⅜ percent. At the same time the company also offered $50 million at 25-year subordinated convertible debentures at 100 with an interest rate of only 5¼ percent.

Had the company been denied the use of convertible debt securities it is clear in this case the company would have had to pay at least 66 percent more interest than was necessary with funds borrowed on a convertible basis.

Would you not agree that the flat ban on so-called equity kicker financing works to force up interest costs for borrowers denied this financing device with the lenders covered by this section of the bill?

Mr. SMITH. It wasn't clear to me, Mr. Williams, at least from a strict reading of the language of the bill, that it included convertible securities. You could see how one might construe the language to include that. But let's assume that it does. Whether you are talking about convertible securities or debt with warrants, I would think that a flat prohibition of this kind would inhibit the flexibility and ingenuity of raising money for American industry, and would as a result have a counter productive effect.

Mr. WILLIAMS. It would really be an adverse effect.

Mr. Chairman, I ask unanimous consent that this Pennzoil United, Inc. advertisement be made a part of the record.

The CHAIRMAN. Without objection, it is so ordered.

(The advertisement referred to follows:)

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Pennzoil United, Inc.

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The CHAIRMAN. Mr. Bevill.

Mr. BEVILL. Thank you, Mr. Chairman.

Mr. Ward, I believe in your testimony your one recommendation is that we expand section 8 of the Clayton Act, and that this would be in the public interest to do this. Is this the only recommendation you have as far as this legislation is concerned?

Mr. WARD. I think the position of the Commission is that we believe that legislation of the type proposed by H.R. 5700, with a prohibition of interlocking directorates on a direct horizontal basis, is in the public interest, and the general concept of that type of legislation is in the public interest.

Now, whether the specific terms of these bills are designed to carry that out in a proper way within the banking context is something that the Federal Trade Commission has no expertise in.

Mr. BEVILL. It struck me that of the five basic areas that H.R. 5700 covers, that you really make only the one recommendation, am I correct on that? In other words, you are not recommending the provisions about the broker deposits, or expanding the insurance coverage, you have no recommendations on any of those?

Mr. WARD. No.

Mr. BEVILL. You are making one recommendation, and that is to expand section 8 of the Clayton Act, is that right?

Mr. WARD. I don't think that the legislation would have to be within the context of section 8 of the Clayton Act. I think section 8 of the Clayton Act, certainly in the industrial and commercial area, is outmoded, that it should be amended extensively. As far as it relates to banks, I think the same defects are apparent, and should be changed.

Mr. BEVILL. And you are not sure that the way this bill is worded that this is the best way to do it?

Mr. WARD. I am not sure, because our jurisdiction doesn't include banks, and there may be—for instance, on the equity kicker, if that were in the commercial field, I have no doubt that it would violate the antitrust laws. But there may be situations in banking where a flat prohibition of that type of practice might prohibit other things that are perfectly proper.

Mr. BEVILL. Mr. Smith, out of the five basic laws that are covered by H.R. 5700, I believe that you stated that two of them were not within your jurisdiction. And I wonder, did you endorse any of the other three?

Mr. SMITH. With respect to the disclosure requirements——

Mr. BEVILL. Your testimony is that you favor the provision as to disclosure?

Mr. SMITH. Not quite. We favor the concept of disclosure of institutional holdings and institutional transactions, but we would prefer, rather than a flat requirement that such information for banks be filed with FDIC, a general rulemaking authority on the part of the SEC to require disclosure from all institutional investors. We think that the flexibility of a rulemaking power would permit us to focus on the cost-benefit equations with respect to particular areas of disclosure. I would be very strongly in favor of the thrust of that provision toward disclosure.

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Mr. BEVILL. Of the five areas that the bill covers, there is one that touches on a subject in which you are interested, but you don't really go along with the way it is proposed.

Mr. SMITH. Right.

Now, in the conflict of interest provisions, while the Commission has no general position with respect to those, we also are generally favorably disposed toward provisions which deal sensibly with conflict of interest questions. And we pointed to the type of regulation in that area which the Commission performs with respect to investment companies.

Mr. BEVIL. Thank you.

Mr. Camp, on these five basic areas here, have you had any occasion in your vast experience as Comptroller of the Currency to run across instances where the public interest was not protected under the existing law?

Mr. CAMP. No, I have not.

Mr. BEVILL. Do you know of anything that this bill would do to protect the public interest?

Mr. CAMP. I don't believe, sir, that this bill contains any facets in law which are not now available. There are many legal tools which are presently available. The common and statutory law of corporate and fiduciary responsibility would provide effective civil remedies to aggrieved shareholders. In addition to this potential civil liability, questionable or improper actions of any bank director are subject to scrutiny, control, and effective sanctions by the bank supervisory agencies.

In addition, section 22 of the Federal Reserve Act, and regulation O issued thereunder, control loans to executive officers.

A very powerful deterrent to self-dealing practices in institutions with more than 500 shareholders is the public disclosure requirements imposed by the Securities Act Amendment of 1964. The hand of the Federal banking agencies in controlling conflicts of interest was greatly strengthened in 1966 by the passage of the Financial Institutions Supervisory Act. That act empowered the agencies to issue a cease-and-desist order against any practice deemed detrimental to sound banking.

The philosophy under sections 2 and 9 appears to me to be one of suspicion of the integrity of the average businessman and of the average banker. And my own 35 years with the Office of the Comptroller of the Currency has not led me to any such conclusions.

Does that answer your question?

Mr. BEVILL. That answers it. My time is up.

Mr. BARRETT (now presiding). Mr. Crane.

Mr. CRANE. I have no questions.

Mr. BARRETT. Mr. Hanley would have been next according to the sequence here, but he was called to the telephone. So we will recognize Mrs. Sullivan of Missouri.

Mrs. SULLIVAN. Thank you, Mr. Chairman.

I have several questions—they are very short—for Commissioner Smith.

In section 32 of the Banking Act of 1933, member banks are prohibited from having interlocking relationships with broker-dealers. Do

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you favor broadening this prohibition to all insured financial institutons as set forth in H.R. 5700?

Mr. SMITH. We have taken no position on that, Mrs. Sullivan. We are quite satisfied with the provision as it affects broker-dealers in the Glass-Steagall Act. We have taken no position with respect to that area beyond broker-dealers.

Mrs. SULLIVAN. Would you really have any jurisdictional interest in studying this question, to see whether or not your concern should extend to the practices of the other insured financial institutions?

Mr. SMITH. We do not interpret our jurisdiction as going to that question. That is a matter of the administration of the banking statute, which is done by the banking agencies, and we did not examine that question itself.

Mrs. SULLIVAN. And you don't think it relates to the information that you need or should have when making decisions on investments, or anything else concerning regulated institutions?

Mr. SMITH. We certainly see the desirability for the disclosure of such relationships, with respect to disclosures to shareholders in banks. I don't know to what extent the disclosure requirements under the 1964 amendments as promulgated by the Comptroller of the Currency get into that area. I am not familiar with that.

Mrs. SULLIVAN. Doing a little studying, as I have, on the relationships of bankers serving as directors of insurance companies, or savings and loans, or other institutions, and vice versa, and seeing some of the failures in some of these areas and losses to the owners of the stock of these institutions, I would think that the SEC would have some kind of jurisdiction, or really should have knowledge of this interlocking relationship.

Mr. SMITH. Mrs. Sullivan, you appreciate that our function with respect to banks is quite limited. They are exempted from most of the statutes that we administer. And the disclosure requirements that are applicable to banks under the 1964 amendments are administered by and reported to the bank regulatory authorities themselves.

Mrs. SULLIVAN. I have one other question for you, Mr. Smith. As your excellent report on institutional investors noted, the percentage of holdings of common stocks by institutional investors is clearly on the rise. And in view of this trend, don't you think that it is advisable to clearly separate the investment role from the management role, so that the financial institution does not dominate portfolio companies?

Mr. SMITH. I am not sure, Mrs. Sullivan, that I understand what you mean by separating the investment from the management role. I don't know if you mean separating the trust investment functions from the commercial banking operations or whether you are talking about an issue that is very current in the securities industry of separating investment management functions from brokerage functions. I am not sure what you are focusing on.

Mrs. SULLIVAN. For instance, under the One-Bank Holding Company Act, we were trying to separate the banking business from any other business that the holding company might be performing. Now, with the institutional investors investing so much, and growing as large as they are, should they be permitted to also get involved in the management of portfolio companies, as well as do the investing?

Mr. SMITH. The industrial companies?

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Mrs. SULLIVAN. I am thinking of managing the companies in which they invest as well as the investing.

Mr. SMITH. Yes. Under the 1940 act we do get into such questions. There is of course, a line to be drawn between an institution whose function is investing and an institution who gets into the controlling of operations. Most investment companies, other than perhaps SBIC's, most investment companies do refrain from controlling operations of companies in which they invest. And, I think, that historically has been the position of bank trust departments as well. There have been cases, such as Cleveland Trust, that have raised questions in that respect, but as a general matter we do not see the phenomenon of financial institutions in fact controlling operations of industrial companies.

Mrs. SULLIVAN. Thank you. My time has expired.

Mr. BARRETT. Thank you, Mrs. Sullivan. Mr. Rousselot.

Mr. ROUSSELOT. Mr. Camp, on page 5 you refer to the substantial risk of liability involved in serving on a board of directors. You have referred to that again in your answer to other questions. Could you expand upon why you brought this into your testimony?

Mr. CAMP. Because, No. 1, I want to emphasize again that I think the banks are certainly entitled to have on their boards the outstanding business and civic leaders of their communities. And it is not without some sacrifice that a man goes on the board of directors of a bank. It is not all "picking peaches." There are liabilities, some severe ones. There are liabilities for making improvident loans. There are liabilities for making excessive loans and, where losses occur, or investments. So that it is just not an honorary position. A man has to be a dedicated, thoughtful person, with great integrity, before he goes on the board of directors of a bank.

Mr. ROUSSELOT. As I recall, in Michigan there is presently a lawsuit involving a bank where the officers and directors may find themselves liable on certain questions. So they are really subject to scrutiny under several proceedings if they act improperly in the management of these funds or these type portfolios, is that not correct?

Mr. CAMP. That is correct, sir.

Mr. ROUSSELOT. And really aren't we here presuming that we need Federal laws because the statutes are not adequate, when really in fact we might even be preempting some State laws?

Mr. CAMP. Sir, in all candor I believe that we do have—and speaking now for the national banking system—ample Federal law. There is an elaborate set of statutory, judicial, and administrative apparatus which exists to control abuses of competitive processes.

As for the use or abuse of inside information, it is also specifically outlawed by existing Federal statutes, supplemented by strict judicial interpretations. And I refer now to the provisions of the law administered by the Securities and Exchange Commission as interpreted by the *Texas Gulf Sulfur* decision.

So we are very careful in our examining process to see that there are no concentrations of credit to officers, directors, or employees of a bank. We have a specific section of our examination report which would be very critical of that situation if it represented a concentration, No. 1, or if, No. 2, it does not represent a concentration, but rep-

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resents an extension of unsound credit. So we follow it very carefully indeed. And if we find conditions like this existing in a national bank, we have ample authority under the provisions of the cease and desist statute to stop it.

Mr. ROUSSELOT. Thank you.

Mr. BARRETT. Thank you, Mr. Smith.

Mr. Stephens, I know you are a very representative member of this committee, but Mr. Hanley, I think, arrived here much earlier. So I will recognize Mr. Hanley.

Mr. HANLEY. Thank you, Mr. Chairman.

Mr. Camp, I believe you have described the interlocking provisions of this bill as being too drastic. I wonder if you might cite some examples where you might think that interlocking prohibitions would be necessary or appropriate.

Mr. CAMP. I think, sir, that we have cited them. I believe that, for instance, within the same general area, the same competitive environment, that one could well prohibit the director of a bank serving on the board of directors of a savings and loan association, and vice versa, the director of the savings and loan association serving on the board of a bank. But that would still go to the same test which applies to banks in the Federal law. In other words, it would not be reasonable, in my opinion, to say that an individual serving on the board of directors of a bank in New York, and maintaining, say, 6 months of the year a home in Florida, that he couldn't be on the board of a little savings and loan association in Florida. So I think we have got to apply the same test now that we did to banks. And I think that is very amply protected.

Mr. HANLEY. If I read you properly, what you are saying is that there actually isn't any valid reason for the language in this particular section of the bill.

Mr. CAMP. Absolutely, sir.

Mr. HANLEY. I believe you further said that about 90 percent of the provisions contained in the legislation are already covered. That leaves about 10 percent apparently which might be appropriate for us to legislate on. Could you tell us what this 10 percent might encompass?

Mr. CAMP. Yes, sir. Basically it would go to, if the Congress in its wisdom wants to do away with "giveaways"—which I don't think it should, but I have no really basic feeling on it, after all, the consumer is entitled to something—we could set limitations on that.

And there is another one here, the "brokered deposits." That one, I think, maybe is a little too severe. There is nothing really wrong with any type of deposit. It is the human action, the use of the money that gets you into trouble. But I have no strong feelings on brokered deposits, except to say that I think that now this bill is a little bit too narrowly drawn, and that there are some legitimate long-term concerns dealing with broker deposits. But I would certainly make it a violation to have a brokered deposit tied into a loan, specific loan. That is where the troubles have come from.

Mr. HANLEY. Wouldn't it be fair to say that the broker deposit is in actuality a circumvention of regulations?

Mr. CAMP. I don't think that you could say that all broker deposits are, no, sir. Some are, very clearly.

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Mr. HANLEY. The major percentage would be a circumvention, isn't that fair to say?

Mr. CAMP. No, sir. I don't believe that to be a fair statement, because there are some very fine firms which do deal with larger certificates of deposit. It is the "fly-by-night" operator who generally comes into a very small town, and through the use of a certificate of deposit imports money to which is attached a loan generally far out of the natural trade territory of the bank, that gets that bank into trouble, and nine times out of 10 there is collusion at the time between the banker and the person who brings the certificate in to the bank. It is a criminal action, really, it is a conspiracy.

Mr. HANLEY. If I may relate back to the matter of interlocks again, you have cited as an example an interlocking director of, say, a New York City bank serving on the board of a small bank in Florida. How would you treat a situation where a New York City banker is sitting on the board of a major banking institution, say in California, San Francisco, or Chicago, how would you treat that sort of situation?

Mr. CAMP. Well, under the present law that would be permissible.

Mr. HANLEY. But is this healthy?

Mr. CAMP. I don't think that I would object to a prohibition against that in a major bank. But you would have to define very carefully what constitutes a major bank. And if you are seeking to merge——

Mr. HANLEY. We are talking about a major institution.

Mr. CAMP. I don't know what position the Justice Department would take. I don't know that the courts would say that these particular banks are actually competing.

Mr. HANLEY. I know that time is running out on me.

I have a question for Mr. Smith relating to page 6 of his testimony.

Mr. Smith, on page 6 you say that the SEC has recently come across situations which indicate that broker deposits may create a situation dangerous to banks and their depositors.

Mr. BARRETT. Would that gentleman yield to me?

Mr. HANLEY. Mr. Chairman?

Mr. BARRETT. Would you be desirous of having the question answered in writing?

Mr. HANLEY. That would be fine.

Mr. BARRETT. To whom are you submitting the question?

Mr. HANLEY. To Mr. Smith.

Mr. BARRETT. Mr. Smith, would you be willing to answer his question in writing?

Mr. SMITH. I am not sure he completed the question.

Mr. HANLEY. It has to do with your testimony on page 6 where you say "We have recently come across situations which indicate that broker deposits may create a situation dangerous to banks and their depositors." I would appreciate it if you could expand upon that in writing to the committee.

Mr. SMITH. With the Chairman's permission, I would like to give a response to that now, which will be quite short.

There are enforcement actions pending involving that situation, and it is for that reason that I would respectfully like to decline to speak further on it. It does involve loan situations such as Mr. Camp described earlier.

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Mr. HANLEY. It does involve matters already under litigation?

Mr. SMITH. Yes.

Mr. HANLEY. Thank you. I withdraw the question.

Mr. CAMP. Could I expand on that just one moment, please, sir?

Mr. HANLEY. Yes.

Mr. BARRETT. Mr. Camp, would you be kind enough to yield to me?

Mr. CAMP. Yes.

Mr. BARRETT. We are running short, and the gentleman has consumed about 5⅛ minutes, plus 10 others. If you make your answer short we can proceed here.

Mr. CAMP. Thank you, sir.

I would like to point out that the 19 banks which have failed since January 1, 1969, represent 0.00137 percent of the total number of insured banks, and those banks held about 0.00041 percent of their total deposits.

Mr. HANLEY. You are a mathematical genius. Thank you.

Thank you, Mr. Chairman.

Mr. BARRETT. The gentleman's time has expired.

Mr. McKinney.

Mr. MCKINNEY. Mr. Camp, do you see any reason why there shouldn't be mutuality of some members of boards of directors? Take an industrial town of 150,000 or 250,000 people. Do you see any reason why the same man or men, at least some of the same men should not serve on both the board of a commercial bank and a mutual savings and loan institution?

Mr. CAMP. Sir, I believe if you considered them in the context that I do, as competitors, that this legislation should extend to the directorships of banks, savings and loan associations, and mutual savings banks.

Mr. MCKINNEY. Do you consider them to be competitive?

Mr. CAMP. Yes, sir, I certainly do, although the Justice Department doesn't seem to go along with my view.

Mr. MCKINNEY. I resigned from the board of a mutual savings bank because I thought being on this committee was a conflict of interest.

Mr. CAMP. A great many mutual savings banks own banks, particularly in Massachusetts, and other States. Was that your case?

Mr. MCKINNEY. No, it was not.

Just for the record, I would like to state that I think the public in general sometimes has a feeling that a bank director rides in a Rolls-Royce and gets a large paycheck. I think my pay was $40 a month.

Mr. CAMP. That is right.

Mr. MCKINNEY. Yes.

Mr. BARRETT. Mr. McKinney, would you just yield to me at this point?

Mr. MCKINNEY. Yes.

Mr. BARRETT. I think Mr. Camp in an earlier statement here said that in his 30 years he has heard of very few dishonest bankers.

Is that accurate?

Mr. CAMP. No. I said that in my 34 years I have never heard of a banker bribing somebody to open an account with a bank.

Mr. BARRETT. That wouldn't be dishonest if he did?

Mr. CAMP. I would say it would be dishonest, but I know of no case like that, sir.

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Mr. BARRETT. Did you read the paper this morning about the Edenton Bank where the president and four stockholders had used $200 million of the bank's money?

Mr. CAMP. $200 million?

Mr. BARRETT. Yes, sir.

Mr. CAMP. Did he bribe anybody, sir?

Mr. BARRETT. It is in the paper this morning.

Mr. CAMP. I understand that. But I thought your question was, did the man bribe anybody to do business with the bank?

Mr. BARRETT. That probably will come out in the trial, don't you think?

Mr. CAMP. I would think it would. But I would be very surprised if the banker bribed anybody to do business with the bank.

Mr. BARRETT. I don't want you to be surprised, I just want you to be knowledgeable of these things.

Mr. CAMP. I am knowledgeable, sir.

Mr. BARRETT. I don't want to consume the gentleman's time.

Mr. McKinney, thank you for yielding.

Mr. MCKINNEY. Mr. Camp, would you consider it to be wrong for a mutual savings bank, where there was a limitation on a participation, to own stock in a commercial bank within the same State or even within the same community?

Mr. CAMP. Sir, I would like to defer that to my counsel, Mr. Bloom.

Mr. BLOOM. I believe the position in the statement on that question, Mr. McKinney, was that we think that any restriction on mutual savings bank stockholderships should parallel the restriction on interlocking directorates generally. Whatever is thought desirable in that way should also be the rule for the stockholders.

Mr. MCKINNEY. The reason I ask this question is that I find myself as an ex—and I underline it—mutual savings bank director, and I was of that opinion, but I am begining to wonder, that a mutual savings bank was basically a nonprofit bank organized to allow home loans in the main, that we had a responsibility to achieve the largest single return for our depositors, and to facilitate our loaning money in the housing market. And the reason I asked this question is that when I look at a portfolio I found it very hard to find any gold chip or blue chip stock that will return to a mutual savings bank the 6.5, 6.2, or 5.7 percent that a gold chip well-run commercial bank will return.

So that I think there is somewhat of an area here of conflict in the fact that we are charged, or a board is charged, with maintaining the best possible rate of return on safe investments that we possibly can in a mutual savings bank, and yet if we limit them in commercial bank stockownership we are cutting the single highest return gold chip stock that they can possibly own out of their portfolio.

Mr. CAMP. I see your point, sir.

Mr. BARRETT. Thank you, Mr. McKinney.

Mr. Brasco.

Mr. BRASCO. I would like to start—because I don't know when I will get the chance again—by making an observation for the record, in response to something that was said by my colleague, Mr. Williams, yesterday when he called this the bank destruction act of 1971. I am one of the cosponsors of this piece of legislation. And I am not a co-

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sponsor because I am interested in destroying the banking industry. But I think that the areas that the bill cover are some areas that we have all found to be abused from time to time. And that is why a greater degree of regulation is sought in these particular areas. And I find it almost amazing how every time we have a bill that has something to do with the banking industry how the industry reacts to it, as if we were talking about regulating the use of their own money. You see, it is not their money that we are talking about. We are talking about something that is known as the public's money. And that is what is in the bank, the public's money. And we give to the banks the franchise to use that money. It is a public trust. And I think that we have a right to look into these matters with this legislation without having it being called destruction when we seek to regulate institutions that manipulate the public's funds.

And now that I have that said, I would like to ask Mr. Camp some questions on the question of interlocks.

Mr. Camp, I don't claim to profess any great expertise in this area, but you mentioned several times that the reason why this provision of prohibiting interlock arrangements between financial institutions, is invalid is because of the lack of talent, and that the institutions involved should have the best talent available. Are you seriously suggesting that we don't have any talent to serve as members of the board of directors of these institutions other than having to borrow talent from other insitutions?

Mr. Camp. Sir, I repeat, I think that a bank—I know that you have outstanding men in your congressional district, men of great integrity, of great business success, leaders in the community, established leaders.

Mr. Brasco. But a lot of them never get a chance to be a board member. It seems to be a well-defined clique, members of one company or one bank—serving in multiple capacities. I can make some recommendations as to individuals who would make good board members.

Mr. Camp. Do you know any bank directors now that you feel shouldn't be on the boards by reason of their lack of ability or integrity?

Mr. Brasco. That is the fallacy, if I may say so, of your observations. I am not here accusing anyone specifically. I am talking about areas that have been abused and have a potential of being abused in an area where public funds are involved. And I am not specifically accusing an individual. But I think it would be a better system if we allowed more people to participate as members of the boards of these various institutions. And I don't think that the argument that there is insufficient talent is a good one. If there is, then we had better start developing some talent to make a healthier system. And I think that service should be spread around, as some of the committee assignments are trying to be spread around in the Congress. That is not to say that the other people who had them are not intelligent and capable people, but it is a healthier situation when you start to spread the action around. Don't you think that should be done here?

Mr. Camp. Let me say here, under the statute, the board may have a minimum of five directors or a maximum of not more than 25. Would you be in favor of expanding that, say, to 50 or 75?

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Mr. BRASCO. You see, the thing that I am concerned about, Mr. Camp, without being put in the position of making specific accusations against individuals, and what I think the bill is alluding to, very simply, is that there is a very distinct possibility of creating an unhealthy situation where you have all of these interlocking directorships. And very simply, it is not a question of our making more seats available or not, the real issue is, very simply, should we have these men sitting on the boards of so many institutions, so many different institutions, and is it a legitimate response to say there is a shortage of talent? I don't think there is a shortage of talent. And as you say, there are certainly capable businessmen in my district, and I can bring in a load of them if you would be willing to help me place them or give them recommendations to go on as members of the boards of financial institutions.

My time has expired.

Mr. BARRETT. Do you desire to ask a further question?

Mr. BRASCO. No.

Mr. BARRETT. You have a little more than 30 seconds left if you are perpared to use it.

Mr. BRASCO. No, thank you.

Mr. BARRETT. Mr. Stephens has come in. Mr. Koch was before him, but he went out to make a phone call. And due to his absence we will now turn to Mr. Stephens.

And Mr. Stephens, incidently, if Mr. Koch comes in, we will have to recognize him before Mr. Chappell.

Mr. STEPHENS. Thank you, Mr. Chairman.

Mr. Chairman, I would like to say one thing to follow up what Mr. Brasco has mentioned.

It is true that the commercial banks have an advantage in having the deposits, the demand deposits, and it is a use of it they make of public money. But it is not just as simple as Mr. Brasco and Mr. Patman have said. In spite of the fact that banks have the use of that money, they do provide a very valuable service in keeping my books and your books, and they provide a very valuable service in protecting your money, because without the banks you would be putting dollar bills in a can and sticking it under the chickenhouse like it was done 50 years ago.

I would be glad to yield.

Mr. BRASCO. I agree with you. And I think that is the crux of the argument. In keeping my books and your books and everybody else's books, we want to see that we keep them correct.

Mr. STEPHENS. That if fine. I didn't want the impression to be left that the banks were just using funds without performing a service, and that we were letting banks milk the public without paying them for demand deposits.

Getting back to the subject on hand, I agree with the testimony that has been given today. First of all, the gentlemen have said that in their field they could not rightfully try to answer some of the points involved here. And I am glad you didn't attempt to do so, because that could cause some confusion for us.

I refer to the testimony of Mr. Camp, am I correct in my understanding that you feel that this is not truly a bank "reform" bill, because we already have limitations? We have gone over that ever

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since I have been on this committee time and time again. We went over the same area when we talked about creating thrift institutions, and the conflicts of interest that were supposed to be inherent in the interlocking directorate. Now, actually as far as I have been able to see, a bank director who was also a director of a savings and loan has only two fields in which he could possibly have a conflict of interest. The first one is, the bank and the savings and loan are both competing for the savings of people, and that could be a conflict. Now, the second conflict that I can see is possibly, if a bank director is also on a savings and loan board, then he would be prone to say, "Let's don't let the savings and loan expand into writing checks and into the whole field of commercial banking." That seems to me to be the only places where you might have a conflict of interest. And that, of course, could readily be resolved, and is resolved, because according to my understanding of the Federal Home Loan Bank Board, if you make an application for a new charter you are supposed to outline the people that are going to be on that, and they will object very strenuously and won't grant you permission to form a new savings and loan association if you have an overabundance of bank directors, knowing that there is the possibility of conflict in the whole area of competing for savings and the purposes for which commercial banks are formed.

As far as the conflict of interest are concerned, what I am about to say is not quite in the testimony here, but I thought I might bring this forward, because so much has been said in the last couple of years about people who are on this committee who have stock in national banks. I think if that is a conflict that you can carry the conflict of interest to the extent that you can say that there is a conflict of interest that I should not have a bank or savings and loan deposit because I belong to this committee.

The second idea, if you carry it to that absurd position, is that if, as a member of the Banking and Currency Committee, I have a savings account in a savings and loan, I have greater conflict of interest when I sponsored—which I have done—legislation that provides for flexible interest rates than by owning bank stock because the interest is guaranteed to be paid. Now, that is a conflict of interest that you don't have when you have bank stock. Bank stock pays in the form of dividends only when the earnings are there. There is no guarantee that I, as the owner of bank stock, will get 1 penny as a result of that. I think that being a member of this committee and being a director in a bank or a savings and loan is definitely wrong, not because of a conflict of interest, but because I have got the responsibility of discharging the duties of this office and also the duties of a directorship, and I would neglect one or the other. My objection is not necessarily because of a conflict of interest as to the subject matter, just the fact that I have got a fiduciary relationship to fully discharge to both jobs.

And I know, to finish my time, Mr. Chairman, that as far as the State of Georgia's laws are concerned, the director of a bank can be held responsible for the actions of the bank, and he has not got a defense that he was not there and didn't vote on the proposition, or that he was not in attendance. He can be liable for his acts of omis-

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sion, for failure to do his duty, as well as for doing it in the wrong fashion.

Mr. CAMP. Correct.

Mr. STEPHENS. And he can be held financially responsible for the actions of the board of directors, and he can't say, well, I wasn't there when it happened.

Mr. CAMP. That is absolutely correct, sir.

Mr. STEPHENS. Thank you.

Mr. BARRETT. Thank you, Mr. Stephens.

Mr. Chappell?

Mr. CHAPPELL. I have no questions, Mr. Chairman. I will yield to Mr. Brasco if he would like to ask more questions.

Mr. BRASCO. If it is all right, I would like to ask Mr. Smith this question. On page 27 of your statement, Mr. Smith, you suggest the procedure whereby exceptions would be permitted with regard to the insider loan situation. I am wondering exactly what kind of a procedure you are suggesting that should be followed in this area. Are you making a proposal wherein the insider loans would be prohibited unless a formal application were made to the appropriate regulatory agency for an exception, rather than permitting them to go along with the requirements to disclose such loans?

Mr. SMITH. No. The former. The Investment Company Act operates in that manner, a general prohibition, but permitting exceptions to be made upon application and hearing, if necessary, and determination by the Commission that the transaction is not unfair or overreaching.

Mr. BRASCO. I am not thoroughly familiar with that. I am wondering if you can elaborate on what you mean by "hearing," if anything.

Mr. SMITH. Public hearing.

Mr. BRASCO. If any. I assume that that is discretionary.

Mr. SMITH. Yes; we will notice it for hearings. And if somebody asks to appear at a hearing, then the hearing is held. Oftentimes under delegated authority, if no one requests a hearing, we determine it on the record without——

Mr. BRASCO. Who would have to request a hearing, Mr. Smith?

Mr. SMITH. Any interested person; for example, a stockholder or creditor of the financial institution.

Mr. BRASCO. I am not familiar with this. You will have to forgive me; you are sort of losing me. How would the interested person know that such an insider loan was contemplated, and how would he know so that he could request a public hearing on the matter? What kind of notice would they receive under this plan?

Mr. SMITH. Under the Investment Company Act we publish the notices as public releases, and they are distributed to people who are on our mailing list, and to the company itself, and they are on the public record.

Mr. BRASCO. But not necessarily all the people that may be involved?

Mr. SMITH. There are not direct mailings to every conceivable person that could be interested; no. But it is a matter of public record. And to the extent that it is feasible to give publicity to that notice, it is done.

Mr. BRASCO. Do you think that that is adequate, then, on something that could be as potentially dangerous as an insider loan?

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Mr. SMITH. I think the primary reliance is upon the Commission's determination that this is not an unfair or overriding transaction. I don't mean to indicate that we simply publish a notice, and, if no one appears, it is then approved. In a number of cases the staff will demand a hearing on its own motion, because it wants to get further matters introduced in the public record.

Mr. BRASCO. One more question for Mr. Smith.

I am not suggesting in all of my remarks that we shouldn't have any trust in the Commission or other people in the regulatory agencies. But I think the problem is—and I think my colleague, Mr. Stephens, pointed out—that the public is getting the wrong idea of what is going on here. And I think that if you explain a plan such as the one you explain on page 27 to the general public, and tell them about that kind of notice, their reaction is what we see today, because it is just very difficult to get notice, in my opinion. I am an attorney, and I know that you just don't get notice to people by doing it the way you suggested. And I think the public is becoming sophisticated enough to know that, too. And that is why they have so many doubts about what we do, not so much that what we do is wrong per se, but that the public is beginning to understand that there are too many shortcuts in the system, that maybe we would rather not have a hearing on a matter, not because there is anything wrong with having a hearing, or that the hearing would disclose anything wrong, but just because we don't want to waste the time to do it. We will have to start getting away from that thinking if we want to reeducate the public in terms of getting their support for all of our institutions.

Mr. SMITH. Mr. Brasco, that is why I think the best way to do it is to have the general prohibition. I think the reason that you permit the administrative agencies to make exceptions within standards laid down by the Congress is because there is a rigidity about the prohibition where there may be transactions quite favorable to the institution from which they would otherwise be prohibited from engaging, and where the forum for a public test and staff examination and Commission determination, that it is not unfair or overreaching, serves to eliminate the possibility that free and easy exceptions would be made. I am certainly in no way indicating that we do that. Indeed, the staff has told me that they cannot remember an instance where an investment company even applied to make a loan to an affiliate.

Mr. BRASCO. Thank you.

I want to ask one last question of Mr. Camp.

On page 2 of your statement, Mr. Camp, you recite section 8 of the Clayton Act which prohibits interlocking relationships between a member bank of the Federal Reserve System and any other bank located in the same city as such member bank in any city, town, or village contiguous or adjacent thereto. I assume you would agree with that.

Mr. CAMP. Yes, sir.

Mr. BRASCO. My question is, it would seem to me that when this was initially drawn it was drawn to take us to a point—but I think when they drew it they were talking with an attitude in mind that did not take into consideration the fact that financial institutions with interlocking relationships compete on a nationwide basis. I think when

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they first drew up that piece of legislation they were obviously talking about a horse and buggy kind of approach to finance.

So with that in mind don't you think that should be broadened in some way?

Mr. CAMP. I would have to study that. I would certainly like to have you testify on that before the Justice Department in an antitrust suit involving the bank mergers. They will, in an antitrust suit, confine the competition to a county or contiguous counties where the bank could branch, and thus far they have utterly failed to recognize that there are broad competitive geographic considerations.

Mr. BRASCO. That may be so, Mr. Camp, but I am asking you if you don't think it should be broadened.

Mr. CAMP. Sir, I would have to study that. And I don't know on what basis you would broaden it. Would you have banking districts, or what did you have in mind?

Mr. BRASCO. I am admittedly not an expert. And I am a cosponsor of this bill because I think that there are areas that need regulating. And you were saying that 90 percent of the bill is unnecessary for one reason or another, and I am trying to find out who is correct here. We heard some testimony from Mr. Martin and Mr. Wille, who have some degree of expertise, certainly far greater than mine, and they agreed with more sections of the bill than you agreed with. And obviously we are involved in some differences of opinion among the experts, and I am more interested in your reaction to whether we should expand section 8 rather than my own opinion.

Mr. CAMP. Sir, it certainly seems to me that it is a well-known fact that our office doesn't always agree with the views of the Antitrust Division, the Department of Justice. But I don't think that anyone, and least of all our office, could fault them for lack of zeal or conscientiousness in pursuing their statutory assignment where they think a merger of banks is anticompetitive, I believe they have the statutory authority now.

Mr. BRASCO. So you don't think that there are any changes necessary, then?

Mr. CAMP. I don't believe that the Justice Department would think so. They certainly filed suit.

Mr. BRASCO. I know that. And I don't mean to get involved in that. You have said twice the Justice Department doesn't think so. But do you think so, sir, or do you agree with them? That is all I am trying to find out. I am not trying to fault anyone, but to get your opinion as to whether or not you agree with the Justice Department that this should remain the same, or we should change it, that is all.

Mr. CAMP. Sir, it is my understanding that the administration is presently developing a proposal which would correct any existing deficiencies without disrupting legitimate business relationships. And under this approach the regulatory agencies would be given authority to regulate interlocks to protect the public from anticompetitive situations, or any other abuses.

Mr. BRASCO. So it is a fair assumption, I take it, that the administration thinks that we should get to a paint, statutorily speaking, by regulation where we go beyond section 8 of the Clayton Act?

Mr. CAMP. That may be the case, sir. I haven't seen the proposal.

Mr. BRASCO. Thank you.

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Mr. BARRETT. Thank you, Mr. Brasco.

Mr. Smith, Mr. Ward, and Mr. Camp, you have been three very fine and very patient witnesses. And we are grateful for your presence here this morning.

All time has expired. The committee will stand in recess until 10 a.m. tomorrow morning.

Thank you.

(The following are written questions submitted by Chairman Patman to Mr. Camp, along with Mr. Camp's answers:)

Question 1. You cite as an example of an innocuous interlocking directorate a New York City banker serving on the board of a small bank in Florida. How would you treat a situation where a New York City banker it sitting on the board of a major banking institution in Chicago or San Francisco?

Answer. Our general feeling is that there should not be any interlocking directorates between banks in actual direct competition with each other. In the case of the few large banks which do business nationwide, the rule should be the same.

We understand that the Administration is working on a proposal which will include this principle, as well as provide administrative flexibility to deal with unusual situations.

Question 2. While you state that some strengthening of the law on interlocking directorates is desirable, you seem to take the approach of leaving most of the disclosures as to the coverage of such interlocks to administrative regulation, is that correct?

Answer. We are not sure what is meant by "the disclosures as to the coverage of such interlocks." The bill itself does not deal with the question of interlocks by requiring disclosures; the bill contains express prohibitions against all interlocks between eight categories of institutions.

We understand that the Administration will propose specific alternatives to the complete prohibitions of the bill and that these alternatives will provide for administrative discretion to deal with atypical situations.

Question 3. You raise the question as to whether a 10 percent limitation on the holding of any particular securities by a bank trust department would cause serious problems in connection with family-owned corporations. However, the provision establishing such a limitation, in order to prevent an over-concentration in specially traded securities by a trust department of a bank, would be unlikely to effect family-owned corporations, since the provision is limited to stocks registered under the Securities Act of 1933. Isn't that correct, Mr. Camp?

Answer. No, as was pointed out by SEC Commissioner Smith during his testimony, the tying of the trust limitation to securities registered under the Securities Act of 1933 would produce rather whimsical results. The 1933 Act requires prior registration before the public sale of any security, with some exceptions. There is no general exception for family-controlled corporations. For example if a family, owning 100% of a corporation having a single class of stock, decided to sell 20% of their stock to the public, it would have to file a registration statement under the 1933 Act. Under Section 13 as written, it would appear that in the event of death in the controlling family or for any other reason, it would be impossible for a bank to assume fiduciary control of the family interest.

Question 4. On page 6 of your testimony, you state you know of no instance of commercial bribery involving a bank. You also state that some States make commercial bribery a crime. First of all, it should be noted that not all States make such an activity a crime. Secondly, it must be some sort of a problem, because a large state with numerous banking institutions like New York does have such laws.

There is a situation that came to our attention during the investigation of the Penn Central matter which may be regarded as a commercial bribery case. It involves obvious preferential loan treatment by a major New York bank, in connection with a loan, and a group of businessmen including several Penn Central officials. There is evidence to show that this highly preferential treatment was granted in order to keep Penn Central business in the bank. It is our understanding that New York law enforcement authorities are investigating this action as a possible violation of its commercial bribery statutes.

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This would seem to be good evidence that a Federal statute covering interstate transactions should be seriously considered. What is your view of this?

Answer. As you know, the Committee staff interpretations of the facts and circumstances involving Penn Central have been vigorously disputed by some of the banks and others named in the reports. These facts and circumstances are presently the subject of numerous investigations and lawsuits. Until such time as at least some of the disputed issues have have been resolved, we do not think that the Penn Central case provides a sufficiently clear foundation on which to base legislation.

Question 5. Equity Participation. On page 11 of your statement you say: "It is apparent from our sample that national banks are not making equity participation loans to any significant degree. Given this small amount of activity, it could be argued that no great harm or inconvenience would be caused (at least to banks) by the enactment of Section 14.

On page 12 you say:

". . . The restrictions of Section 14 would apply only to banks, savings and loans, thier holding companies and insurance companies. The omission of mortgage companies, pension funds and other possible sources of construction and commercial loans would give such lenders an obvious and unfair competitive advantage."

Are you saying that you recognize that equity participation in general is a problem within the financial industry as a whole, and that the bill should be amended to achieve broader prohibitions in this area?

Answer. No. It is my belief that the equity participation loan has not created a substantial problem either for the financial industry as a whole or for commercial borrowers as a whole. I am saying that if the Congress decides to prohibit equity participation loans, in fairness it should prohibit them for all types of lenders who have engaged in the practice.

Question 6. In 1962, your predecessor as Comptroller of the Currency received a report from his Advisory Committee on Banking. This was a very prestigious committee including such well known banking figures as Donald M. Graham, Chairman of the Board of the Continental Illinois National Bank of Chicago; George S. Moore, President of the First National City Bank of New York; and Frank E. McKinnney, Chairman of the Board of American Fletcher National Bank of Indianapolis, Indiana. This distinguished Committee recommended, and I quote, "The prohibition of present law on interlocking directorates should be made applicable between banks, savings and loan associations and mutual savings banks, whether chartered under Federal or State law."

Do you agree or disagree with the recommendation of this distinguished committee:

Answer. I agree whole-heartedly. As I stated in my prepared statement. "We support an expansion of the present statute to cover any of the eight types of financial institutions within the same geographic boundaries as are now contained in the Clayton Act."

Question 7. On page 8 of your statement you say:

"These limitations [contained in Section 13 of H.R. 5700 regarding holding more than 10 percent of any class of stock in any corporation] would be of questionable benefit. They would eliminate certain conflicts of interest and limit the potential for concentrations of control of corporations by banks through their trust departments."

Would you please elaborate on this. What conflicts and what concentration of control?

Are you saying we have to have conflicts of interest and concentrations of control for the sake of professional corporate fiduciaries?

Answer. Your paraphrase of our comment does not properly reflect its entire scope. "These limitations" refer to all of Section 13, including the prohibition on ownership in a bank's trust department of that bank's stock or that of its parent holding company. The conflicts of interest to which we are referring are those which are the subject of Section 9.12 of Regulation 9. They arise when a bank owns its own stock or that of an affiliate in a fiduciary capacity. As you know, Regulation 9 prohibits the holding of such stock unless the customer who establish the account has specifically authorized it. Its purpose has been to enable this office to ensure that a bank does not act improperly when it is placed in this position. This has been a concern of the examiners of this office. The concentration of control to which the statement refers is that which exists when a control-

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ling interest in a corporation is held in a trust account. This usually occurs in trust departments in the case of closely-held family corporations.

The outright prohibitions of H.R. 5700 upon ownership of stock of the trustee bank or its holding company, even when authorized by the customer who set up the account, would obviously, we think, eliminate that conflict without regard to whether an adverse effect resulted therefrom. Similarly, when a bank is precluded from holding over 10% of the stock of a company which is registered under the Securities Act of 1933, as H.R. 5700 would do, it is impossible for anyone owning a controlling interest in such a company to plan on placing that interest in an account at a bank. This is what we were recognizing in the statement upon which you requested elaboration.

The bill would make no distinction as to whether an adverse effect or abusive practice was resulting from the holding. Both H.R. 5700 and your present questions apparently assume that all conflicts of interest and all possible means by which a bank may find itself holding a controlling interest in a corporation are inherently evil, not subject to administrative control, and must, therefore, be obliterated. We do not share these conclusions.

To respond specifically to your second question, we were saying in our statement what a flat prohibition in the one case, and an absolute limitation in the other, administered without regard to whether the wishes of the creator of the account are being carried out, and without regard to whether an abuse is being committed, or whether an adverse situation has resulted, would severely and needlessly limit the availability of the professional corporate fiduciary to the public. We believe that improper or adverse results which could occur in these situations can be adequately prevented through banking supervision, without in the process depriving a large portion of the public of the use of a corporate fiduciary.

(Whereupon, at 12:25 p.m., the committee recessed, to reconvene at 10 a.m., on Thursday, April 22, 1971.)

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THE BANKING REFORM ACT OF 1971

THURSDAY, APRIL 22, 1971

House of Representatives,
Committee on Banking and Currency,
Washington, D.C.

The committee met, pursuant to recess, at 10 a.m., in room 2128, Rayburn House Office Building, Hon. Wright Patman (chairman) presiding.

Present: Representatives Patman, Barrett, Sullivan, Gonzalez, Hanna, Gettys, Griffin, Chappell, Mitchell, Widnall, Johnson, Stanton, Blackburn, Williams, Wylie, Heckler, Rousselot, McKinney, and Archer.

The Chairman. The committee will please come to order.

The first witness this morning is Prof. Stanley C. Vance, Miner Professor of Business Administration at the University of Oregon. Professor Vance is one of the leading experts in the country on the boards of directors and management of major corporations. He is the author of three leading books in this field, including "Boards of Directors: Structure and Performance," "The Corporate Director," and his most recent book just published in February of this year, "Managers in the Conglomerate Era."

The members have before them an article which Professor Vance wrote on Penn Central in the winter 1971 issue of the Bankers Magazine.

We appreciate very much your coming all the way from Oregon to testify before the committee, Professor Vance, and, if you will, summarize your statement, and we will proceed to asking you questions on H.R. 5700 and the other bills before us.

Before you proceed, may I inquire as to two other witnesses who will go on after Professor Vance, Mr. Greene, and Mr. Scott.

They are not here as yet. You may proceed, Professor Vance.

STATEMENT OF PROF. STANLEY C. VANCE, H. T. MINER PROFESSOR OF BUSINESS ADMINISTRATION, GRADUATE SCHOOL OF MANAGEMENT AND BUSINESS, UNIVERSITY OF OREGON, EUGENE, OREG.

Mr. Vance. Chairman Patman and Members of Congress. I have spent more than a quarter of a century in the field of teaching in higher education in the area of industrial management. If I have to summarize in a single word what I have been trying to do, I would say it would be to stress the meaning of productivity.

Our system, as we all know, our enterprise system, has been extremely effective in developing and improving productivity. And boards of directors have probably been among the most important

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of all the facets in making our system so great in improving productivity. However, typical of any institution or component of any institution, boards of directors need continuing modification, refurbishing and improvement, and I think at this point in our society, when things are changing in partically every sector we must not neglect to look at boards of directors to see what can be done to improve our system and make it even more effective than it has been in the past.

I do not have too much of a presentation to begin with.

I would like to save my time to answer any questions that you might have.

The CHAIRMAN. That will be very fine, Professor Vance.

Your statement was given to the members of the committee with that thought in mind.

The other witnesses have not appeared, neither Mr. Scott or Mr. Greene, but when they come in I will reserve the right to put them on so we can examine all the witnesses at the same time.

We will place your prepared statement in the record at this point, and when the transcript is sent to you for approval you can make any additions you desire.

Mr. VANCE. Thank you.

(The prepared statement of Mr. Vance follows:)

PREPARED STATEMENT OF STANLEY C. VANCE, H. T. MINER PROFESSOR OF BUSINESS ADMINISTRATION, GRADUATE SCHOOL OF MANAGEMENT AND BUSINESS, UNIVERSITY OF OREGON, EUGENE, OREG.

This statement is intended as a strong plea for H.R. 5700 and particularly for those sections dealing with boards of directors. My position is the consequence of more than twenty years of study and research on the subject of directors and directorates in large-scale publicly-owned American enterprise. These research findings have been set forth in a number of articles and in three books on the subject of directorate structure, function, performance, and future.

Out of my probings the most significant influence is that the knowledgeable American public is rapidly coming to the conclusion that boards of directors are unnecessary and perhaps even a corporate handicap. This view was succinctly set forth in a 1965 editorial in *Forbes* magazine by its editor Malcolm S. Forbes. The comment was captioned: "Boards of Directors: Who Needs 'Em?". In a subsequent letter to the editor I stated, "Sir: Your November 15 Fact and Comment on 'Directors—Who Needs 'Em?', while miniature in size, totes a lot of substance. There does seem to be a growing sentiment that the conventional board of directors is in a state of obsolescence. Directors, like dodos and dinosaurs, can become museum items if we continue to view the directorship function as some sort of charismatic attribute."

Much of the public dissatisfaction and disillusionment with the directorate concept can be attributed to directors who assume honorific posts and to others who seek only self-aggrandizement opportunities. H.R. 5700 in its first basic area, that of interlocking relationships, is definitely a step in the right direction. Personally, I would like to see the prohibition even more stringent, covering corporate officers of client corporations and lawyers and accountants with a vested interest. I would also like to see a one-man one-directorate philosophy pervade the industry, thus creating opportunities for other competent executives.

While H.R. 5700 is a good start in the right direction, it apparently applies only to one type of interlock, the personal variety. The Bill does not touch upon two other important types of interlock; familial and institutional. The latter form is by far the most prominent at present and presumably will continue to increase in incidence.

Nevertheless, H.R. 5700 does have real value. Consider one typical case, Chase Manhattan Bank. In 1967 Chase Manhattan Bank's directors had immediate and imminent contact with 28 industrial firms, 16 utilities, 10 insurance companies, 10 financial institutions, and 4 miscellaneous; a total of 68.

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Among the insurance companies were: New York Life, Equitable Life (2), Metropolitan Life (4), Travelers (2), and Continental. The financial institutions included: Bowery Savings, Provident National, Lehman Corp., Rockefeller Brothers, Wells Fargo, Harris Trust, and First National of Chicago. The industrials covered an even more impressive list of distinguished corporations. This focus upon Chase Manhattan Bank is not intended to put this eminent bank in a bad light. Virtually every one of our major financial firms has a comparable interlocking directorate complex.

The negative aspects of director interlocks can be summarized as:

1. The very real opportunity for collusion. This is especially the case for institutional director interlock.

2. Even when blatant collusion is not practiced, institutional interlock gives very obvious preference to a few elect firms. Competitively this handicaps the vast majority of smaller and less influential American firms.

3. Interlock too frequently implies questionable ethics, particularly in conflict-of-interest situations.

4. Interlock in any form tends toward inbreeding.

5. Interlock leads to part-time directors who progressively give less attention to their secondary boardroom responsibilities.

6. Interlock strifles top management development by superimposing a layer of elite directors. In one of my studies ("The Bank Vice Presidency: Last Stop on the Line", *The Bankers Magazine*, Vol. 147, No. 4), I found that among the top 50 commercial banks there were only 60 directors out of 1,150 who held vice-presidencies in their respective banks. These 50 banks at that time had approximately 7,000 vice presidents. Statistically this gives us a less-than-one-percent rate for bank vice presidents who also serve their firms as directors. By contrast over 80 percent of these bank directors came from without. As a judicious estimate, there were in this outside director group at least 2,000 interlocks, of which perhaps 700 would now be affected by H. R. 5700.

7. Interlocks are undemocratic. In an era when we postulate the dignity and equality of all men, interlocks perpetutate an antiquated, aristocratic, and elitist form of control. If we really believe in equal opportunity for all people then we must remove the constraints which now prevent the great majority of Americans from ever reaching the ultimate in our corporate structure.

Even though I feel H. R. 5700 does not go nearly far enough in rectifying the boardroom imperfections in our banks and other related enterprises, it is a very laudable measure. It is one small step in the right direction.

The CHAIRMAN. You have before you a chart of the Penn-Ceneral Board showing the relationship with other corporations, professor. This chart shows the following:

Of the 23 directors, 16 had direct relationships with banking institutions or bank-holding companies. Of the above 16 directors, four listed their principal occupations as banking. Of the remaining directors, one director had fiduciary relationship with an investment banking firm, and one other director was chairman of the board of an insurance-holding company.

In toto, 18 of the 23 directors were interlocked with banking and other financial institutions. There were 14 commercial banks and three savings banks interlocked with the Board of Directors of Penn-Central.

Let me ask you the following questions in connection with this chart:

Was this high percentage of financial interlocks, almost 80 percent of the directors, typical for the board of directors of a railroad or any other major corporation?

You may answer that now, if you please.

Mr. VANCE. Well, in terms of railroads, Penn-Central was the outstanding firm, and, therefore, its board may not have been quite the same as other boards. But on the other hand, in terms of banking

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associations and in terms of other outside associations, Penn-Central is quite typical of the railroad industry.

The CHAIRMAN. How important are the directors to the financial success of a large corporation?

Mr. VANCE. In terms of operating efficiency, zero.

In terms of the flow of funds, I do not have any inside information but as a private citizen I would guess that their influence is quite significant.

The CHAIRMAN. Did the make-up of Penn Central's board provide any advantages to the railroad?

Mr. VANCE. To the railroad, I doubt it very much.

The CHAIRMAN. Would the railroad have been better off with a board composed of directors more familiar with the industry problems facing railroads rather than a board almost entirely composed of financially oriented people?

Mr. VANCE. I think very definitely the big weakness in many outside boards is that we have individuals who are not cognizant with the problems of that industry, at least from the technical point of view. And our society is getting more complex technologically. We need people at the top who do know something about what that particular firm or company or railroad or bank is doing.

The CHAIRMAN. What adverse effects could have occurred because the board was dominated by financial people, especially where the railroad conducted substantial business with many of these banks?

Mr. VANCE. Well, of course, this is a restriction in competition, and from one angle smaller banks or smaller lending institutions might have difficulty in terms of making contact financially with Penn Central. There could be undue favoritism to certain banks that have direct contacts. But, in total, it would be almost in the direction of a collusive effect.

The CHAIRMAN. What are the disadvantages as regards financial success of director interlocks between a corporation and banking institutions doing business with that corporation?

Mr. VANCE. To the corporation or to the bank?

The CHAIRMAN. Either—to the corporation, really.

Mr. VANCE. What would be the handicap to the corporation?

The CHAIRMAN. What are the disadvantages as regards financial success of director interlocks between a corporation and banking institutions doing business with that corporation?

Mr. VANCE. Especially, for smaller firms, corporations, there is a strong probability that the best possible price for money borrowed might not be available.

The CHAIRMAN. And it does not give the smaller bank an opportunity to compete?

Mr. VANCE. Precisely.

The CHAIRMAN. The premise of much of your writing on corporate directorates is that the present interlocking relationships create an elitist and aristocratic form of control of the country's larger business enterprise. Could you elaborate on this premise with an eye toward the reform presented in H.R. 5700?

Mr. VANCE. I think this touches on the crux of the problem, that in a democratic society we should have opportunity for all people to

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attain the very top level. And when we do have interlocks, the number of opportunities open to the general public, those who are competent and capable in this particular field are limited very, very drastically.

In the banking business, if half or more of the, roughly say, 25,000 directors of the top 1,000 banks is held in an interlocking fashion, very obviously, those 25,000 positions are closed to the most effective people, the vice presidents, or the other people in the community, who might serve a particular bank or corporation quite effectively.

The CHAIRMAN. Mr. Widnall.

Mr. WIDNALL. Mr. Chairman, I have no questions at this time.

The CHAIRMAN. Mr. Barrett.

Mr. BARRETT. Just one or two brief questions, Mr. Vance.

I reside in the city of Philadelphia. We get quite a number of questions on the Penn Central bankruptcy. I was thinking, because of your background and your position in Oregon, that you might be able to come up with some answers. For example, this committee has become very familiar with the Penn Central Railroad Co. because of our study of the role of financial institutions in its ultimate collapse. It is known that the Penn Central has an incredible number of interlocks with the Nation's largest banks, as geographically shown on this chart that you have here. Do you believe that these interlocks play a part or played a part in the bankruptcy of our Nation's largest transportation company and system?

Mr. VANCE. Congressman Barrett, although I am from Oregon, I am an expatoriate Philadelphian, and, so, I have a keen sympathy with the Pennsylvania Railroad and its problems.

And, to answer your question, I might point to one or two individuals. For instance, Dr. Gaylord Harnwell, president of the university. I believe that in his participation at Penn Central he was injuring the university. In this particular era, universities have massive problems, and I think the president ought to give attention to his prime obligation. So, from one direction, an educational direction, Dr. Harnwell should have stayed home, at the university, and taken care of problems at the university, which now has a very serious financial problem, as you know.

Switching, and taking a look at the topman, Mr. Stuart Saunders, just glancing at the list here, I notice that he is a director of Georgia Pacific. I made a trip to visit with you here, and it took 1 entire day to get here, and it will take another day to get back. For Mr. Saunders to attend a meeting of the board of directors of Georgia Pacific, he would have to travel 3 days. The board of directors of a corporation should have a meeting at least once a month, and any board that does not have a meeting at least once a month is a very ineffective board. So, in order for Mr. Saunders to attend to Georgia Pacific's problems, he would have to spend 3 days a month, and I think that would be cheating Penn Central. And I think this is the basic reason we had trouble at the Penn Central. Its board was much too spread out, it was dedicating its time piecemeal to too great a number of corporations, and consequently there is inefficiency, ineffectiveness, and bankruptcy.

Does that sort of answer it? Or is that too strong a statement?

Mr. BARRETT. It does, somewhat.

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I wonder if you are now indicating that because of the lack of meetings held at an appropriate time there is much going on without the knowledge of the directors that you have named here—I will not name him again. Is that what you are saying?

Mr. VANCE. No. What I am saying is that people are human and people have fatigue factors built into their systems, and to attend to too many obligations can be most fatiguing and can, therefore, lead to inefficient performance.

Mr. BARRETT. Would this indicate, then, that the only way we can prevent the interlocking relationships would be through statutory law and not regulation?

Mr. VANCE. Hopefully, this control or this basic policy would stem from corporations, banks, insurance companies. I hope they can see the light. But, unfortunately, a system once it is established tends to continue in the same direction. That is natural, and I think some kind of control must be imposed, and I think the control stems from this particular august group.

Mr. BARRETT. I probably have another half second.

Do you think restricting the director interlocks along the lines that are recorded in this bill—namely, H.R. 5700—will have the positive anticompetitive effects intended?

Mr. VANCE. I do think that the bill will increase competition in this particular sector in banking. But I think one of the greatest values is that it would put other corporations on notice that there is a possibility of sanction of law being imposed upon endeavors other than in the banking sector, in the insurance sector, or the manufacturing end of business. And I think that would be real therapy, and, hopefully, that corporations would then look at themselves introspectively and take the necessary steps to have a more modern type of board of directors.

The CHAIRMAN. Mr. Scott, will you come around, please, and take your place at the table as a witness.

We have heard from Professor Vance. We have not finished with him, because we want to ask him questions. But we will let you proceed.

Will you please summarize your testimony, make it brief, and then we will then ask you questions, because all of the members have your testimony and they are acquainted with it and are, therefore, in a position to ask questions.

And, if anything is not included, after you get through answering questions that you think should be included, you have a right to extend your remarks in the record and include anything that you want to that is pertinent to this inquiry. It that satisfactory?

Mr. SCOTT. Yes; thank you, Mr. Chairman.

The CHAIRMAN. You represent the U.S. Savings & Loan League and the National League of Insured Savings; you represent both of them?

Mr. SCOTT. No; I just represent the U.S. Savings & Loan League. I do not know where the National League witness is.

The CHAIRMAN. And you are president of the First Federal Savings and Loan Association of Jackson, Miss., I believe?

Mr. SCOTT. That is correct, sir.

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The CHAIRMAN. Thank you very much for coming. And you may summarize your testimony, and then we will permit members to ask you questions, along with Mr. Vance at the same time.

Mr. SCOTT. Thank you.

STATEMENT OF TOM B. SCOTT, JR., CHAIRMAN, LEGISLATIVE COMMITTEE, U.S. SAVINGS & LOAN LEAGUE; ACCOMPANIED BY STEPHEN SLIPHER, LEGISLATIVE DIRECTOR, AND ARTHUR EDGEWORTH, WASHINGTON COUNSEL

Mr. SCOTT. The Bank Reform Act is clearly one of the most comprehensive and substantive pieces of financial legislation to be taken up by the Congress in recent years. Perhaps the most comparable legislation was the Federal Supervisory Act of 1966, which dealt only with banks and savings institutions. The Bank Reform Act covers these institutions plus credit unions, insurance companies, brokers, title companies, appraisal firms, and real estate closing businesses. It also touches on thousands of regular business corporations insofar as they have certain relationships with financial institutions. Also the Supervisory Act dealt primarily with actual violations of law and regulation of specific wrongdoing. In a sense, its real impact was on that tiny minority of institutions where there was significant wrongdoing. By contrast, the Bank Reform Act deals with many practices that are traditional and of themselves have not been considered improper or unethical.

We recognize, of course, that review and updating of laws with respect to the conduct of financial institutions is a very appropriate and essential part of this committee's work. The complexities of modernday business and some of the recent developments in the corporation area make it obvious that the spirit and intent of this legislation is most commendable.

Since this legislation is applicable to many types of institutions, the committee has scheduled a variety of supervisory agencies to testify. At the time of our executive committee meeting on April 17, when we were arriving at our policy, we were, of course, not cognizant of the positions being presented to the committee. We will be influenced by these hearings and may offer additional comments after studying all the testimony. We have, however, reached certain conclusions and are prepared to express some opinions on the bill at this time.

INSURANCE OF PUBLIC FUNDS—100 PERCENT

We strongly endorse the provision to provide 100 percent insurance for funds in the custody of public officials. We feel it is very appropriate and in the public interest to provide full insurance for these funds which, in reality, consist of an accumulation of deposits of many individuals. Currently, savings and loan associations cannot receive these funds over the $20,000 ceiling. Banks are able to accept these accounts regardless of size but there have been several instances where there have been bank failures resulting in losses over the $20,000 insurance limit. I am sure that the municipality of Eatonton, N.J., wishes that 100 percent insurance of public funds was on the law

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books now. Also, according to the American Banker of April 13, the Governor of Illinois has recommended 100 percent insurance as the result of certain bank failures.

This committee approved a provision with a similar objective last year in the Emergency Home Finance Act but it did not become law. We hope the committee will approve section 25 of the present bill.

PROHIBITION ON GIVEAWAYS

The U.S. Savings and Loan League endorses the provision which would prohibit financial institutions from using premiums as an inducement to open or add to savings accounts. We feel this could have been accomplished by regulation but apparently not all the Federal agencies would agree to do so. The use of giveaways has a tendency to spread among financial institutions and eventually become a nuisance and nonproductive. We had a very chaotic and excessive giveaway situation in California some years ago and the business there supported a California law completely prohibiting the practice. So far as I know, there is no desire in California to repeal that law.

BAN ON EQUITY PARTICIPATIONS

Savings and loan associations rarely use any form of equity participation and we are not prepared to take a strong stand for or against them. As has been pointed out, this was something primarily used by insurance companies with respect to major projects during the height of the tight money period We would urge, however, that there be a clarification so as not to prohibit the existing practice of "joint ventures." Under some State laws, savings and loan associations, to a limited extent, may undertake development of housing in a joint venture with the builder. We think this is quite different from the so-called "equity kickers" and should not be prohibited.

BROKERED DEPOSITS

The use of brokered deposits is not a significant practice in the savings and loan business and we would support a prohibition against it. We agree fully that there are dangers when large brokered accounts have been tied into loan transactions.

A few associations use employees or agents to develop savings business and we think the law might be clarified to permit this practice to continue. It is in no way involved in the practice which has brought brokered deposits into such disrepute.

INTERLOCKING DIRECTORSHIPS

With respect to interlocking directorships, we do not feel that so far as the savings and loan business is concerned that there has been a significant problem. On balance, our institutions have probably gained substantially by the presence of knowledgeable financial men on our boards. The savings and loan business is extremely competitive and we do not believe that the makeup of our boards of directors has in any manner reduced this competitive vigor. Nor do we know of any

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instances where interlocking directors, per se, have been a material factor in savings and loan supervisory problems.

However, we recognize a mounting sentiment in Congress and among the supervisory agencies to abolish or eliminate interlocking directors between potentially competing instructions.

We would offer for consideration that there is a distinction between those institutions dealing with savings and home lending and those who are in the insurance, securities, or title business. Thus, we suggest that the interlock restriction be limited to directors who serve a commercial bank, savings bank, or savings and loan association. The Federal Deposit Insurance Corporation and the Federal Home Loan Bank Board, in their statements Tuesday, suggested that this proposed language is too rigid.

We also believe there is a distinction between a person who merely serves as a director of several financial institutions and one who is an active officer of an institution. It may be appropriate to restrict the service of a managing officer of a savings and loan association on a commercial bank board and vice versa, but it does not necessarily follow that a retail store executive, a professor, or an accountant could not serve on several boards.

The committee might also want to make some exception for the small cities where financial institutions may have difficulty in obtaining competent directors outside the financial institutions.

We would also want to emphasize the need for a longer period to adjust to any restriction on interlocks than the 3-year phaseout period provided in the bill's enactment clause. Directors typically serve 3-year terms and the changeover should be made on a gradual scale to avoid disruption.

A number of ideas for providing for this phaseout have been considered. One such formula would require that after 3 years, two-thirds of the directors be independent (noninterlocking), after 6 years, five-sixths, and after 9 years, 100 percent. Thus, a typical board of nine or 10 could have only three interlocking directors after 3 years, one after 6 years, and one after 9 years.

RESTRICTIONS ON OFFICERS, DIRECTORS, AND EMPLOYEES

H.R. 5700 contains a number of restrictions with respect to the relationships of officers, directors, and employees to other business-related activities and the performance of legal services. We feel that, as drafted, this is a severe change in many of the traditional relationships which have existed and served the association and its customers well in the past.

There is already a great deal of regulation, scrutiny and control in this area. For example, since 1968, regular reports filed by savings and loan associations have contained extensive information on business affiliates and activities of officers, directors, employees and attorneys. I have attached a copy of such a document entitled, "Officer's Questionnaire" to our supplemental statement. I call particular attention to paragraphs 9 through 13. I think the committee will agree that it is very searching and thorough. (See p. 185.)

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Last November, the Federal Home Loan Board issued comprehensive regulations dealing with conflicts of interest, spelling out many prohibited acts.

In the last few days, the Board has proposed a new set of regulations dealing with affiliated persons designed to further protect against improper relationships, particularly "insider" loans.

Clearly, there is no vacuum so far as controlling conflicts of interest in the savings and loan business. The Federal Home Loan Bank Board has testified that it is satisfied with its present authority except as to some flexibility to equalize rules for various types of institutions.

As a supplement to this statement, we comment on some other sections of the bill, which I will touch on just briefly at this point.

We would like to call special attention to section 413, prohibiting an officer, director, or employee from providing certain legal services. Although it may not have been intentional, the literal wording would appear to prohibit a lawyer who serves as an officer, director, or employee of an association from giving legal advice to the association itself, even at a board meeting. We also do not believe that it is necessary, or in any sense desirable, to prohibit a borrower from paying for legal services rendered by the counsel of an association in connection with a loan. Both the association and the borrower need a legal opinion on property title and the borrower should not be required to obtain outside counsel at additional expense.

We also are concerned about section 8, which sets a blanket prohibition against certain interlocking relationships where the interest is as small as 5 percent. We are particularly concerned that this statutory prohibition would be extremely disruptive to the existence of service corporations formed and owned by savings and loan associations under Federal law. There should be a specific exemption from the prohibition with respect to service corporations closely paralleling the exemption provided for holding companies.

We do not believe that public inspection is needed for the loans on homes made to officers, directors, and employees. These loans are reported to the superviser under present rules.

Again, our supplemental statement goes into more detail on these questions.

CONCLUSION

In conclusion, we would like to commend the committee for holding extensive hearings on this legislation. As is true with most major bills, we can support some, but not all, of H.R. 5700.

The CHAIRMAN. Thank you very much.

(A supplement to Mr. Scott's statement and the document entitled, "Officer's Questionnaire" follow:)

SUPPLEMENT TO STATEMENT OF TOM B. SCOTT, JR., CHAIRMAN, LEGISLATIVE COMMITTEE, U.S. SAVINGS AND LOAN LEAGUE, RE: BANK REFORM ACT (H.R. 5700)

DISCUSSING SECTIONS 3, 8, 9, AND 16 OF THE BILL

In his testimony Mr. Scott commented briefly on the sections of the proposed Bank Reform Act which apply to a variety of financial institutions and business inter-relationships. The purpose of this supplement is to give additional comment on some of the provisions which would have specific and significant impact

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on savings and loan associations, though it is recognized that other types of financial institutions and corporations would also be subject to a similar set of restrictions found in the bill.

Title companies, etc.

Section 3 of the bill, in addition to prohibiting interlocking directorates, would place severe prohibitions on savings and loan associations and persons closely connected with them with respect to operating title companies, appraisal businesses and real estate closing services, and obtaining and giving legal advice. We are opposed to these provisions as presently drafted (page 5, lines 6 through 20). For example, on the question of "controlling" a title company, it is altogether too stringent that an insured institution or its officers or family members be prohibited from directly or indirectly controlling a title company. In many instances the only business people truly interested in the operation of a title or abstract company are the savings and loan associations and other mortgage lenders in a particular area. So long as the borrowers are not forced by contract or otherwise to deal with that particular title or abstract company, what real harm is there in the savings and loan and its officers having a substantial interest therein?

The Committee, of course, may be concerned about possible abuses in this area. For that reason the Committee should consider the existing regulations and policies followed by the Federal Home Loan Bank Board (FHLBB), which clearly minimize any chance for abuse. For example, in connection with the yearly examination of a savings and loan association, key personnel must fill out a comprehensive questionnaire, a copy of which has been attached to this statement. One of the principal questions on that form (#9) requires directors, officers, employees, attorneys and agents to list each "business enterprise" in which any of them may have a direct or *indirect* interest since the last examination, especially where the business enterprise has had any transaction with the savings and loan. Further, the person must indicate the nature of his interest and the volume and type of business involved. The definition of "business enterprise," moreover, includes every conceivable significant function, such as, construction, land ownership and development, building materials, real estate services and sales, real estate financing and investing, commercial banking, all types of insurance, escrow companies, and loan origination and closing firms. There are many other similar disclosures which the questionnaire requires. Furthermore, associations are already subject to a number of legal prohibitions against coercing any borrower to go to any particular company whether it be a title or abstract firm or a lawyer. It seems clear that the combination of yearly disclosure requirements and these prohibitions against coercion, including the Bank Board's regulation 12 CFR, § 563.35, dealing with tie-ins, are together sufficient to deal with potential abuses. Clearly a borrower today already has the right to deal with any reputable title or abstract firm he may wish to, including any company controlled by a savings and loan, its officers or family-connected persons.

Legal advice

Section 3 of the bill, as mentioned, would prohibit any director, officer, or employee of a savings and loan from providing legal services for "any person" in connection with a loan or other business transaction involving the savings and loan association. It appears that this prohibition is altogether too stringent. Read literally it would prohibit a lawyer who is an officer, director, or employee of an association from advising or representing either the association itself or anyone else in connection with any loan or "other business transaction" with such institution. This is a drastic result, and one which would prohibit a lawyer-director from advising the association of any business transaction, even in a Board meeting. It would prohibit a lawyer-employee from handling even a loan closing in the association, or doing any title work for the association.

At the very least any such statutory change should clearly recognize that it is perfectly proper for the association to choose any lawyer it may wish to give it advice in connection with any transaction in which it is involved, even a director, officer or employee. Whatever satutory language is eventually enacted in this area, it should be made clear that there is no intention to place restrictions on the selection, employment or retention of counsel by a savings and loan association for legal services rendered to it, nor upon the right of the

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savings and loan association to require a borrower or other person in connection with a business transaction to pay for legal services rendered to the association by such counsel in connection with a loan or other buisness transaction. Incidentally, this same principle should apply to the selection of title companies, appraisal firms or loan closing companies. The association should be free to select whom it wishes when it comes to obtaining services from these business entities.

Prohibition against S. & L. director from serving other companies in which the S. & L. has a 5 percent stock interest

Section 8 of the bill (pages 8–9) would prohibit directors, officers and employees of savings and loans from serving as directors or officers of any other corporation in which the association has a voting stock interest greater than 5%. Without quarreling with the general thrust of this section, it should be pointed out that a 5% interest in most cases is far too insignificantly to require this kind of blanket prohibition. Even 25% ownership may be unimportant where control is insignificant. Therefore, it might serve the savings and loan business, the public in general and all other businesses to do no more than require the disclosure of financial inter-relationships involving stock ownership to State and Federal supervisory authorities, who would generally have power to limit these relationships where potential abuses are obvious.

As has already been noted, the present regulations and policies of the FHLBB on disclosure of financial relationships by directors, officers, and employees are clearly sufficient to meet the question of possible abuses. The fact remains that there is a need for flexibility in this kind of statutory proposal, which will allow the regulatory agencies to protect both private and public interests, while balancing one against the other within a framework of equity and fairness.

In addition to the basic argument that a prohibition against interlocking relationships simply because of a stock ownership percentage would prove too inflexible and, in any event, is actually unnecessary in view of present supervisory policies, it should be noted that any new statutory prohibition should nevertheless recognize the existence of service corporations formed and owned by savings and loan associations pursuant to Federal law. You may recall that Congress has already authorized Federal savings and loan association to invest in these service companies when it passed the Housing Act of 1964. There should be a specific exemption from the prohibition against interlocking relationships closely paralleling what the bill already provides for holding company relationships. In fact, the bill provides in a number of places an exemption wherever holding company relationships might be involved. We feel this same exemption should be provided for any service corporation relationship which might involve directors, officers, and employees of savings and loan associations which have legally formed and invested in such service companies.

Public inspection of loans to officers and directors

Section 16 would require savings and loans to report to the Federal Home Loan Bank Board all loans made to directors, officers, employees, and their families so that this data can be made available to the public. There can be no real objection to the requirement that such data be made available to the FHLBB. In fact, such information already is available. For the most part any such loans are limited to mortgage loans on single-family dwellings, and according to various regulations can be made available to directors, officers, and employees only on a restricted basis.

However, there seems to be no purpose in making the details of these mortgage loans available to the public. In fact, the details on mortgage and home improvement loans made to officers, directors, and employees should be specifically exempted from the requirement that loan data be made public.

Section 16 (pages 18–19) would also prevent a savings and loan association from making any loan to a corporation where the directors, officers and employees (individually or in the aggregate) of the savings and loan own 5% of any of the corporation's stock (voting or non-voting). We oppose this provision as clearly too stringent and unnecessary. It lacks the necessary flexibility which a regulatory agency could better provide by requiring adequate disclosure of the details *and* establishing more reasonable guidelines than simply a 5% stock ownership benchmark. This would also assure the public and private businesses that their respective interests would be adequately and fairly protected.

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Prohibiting interlocking directors where an S. & L. has a "continuing" loan relationship with a corporation

Section 9 of the bill would prevent a director, officer, or employee of a savings and loan from acting as a director of a corporation because the savings and loan has a "substantial and continuing relationship" in making loans to a particular company. The bill of course provides that the Bank Board would define a "substantial and continuing relationship". From the outset the provision appears too stringent, particularly since the meaning of a "substantial and continuing relationship" for making loans has not yet been defined. But, in any event, there is really no need to prohibit interlocking relationships in this situation since there is already adequate authority to require disclosure of any relationship, as well as a legal duty on the part of the director or officer involved to disqualify himself when any loan-making decision involving the corporation should arise.

OFFICER'S QUESTIONNAIRE

Date of this Examination ------------
Date of Last Examination ------------ Docket No. ------

In order to make a comprehensive analysis of the financial condition of the institution, certain information is needed which is not ascertainable from the books and permanent records. This information must therefore be furnished by an executive officer who has such knowledge or can obtain it by appropriate inquiry. Signed supporting schedules should be attached where space provided on the form is inadequate. If any question is not applicable, insert the word "None." This information is requested under the authority of Section 407(m)(2) of the National Housing Act.

AFFILIATES

For each of the institution's affiliates, as defined in Section 407(m)(1) of the National Housing Act and Section 2(b) of the Banking Act of 1933 (12 USC 221a(b)), list its name and address; its officers; its directors (or other similar officials); and persons or business entities who own or control 10 percent or more of the voting shares. Show the manner of affiliation, type and volume of business transacted with the institution, and any indebtedness to the institution. An affirmative answer to any question from 1 through 8 indicates an affiliate of the institution, in which case the information requested in this paragraph should be furnished.

1. Does the institution own or control either a majority of the voting shares or more than 50 percent of the number of shares voted at the last election of directors, trustees, or similar officials of any corporation, business trust, association, or other similar organization? ------

2. Does the institution control in any manner, other than as described in question 1, the election of a majority of the directors, trustees, or similar officials of any corporation, business trust, association, or other similar organization? ------

3. Is any corporation, business trust, association, or other similar organization controlled, through stock ownership or otherwise, by shareholders of the institution who own or control either a majority of the shares of the institution or more than 50 percent of the number of shares voted at the last election of directors of the institution? ------

4. Is any corporation, business trust, association, or other similar organization controlled, through stock ownership or otherwise, by trustees for the benefit of the shareholders of the institution? ------

5. Does the institution's board of directors include a majority of the directors, trustees, or similar officials of any corporation, business trust, association, or other similar organization? ------

6. Does any corporation, business trust, association, or other similar organization own or control either a majority of the shares of capital stock of the institution or more than 50 percent of the number of shares voted at the last election of directors of the institution? ------

7. Does any corporation, business trust, association, or other similar organization control in any manner the election of a majority of the directors of the institution? ------

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8. Is all or substantially all the capital stock of the institution held by trustees for the benefit of the shareholders or members of any corporation, business trust, association, or other similar organization? ______

INTERESTS OF INSTITUTION PERSONNEL

For purposes of this section, all references to the institution's personnel include its directors, officers, employees, attorneys, and agents. In capital stock institutions, all references also include persons or business entities who own or control 10 percent or more of the institution's capital stock. Also, for purposes of this section, unless specifically excluded by the language in the question, references to a business enterprise, regardless of its legal form, include but are not necessarily limited to, construction, land ownership and development, building materials and services, real estate services and sales, real estate financing and investing, commercial banking, financial institutions other than such banking, insurance (including casualty, fire, mortgage, title and life), escrow companies and loan origination and closure.

9. List each business enterprise in which any of the institution's personnel have a direct or indirect interest if such enterprise had any business transactions with the institution since the last examination. Indicate the nature of the interest and the volume and type of business involved.

10. List all loans or contracts made or purchased by the institution since the last examination wherein any part of the proceeds was disbursed or credited to the benefit, directly or indirectly of any of the institution's personnel (except loans on their own savings accounts and appraisal, title, deed recording, and cancellation fees). Name the persons benefited and state the amount and purpose of, and the basis and reasons for, such disbursements or credits.

11. List all loans or contracts made or purchased by the institution since the last examination, not listed in answer to question 10 in which any of the institution's personnel had a personal interest of any kind, directly or indirectly. Name such persons and state the amount and purpose of, and the basis and reasons for, such disbursements, credits, or other benefits.

12. List the institution personnel who receive any commission, fee, or rebate from outside sources, or benefit, directly or indirectly, from any business placed through, by, or with the institution, if such information has not been furnished in response to questions 9, 10 and 11. Name such persons and state the amount and purpose of, and the basis and reasons for, such disbursements, credits, or other benefits (Exclude legal, appraisal, and inspection fees formally approved by the Board of Directors.)

13. Identify institution personnel who have an interest in another business enterprise which is in competition with the institution for loans, savings, or any other kind of business engaged in by the institution. Identify the business enterprise and furnish information about each such interest which has not been furnished in response to the questions in this section.

BOOKS AND RECORDS

14. List the assets (except recurring current accurals) which are not carried on the general books of the institution.

15. List each asset which, in your opinion, has a security or collectible value less than book value. Give an estimate of the current value of each such asset.

16. List each check, note, mortgage, or other security instrument, which is invalid or is not in full force and effect. Give an estimate of the current value of each item.

17. List all loan commitments not recorded on the institution's commitment register or other similar type of record. State the amount that is legally binding and the amount that is not. Show the amount of each expected to be exercised within 6 months, 6-12 months, and after 1 year.

18. List all liabilities and all contingent liabilities (except loan commitments and current accurals) which are not recorded on the general books.

19. Furnish details of each oral or written agreement not recorded on the institution's permanent records which affect the financial condition of the institution. State where the information is located and what person knows the facts about such agreement.

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OTHER INFORMATION

20. Identify any proposed changes on the board of directors, in the status of officers, or in control of the institution's capital stock.

21. List all known holders of proxies of shareholders, state the number of votes cast by each at the last election of directors, and show the total number of votes cast at that election.

22. List the suits in law or equity and the court having jurisdiction in which the institution is defendant. State the names of the plaintiffs, the amounts sued for, and the nature of or alleged basis for the litigation. Furnish the name and address of the attorney handling each such suit for the institution.

23. Name any director, officer, employee, or agent who has at any time been convicted of any criminal offense involving dishonesty or a breach of trust.

24. Name any director, officer, employee, attorney, or agent who has since the last examination, embezzled, abstracted, misapplied or otherwise misused any funds or other assets for which the institution was accountable. State the dates, nature of irregularities, whether the FBI, local prosecuting authorities, supervisory authorities, and insurer under fidelity bond were notified, and the extent of restitution or settlement by insurer. State whether the surety has furnished written assurance that its bond continues in full force with respect to any person named in response to this question.

25. Furnish any other information not recorded on the general books or permanent records or disclosed by your answers to questions 1 through 24 which affects the financial condition of the institution.

The foregoing statements are made with due recognition of the provisions of Title 18, United State Code, and to the best of my knowledge and belief they are true and correct.

(Signature)

(Title)

(Institution)

(Notary Public)

STATE OF:
County of:
Subscribed and sworn to before me this ------ day of --------------------.
My commission expires -------------.
(Notarial Seal)

The CHAIRMAN. The statement of Mr. Raleigh W. Greene, chairman, Committee on Legislation, National League of Insured Savings Associations has been received by the committee and will be placed in the record at this point.

(The statement referred to of Mr. Raleigh W. Greene follows:)

STATEMENT OF RALEIGH W. GREENE, CHAIRMAN, COMMITTEE ON LEGISLATION, NATIONAL LEAGUE OF INSURED SAVINGS ASSOCIATIONS

Mr. Chairman and members of the Committee. My name is Raleigh W. Greene. I am President of the First Federal Savings and Loan Association of St. Petersburg, Florida and Chairman of the Committee on Legislation of the National League of Insured Savings Associations, a nationwide trade association composed of members that are part of or affiliated with the savings and loan industry. On behalf of the National League, it is my privilege to present this testimony with reference to those portions of the Banking Reform Act of 1971 (H.R. 5700) that affect savings and loan associations and to comment upon other legislation either pending before the Committee or that we would like the Committee to consider.

First, the National League expresses appreciation to this Committee for its continuing efforts better to enable the savings and loan industry to serve the public through the passage of appropriate legislation affecting that industry. Over recent years, those efforts have expanded the ability of the industry to encourage thrift by enabling it to offer savers a variety of types of savings accounts and investments. Legislation approved by this Committee has also wid-

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ened the types of loans and investments that can be made by the industry to meet the demands of its customers. We are hopeful that the Committee will look kindly upon certain amendments we will propose to H.R. 5700 that are designed to increase further the ability of savings and loan associations to serve their customers while retaining those attributes of financial strength and soundness that have rightfully earned the confidence of the American public.

THE BANKING REFORM ACT OF 1971

We realize that the Committee is properly looking into other aspects of the structure and operations of the savings and loan industry with the intention of safeguarding the public interest. The National League appreciates the sincere desire of Committee members to assure, insofar as human foresight can do so, that the framework and methods of operation employed by this industry will establish an equitable balance among the respective interests of savers, borrowers and personnel connected with savings and loan associations.

The National League's study of H.R. 5700, however, leads it to question whether some of its provisions would really accomplish the desired result. Would these provisions lead to the financing of more residential ownership or rental? We ask you to join with us in taking a closer look at certain specific provisions of the bill.

Section 3(a) would prohibit a director, officer, employee or trustee of a savings and loan association having savings accounts insured by the Federal Savings and Loan Insurance Corporation from serving at the same time as director, officer, employee or trustee of seven listed types of organizations that have a connection with finance. Included among the seven is "any insurance company", a term that needs clarifying. If it refers only to a company that issues insurance policies as a carrier, its scope is much smaller than if it encompasses any insurance agency. Recent regulations of the Federal Home Loan Bank Board concerning service corporations either wholly or partly owned by a savings and loan association make it possible with the Board's approval to have the service corporation perform the functions of an insurance agency. (Section 545.9–1(b)(2), Regulations for the Federal Savings and Loan System).

Another of the seven classes of organizations a director of an insured institution could not simultaneously serve would be a company with which the institution has a substantial and continuing business relationship that is either a title company, a property appraisal company or a real estate loan-closing company. Abstracting and appraisal functions can presently be performed by service corporations wholly or partly owned by insured institutions, under authority set out in section 545.9–1 of the Regulations for the Federal Savings and Loan System issued by the Federal Home Loan Bank Board.

Section 3 of the bill would also bar an insured institution (as well as any officer or director thereof or member of his immediate family) from directly or indirectly controlling any title company, appraisal company or real estate loan-closing company. If enacted, that provision would outlaw an arrangement now authorized by section 545.9–1 of the regulations cited above whereby Federal associations are entitled to own such companies in whole or in part when they take the form of service corporations organized under the law of the State in which the home office of the owning institution is located.

The proposed provision would, in addition, bar any control of such a company by an officer or director of the insured institution or any member of the immediate family of the officer or director.

Section 8 of the bill would prohibit a director, officer, employee or trustee of an insured institution from serving at the same time as an officer or director of any corporation in which the institution holds more than 5 per cent of any class of voting stock. This provision would outlaw the present lawful arrangements whereunder insured institutions can own more than 5 per cent of a class of voting stock of a service corporation and can have personnel of the institution also serve as officers or directors of the service corporation.

Section 9 of the bill would bar a director, officer, employee or trustee of an insured institution from serving at the same time as a member of the board of directors of any corporation with which the institution has a substantial and continuing relationship with respect to the making of loans, discounts or extensions of credit. That provision would prevent continuation of the present

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lawful arrangement whereby a service corporation that receives financial support from the savings and loan association or associations that own it may have on its board of directors persons who are also personnel of the insured institution.

Section 16 of the bill would bar an insured institution from making any loan, discount or other extension of credit to any corporation in which 5 per cent of the outstanding shares of any class of stock is owned by personnel of the institution or their immediate families. This would affect the ability of insured institutions to have financial dealings with corporations in which their personnel, as distinguished from the institution itself, hold as much as 5 per cent of any class of stock in the aggregate. The result might well interfere with loan arrangements with building contractors who happen to serve as officers or directors of the insured institution.

While business arrangements are, of course, subject to change, it is a historical fact that the Congress in 1933 authorized an appropriation of funds to enable the Federal Home Loan Bank Board to promote the organization of Federal savings and loan associations (Section 2.6, Home Owners' Loan Act). In making use of these promotional funds, it would be natural for the Board to seek formation of Federally-chartered savings and loan associations by those engaged in collateral activities that might interest them in encouraging the development of savings and loan associations as a source of thrift and home finance. The pattern of business affiliations that developed in that era has continued to the present. Enactment of the bill in its present form would introduce an element of forced reorganization of business relations between insured institutions and other business organizations.

It is true that the bill would exempt from its prohibitions against simultaneous service for two business organizations any such service that occurs within the structure of a single savings and loan holding company. Presumably this exemption is based on the theory that internal transactions of such holding companies are already adequately controlled by statutory provisions applicable to savings and loan holding companies.

In passing, it is noted that the use of the noun "trustee" in connection with an insured institution employs nomenclature not ordinarily associated with savings and loan associations, although readily associated with mutual savings banks. Although its use may be harmless, the Committee may want to eliminate it from the bill in this context.

It is also noted that the term "immediate family" is not defined either in this bill or in the National Housing Act of which the pertinent term would become a part. Clarification of the meaning of that term is desirable. Some earlier proposed administrative definitions of this term have ventured too far out on the limbs of the family tree, in the view of the National League.

Another provision in the bill that calls out for classification is the meaning to be ascribed to the word "person" as used in that portion of section 3 which would add a new section 413 to the National Housing Act and would prohibit any "trustee, director, officer or employee" of an insured institution from performing legal services in connection with a loan or other business transaction with that institution, for any *person*. If "person" as there used is intended to refer to someone other than the institution the trustee, director, officer or employee serves, the restrictions imposed by the provision would be less severe than if the term includes that institution. "Person" is defined in Section 408 of the National Housing Act, but only for the purposes of Section 408 itself. There the term includes an individual or a company. Section 408 further defines "company" to include a corporation, which would include an insured institution that has a corporate form, as do most savings and loan associations.

If the proposed section 413 would bar a lawyer who is an officer, director or employee of an insured institution from representing that institution in loan transactions or other business transactions in which it is involved, the prohibition would seem to put an end to the employment of house counsel by any insured institution.

If "person" as used in proposed section 413 means someone other than the insured institution for which the individual works, the prohibition is not so sweeping. But it would presumably be more strict than the canons of legal ethics, which permit a lawyer to represent more than one party to a transaction as long as the parties he represents know he is doing so and consent to the arrangement.

Indeed, the principle of disclosure to all having a legitimate interest that an individual serves in some capacity for more than one institution offers a means of discouraging abuse of authority by those in a position to do so.

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There is nothing inheretly evil in an agent working for more than one principal or an employee working for more than a single employer. Potential conflicts of interest abound throughout our way of life even being evident in such a basic theme as the favoritism shown by parents to a particular child or children. Fortunately in only a few of those cases is the potentiality transformed into an actual conflict of interest by means of a misuse of power. And as the literal lighting of public ways has been found to be a deterrent to crime, so the figurative light cast by public disclosure exerts a strong influence against a temptation to misuse authority. In such a light, a man is encouraged to respect his various loyalties by rendering to Ceasar what is Ceasar's and to God what is God's. Nor can one who disregards various loyalties do so with impunity, because the law normally and rightly makes remedies available to victims of such a misuse of authority.

Combining a requirement for public disclosure of dual service with a requirement that the dual servant disqualify himself from taking part in transactions that involve a conflict-of-interest under penalty of civil and/or criminal sanctions offers an adequate alternative to the prohibitory approach to the situation which would be adopted by the bill in its present form.

Basically, the disclosure approach is adopted in section 16 of the bill which would add a new section 414 to the National Housing Act. That provision would require each insured institution to report to the Federal Home Loan Bank Board the nature and amount of all loans made by the institution to any of its personnel or member of their immediate family. It also would require that the Board make such information available to the public. With a reasonable definition of "immediate family", such a provision is preferable to a prohibition against any such loans and can serve the public interest fully as well.

The criminal sanction approach for misuse of power is contained in section 11 of the bill. This subjects to criminal penalties both parties to a bribe designed to influence the conduct of an agent in a transaction between his principal and the party offering the bribe. Even here the element of disclosure and consent is brought into play, because the penalty would not attach if the benefit offered to the agent is accepted with the consent of the principal, presumably on the theory that one forewarned is forearmed and therefore immune from undue influence.

I realize we have not yet taken note of the fact that section 27 of the bill would grant more than 3 years for those affected by the bill's dual service prohibitions to come into compliance with those provisions of the bill. But that is because the National League is not of the opinion that any phase-in period would remove the basic objections to the prohibitory approach taken by these provisions of the bill.

Dual service by individuals also has many points in its favor in the public interest. Particularly in smaller communities, it enables the citizens to obtain the services of financially knowledgeable men in the operation of various types of financial and other institutions. Such advantages would be difficult, if not impossible, to obtain if the one-man, one-job principle were to be invoked.

It has also been argued that appropriate distinction should be made where one of the dual service positions consists of service to a mutual form of institution. That type of service is not susceptible of improving the servant's equity position, as is true in the case of ownership by the servant of permanent capital stock whose increase in value can be translated into cash through sale of the stock.

In summary, then, as to the provisions in the bill dealing with dual service, the National League recommends control through disclosure rather than through prohibition.

EQUITY PARTICIPATION

Section 14 of the bill would prohibit any lender as therein defined from accepting any equity participation in consideration of making a loan. The category of "lender" as defined in that section is noticeably more exclusive than the category of "financial institution" defined elsewhere in the bill. Apparently because they lack a nexus to the Federal government (other than special tax treatment) real estate investment trusts are omitted from the definition of "lender". So are all individual lenders and all corporate or trust lenders except FDIC-insured banks, FSLIC-insured savings and loan associations, mutual savings banks whose deposits are not insured by FDIC, insurance companies, bank holding companies and savings and loan holding companies. Thus, mortgage bankers (as distin-

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guished from mortgage brokers acting for covered principals) are not subject to the prohibition. With so many lenders free from the control of section 14, the Committee may well consider whether its passage would create an unfair competitive situation in which controlled lenders would be compelled to rely mainly on interest as a return on loans while uncontrolled lenders could reduce the interest cost in return for sharing an equity position in the loan project. Is this provision thereby setting up a condition increasing the risk of operating institutions that are members of Federal share or deposit insurance agencies?

BENEFICIARY OF LOAN

Section 16 of the bill would add a Section 414(c) to the National Housing Act prohibiting an insured institution from making a loan to a fiduciary except on condition that the identity of the beneficiary of the loan be revealed to the institution. While a prudent lender welcomes the maximum amount of information about the use of loan proceeds, the lender looks to the fiduciary for repayment of the loan and is not always in a position to assure that the declared beneficiary is in truth the actual beneficiary. No objection is raised to making disclosure of the beneficiary a condition to the loan, but likewise no assurance can be given that the disclosure made will be accurate. The extra cost involved in policing the actual use of loan proceeds (where such policing is feasible) would increase the cost of handling the loan and therefore make the loan less attractive to the lender and consequently less available to fiduciaries.

BROKERED DEPOSITS

Section 20 would amend Section 5B of the Federal Home Loan Bank Act so as to prohibit the payment of compensation to a third party for obtaining funds for deposit or investment in an insured institution.

Section 21 would provide criminal sanctions for the finder who knowingly fails to comply with that prohibition. The National League questions the need for such an outright prohibition and criminal sanctions in view of the strict restrictions already placed on insured institutions with respect to the payment of finder's fees, by virtue of outstanding regulations issued by the Federal Home Loan Bank Board. Under the circumstances, section 20 seems to provide an example of overkill as it relates to FSLIC-insured savings and loan associations.

GIVEAWAYS

Section 23 of the bill would add a provision to section 5(B)(a) of the Federal Home Loan Bank Act to prohibit giveaway premiums for opening or adding to a savings account, "except in the case of interest or dividends subject to limitation under this section." If that exception is intended to exempt giveaway premiums that count as dividends or interest under the rate control ceiling, the situation seems to reflect the status quo, as far as insured institutions are concerned. Federal Home Loan Bank Board regulations already prescribe such a limitation on giveaway premiums. (Section 526.2(f) of the Regulations for the Federal Home Loan Bank System.) This could well lead to the conclusion that section 23 is not necessary while Federal rate control authority over interest and dividends remains on the statute books. A question may be raised as to whether the provision is intended to invoke an absolute prohibition against such giveaway premiums if (as was recently true for a short period) the Federal Home Bank Board's direct rate control authority expired.

H.R. 5685 employs a different approach to restrictions on giveaway premiums. Section 24 of that bill would not relate those restrictions to rate control ceilings. Moreover, they would permit the use of such premiums up to a value of $5.00 on a non-recurring basis as an inducement to open or add to a savings account in an institution that is a member of the Federal Home Loan Bank System. The pertinent provisions would further allow sale of merchandise to a depositor as part of a promotional campaign, presumably a campaign conducted by the member institution. The dollar limits now applicable under section 526.2(f) of the Regulations for the Federal Home Loan Bank System are $5.00 for an amount of less than $5,000 placed in an account and $10.00 for an amount of $5,000 or more so placed. Giveaway premiums within these limits need not be counted against the rate control ceiling under the regulation.

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On the matter of giveaway premiums, the National League has been willing to follow the State law or practice applicable in any given jurisdiction where the institution involved is located.

In the case of mutual savings banks not members of FDIC, the similar provision in Section 24 of H.R. 5700 would exempt the use of giveaway premiums for payment of ordinary interest or dividends. Since it is difficult to determine what rate of dividends or interest would be "ordinary" in the case of such mutual savings banks operating under the law of different States, the meaning of the exception needs clarification, particularly if it intended to place such mutual savings banks under competitive restraints like those proposed to be placed on FDIC-insured banks (including FDIC-insured mutual savings banks) and FSLIC-insured savings and loan institutions.

FULL INSURANCE FOR PUBLIC UNIT FUNDS

Section 26 of the bill would provide full insurance by FSLIC of public unit funds placed in savings accounts in insured institutions. Present law is interpreted to limit the insurance on such funds to a total of $20,000 for any number of public money accounts maintained in a single insured institution by a single public official. The National League has supported a position that would increase that insurance ceiling in line with a "separate fund" doctrine. Under this theory, a single public official could obtain up to a total of $20,000 insurance coverage on each account in a single insured institution that represents a deposit of funds designated for separate uses by the appropriate public body. In other words, this would allow a single public official who has custody of several separate funds to obtain as much as $20,000 insurance coverage for each such separate fund to the extent it is deposited in a single institution. No change would be made in the present situation whereby a single public official can obtain up to $20,000 insurance per account by opening accounts in more than one insured institution. This separate fund proposal provides a way to increase insurance coverage somewhat while still preserving a less than 100 per cent ceiling on insurance coverage of public unit funds. Under this arrangement, deposits exceeding the insurance coverage would be secured, if at all, by a pledge of specific collateral by the institution accepting the account.

The recent Legislative Conference of the National League recommended that the League support legislation to introduce the separate fund doctrine if it became impractical to obtain legislation that would provide 100 per cent FSLIC insurance coverage for public unit accounts.

Unfortunately, savings and loan associations suffered withdrawal of public unit funds in some instances when the Federal Home Loan Bank Board revised its regulations governing insurance of accounts a few years ago and the strictures of present coverage for public unit accounts impressed themselves upon the public officials who were custodians of such public funds. Since then, administrative attempts that have unfortunately proved inadequate have been made by Federal regulatory bodies to alleviate the situation. Remedial legislation is definitely called for at this time. It is within the discretion of the Congress to determine the exact form such legislation should take.

The National League has no objection to the provision in section 26 that would authorize the Federal Home Loan Bank Board to regulate the total amount of public unit funds that can be carried by an insured member in savings accounts in insured institutions.

H.R. 7440

I now invite your attention to H.R. 7440 which is pending before the Committee and also deals with potential conflict-of-interest situations that involve savings and loan associations and their personnel and others who perform services for such associations. This bill is identical with section 911 of the Housing and Urban Development Act of 1970 as reported by this Committee last year. The National League appreciates the opportunity to comment on the provisions of this bill in the course of a hearing, an opportunity not presented to it last year because of the parliamentary situation.

Our earlier comments about the conflict-of-interest provisions in H.R. 5700 apply with equal force to provisions on that topic in H.R. 7440. We recommend adoption of a disclosure technique rather than a regulatory or prohibitory technique, to control the fortunately rare instances in which savings and loan officials abuse their trust. The National League completely concurs with the desire

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of the sponsor of H.R. 7440 to achieve fair treatment for borrowers from insured institutions and institutions that are members of the Federal Savings and Loan System. But in all sincerity it fears that the major provisions in that bill would unnecessarily interfere with efficient and fair operation of these savings and loan associations that would be subject to it. For example, the pervasiveness with which and detailed manner in which the Federal Home Loan Bank Board would be empowered to regulate or prohibit every facet of operations of an association would seem to substitute the Federal Home Loan Bank Board for the board of directors and management personnel of the association as the dominant force in carrying on daily operations of the association. With all due respect to the supervisory expertise of the Board and its staff, there is no reason to suppose that such intensive intrusion into daily operations of association would serve the public interest nearly as well as operations conducted in accord with lawful policy determined by thousands of boards of directors and management officials of associations closely attuned to local needs by continuous attention to the appropriate role to be played by savings and loan associations in the community. Admittedly, complete prohibitionary tactics could prevent any evil being done by associations, but they would be fortiori also prevent any good from being accomplished by associations. The National League prefers an economic climate in which associations can operate in accordance with private enterprise doctrines while being subject to reasonable regulatory and supervisory restraints because of their practice of working largely with capital supplied by others than the directors or officers of the associations.

The National League questions the advisability of enabling the Federal Home Loan Bank Board to set up registers or rosters of persons eligible to perform services for savings and loan associations or for any "affiliated person" of such associations, as that term is defined in the bill. It particularly questions the proposal that the Board be authorized to remove persons from such registers or rosters involuntarily. This appears to ignore any semblance of due process with respect to the removal of names from the lists of the favored. The services expressly brought within the ambit of such authority would include not only appraisal or valuation services, but also legal services, title services, insurance services, settlement services, escrow services and trustee services. However, the express listing of these types of services would not be deemed to exclude other type of services.

The Board's present authority over Federally-chartered savings and loan associations is extensive. H.R. 7440 would not only expand that authority, but by applying these provisions also to State-chartered associations that are members of FSLIC or the Federal Home Loan Bank System, would expand to a far greater extent the present powers of the Board with reference to those State-chartered associations and thereby usurp from State supervisory authorities the practical value of powers granted to them by State law.

We respectfully note that all other provisions put forth by the sponsor of H.R. 7440 to prevent a recurrence of unsavory treatment of borrowers by a few were enacted into law as part of the Housing and Urban Development Act of 1970. Combined with additional legislative provisions the National League is here supporting, a state of law should be achieved that places in the Federal Home Loan Bank Board the authority, coupled with appropriate disclosure and reports, required to forestall any new instances of shoddy treatment of borrowers of the type brought to light by the investigation conducted by the Ad Hoc Committee on Home Financing Practices and Procedures very capably chaired by the sponsor of H.R. 7440.

CONSUMERS BANK ACT OF 1971

At this time, Mr. Chairman, I should like to note general National League support for the Consumers Bank Act of 1971 (H.R. 2473). The League is in full accord with the declaration of purpose in that bill to the effect that additional powers are needed by the savings and loan industry in order to serve better the needs of the public for financial services.

The bill contains provisions dealing with two of the five legislative topics given high priority in the recent National League Legislative Conference.

Section 2 would authorize the Federal Home Loan Bank Board to issue stock charters, as well as mutual charters, to savings and loan associations and would permit conversion to a Federal stock form by mutual savings and loan associa-

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tions after obtaining Federal Home Loan Bank Board consent. The National League strongly supports these provisions.

Section 4 of the bill would enable Federal savings and loan associations to offer its customers checking account services by handling demand deposits. The reserve requirement authority as to such deposits would be parallel to that vested in the Federal Reserve Board with reference to member banks of the Federal Reserve System, but the regulatory body would be the Federal Home Loan Bank Board instead of the Federal Reserve Board. Federal Reserve Banks would be authorized to accept such checks for clearance. The National League lends strong support to these concepts.

Section 5 of the bill would confer trust powers on qualified Federal savings and loan associations to act as trustee for trusts containing not more than $100,000 at the outset. Such a proposal was among those fully supported by the National League Legislative Conference, although being assigned a lower level of priority.

In the case of all the checking account and trust powers in this bill, if granted, they would enable the savings and loan industry to extend its sphere of service to the individuals who normally make up its list of customers. The stock form of organization would offer the association an alternative framework within which to provide that service.

Sections 6 through 8 of the bill would enlarge the operational opportunities of Federal associations by authorizing them to make small business loans in a limited amount, issue credit cards and act as insurance agent. While the National League has adopted no express legislative position on such proposals, they come within the concept of enabling savings and loan associations to increase the services they render to individuals. The recipients of small business loans of the type authorized in the bill would be individuals whose needs for financial service could be more sympathetically handled by the savings and loan association that is accustomed to dealing with people of modest means. If the small business is that of a land developer or building contractor, this new form of small business loan would afford both the small businessman and the association more flexibility in their transactions with one another. Because of these considerations, those provisions of the bill also deserve National League support.

NATIONAL LEAGUE LEGISLATIVE PROPOSALS

With your permission, I would now like to invite the attention of the Committee to four legislative proposals supported by the National League. We hope your Committee will see fit to add the gist of these proposals as amendments to whatever bill is reported out of Committee favorably as a result of these hearings. At this point I respectfully request permission to include in the record a copy of a proposed bill that would carry the title of the Savings and Loan Act of 1971 and contains the four legislative proposals to which I have referred and a copy of a brief summary of those provisions.

Section 2 would authorize Federal savings and loan associations to make consumer loans for any lawful purpose.

Section 3 would empower such Federal associations to offer checking account services to individuals and organizations that do business with the associations. The provisions are very much like those on checking accounts in H.R. 2473.

Section 4 would authorize the Federal Home Loan Bank Board to issue Federal stock charters for savings and loan associations and would allow Federal mutual associations to convert to a stock form with Federal Home Loan Bank Board approval. Again the provisions are like those in H.R. 2473.

Section 5 would employ the FDIC method of computing depost insurance premiums for computing similar insurance premiums to be paid to FSLIC by insured savings and loan institutions.

The National League believes that all four of these provisions would enable the savings and loan associations they affect to provide better service to individuals and organizations that ususally deal with savings and loan associations. We would welcome the opportunity to discuss in more detail with Committee members or staff personnel of the Committee the provisions in the proposed bill.

CONCLUSION

Mr. Chairman, this concludes my testimony on legislative matters pending before the Committee that affect National League members more or less directly. We appreciate the opportunity to present these comments to the Committee.

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(Proposed bill containing four legislative proposals and a summary of those provisions follows:)

A BILL To expand the ability of savings and loan associations to serve individuals and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Savings and Loan Act of 1971".

CONSUMER LOANS

SEC. 2. Subsection (c) of Section 5 of the Home Owners' Loan Act of 1933, as amended, is amended by adding thereto the following paragraph:

"Without regard to any other provisions of this subsection, any such association may make and invest in loans to individuals made for any lawful purpose."

CHECKING ACCOUNTS

SEC. 3. (a) Subsection (b) of Section 5 of said Act, as amended, is amended by renumbering paragraph (2) as paragraph (3) and by adding thereto the following paragraph (2):

"An association may also raise capital in the form of demand deposits as a means of offering checking account services to individuals and to any organization that (i) maintains a savings account in the association or (ii) that is, or has been within one year proir to the date such services are offered to it, a borrower from the association or a purchaser of loans (or any interest therein) from the association or (iii) that supplies to or purchases from the association any goods or services in the ordinary course of business. Any such association for such a purpose may accept deposits subject to withdrawal on demand, including deposits of its own funds, and may honor requests for withdrawal of such deposits in the form of checks and drafts. Any association that accepts demand deposits pursuant to this subsection shall at all times maintain reserve balances in addition to all other reserves held or maintained by it, as herein provided. The reserve balances shall equal not less than 7 per cent and not more than 22 per cent, as prescribed from time to time by the Board, of the full amount of such deposits held by an association as determined by the Board. Such reserves shall be held in one or more of the following forms:

(1) Demand deposits in one or more Federal Home Loan Banks.

(2) Demand deposits in one or more Federal Reserve Banks.

(3) Demand deposits fully insured by the Federal Deposit Insurance Corporation in one or more commercial banks.

(4) Marketable securities having not more than seven years to run to maturity, issued or guaranteed by the United States.

(5) Items in transit, as defined by the Board, to the extent that demand deposits in the associations are increased by such items.

(6) Coins and currency of the United States.

For the purposes of this subsection, the Board is authorized to define the terms 'demand deposit', 'savings deposits', 'shares', or 'other accounts'. The Board is further authorized to suspend for a period not exceeding thirty days and from time to time to renew such suspension for periods not exceeding fifteen days, any requirement for reserve balances specified in this subsection. No association shall, directly or indirectly, by any device whatsoever, pay any interest on any demand deposit.

An association accepting demand deposits may become a member of a clearing facility for checks and drafts and may pledge its assets and meet other conditions required for such membership.

(b) The first paragraph of section 13 of the Federal Reserve Act is amended by inserting "or savings and loan association" immediately after "nonmember bank or trust company" both times the last-quoted words appear therein.

FEDERAL STOCK SAVINGS AND LOAN ASSOCIATIONS

SEC. 4. (a) Subsection (a) of Section 5 of said Act, as amended, is amended—

(1) by deleting the word "mutual" both times it appears therein, and

(2) by inserting "(1)" immediately after "(a)", and by adding at the end thereof the following:

"(2) An association may be chartered either as a mutual institution or as a corporation having capital stock. Except where otherwise indicated by the context, references in this Act to 'associations' refer to both mutual associations and stock associations.

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"(3) In the case of a stock association, the capital stock shall represent the permanent capital of the association, subordinate to all other liabilities and capital of the association. Stock may be issued only in accordance with the regulations of the Board.

"(4) Upon the written application of a mutual association, the Board may permit the association to convert into a stock association if the Board determines that—

"(A) two-thirds of the association's directors have voted in favor of the proposed conversion;

"(B) two-thirds of the votes cast by account holders in person or by proxy have been cast in favor of the conversion at a meeting duly called and held not more than six months prior to the filing of the application with the Board; and

"(C) the conversion will be conducted pursuant to a plan which is approved by the Board as fair and equitable."

(b) Paragraph (2) of subsection (b) of Section 5 of said Act, as amended, is amended by deleting therefrom the parenthetical expression "(except capital stock)".

FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION PREMIUMS

SEC. 5. (a) Subsection (b) of Section 404 of the National Housing Act is amended—

(i) by renumbering the present paragraph (3) as paragraph (4); and

(ii) by inserting as a new paragraph (3) the following: "As of December 31, 1971 and as of December 31 of each calendar year thereafter in which an institution pays a premium in accordance with the requirements of this subsection (b), the Corporation shall transfer 33⅓ per centum of its net premium income received under this subsection (b) to its capital account and the balance of such net premium income shall be credited pro rata to the insured institutions from which such premium income has been received, based upon the premiums of each institution becoming due during said calendar year. Each year such credit is made, it shall be applied by the Corporation toward the payment of the total premium becoming due from the institution on the next premium payment date and any excess credit shall be applied upon the premium payment becoming due on the premium payment date succeeding the next premium payment date. The term 'net premium income' as used herein means the total premiums which become due during the calendar year under this subsection (b) less (1) the operating costs and expenses of the Corporation for the calendar year: (2) additions to reserve to provide for insurance losses during the calendar year, except that any adjustments to reserve which result in a reduction of such reserve shall be added; and (3) the insurance losses sustained in said calendar year plus losses from any preceding years in excess of such reserves. If the above deductions exceed in amount the total premiums which become due during the calendar year, the amount of such excess shall be restored by deductions from total premiums becoming due under this subsection (b) in subsequent years."

(b) Subsections (c), (d) and (h) of Section 404 of said Act, as amended, are hereby repealed.

(c) Subsection (g) of Section 404 of said Act, as amended, is revised to read as follows:

"Any provision of law to the contrary notwithstanding, no insured institution hereafter shall be obligated to make any prepayment to be credited to the Secondary Reserve and the Corporation hereafter shall not accept or receive further such prepayments. Each insured institution's pro rata share of the Secondary Reserve shall be used as follows. Earnings hereafter realized on amounts in the Secondary Reserve shall be paid in cash semiannually on May 1 and November 1 to each insured institution in accordance with its pro rata share of the Secondary Reserve. The remainder of each insured institution's pro rata share of the Secondary Reserve shall be used, to the extent available, to discharge such institution's obligation for its premium under subsection (b). In the event that obligation ceases for any reason other than as provided in subsection (f), any residue of an insured institution's pro rata share of the Secondary Reserve shall be paid to it in cash as soon as practicable after the cessation of such obligation."

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SUMMARY OF THE SAVINGS AND LOAN ACT OF 1971

Section 1. Short Title—Savings and Loan Act of 1971.

Section 2. Consumer Loans—Authorizes any Federal savings and loan association to make loans to individuals for any lawful purpose.

Section 3. Checking Accounts—(a) Authorizes any Federal savings and loan association to accept demand deposits to offer checking account services to individuals and also to organizations that are savers in or borrowers from the association or purchasers of loans from it or dealers in goods or services with the association. Required reserves ranging between 7% and 22% of deposits would be set by the Federal Home Loan Bank Board. Reserves may be held in the form of specified demand deposits, marketable U.S. Government-issued or -guaranteed securities maturing within 7 years, items in transit and U.S. coins and currency. The Board could suspend reserve requirements for short periods. No association could pay interest on demand deposits. The association could join a clearing house.

(b) Authorizes Federal Reserve Banks, solely for purposes of exchange or collection, to receive from any savings and loan association deposits and checks and drafts payable upon presentation or maturing notes and bills, if the association maintains with the Federal Reserve Bank a balance sufficient to offset items in transit. This subsection amends section 13 of the Federal Reserve Act (12 U.S.C. section 342).

Section 4. Federal Capital Stock Savings and Loan Associations—

(a) Authorizes the Federal Home Loan Bank Board to charter Federal capital stock savings and loan associations. The stock represents permanent capital subordinate to all other liabilities and capital of the association. The Board would have regulatory power over the issuance of such stock.

Also authorizes a Federal mutual association to convert to a Federal stock association upon ⅔ favorable vote by the association's directors and ⅔ favorable vote by association members voting at a meeting held no more than 6 months before applying for conversion, provided the conversion is conducted under a plan approved by the Board as fair and equitable.

(b) This is a technical amendment to remove from Section 5(b) of the Home Owners' Loan Act of 1933 the present prohibition against issuance of capital stock by Federal savings and loan associations.

Section 5. FSLIC Premiums—(a) Authorizes savings and loan associations to follow the premium pattern applicable to FDIC-insured banks by receiving a credit for ⅔ of the net premium income received by the Federal Savings and Loan Insurance Corporation annually. FSLIC is to place the remaining ⅓ of the net premium income in its insurance reserves. The association's credits apply toward future premium payments. Net premiums are computed by deducting from gross premiums (1) FSLIC annual operating costs and expenses, (2) insurance losses during the year, and (3) the amount, if any, by which insurance reserves are exceeded by losses during that year and preceding years. If the deductions to be made exceed premiums due in a year, the excess will be deducted from gross premiums received in future years.

(b) Section 404(c), dealing with assessment of premiums to equal FSLIC losses and expenses at not over ⅛ of 1% of accounts of insured members per year, section 404(d), dealing with prepayment of premiums to be placed in the Secondary Reserve, and section 404(h), dealing with mandatory deposits up to 1% of savings accounts by institutions in FSLIC upon call of the Federal Home Loan Bank Board, would all be repealed.

(c) In place of the present provisions in section 404(g) that suspend prepayments to the Secondary Reserve once the Primary and Secondary Reserves together equal 2% of insured accounts of FSLIC member associations and require resumption of prepayments if that percentage level drops below 1¾%, a revised subsection (g) terminates the requirement for any further prepayments to the Secondary Reserve. The revision also requires semiannual cash payment to institutions of future earnings on their pro rata share of the Secondary Reserve and use of the balance of that share to pay regular premiums to the Primary Reserve. If the Secondary Reserve has not been completely used when regular premium payments no longer become necessary, the balance in the Secondary Reserve would be paid to institutions in cash on a pro rata basis.

WILLIAM F. MCKENNA, *General Counsel, NLISA.*

60-299—71—pt. 1——14

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(At this point, the committee retired into executive session, after which, the hearing was resumed in open session as follows:)

The CHAIRMAN. We will resume now with the bill before the committee.

I have interrogated the witness. Mr. Widnall was given an opportunity to interrogate him, but desired not to, and Mr. Barrett has interrogated the witness. Now, it is Mr. Johnson's time to interrogate the witnesses.

Mr. JOHNSON. I would like to ask some questions of Professor Vance.

You are espousing a novel idea here today, that of doing away with boards of directors in corporations.

When you lecture to your students at the University of Oregon, is that what you are advocating, that they do away with directorates entirely and just run a corporation by executive control?

Mr. VANCE. On the contrary, I am advocating a stronger board of directors. I am advocating a reconstituted or stronger board of directors where all the board members really participate and where the net effect is not a passive directorate but is actually a working directorate. I am not advocating abolition of boards.

Mr. JOHNSON. You are not?

Mr. VANCE. Definitely not.

Mr. JOHNSON. And you are endorsing what Malcolm Forbes had to say about who needs boards of directors, and you just threw this in; is that it?

Mr. VANCE. I just threw that in to indicate that there is a strong sentiment among the American public questioning boards of directors. And I think that is a terribly important question, if the public concern continues to move in that direction; then, I think we ought to constitute the board so that it would perform is function and the directorate not be, simply, as I mentioned, and honorific position.

Mr. JOHNSON. Mention was made yesterday of the Mellon National Bank in Pittsburgh.

They have a pretty well diversified board of directors, and are a tremendously great, successful institution. Now, can you see anything sinister in the fact that the board of directors of the Mellon Bank are men of affairs and widely distributed throughout the Nation and have pretty much been greatly successful in what they have been doing in their own lines of endeavor, or do you think that the board of directors should be confined to shareholders of the Mellon Bank?

Mr. VANCE. I think that a broader representation would be very effective, including men of affairs but also including more individuals who have a direct association with the working mechanisms of the bank; namely, the vice presidents, sir, and perhaps shareholders, too. There would be nothing wrong with having a balanced representation.

I think that is in the interest of our democratic system.

Mr. JOHNSON. Of course, to be a director in any bank, you must have a certain number of shares of stock in the bank, so every director is a shareholder of a bank.

Mr. VANCE. Right.

Mr. JOHNSON. I am thinking now of the other banks in this country that have pretty well diversified boards of directors and have created the greatest banking system in the world. But, if I understand what you are saying, the boards of directors are terrible and they should be

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done away with, and they have made a flop of it, and you are here to advocate that what they are doing is sinister, and that we had better cut it out. Isn't that what you have been saying?

Mr. VANCE. Absolutely not.

Mr. JOHNSON. What are you saying, then?

Mr. VANCE. I think that in any institution or organization typically there comes a time when we have to modify, we have to reconstitute, we have to rebuild, we have to renovate, and on the board of directors' end of it, the board room end of it, it is time to take some steps to correct perhaps abuses or practices that at one time were not negative but today are negative.

At one time there was nothing wrong with having a small elite type of directors in an institution; but, today, 31 mililon Americans own stock, and what I am advocating is to keep in step with the times, in that we are having, practically in every institution of our Nation, a greater participation by the people, a democratic participation, and especially in banks but also in most of our large corporations where now we do not have that type of participation. It is a small group of individuals that tend to perpetuate their board-room affiliations. There is not real democratic process in the election of most of our directors today. There is a single slate of candidates.

By contrast, if I could put it facetiously, perhaps, even in the totalitarian nation, you do tend to have more than one candidate run for one post. In Yugoslavia very recently this was true for the top 200 positions, or whatever it was, they had double the number of individuals running for the positions. They are all in the same party. But nevertheless they do have a choice, whereas in most of our board-room elections by proxy there is absolutely no choice. You vote for the man designated by management.

Mr. JOHNSON. Now, the other power structure in this Nation is the great unions. And it goes without saying that the same men, the same boards of directors, the same persons, each year are reelected and control the larger unions in this Nation, and they are becoming more powerful all the time.

Do you advocate a more democratic selection, let's say, of directors and chiefs of our great unions in the same way that you are advocating it for banks and corporations?

Mr. VANCE. Very definitely, sir.

I think that many big mistakes have been made just by having two great union chiefs in for so long. John L. Lewis was head of the coal miners' union for 30 years. And I know something about that, because I have had an association with anthracite coal mining in Pennsylvania. And Walter Reuther was the head of the automobile workers for 26 years. I think that is much too long. I think that is anti-democratic.

Mr. JOHNSON. My time has expired.

The CHAIRMAN. Mrs. Sullivan.

Mrs. SULLIVAN. Thank you, Mr. Chairman.

First, Mr. Chairman, I want to take this opportunity to welcome our witnesses this morning, and particularly Mr. Scott. I want to thank Mr. Scott for the support and assistance he gave me on the first nonprofit homeownership subsidy program, section 221(h). And, as a result, in part, of the difficulties his group and other nonprofit groups ran into in sponsoring such projects. Due to the information we got

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here in Washington during the investigation of the Ad Hoc Subcommittee on Home Financing Practices and Procedures, we created a new office in HUD to work exclusively with the nonprofit sponsors of subsidized homeownership projects to help them cut through and reduce the paper work and red tape.

So, I thank you, Mr. Scott, for the help and encouragement you gave me on this. As you remember, I placed our correspondence on this subject in the hearings of the ad hoc subcommitee.

But, Mr. Scott, I do not find anything in your statement this morning dealing with the need for legislation to deal with the conflict of interest situations which the ad hoc subcommittee brought out in the last Congress, and which the Friend report certainly underscored.

Your statement refers to the legal and economic complexities of the prohibitions in Chairman Patman's bill dealing with interlocking directorates, and so on. But what about the moral aspects of this problem?

Do we have a situation which requires action and which requires correction?

Mr. SCOTT. I really do not think so. Please look at the document that is called the officer's questionnaire, beginning with question 9 through 13. (See page 186.) If these questions are answered to the supervisory authority honestly—and certainly I can't imagine that any managing officer, in the fact of title XVIII of the U.S. Code would answer otherwise—if these questions are answered honestly, then all of the facts as regard any sort of relationship of officer, director or employee that could occur and would in any way benefit an individual as opposed to the association will come out clearly. When we file this report, Mrs. Sullivan, the attachments will make the report look several inches thick.

Mrs. SULLIVAN. Do you feel they are all answered honestly?

Mr. SCOTT. I just cannot imagine anyone, in the face of title XVIII of the U.S. Code, not answering this in full and in all honesty. One would have to desire to do wrong to do otherwise. And I do not believe this is widespread in our business.

Mrs. SULLIVAN. Mr. Scott, do you feel that the regulations already established by the Home Loan Bank Board, and those which it has proposed, or regulations it might issue under the present authority, can more than correct any problem situations in conflict of interest, and did your organization support the regulations proposed in this field by the Home Loan Bank Board?

Mr. SCOTT. You are speaking of the regulations that have just been entered into the Federal Register?

Mrs. SULLIVAN. Over this past year—because they have issued proposed regulations that some people in the industry thought they did not have the authority to do.

Mr. SCOTT. The first set of regulations that they issued last year, our business felt were too extensive. And, as I understand it, they have reviewed these regulations and have recently put into the Federal Register conflict-of-interest type regulations, and I have not had an opportunity to study those regulations in detail.

Mrs. SULLIVAN. Do you know if the U.S. Savings and Loan League endorsed the efforts of the Home Loan Bank Board to tighten up on

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the conflict-of-interest matter, and can you support the proposed regulations?

Mr. SCOTT. Yes, we favored stronger regulations, as far as conflicts of interest are concerned.

Mrs. SULLIVAN. Just one other short question.

Chairman Martin of the Home Loan Bank Board has testified that his agency does not have sufficient clear-cut authority to deal by regulation with all of the serious problems in the area of conflicts of interest. Do you disagree with the position of Chairman Martin on that?

Mr. SCOTT. I do believe I do disagree with Chairman Martin. I am not aware—did he testify in this respect? I do recall that.

Mrs. SULLIVAN. Instead of answering it now, when you review and correct your transcript, would you like to give us an answer to that?

Mr. SCOTT. Thank you.

The CHAIRMAN. Without objection it is so ordered.

(The information requested follows:)

REPLY RECEIVED FROM MR. SCOTT

Mrs. Sullivan, we feel the Board clearly has full authority to deal by regulation with all serious and objectionable conflicts of interest which may have developed or which could develop involving the savings and loan business. I have already pointed out in my earlier statement the very comprehensive "Officer's Questionnaire" which requires *yearly* disclosure of the various business and other ownership relationships among directors, officers, employees and attorneys, with particular emphasis on functionally related businesses such as construction, land ownership and development, building materials and servicing, real estate services and sales, real estate financing and investing, commercial banking, financial institutions other than banking, insurance (including casualty, fire, mortgage, title and life), escrow companies and loan origination and closure.

I have also noted the newly proposed regulation which would govern conflict of interest situations among affiliated persons. New § 563.33 will prohibit nearly every conceivable objectionable "insider loan". I can't imagine the Board proposing a regulation along these lines if it had no power to do so. New § 563.33 of course is only a proposal, but the Board already has existing regulations and policy statements carefully controlling other possible abuses. For example, R-memo #19 (10-30-68); R-memo #19-1 (1-16-69) and § 563.35 and § 571.7 (11-19-70) already regulate:

Loan transactions involving directors, officers, attorneys, et al., connected with a savings and loan (10 specific situations).

Selection of a depositary.

Remuneration and other financial benefits of officers and directors (10 specific situations).

Moreover, § 563.35 prohibits tie-in arrangements involving insurance, building materials, legal services and real estate brokers.

I know, Mrs. Sullivan, that your question did not specifically relate to appraisers and loans to single-borrowers, but I also am familiar with your Ad Hoc Subcommittee Report and your concern with these matters. I simply point out that § 563.17–1 calls for examinations and audits of savings and loans, "*with appraisals when deemed advisable*" by the Board; and allows the Federal Savings and Loan Insurance Corporation (FSLIC) to make independent appraisals in connection with any examination of any loan by using appraisers selected by the regional Home Loan Bank's Chief Examiner (at the expense of the savings and loan). Also § 571.1 sets the criteria for making independent appraisals, lists more than 12 situations when such appraisals should be made, and defines the term "professional appraiser" (see Federal Register, June 7, 1966).

As to loans-to-one-borrower, § 563.9–3 already limits the aggregate of loans-to-one-borrower to the lesser of either (1) 10% of savings or (2) the total of an institution's net worth. As you know, any of the regulations or policy statements

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which I have made reference to can be changed without the need for legislation, which, of course, is the kind of flexibility strong supervisory agencies like the Federal Home Loan Bank Board should be permitted to exercise in most cases.

I would like to conclude by stating that we feel the Board under the Supervisory Act of 1966, already made permanent by the 91st Congress, has been given unprecedented authority over savings and loan associations representing more than 97% of all savings and loan assets. The fact is, the Board clearly has significant authority to issue and enforce cease and desist orders against any association which the Board believes is engaging in or is about to engage in a violation of a law, rule, regulations or unsafe and unsound practice, *as defined by the Board.* As has been pointed out to you before, the scope of the Board's authority is so comprehensive and adequate as to achieve the objectives of the recommendations and concerns of your Ad Hoc Subcommittee. Moreover, the anti-trust laws of the country and your truth-in-lending law (Regulation Z) are also laws available to the Board within the scope of its supervisory responsibilities.

The fact remains that the Board has more than adequate authority to prevent and correct any abuses, serious conflicts of interest, or unsafe and unsound practices in which a few savings and loan managers might engage. I feel strongly that great care should be exercised in adopting any legislative proposal which would take that one last step of putting in the hands of the Board the unprecedented opportunity to take over the complete management of each savings and loan association.

(At this point, the committee retired into executive session, after which the hearing was resumed in open session as follows:)

The CHAIRMAN. Mr. Stanton.

Mr. STANTON. Thank you, Mr. Chairman.

Mr. Vance, have you ever served on the board of directors of a bank?

Mr. VANCE. Yes and no; I served on the board of directors of—what is the organization—where high school students make projects, junior achievement, and also a small corporation as an outside director, and, after about 5 months after I joined it, it went broke.

Mr. STANTON. I was just curious.

I wonder if you would not, recognizing and generalizing the way you do, agree that some of the examples that you set for the big ones do not apply to the small ones or the vast majority of financial institutions in this country?

Mr. VANCE. I would agree completely that it would be quite difficult to have a single rule which would be equally applicable to large and small. Most of my research work has been done with the large industrial corporations. I spent 16 months under the auspices of Standard Oil visiting the headquarters of the biggest corporations. So, I might have a slant in that direction and, therefore, in regard to banks there might be some aspects that I cannot speak with general authority.

Mr. STANTON. Let me give you a specific example.

We talked yesterday about the Mellon Bank. I am not sure of my facts, but I think the gentlemen I have in mind is on the board of the Mellon Bank, and he is chairman of the board of one of the first 20 largest corporations in America. He has a summer home in my district, 180 miles away, in a little community which I would say is about the size of Patman's Junction, Tex. The local people want this man. He is very successful, financially and otherwise. They want him to serve on the board of this financial institution, and he does. And it is very, very small. And he has done it, because, primarily, he looks forward in a couple of more years to retiring, and this will be his permanent home. He has a great interest in that community. And by his particular

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influence and the prestige that he has brought to this board the institution is growing. I think he spends more time on this little board's activities than he does on the Mellon Bank. Do you think that is wrong?

Mr. VANCE. In that particular instance, probably not. I do not know the facts, and I would hate to say.

Mr. STANTON. Admitted, it is very broad. But I do not think it would be wrong. I can't see how it could be wrong. And, therefore, if it is not wrong, then your testimony in support of H.R. 5700 is not consistent, and you cannot, in my opinion, generalize for the thousands of financial institutions that we have in this country. The people that we have had before us say that they have the authority to regulate these things, and perhaps they should be stronger regulated. But to legislate across the board for the thousands of institutions—I do hope you do not teach that generalization to your students.

At the same time, I disagree wholeheartedly with your testimony. Your two and a half pages of testimony primarily expresses the growing sentiment that the conventional board of directors is in a state of obsolescence. You can point out specific examples to your students, but, once again, I do not think you can generalize because of the tremendous diversification of the types of boards that we have in this country.

Mr. VANCE. But, by contrast to the gentlemen that you mentioned whose situation or case might be justifiable or excusable, there is an equal number and perhaps a much greater number of individuals who serve in quite a different capacity and whose positions in a dual role could be seriously questioned, and I think that is the prime intent of the bill, rather than to take the few instances where there is no harm.

Mr. STANTON. Yes. But we have had the regulatory agencies who have appeared previously this week say that they have considerable leeway to regulate this problem themselves without specific legislation.

I yield back the balance of my time.

Mrs. SULLIVAN (presiding). Mr. Gonzalez.

Mr. GONZALEZ. Mr. Vance, it seems that the thrust or the premise of your writtings on corporations and directors is that there exists an elite or an aristocratic element at this corporate control level.

Could you elaborate on that, in view of the intended reforms that are contained in H.R. 5700?

Mr. VANCE. First, I do not think this elite-ist approach is collusive. I do not think it is an elite by birth necessarily, but it is an elite in terms of being self-perpetuating by way of individuals who belong to the same clubs, perhaps go to the same schools or have come from the same schools. The prime reason is that they perform a function in our economic system which puts them on a par.

Mr. GONZALEZ. The question, I guess, could be directed to both you and Mr. Scott.

Mr. Scott seems to be saying that you can't quite get this talent from small cities or small communities.

Now, do you really believe that there is a shortage of talents in small towns, and if so how small is a cut-off board?

Mr. SCOTT. The problem, I think, that we are pointing at is that banks typically have larger boards of directors than do savings and loans, and where the two coexist in one small community—let me use the

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standard metropolitan statistical area as an example of the larger communities—the banks tend to be able to attract, for many reasons, people that are more talented and more knowledgeable in the area of finance. And I think if a man is going to make a choice, surely it is going to be in favor of the bank rather than the savings and loan.

Mr. GONZALEZ. Along those lines, the committee, as long ago as about 4 years ago, produced a report. I was surprised that it was not analyzed any more than it has been. To me, it was particularly disturbing, because it showed that there is a pattern on this interlocking question and that about $30 million worth of assets were used to acquire—I forgot how many—to acquire control of billions of dollars of bank interest. In my area alone, we had about $50 odd million, in a short period of time, less than a 2-year period, that was diverted by the banking institutions in my city. I do not have the big banks of Texas, yet they were acquiring, through diversion of over $50 million worth of their assets, a lot of other banks as far away as 250, 300, 325 miles. This would seem to indicate that the acquisition pattern was from the big to the smaller. But here in the last few months, again in my own city which is the third largest city in Texas—it is not a small city; it is a metropolitan area—we have a fairly substantial bank with total assets of some $80 million or better, and here we have an apparent takeover attempt by the use of at least $6.5 million of credit from a large bank in a large city about 190 miles away—Houston, Tex. What do you think of that?

These studies and the failures of banks in the last 5 years indicate that there is a pattern here that is with us. Your acquisition of banks, takeover of banks, is happening very frequently. And what I want to know is how do you reconcile this with the normal procedure of chartering a bank?

Is this tendency something that we should ignore, or is it something that we are clearly on notice—that we ought to do something about?

To add another bit of information, the recent celebrated closing down of the Sharptown State Bank—which was an insured bank in Texas—now reveals that about $23 million worth of its assets had been used in acquiring four other banks, one as far away as Illinois.

Is it your opinion that under the circumstances, Congress has a duty or no duty, or that the regulatory authorities have a duty or no duty, or should it just be completely ignored?

Mr. SCOTT. I think the Congress very definitely has a duty in this area.

Mr. GONZALEZ. Yes, I put in a little bit of that in very simple language. Do you have any comments about it?

Everybody seems to be against it.

We seem to say: You will prevent acquisition of banks by another bank, or the use of credit to buy a bank. If it is that bad, we should not have it that way.

But what alternative do we have in view of the fact that you feel there is a responsibility to do something about this?

Do you have any suggestions?

Mr. SCOTT. Of course, I am not familiar with the study that you have mentioned at all. It is a bank study. But I can probably dig it out and look at it. But I am aware that there has been a pattern of

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concentration, growing concentration, in banking, and some economies feel that this is a desirable pattern, especially in capital poor areas, such as Mississippi, for instance. I would not think that would be true in Texas. Texas is not capital poor.

Mr. GONZALEZ. It could be. Texas is a highly diversified State. And we have some areas in which there is no question but that an infusion of capital and credit would be helpful, and that this probably could be provided in an acquisition. But this is what I am getting at. Shall we just admit that it is impossible to draft a bill to help prevent innocent depositors from being hurt as they have been and are being hurt, or is regulation the answer, and can it be exercised?

That is what I am trying to get at. What can be done constructively? Can we legislate in such a way that it will not work a hardship on honest banking practices?

My time has expired.

So, may I ask unanimous consent that if possible this answer or comment be given to us for the record.

Mrs. SULLIVAN. I think that would be better.

Mr. GONZALEZ. Thank you very much.

(The information requested follows:)

REPLY RECEIVED FROM MR. SCOTT

Congressman Gonzalez, we share your concern of the public's loss of deposits in any financial institution; but this matter is one solely related to commercial banks and is a bank supervisory problem, and the banking agencies can more appropriately make recommendations in this field.

(At this point, the committee retired into executive session, after which the hearing was resumed in open session as follows:)

Mr. VANCE. Madam Chairman, could I direct a comment to Congressman Gonzalez relative to his first question?

Mrs. SULLIVAN. Mr. Vance, will you add it in the testimony when you correct your transcript?

Mr. VANCE. Thank you.

Mrs. SULLIVAN. Mr. Blackburn.

Mr. BLACKBURN. Thank you, Madam Chairman.

Professor Vance, I am going to be very candid with you. I have read your testimony and I have heard your comments here.

I have the very distinct feeling that you have been traveling in the rarified atmosphere of the university too long and that your testimony is living proof of the efficacy of the Peter principle.

I want to explore a few things with you.

Am I to understand that American enterprise is a failure because it is not structured the way you think it should be structured?

Mr. VANCE. Definitely not. It is a success.

Mr. BLACKBURN. I think it is rather successful.

Mr. VANCE. Very definitely.

Mr. BLACKBURN. In the view of the success of our economic system, why should we use the power of government to very seriously disrupt the organization of that system for some unknown result?

Mr. VANCE. For the simple reason that in every successful organization we have a research and development component that tries to

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keep us on a par with other institutions or corporations, and even nations competing with us.

Mr. BLACKBURN. We are successful competing, are we not?

Mr. VANCE. Internationally, we are very definitely not; in many areas—steel—you name it.

Mr. BLACKBURN. But that is because of the fact that business enterprise does not control.

Mr. VANCE. Very evidently not.

Mr. BLACKBURN. Where we are being defeated is in those areas such as textiles and steel in which the labor component is a major factor.

Mr. VANCE. I would disagree with you.

Mr. BLACKBURN. In our technical skills, we are more than competing with other countries.

Let's explore some of your testimony a little further here.

You are suggesting that we make our enterprises more democratic, and that we must remove the constraints which now prevent the great majority of Americans from reaching the ultimate in our corporate structure.

Well, now, am I to understand that we ought to have 75 percent of all Americans on boards of directors?

Would that be a sufficient majority? Or should it be 90 percent?

Mr. VANCE. I do not think the question is quite pertinent.

Mr. BLACKBURN. I think the statement is pertinent. And I am trying to find out what you are talking about here.

Mr. VANCE. The sort of thing that I was talking about in my statement, the 50 biggest banks with approximately 7,000 vice presidents, of whom less than 1 percent have ever reached the ultimate—I think this is a constraint upon our talent.

Mr. BLACKBURN. Yet you do not challenge me when I say that our economic system has proven to be quite successful.

Why should we seriously disrupt it when we may run the risk of destroying it?

Mr. VANCE. I do not quite see how this would be disruptive.

Mr. BLACKBURN. You do not think it would be disruptive?

Mr. VANCE. No.

Mr. BLACKBURN. I can't imagine anything that would be more disruptive than some of the provisions of this bill. If we completely reconstitute the directors of our major institutions and make them more democratic, as you so urgently urge, should we provide a greater opportunity for Americans to be in Congress?

Should we shorten the term to 2 hours so that we can get more Congressmen during our careers?

You know that most Americans will never be in Congress.

Mr. VANCE. I think I would be completely opposed to having a Congress where we had a self-perpetuating group. I think that you should represent the people, and if you do not, then I am opposed to you; but I think you do, and, therefore, I am in favor of you.

Mr. BLACKBURN. We are elected, aren't we?

Mr. VANCE. Precisely. But that election has to be a free election and not a constrained election. Similarly, in a corporation, there should be free election and not a small group perpetuating itself.

Mr. BLACKBURN. I am not on a board of directors but I participate occasionally in the election of directors, because my insurance firm

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is one where we do elect the directors. And, frankly, they are doing a good job, and I see no reason to throw them out and bring in another bunch just hoping that they will do a better job. And I think that the whole thrust of your statement would do great mischief to our economic system. And thank heavens that you do not represent the majority of thinking in our country.

I yield back the balance of my time.

Mrs. SULLIVAN. Mr. Hanna.

Mr. HANNA. Thank you, Madam Chairman.

Since we have talked about unanimous consent, Madam Chairman, I wonder if I could make a unanimous consent request?

I understand that previously you, yourself, made the request that your legislation relative to some institutional changes be considered at the same time, and that the witnesses be allowed to testify on your bill. I have personally introduced H.R. 2473 which I think goes along with the major goal the chairman announced Tuesday when he said H.R. 5700 is intended to reach a goal of the enhancement of competition among financial institutions. I think the legislation I have introduced has a parallel goal. And I have asked unanimous consent for any witness who cares to, to testify on that bill. I am not making any great drive to inject it, but if they would care to, I would like to hear some testimony.

Mrs. SULLIVAN. I would say that I would not be allowed to rule on this. I think you have to consult the Chairman on it. When I made my request, it was at the very beginning of the hearings, to include a bill on conflicts of interest which we had approved last year.

Mr. HANNA. I would have made the same request. I regret I was not here the first 2 days, but I was out on official business of this committee, as I think the chairman knows.

If the chairlady does have any compunctions about the rule, I will make that unanimous consent request when the chairman is here.

Mrs. SULLIVAN. I think that would be better.

Mr. HANNA. I want to be sure that everybody is comfortable.

Madam Chairman, I want to ask the witness: Is there, Mr. Vance, an elite in your European corporations similar to the elite you have talked about?

Mr. VANCE. I think you should take that nation by nation. In Japan we have the zaibatsu.

Mr. HANNA. That certainly is an elite.

Mr. VANCE. Very definitely.

I think in England we have a situation, probably, which I think we ought to avoid by all means. The big boy relationship, Eaton, et cetera.

Mr. HANNA. How about France?

Mr. VANCE. In France, I think we have an engineering elite.

In Italy, a family elite, which is probably moving more in our direction. Of course, In Russia, we have a different type of elite.

Mr. HANNA. I am glad that you have made that overall representation, because I was struck by an article written by a Dutchman whose analysis read something like this:

> Americans build institutions of such strength that they can tolerate a leadership that is less than the best. Europeans build such poor institutions that they have to have superior leadership.
>
> The Russians, given time, can reduce both the quality of their institutions and the quality of their leadership to mediocrity.

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It would seem to me that is a penetrating analysis.

And I have noted, and I would like to bring it to the attention of Mr. Blackburn, that there is a tendency in the United States for the institution to carry whatever leadership it has, even Congress. And when things have been going well, it has been my observation that the leadership takes credit; and when things are not going well, they blame something further down the institution.

Has that been your observation?

Mr. VANCE. Very definitely.

And to mention specifics, let us take a glance at Chrysler Corporation. Perhaps, I should not mention the name of corporations. But Mr. Townsend has taken credit for a very successful rejuvenation of Chrysler from the mid-1960's up to recently. What happens from here on? Mr. Townsend and the president, Mr. Riccardo, will be punished if Chrysler fails. But what about the board of directors? Will any director be fired? Absolutely, not.

Mr. HANNA. That raises another question.

It seems to me that recently I read that in the spirit of hardship perhaps some of the relationships of the board of directors are being spelled out a little more strongly, their responsibilities as well as their prerogatives and prerequisites, or any other way you want to express what you get out of it, and that many were dropping directorships because they realized that when things go wrong, there are certain responsibilities, and I know that is true in banks, because I happen to be involved in a situation in my own district indirectly as their Congressman, where the board of directors of the bank is in real trouble, because they did not realize what responsibilities they were assuming. Maybe we need to make more strong the legal responsibilities of the directorship so that people will not be so anxious to take them unless they want to take the burdens with the benefits.

Wouldn't that be a way of doing it, instead of just trying to figure some way to second-guess the operation of the system, as to how it selected its leadership?

Mr. VANCE. I think very, very definitely.

In my tour of major corporations, and meeting with some of the top in our industrial system, I would like to give credit to Mr. Roger Blough who stressed the concept of involvement among his directors, and he was constantly groping for ways and means to involve his people—directors, that is.

And I think this is where we need to pay a lot more attention, namely, stressing involvement. Involvement means responsibility, and it means reliabilty also.

Mr. HANNA. I hoped that you had stressed that. I think that is a better way to put it.

Thank you. And my time has expired.

Mrs. SULLIVAN. Mr. Williams.

Mr. WILLIAMS. Thank you, Mrs. Sullivan.

I would like to thank you gentlemen for being here this morning and testifying before this committee.

Mr. Scott, on the first page of your testimony, you deal with the Federal Supervisory Act of 1966. Then, you go on to say that this act had a very real impact. Then, referring to H.R. 5700 which we have

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under consideration here now, you say that the Bank Reform Act deals with many practices that are traditional and of themselves have not been improper or unethical. Do I take it that you mean that the section of this H.R. 5700 that deals with these practices is unnecessary?

Mr. SCOTT. That would be the import of my statement.

Mr. WILLIAMS. You also state on page 2 of your testimony that you strongly endorse the provision to buy 100 percent insurance on funds in the custody of public officials.

Now, we have already heard testimony—I believe it was from Mr. Frank Wille, the Chairman of the FDIC, that 30 States right now require financial institutions to cover the full amount of public deposits, deposits of public money, with certain specified securities. So, therefore, the public funds are protected.

The statement was also made that the securities used to cover these public deposits are usually Government bonds, municipal bonds, county bonds, State bonds, or something of that nature, and if this practice was discontinued, it could have an adverse effect on the public bond market. We all know the public bond market is in some difficulty right now.

Have you taken into consideration the statement made by Mr. Wille in reaching this conclusion?

Mr. SCOTT. I could not agree with that at all. Mr. Wille's argument is very imaginative. I think banks buy municipal bonds because they have a very favorable tax treatment.

Mr. WILLIAMS. And at the same time they are using these bonds to specifically cover the full amount of public deposits, so that therefore they are really insuring those deposits to the fullest extent right now.

Mr. SCOTT. I just do not agree with Mr. Wille's statement.

Mr. WILLIAMS. And you also say that this business of using premiums as an inducement to save, that this could have been accomplished by regulation, but apparently not all Federal agencies would agree to do so. I do not believe that that is exactly a true statement. I think that some regulation has been agreed to by all of the regulatory agencies.

Mr. SCOTT. I think what I was trying to say was that the complete ban of it was not agreed to by all Federal agencies.

Mr. WILLIAMS. The regulation of it was.

Mr. SCOTT. By regulation.

Mr. WILLIAMS. Now, in your statement, Mr. Vance, at the bottom of page 3, you make the point that these 50 banks at that time had approximately 7,000 vice presidents. Are you aware of the fact that many of the big banks in States which permit branch banking do have branch banks, and it is their custom to give every manager of a branch bank the title of vice president?

Mr. VANCE. I am aware of that, yes, plus the various functional areas, geographic areas.

Mr. WILLIAMS. Do you at the same time realize that just because a man has worked himself up to be the manager of a branch bank he, in all probability, does not have the qualifications to serve as a director?

Mr. VANCE. That is very definite. I do not think all people have that particular talent. I think people, vice presidents in particular, ought to be given an opportunity to develop this talent, correct.

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Mr. WILLIAMS. But nevertheless it does not mean that because they have got the title of vice president that they have already developed those qualifications.

I would like to make this observation, too. You mentioned sort of an elite group serving on boards of directors. Actually, I think that is a misstatement. I think that the main criterion for serving on a board of directors is not which school you went to, or how many friends you have, but rather the success that you have achieved. All banks and corporations want successful men on their boards of directors in order to take advantage of their knowledge which they had to have in achieving their success.

Mr. VANCE. I would not know how to answer that particular question.

I think every organization, banks included, should seek leadership that would have talent that would help, yes. And if a man has succeeded and demonstrated a certain capacity, then that person would definitely have an inside track.

Mr. WILLIAMS. What I am saying is: This is the practice today.

My time has expired.

Thank you.

Mrs. SULLIVAN. Mr. Gettys.

Mr. GETTYS. Thank you, Madam Chairman.

Mr. Vance and Mr. Scott, this whole subject of ethics and morals and conflicts of interest is an intriguing one, and I wonder, where a conflict of interest occurs, where does it begin and where does it stop?

The man who has been engaged in a number of activities in his lifetime may not be eligible to serve on anything, even a church board, because there are so many conflicts of interest. We sometimes wonder if a farmer should serve on the Agriculture Committee, if a lawyer should serve on a judiciary committee, or if a banker should serve on this committee.

I am wondering if it is going to come to a point that a prerequisite for a man to serve on a board is that he know not anything about the subject. What is a conflict of interest?

And, then, are we to presume that a man who has gained stature in his community is not to be asked to serve on some of these boards of prestige and financial importance? The very fact that he has attained that stature appears, in the thinking of some, to eliminate him from selection as a director on a board?

These things worry me.

Should we have to have incompetents running this country?

Should we say that a man who has practiced law ought not to be able to serve in Congress, because it has something to do with making laws?

Where is the point that you have a conflict of interest?

One further thing. Is it that we have come to the point in this country that we must presume that everybody is dishonest?

It used to be, you know, under our Constitution that we presumed that a man is honest, that he was not guilty until proven otherwise, but today it seems there is an element throughout our country that thinks you have got to assume that this man or that man or that woman is

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dishonest, and we have to protect ourselves against him before we give him any responsibility.

I wonder, if you as a professor, Mr. Vance, and Mr. Scott, as a practitioner in business, could comment on that?

The whole subject disturbs me greatly.

Mr. VANCE. I think that, as a beginning point, in terms of conflict of interest, you might take the exceptional case. And, hopefully, there are not too many. Glancing at the Penn Central chart that I have here, I note that there are two relationships, or two people with contacts with United States Steel, two with Allegheny Ludlum, and one with National Steel. Now, if Penn Central has been purchasing large quantities of steel rail or steel of any sort from these three enterprises, I think they ought to be looked at a little more carefully. I do not think there should be contact between the steel supplier and the steel user. Obviously, I think, this is an outright case of conflict of interest.

And let me go to the other extreme. And I think this could be debated at great length. When a man has divided his time over so many ventures that he can't give his own venture his prime time and enough time to keep that organization working effectively, then he is in conflict of interest even though no dollars are involved, his time is involved, and his dedication to his prime objective is involved. And that is why I pointed out Mr. Saunders, for instance, with his diverse endeavors. I think he is in conflict of interest on that score, ethically, or call it what you will. Somewhere in between, we will have the courts determining in the next 20 years or so what conflict of interest is. We will have many more cases than are currently pending in terms of director reliability and related areas.

Mr. GETTYS. You feel that an individual in our country is no longer competent to judge in his own conscience whether he is an honest man or has a conflict of interest?

You see, you can't legislate morals. You take a man elected to Congress. I don't care how many laws you pass or how many regulations. If he is dishonest he is going to be dishonest; if he is honest, he is going to be honest, whether you have got laws or not, on a bank board or on a savings and loan board in Congress. If you have got a dishonest man, all the rules and laws in the world are not going to keep him from being dishonest.

Mr. VANCE. I agree with you completely. Honesty should begin in the individual, and in terms of a small enterprise, bank or otherwise, where the ownership is vested within the individual, then, I do not think there is that much of a problem; it is not serious.

But where you have widespread ownership and where you have 31 million Americans—and the number is increasing rapidly—who are direct owners of stock in fee, then, I think it is another problem, and I think you should take a very careful look in terms of the honesty aspects, because you are protecting us.

Mr. GETTYS. Thank you, Madam Chairman. My time is up.

Mrs. SULLIVAN. Mr. Wylie.

Mr. WYLIE. Thank you, Madam Chairman.

Mr. Vance, I start out by saying that I find it difficult to accept your statement and then make the observation that the fact that 6 percent of the earth's people live in the United States and yet produce 50 percent

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of the earth's goods is pretty good indication to me that our system has not been too bad, or is a pretty good system.

How would you advocate that the board of directors of corporations be selected?

Mr. VANCE. Getting back to the previous comment, I do not think I mentioned 6 percent and 50 percent, but I think there is some relationship there.

But my concern is for example with the fact that United States Steel is no longer the biggest steel company in the world; a Japanese merger a short time ago created Nippon Steel, the biggest steelmaker in the world.

Mr. WYLIE. How do people in Japan elect the members of their boards of directors?

Mr. VANCE. Birthright, the zaibatsu.

Mr. WYLIE. You mean the stockholders in the companies in Japan do not have anything to say about who serves on their boards of directors?

Mr. VANCE. Stock ownership is far more concentrated than in the United States. This is our problem, that our ownership is spread out.

Mr. WYLIE. Then, don't you think that in Japan ownership of stock is important? Pursuing the matter of Japan, I think Japan is now second in production of goods in the world; is it not?

Mr. VANCE. I think so—probably Russia. But we have limited statistics.

Mr. WYLIE. Do you think Russia might be second in the production of goods?

Mr. VANCE. I would guess so.

Mr. WYLIE. West Germany comes in there someplace.

And I think they elect their members of boards of directors in West Germany pretty much the same way as we do.

Mr. VANCE. They have the codetermination technique where you have representation of labor and the management and the public on a single board, in a relatively small section of the total economy, steel, coal, and so forth.

But in the free enterprise section, the board is elected.

I think it is basically the banking type of influence that elects the board.

Mr. WYLIE. You would not suggest that we have the Russian system of forming corporations in the United States?

I guess they do not have any corporations.

Mr. VANCE. Obviously, not.

Mr. WYLIE. I think the point I am trying to make here is what would be the alternative to our system?

I do not see how this could be more democratic.

The stockholders all have an opportunity to vote as to who runs their corporation.

How could you make it more democratic than that?

Mr. VANCE. I must have used some injudicious phrases in my statement, because I do not recall stating anywhere anything in terms of an overthrow of our system. What I want is a strengthening of our system, and I want a correcting of imperfections in the directorate election, and in the directorate function, not an overthrow or any radical change at all. I think what we have is excellent.

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Mr. WYLIE. That goes back to my first question, then.

How would you advocate that the members of the board of directors be selected, then?

Mr. VANCE. Well, the current method, with more choice perhaps, instead of electing a slate which is designated by management.

I hate to take Ralph Nader's side, but I think there is a point there in terms of having a broader representation, a broader spectrum of the ownership being at least put on the ballot, a choice, not just the 15 directors to be elected but probably 20, 30, 40 names and a complete and adequate statement in terms of the backgrounds of these people rather than a sentence or a name.

I think, in a recent statement——

Mr. WYLIE. Aren't these relationships between the corporations, boards of directors, and stockholders all provided for in our antitrust laws?

Mr. VANCE. I do not quite follow the particular——

Mr. WYLIE. What I am trying to say is that under the antitrust laws, as far as corporations are concerned, I think the relationships between corporations are spelled out, and the rights of stockholders, and this sort of thing. Would you suggest that these antitrust laws be repealed?

Mr. VANCE. Definitely not; strengthened, if anything, but not repealed.

Mr. WYLIE. Then, maybe I have misunderstood your testimony, I don't know.

But, as I say, I gained the direct impression, as we went through the testimony, that you did not care for the present system of electing members of the board of directors and suggest that it be more democratic, and I am attempting to find out how you could suggest that it be made more democratic. There ought to be some ownership in the corporation.

Would you suggest that the board of directors be elected by the public at large across the United States?

Mr. VANCE. Definitely not. The stockholders have that function, and I think that ought to be kept with the stockholders.

Mr. WYLIE. I think my time has expired. Thank you very much.

Mrs. SULLIVAN. Thank you, Mr. Griffin.

Mr. GRIFFIN. Thank you, Madam Chairman.

I would like to join in welcoming you gentlemen to the committee, particularly Mr. Scott whom I have had the pleasure of knowing for many years. He is an outstanding community leader and business leader in Jackson.

Inasmuch as Mr. Gettys' time expired before you had an opportunity to comment, Mr. Scott, on the conflict-of-interest questions, would you like to comment?

Mr. SCOTT. Yes, thank you, Mr. Griffin.

I guess Mr. Gettys put his finger on the real problem: "Where do you draw the line?" And this is a very tenuous problem. And he also points out that much of our whole structure is based on trust and faith. And I think it probably points up the fact that 99 percent of business transactions are honest. And it is difficult to draw this conflict-of-interest line. If you make it too severe you weaken the whole business structure. And if you do not have some regulation by the supervisory authorities, then it can be abused. It is a very hard area to deal with effectively.

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Mr. WIDNALL. Would the gentlemen yield to me?
Mr. GRIFFIN. Yes, I yield, Mr. Widnall.
Mr. WIDNALL. Mr. Scott, could you tell us what types of firms may be represented on the board of directors of a typical savings and loan?
Mr. SCOTT. If my institution is typical—may I use that?
Mr. WIDNALL. Sure.
Mr. SCOTT. We have a wholesale fruit man; we have a supermarket firm executive; we have a school supply man; we have a utility company executive; we have a surgeon, who, incidently, is a very outstanding and able director. I think that gives you sort of an idea.
Mr. WIDNALL. One last question. Very short.
If the board had 15 members, would more than one or two be from other lending institutions?
Mr. SCOTT. In our institution, we do not have any directors who are officers of another financial institution. We do have several directors who also serve on bank boards.
Mr. WIDNALL. That is all. Thank you.
Mrs. SULLIVAN. Mrs. Heckler.
Mrs. HECKLER. Thank you, Madam Chairman.
I should like to thank the two gentlemen who testified today, and address my question to Professor Vance.
Professor Vance, I think we all share a desire to improve our system to allow for the introduction of new elements in leadership in the society. There is a question as to how we can accomplish all of our objectives most effectively, and here we might agree or disagree.
I find that in your statement great stress is placed on the case of institutional director interlock, and that seems to be the basis for the work in which you have spent a great number of years.
Now, of course, this bill does not deal with that.
So, therefore, it is the question of how the experience of the institution of interlock really relates to the kind of situation we have today.
I am also concerned about the stress on developing a more democratic means of selecting a board of directors of an institution.
In your studies, have you studied the bylaws of, say, the banks or other financial institutions?
And could you tell me whether or not in most of these bylaws there is a provision or mechanism for election of nomination by the shareholders or stockholders who might disagree with the selections that have been made or presented to them?
Mr. VANCE. There are provisos, I think at GAF we currently have a dissident group, Mr. Millstein and his associate, which is trying to wrest control. That might represent the democratic process. I am not sure. I am not on the inside of that.
Mrs. HECKLER. You are saying that more democracy should be introduced. Do you feel that the provisions for nomination from the floor or from the shareholders do not provide a sufficient vehicle for democracy?
Mr. VANCE. At the moment, I would say "Yes," that I do not think it is feasible to nominate from the floor—it is perhaps possible—in a specific major annual meeting to make a nomination from the floor but I do not think it is ever done.
Mrs. HECKLER. Have you studied the procedures in the bylaws and viewed these mechanisms on a scientific basis?

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Mr. VANCE. I have never made a study of that particular aspect, but to the best of my knowledge, within the bylaws there are provisos which state that you have to put your proposition before the management committee prior to the meeting; in fact, in all of the proxy statements that you or I receive it is already determined what is going to be voted on. So, you may earlier make an attempt at having a director of your choice nominated but not from the floor.

Am I clear as to that?

Mrs. HECKLER. Would that kind of a mechanism allowing for a direct nomination by shareholders, were prior notice given, be an improvement; would you say?

Mr. VANCE. I think it would be an improvement. Whether it would be optimal, I am not sure.

Mrs. HECKLER. I am concerned with the function of the board of directors, and I am interested in your comments in The Bankers Magazine on the subject of "Penn Central—A Lesson for Bank Boards and One-Bank Holding Companies," in which you say, on page 79 of that magazine:

> The situation all boils down to simply this: Penn Central's top management and, in particular, its board of directors, just was not groomed and geared to venture the conglomerate way. There has been entirely too much naive generalizing to the effect that 'business is business' and that any board of directors can tackle any kind of business endeavor.
>
> A board of directors, like any competent decisionmaking body, must be qualified to analyze pertinent problems and to guide the organization on the optimal course.

I wondered, in the case of small companies particularly since we are involved with not merely large institutions but small ones, if you deprive individuals in the eight categories you mentioned in H.R. 5700 from coming in as directors, those with financial expertise in other fields, how would you then constitute a competent board geared to tackle the kind of decision-making that is necessary?

Mr. VANCE. I think we might be underestimating the talent available in most of our communities. I come from a relatively small community, 80,000 people. I know most of the individuals. I have been a Rotarian; I am currently on the city of Eugene Budget Committee. I think that I know must of the leading citizens, and I think that we have an abundance of talent, given an opportunity to develop it. But if that opportunity is never forthcoming, obviously these people will never have a chance to demonstrate their talents. So, I think that even within a small community there is adequate talent. And I think that most small banks, or banks in small towns, do not need the massive boards that we have as in New York City. I think a board of eight or ten or twelve people could do an effective job, and I am sure there would be no need, therefore, for interlocking aspects. I think I can find eight individuals without conflicts of interest or interlock relationships who might or could do an effective job within the smaller communities.

Mrs. HECKLER. Of course, we do not wish to perpetuate conflicts of interest. However, the witnesses we have had so far from the regulatory side have indicated that they have not seen great abuses and have not pinpointed any cases in the specific nature of abuses.

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Now, I just wonder if the board of Penn Central was incompetent, according to your analysis—and, indeed, you might be right. I do not question that, but nonetheless if they were not able to handle their jobs, were not competent to handle their jobs, how can you say that people without financial background and all—if people who have experience in these other corporations are barred, how can you say that the level of confidence can be obtained from any board of directors?

Mr. VANCE. I think the basic financial competence should be forthcoming from the institution itself.

Second, financial talent can be purchased; experts in various areas are available for a fee. And I think the function of the other members of the board can be to appraise local conditions, the various items that pertain to the community, more so than to the financial aspects. Of course, the two cannot be completely separated.

Mrs. HECKLER. I think if we have not experimented in developing new talent on a broad basis, it is quite unlikely that you will maintain your shareholders' consent on a continuing investment. And that would be a problem, too.

My time has expired.

Mrs. SULLIVAN. Mr. Chappell.

Mr. CHAPPELL. Mr. Scott, I notice on page 6 of your statement that you say:

> In the last few days, the Board has proposed a new set of regulations dealing with affiliates designed to further protect against improper relationships.

I just wonder whether or not you are satisfied with these proposals?

Mr. SCOTT. I have not had an opportunity to read them carefully.

Mr. CHAPPELL. And you have no comment?

Mr. SCOTT. In general, we favor them, but I have not had an opportunity to inquire.

Mr. CHAPPELL. If you did favor them, would you object to their being written into the legislation?

Mr. SCOTT. I do not understand why we should write them into the legislation if they are satisfactory.

Mr. CHAPPELL. Is it the sort of thing——

Mr. SCOTT. When you write legislation, it is no longer flexible. When you write a regulation, if you have made an error, why, you can adjust it with an improvement of the regulation.

Mr. CHAPPELL. Are you familiar with the type of regulations? You say you did not have a chance to study it.

Mr. SCOTT. Yes, sir.

Mr. CHAPPELL. Are you familiar with the type of regulations?

Mr. SCOTT. Yes, I am.

Mr. CHAPPELL. All right. Are any of these regulations the sort that should be written into law, or would you take each of those and prefer that it be handled by regulations?

Mr. SCOTT. I would prefer that all of that be handled by regulation, because of the flexibility.

Mr. CHAPPELL. I take it from that, that you would feel that the Congress itself would be inflexible, that the Congress itself would be so inflexible that it would have trouble keeping up with the economic situation.

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Mr. SCOTT. No, I do not mean that. Obviously, a regulatory agency which the Congress created is intended to function with greater ease and flexibility and rapidity than the Congress itself could function. You are dealing, I think, in the Congress with the broad general problems, and you want these regulatory agents to deal with the nitty-gritty.

Mr. CHAPPELL. With the policymaking and so forth.

Mr. SCOTT. Yes, sir.

Mr. CHAPPELL. I just wondered whether or not you thought all of the proposals, or the approaches made in the regulations, were such that they ought to be retained just as regulations, or whether or not they were matters which you would perceive to be policymakers touched on in those regulations. And you say they are all regulatory?

Mr. SCOTT. I think they are all regulatory.

Mr. CHAPPELL. No further questions.

Mrs. SULLIVAN. Thank you. Mr. Rousselot.

Mr. ROUSSELOT. Dr. Vance, you mentioned in your statement that H.R. 5700, in its first basic area, that of interlocking relationships, is definitely a step in the right direction; but that, personally, you would like to see the prohibition even more stringent. How would you do that?

Mr. VANCE. I jotted down a few notes. As I mentioned, in the terms of the proxy system——

Mr. ROUSSELOT. How should we change that in this bill? You would want it legislatively in this bill.

Mr. VANCE. No. I think the bill is good enough as is.

Mr. ROUSSELOT. Your statement is, you say, it is a step in right direction, but that you would like the prohibition even more stringent. Tell us those areas that you want more stringent.

Mr. VANCE. Item 1, the proxy system. I would like to see—as a simple example, I think that Standard Oil currently has an issue before it——

Mr. ROUSSELOT. We are, of course, talking about banks and financial institutions. Let's speak to those.

Mr. VANCE. My competency is not as broad in the area of banking——

Mr. ROUSSELOT. I beg your pardon. Your competency is not great in the field of banking, but you are telling us how to legislate in the field of banking?

Mr. VANCE. I say more so in the area——

Mr. ROUSSELOT. That is an incredible statement. You are here to tell us how to legislate in the field of banking, and, by your own admission, you tell us you are really not competent in the field to talk on it. That is an incredible statement, but go ahead.

Mr. VANCE. The boards of directors of banks and of the corporate system do have much more in common than they differ, and I think that my experience in the field of the corporate structure does carry over into the field of banking.

The proxy system, I think we all agree, is identical in banking as it is in the corporate system.

Mr. ROUSSELOT. Similar.

Mr. VANCE. Therefore, any inconsistencies or any weaknesses in the proxy system as it pertains to the corporate end of it very likely—in fact, almost certainly—do carry over into the banking system.

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Mr. ROUSSELOT. Specifically, in this bill, how would we tighten up on the proxy system?

Mr. VANCE. I think—and this is where you threw me off by way of implying that my competency is zero——

Mr. ROUSSELOT. No; that is what you said. I am just quoting you.

Mr. VANCE. No. Well, it is misunderstanding.

In the corporate field at the moment, there is a move on the part of the dissident groups and, perhaps, the Ralph Naderites—I am not sure—and those like the Gilbert Brothers to disqualify proxies that are not signed. Apparently, management has been voting all these proxies.

Mr. ROUSSELOT. Do you know any banks today, that allow proxies that are not signed?

Mr. VANCE. I am sorry, not signed, but with no indication that they are for or against the management proposal, they have to be signed. My error. But when there is no indication that you are for or against, then that particular proxy is voted management's way.

Mr. ROUSSELOT. Would you make those prohibitions more stringent?

Mr. VANCE. I would like, as I mentioned earlier, to see more than one person designated as the candidate for one post. You all go through that same operation, and I do not think that is undemocratic.

Mr. ROUSSELOT. Will the stockholders in those banks have an opportunity to offer additional candidates?

Would other people offer candidates?

Mr. VANCE. Hopefully, the stockholders would.

Mr. ROUSSELOT. Don't most banks provide, prior to their annual meetings, an opportunity for people to submit candidates?

Mr. VANCE. I do not think it is done on a broad basis. It is not done effectively. I can't name, and I wonder if you can name, situations where the banks have asked for and have received an additional number of candidates over and above those that are being elected?

Mr. ROUSSELOT. How many there are, I can't say, but I know that the Bank of America which operates in our State does.

What other areas could we make more stringent?

Mr. VANCE. I would like to see—and now you are pushing me.

Mr. ROUSSELOT. It is your own statement.

Mr. VANCE. I would like to see the record of directors who attend——

Mr. ROUSSELOT. The stockholders' meeting?

Mr. VANCE. No, at their regular monthly meetings, or the quarterly, whatever they might be.

Mr. ROUSSELOT. You would like to see it, or you would like to see it published?

Mr. VANCE. I would like to see it published, what directors attended such meetings.

Mr. ROUSSELOT. Would you put this in the legislation, that all of those who attend should be published?

We are talking about legislation.

You have spoken in favor of this bill.

Your statement to us is that if you were legislating, you would make it more stringent. Tell us how.

Mr. VANCE. If I were legislating, there would be a supplementary bill. This bill as is——

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Mr. ROUSSELOT. Maybe you can submit that for the record, as to how you would change this. We would be glad to have it.

Mr. VANCE. At the moment, I do not have a bill worked out. As you know, a bill——

Mr. ROUSSELOT. You were the one that said that you would like the prohibitions to be even more stringent. And I was merely trying to ask how you would do this.

Mr. VANCE. I mentioned a few instances——

Mr. ROUSSELOT. One way is for the banks, themselves, to publish somehow, more broadly, who attended the meeting and who did not.

Mr. VANCE. Correct. It is a very minor step, but I think that would help. It would indicate that certain individuals are honorific in terms of their position, that they have the title but they do not attend and do not participate. This is very difficult to implement, but I would like to see the positions of various directors on various issues, for instance, on conglomeration——

Mr. ROUSSELOT. You would like them to publish their vote in the record?

Mr. VANCE. Yes. It would be very difficult to implement this point.

Mr. ROUSSELOT. Maybe we should do this in this legislation.

Mr. VANCE. Probably not in this legislation.

I think that would be a time-consuming operation.

Mr. ROUSSELOT. That is what we are here to do. We are talking about this specific legislation.

Mr. VANCE. I think this legislation is excellent and it ought to be passed.

Mr. ROUSSELOT. But your statement was that as it relates to interlocking relationships—and you spent a lot of time on that issue—that one of the problems was that this was a step in the right direction but it did not go far enough in its prohibitions, and I thought maybe you could elaborate on how, if you were a legislator, you could improve that.

I see my time has expired. Thank you very much.

Mrs. SULLIVAN. Mr. Vance, may I just ask this?

Would disclosure of who the institutional stockholders are and publishing copies of the minutes of the board meeting be other areas to make a board of directors more democratic?

Mr. VANCE. Very definitely so. I think at least it woud give us a glance at who constitutes the owners of this particular corporation.

Mrs. SULLIVAN. And, then, also, a showing of who attends these board meetings, and who does not, and whether it is an active board?

Mr. VANCE. Precisely.

Mr. ROUSSELOT. And how would we publish those—in the paper? What would be the restriction we placed on them?

Mr. VANCE. We do get annual reports that tell us very little, beautiful pictures of a project——

Mr. ROUSSELOT. I am very familiar with it. I saw the annual report of the University of Oregon, and I did not think it showed very much.

Mrs. SULLIVAN. Let's argue that later.

Mr. Mitchell.

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(At this point, the committee retired into executive session, after which the hearing was resumed in open session as follows:)

Mr. MITCHELL. Mr. Vance, I read your statement very carefully, I am quite intrigued by it, and I find it quite attractive. Though I sit on this side of the aisle, I must admit that my philosophical tradition is more in the line of Mills as delineated in "The Power Elite" and much more in line with Lundberg as delineated in "The Rich and Super Rich." I would like to indicate that I found it very, very attractive, because I share philosophically with you the concern over the differential aspects which have led to certain undemocratic processes in this whole system.

Also I would like to indicate that I understand, as a witness here—although you may be required to give specific answers to certain questions—that you may also lay out general comment from which my astute colleagues can extract certain information which might strengthen the legislation.

My colleague has spent a great deal of time asking you for specific recommendations about strengthening H.R. 5700. I think it is a good bill—a needed one. I do not want to put you on the spot at all, but I would like to ask you very specifically: Are there any things at all, in 1, 2, 3 order, that you would like to submit as recommendations at this juncture or at a later juncture to strengthen this bill even more?

I, too, am mulling over in my mind some possible means of strengthening this legislation. If you have any suggestions at all, I would be glad to listen to them, or if you would prefer to submit them at a later date to the entire committee or individual members, that would be fine, I am sure.

Mrs. SULLIVAN. If the witness wishes to submit them later, when he corrects his testimony, that would be satisfactory.

Mr. VANCE. I think that would be more judicious. I am not experienced enough in speaking before such an august body to enumerate such things spontaneously, and, perhaps, I have not followed through with the amenities in the proper place; perhaps, I stated it too candidly. But I think that it is a lot more important than being a lobbyist of the suave type. So, I hesitate at this point to set forth anything that I would be held to, but if you wish I would be very pleased to work on any aspects that I think might be helpful to you.

Mrs. SULLIVAN. May I say, Mr. Vance, that you should send these as soon as possible to the committee itself to be included in this portion of the testimony.

(The information requested from Mr. Vance follows:)

REPLY FROM MR. VANCE

As I tried to stress in the preceding comments, a one-man instantaneous proposal to make HR 5700 more "stringent," would be pretentious and quite superficial. However, at Congressman Rousselot's insistence, I venture to suggest the following as meriting investigation and possible legislation, not only for corporation boards but also for banks since there is basically no difference in their function.

1. My sentiments on one-slate directorate elections have already been stated.

2. Certain dissident stockholder groups have begun to question the common practice whereby all managements vote unmarked ballots. A similar practice in the political sphere would undoubtedly create a stir. It seems reasonable that only marked proxies should be counted.

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3. More detailed information on the backgrounds, associations, and specific competencies of all candidates is needed. Many major corporations such as Standard Oil Co. (New Jersey) have for quite some time been providing this type of information. On the other hand, as late as 1966, American Telephone and Telegraph Co. refused to provide its stockholders more than the candidates' names in its proxy solicitations. This practice was changed at AT&T in 1967.

4. Mention has already been made of the need for published attendance records. At the April 28, 1971, General Electric Co. annual meeting at Miami, Florida, only five directors out of eighteen deigned to attend This is an attendance rate of only 28 percent. Only one out of the fourteen outside directors attended. If this had not been a public meeting, this below-quorum participation would not have been known. Certain dissident groups are trying to get individual corporations to adopt proposals to drop directors who miss statutory meetings for two years in a row. However, nothing is being done to ensure director attendance at the regular monthly or quarterly meetings.

5. Consideration should be given to disclosing how individual directors feel about and vote on the really crucial issues. The first real breakthrough in this respect occurred last month when General Motors Corporation revealed that Dr. Leon Sullivan, its most recently appointed director, cast a dissenting vote on an issue pertaining to GM's affiliate in South Africa. This previously unheard of action proves that it can be done. In the Penn Central case, the stockholders have a right to know which directors advocated the conglomeration gamble which resulted in investors losing nearly $2 billion.

6. Shareholders should be given an opportunity to participate with the directors, in at least a few "open" meetings, just as I have had the opportunity to testify publicly before this group. This does not preclude necessary "executive" sessions of the board. At present the only opportunity interested investors have to see their top policy makers in action is at the annual meeting which too frequently is a mere formality and at times, even a farce.

7. More frequent boardroom meetings are essential. The quarterly pattern reflects upon the inactivity of that board and perhaps even of the firm.

8. Officer-directors must be given some form of job security, thus, hopefully, reducing the fear of executive sanction on recalcitrants.

9. The question of director liability should be studied. Penn Central's payment of an annual premium of $305,360 to Lloyds of London for a $10 million policy to protect its officers and directors against charges of wrongdoing is a good illustration. Here we have a situation where the stockholders are indirectly insuring officers and directors who might subsequently be proven to be derelict, incompetent or even guilty of unethical or illegal action which directly affect these same investors' interests.

10. All fees and retainers, except for reasonable travel and per diem payments, made to outside directors should be paid not to the outside directors but to their respective banks or corporations. At present the median pay per meeting is about $500 while annual retainers average about $4,000 (with a growing number moving toward the $20,000 level). The typical justification, that even this is a low price for such talent is an unsubstantiated subjective judgment. To me, the current outside director payment practice is simply executive moonlighting. Such a practice might be overlooked for a wage earner who is on the payroll eight hours a day but executives presumably are employed on a "total-time" basis.

These are a few of the areas which are equally vital to corporation and bank boards where more stringent measures might be considered for strengthening HR 5700. The most significant area, however, is probably outside the jurisdiction of this committee; namely, these restrictions, together with those already incorporated in HR 5700 should also be extended to the corporate sector.

Mr. VANCE. Congressman Mitchell, I have just finished a paper on "Black Power in the Board Room." I think you might be interested, because it touches on this particular thing very definitely.

Mr. MITCHELL. This is one of the areas of concern to me. I look at the large numbers of blacks who have substantial amounts of money in the banks and never appear at board meetings. Often I hear from people who say they never even get a notice about a board meeting. So, I think there are areas of concern. I have about a minute left, and I

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do not intend to use it all, but I just want to insert for the record this comment, that based on your statement and your testimony presented before this committee, I personally have no reason to doubt your competency as a witness before the committee.

Thank you very much.

Mr. VANCE. Thank you.

Mrs. SULLIVAN. Mr. McKinney.

Mr. MCKINNEY. Mr. Scott, I am very interested in your association's viewpoint on equity participation.

In your testimony, on pages 3 and 4, you allude to it but you are not terribly specific, and I am particularly disturbed about what I would call the statement "joint ventures," because I really fail to see any difference between equity participation and joint ventures, so I would assume by joint ventures, you are calling for a larger percentage participation on the part of savings and loan or the bank involved.

Mr. SCOTT. No, I would say that the equity participation is maybe the shotgun wedding and the joint venture is one by consent. The two parties get together willing to produce an end result, such as perhaps a massive housing project, where the builder does not have the capital but maybe has the know-how and the institution has the money.

Mr. MCKINNEY. But isn't equity participation, in actuality, No. 1, a way in which a savings and loan association and, for instance in my State, a mutual savings bank can participate and protect the bank and the depositors from the increasing inflation and the cost of living, and isn't it true that in most of our leases we see signs today on a commercial basis that there is in fact a cost-of-living escalation clause which reflect into this equity participation?

And, then, in reality, the shotgun approach that you allude to is really just a result of the free marketplace anywhere.

Mr. SCOTT. That is right. In other words, the cost of money got so high that the only way that the people who were interested in the project could get to the project was to give part of it to the lender.

Mr. MCKINNEY. I would assume that equity participation or the shotgun approach to it would diminish as rapidly as the supply of money grows.

Mr. SCOTT. I think it has.

Mr. MCKINNEY. Another question that I had for you is: On page 4 and 5, you stress the viewpoint—and I quite agree with you. You say:

"On balance, our institutions have probably gained substantially by the presence of knowledgeable financial men on our boards."

But then when we go down to paragraph 3 on page 5, we find:

> We would offer for consideration that these are distinction between those institutions dealing with savings and home lending and those who are in the insurance, securities, or title business.

I would agree with you that there is a definite difference. I would go along with that statement, but I find it difficult when we then come down to savings banks, because, for instance, under the State charters of mutual savings banks in such States as have them in the northeast, I find very little difference between them and the savings and loan associations as they are known in your State.

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Mr. SCOTT. Yes. What we are saying there is that maybe there should be some restriction on interlock between commercial banks and savings and loan associations because they are so much alike and they are competitive.

Mr. MCKINNEY. Mr. Vance, one thing in your testimony that particularly disturbed me is that—I might say that my public references and thoughts on the subject of the board of directors of the Penn Central Railroad are well known to anyone who happens to read any of the northeastern newspapers who publish what I have to say about these various questions. But one thing really distrubs me is that you talk about making a board more democratic by bringing on vice presidents of the corporation involved. What distrubs me most is that this bill—and I have served on several boards, all of which I have resigned from. I would say that one of the things that disturbs me the most is the fact that corporate officers, I feel, should probably, if anything, be ex-efficio nonvoting chairmen of boards, and that to talk about bringing more of the corporate structure of a bank onto the board of a bank which supposedly represents the stockholders to me is not democracy; it is building the most incredibly ingrained power structure that you could possibly come across, and I would far rather see a gentleman without financial expertise on the board of a bank making a decision than I would a man who has to kowtow to the president of the bank everytime he moves.

Mr. VANCE. Once, again, my analogy is from the corporate field where we have the executive committees in most of our large corpora- tion sand middle-sized and small corporations made up of officers of those corporations. That gives the corporation an instant response to a problem, because you can convene your executive committee instantaneously, whereas if you have an executive committee made up of outside directors, or if you have no executive committee, then you are at the mercy of the phone, perhaps, and you get garbled communications, or you have to convene an emergency session of the board, but you do not have the immediate response to problems that is feasible as demonstrated in corporations that have officer-directors currently available who have the power to make such decisions.

Mr. MCKINNEY. Do you know of any instance whatsoever—I certainly do not know of any—where the full board does not have the right to change, eradicate, remove, or do anything they wish to with the decision of the executive committee?

The executive committee is, as you say, a fast, immediate source of information or action, but it appears to me that any board in this country of any type of corporation, even a bank, has the right to revoke that action taken by the executive board at any time.

Mr. VANCE. Precisely. But, generally, the executive committee does have the right to act in lieu of the full board and rarely, especially if it is large enough to comprise the significant portion of the board—rarely are its decisions repealed.

Corollary to this, we are developing nationwide the office-of-the-president concept which is nothing but a substitute for an effective executive committee, indicating a need for a power structure, or call it what you will, available and capable of making decisions on questions that come up so suddenly.

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Mr. McKINNEY. My time has expired. But I would simply say that the last place I would look for democracy on the board is within the corporate structure itself.

Mrs. SULLIVAN. Mr. Archer.

Mr. ARCHER. Mr. Vance, your testimony has been almost exclusively to treating situations in nonfinancial corporations—oil, steel, autos. And, of course, as it has been pointed out, the only authority that this committee has is with respect to financial institutions—that is the only way we can get a handle on legislation.

With respect to this and trying to orient your testimony toward this bill and toward the financial institutions, let me ask you this: Have you ever served on a bank board?

Mr. VANCE. No.

Mr. ARCHER. Have you ever attended a bank directors' meeting?

Mr. VANCE. I held no bank directors' meetings?

Mr. ARCHER. I did not ask you that. I asked you if you had ever attended one.

Mr. VANCE. Very obviously no.

Mr. ARCHER. You have not attended, then?

Mr. VANCE. No. They are closed to the public and even to stockholders.

Mr. ARCHER. Do you realize that in a bank directors' meeting it is customary for the directors to proceed to go over all the loans that the bank has been made in the previous period of time since the last meeting and to evaluate these loans and give their expertise as to whether these loans are solid, how they should be policed and this sort of thing? Are you familiar with the fact that such action is customary in bank directors' meetings?

Mr. VANCE. Yes, I am.

Mr. ARCHER. Are you also familiar with the fact that the bank directors carry different responsibilities than the directors of other types of corporations with respect to individual liability; are you familiar with that?

Mr. VANCE. I did not think there was any difference in liability.

Mr. ARCHER. Mr. Vance, you are testifying before this committee with respect to banking legislation, and you do not know the responsibilities of a director of a bank, yet you are coming here and testifying before us as to what we ought to do on this bill.

Mr. VANCE. I do not know what the question is.

Mr. ARCHER. I think I made the question very precise.

You are stating here that there is public dissatisfaction and disallusionment as to directors who assume honorific posts and you equating a bank director to an honorific post. And the point of my question is: Do you understand the functions and the responsibility of a bank director? And you have just told me you do not know, and yet you are calling them honorific.

Mr. VANCE. I do not think that there is much difference between a bank director and a director of a major corporation in terms of the basic liabilities.

Mr. ARCHER. Mr. Vance, I think you had better go back and consult the laws as they relate to bank directors, because the imposition of responsibility on a bank director is significantly greater than it is in

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the private corporations that you have been talking about, and, personally, I think, when you refer to a bank director as honorific that you do not understand what a bank directors' responsibilities are.

I yield back the balance of my time.

Mrs. SULLIVAN. Mr. Archer, may I say that if what you say is true, we would have many directors in jail right now.

Mr. VANCE. Exactly.

Mr. ROUSSELOT. That would be good.

Mrs. SULLIVAN. I can give you some excellent examples.

Mr. VANCE. Congressman Archer I would challenge you to provide me with any instance——

Mr. ARCHER. You are not here to challenge a member of this committee on anything, and I think you are out of order.

Mr. VANCE. I withdraw that.

Mr. ARCHER. Madam Chairman, let's proceed.

Mrs. Sullivan. I want to thank both of you gentlemen for coming. The time of everyone has expired. The third witness has not shown up as yet this morning. So, the committee will stand in recess until 10 o'clock tomorrow.

(Whereupon, at 12:18 p.m., the committee recessed, to reconvene at 10 a.m., Friday, April 23, 1971.)

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THE BANKING REFORM ACT OF 1971

FRIDAY, APRIL 23, 1971

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
Washington, D.C.

The committee met, pursuant to recess, at 10:05 a.m., in room 2128, Rayburn House Office Building, Hon. Wright Patman (chairman) presiding.

Present: Representatives Patman, Sullivan, Mitchell, Widnall, Brown, McKinney, and Archer.

The CHAIRMAN. The committee will please come to order.

Our first witness this morning is Prof. Edward S. Herman, of the Wharton School of Finance, University of Pennsylvania. Professor Herman is the author of the section entitled, "Conflict of Interest in the Savings and Loan Industry," which is a part of a four-volume study of that industry carried out by Professor Friend of the University of Pennsylvania in 1969.

Professor Herman's study has received wide attention and we are very glad that he could take the time to give us the benefit of his views on the legislation before us, much of which relates to the question of conflict of interest among financial institutions.

After Professor Herman's statement we will have Mr. Angus McDonald. After they are finished the members will each be allowed the privilege of interrogating them.

Professor Herman, you may present your statement to the committee, or summarize if you wish, and then we will proceed with the questions. We have found that we are really cover the text of a statement pretty well in the questioning by committee members. The committee members get the statements in advance and go over them and therefore are prepared to ask questions, otherwise they would not be prepared to.

So you are recognized, sir. You are welcome to the committee, and we are glad to have you, and we look forward to hearing testimony.

STATEMENT OF PROF. EDWARD S. HERMAN, WHARTON SCHOOL OF FINANCE, UNIVERSITY OF PENNSYLVANIA

Mr. HERMAN. Thank you, Mr. Chairman. I am happy to be here before this committee.

Since my statement is very short I think the most expeditious thing would be to read it to you.

I have divided my statement into three parts, the last two of which overlap rather substantially. First, I have summarized several parts

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of my study on "Conflict of Interest in the Savings and Loan Industry," published by the Federal Home Loan Bank Board in 1970, which seem most relevant to the matters covered in H.R. 5700. Second, I have put together some general comments on the problems involved in regulating interlocks. Finally, I make a few very specific comments and suggestions on the bill.

One of the most striking features of the savings and loan industry is the extent to which associations are interlocked with other financial institutions, especially commercial banks.

An internal FHLBB study of 1965 found that two out of three associations were interlocked with at least one other financial institution, and that one out of three associations were interlocked with another financial institution. In a large random sample of 805 associations which I prepared on the basis of 1968 data, 451, or 56 percent of them, had one or more commercial bank interlock. The breakdown by number of bank interlocks is shown in table I, which is reproduced in my statement, from the study.

One can see, for example, that 153 associations had three or more interlocks with commercial banks. Many of these associations, of course, had more than one interlock with the same bank.

In table II, which I have also presented in my statement, taken from the study, it is shown that 173 of the 805 sample associations had two or more interlocks with the same bank.

My own assessment of these data is that, on a very conservative estimate, at least 20 percent of the sample associations were under common control with a commercial bank in 1968. In many instances this had come about as a result of bank interests being permitted to organize a de novo savings and loan association, although in quite a few cases the fusion of interests occurred subsequent to organization.

In any event, this structure of interlocks and extensive common control of savings associations and banks would seem on its face unhealthy, because banks and savings associations can and do compete for savings deposits and mortgage loans. Furthermore, especially when the association is a mutual organization, control by a bank organized as a stock company holds open the possibility of various other kinds of abuse, such as fee allocations favorable to the bank, and the use of the association as a dumping ground for unwanted loans.

The justification usually given for this state of affairs has been twofold:

(1) An association under bank control is better—and will produce more local mortgage loans—than no association; and

(2) It is argued that, in many cases, especially in small towns, technical expertise is in short supply, and must be met from the local financial community, including banks. I am sure that these justifications are valid in some cases, but my impression is that the proportion of bank interlocks that can be adequately defended by such considerations is not very large. In some cases, also, the first justification only applies in the short run; that is, the bank may only speed up the date of formation of the association. But the bank-sponsored association may then preclude a new independent

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entrant more or less indefinitely. In other words, if a bank is permitted to organize an association it may preempt that opportunity more or less permanently; and this has happened in a number of cities where the banks got in early. And in a couple of cases I happen to know, there were potentially independent associations in the offing, and they were precluded by the bank entry, and as far as I know, a new nonbank entrant has not come into those markets up to this point.

It seems to me that the advantages of this great proliferation of bank-association interlocks and the establishment of control relationships between them, especially at this stage in the development of the savings and loan industry, are far outweighed by their negative potential. These relationships seem to me contrary to public policy in at least three respects:

(1) They are likely to impair competition, an outcome that can be observed in some cases in the form of less aggressive and noncompetitive behavior by the controlled associations;

(2) They may involve fee and asset allocations and transfers detrimental to the interests of the associations; and

(3) They enhance the burden of regulation, which cannot assume arm's-length bargaining in transactions between the interlocked firms.

Remedial action in the area of bank-association interlocks seem to me long overdue, and this is provided in H.R. 5700.

Another finding in the savings and loan conflict study that is worthy of the committee's attention is the extent of, and lack of control over, reciprocal lending. This is a method of evasion of the prohibition of lending to officers and directors of associations, whereby the officials of one association borrow from another and reciprocate by lending to the officials of the association from which they borrow. Banks may enter into this system of reciprocal lending with associations. In a late 1968 compilation by the supervisory authorities, 14 associations in the Houston area were found to have 54 loans outstanding to officers and directors of other associations, with an aggregate volume of $14.6 million. This does not include loans from banks which are heavily interlocked with savings associations in the Houston area.

I provide in my statement a table from the study showing the extraordinary network of interlocking among financial institutions in the Houston, Tex., area.

This practice seems to me to need much greater legislative and regulatory attention than it has received up to now.

I turn now to part II of my statement, which is about the genreal problem of controlling interlocks.

I have a great deal of sympathy with the purpose of H.R. 5700 and agree with the specifics of some of its most important provisions, especially those placing limits on horizontal interlocks. Their passage would represent a constructive step in the continuing efforts to preserve a competitive financial system.

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It should be recognized, however, that interlocks are of secondary importance in comparison with close-knit combinations in determining the distribution of economic power. They may help cement alliances, and they can serve as a mechanism for facilitating coordinated behavior, but they can hardly be put in the same class of importance with, say, a series of bank mergers that reduce the number of rivals in an area by two-thirds and triple the average size of banks. It is a classic case of trying to shut the barn door long after the mare and all the little colts have been swallowed and digested, to try to deal with bank lending and trust department power after the great wave of mergers that was permitted to take place after 1945.

Great aggregations of capital and assets mean great capacity to buy, sell, lend and borrow; in a word, primary economic power. That power will be felt and it will be employed. Prohibiting vertical interlocks with borrowers or portfolio companies would, I suspect, have only modest value in limiting the extent and exercise of power. The views of real power holders can be made known and their interests can be protected by means other than through directorships. Interlocks may contribute a marginal addition to power, but they are not likely to add very much, especially where there is a single interlock and the firm in question is reasonably large and important. The power that comes from lending is not eliminated by prohibiting board representation to the lender; in fact, insofar as the lender regards his capacity to protect his interests as weaker, he might feel compelled to exact more onerous terms, including greater restrictions on managements incorporated into the credit agreements themselves.

However, insofar as interlocks reinforce a power position, and reduce the ability of outsiders to obtain credit or do business within the more tightly knit circle, they weaken competition. Equally important, vertical interlocks may have important horizontal effects where the interlocks by one institution, say a bank, extend to many firms that compete with one another, that is, a group of producers of steel. In this case vertical interlocks amount to horizontal interlocks among competitors at a second degree removed.

It is hard to see how this can be legislated against without a fairly broad limitation on vertical interlocks. The present bill would not get at these interlocks in the absence of a creditor or substantial owner position, but this may be an unimportant limitation.

The qualifications in my support of limitations on vertical interlocks do not apply to an attack on horizontal interlocks among financial institutions, although there too constraints on primary structural change in the form of increased concentration would seem considerably more important than control over interlocks.

In the case of horizontal interlocks, however, the potential for damage to competition among institutions whose functions have increasingly tended to overlap, and who are therefore both actual and potential competitors, seems to be a fairly important vehicle for establishing and maintaining common control. This is a consequence, in part, of the relatively small size of many associations; in part it results, from the mutual form, which increases the importance of officer-director positions—versus stock ownership—in control maintenance.

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Returning to the greater importance of close-knit combinations than looser alliances, there is a further question to be considered. If companies want to affiliate with one another, and this is prohibited in looser-knit forms, they may be inclined to combine more closely if this option is open. H.R. 5700 in this respect encourages the fusion of, say, title and real estate companies, into holding company systems, as they are no longer permissible private affiliates.

This is defensible as a means of eliminating open conflict of interest situations, but it should be recognized that it involves stimulating larger more diversified power entities.

Let me conclude with a few specific comments on H.R. 5700.

First, I have already indicated my basic support of the limitations on horizontal interlocks, and my support, with reservations, of limiting vertical interlocks in section 7, 8, and 9.

Section 11 seems to me to be unworkable in that "intent" and "understanding" regarding officer conduct are too fuzzy, too elusive, and too impossible of proof to constitute appropriate legislative raw material. Absolute prohibitions on officer-director loans from company banks would be more workable but would suffer from other serious difficulties.

I support the disclosure requirement on bank fiduciary security holdings in section 12 and the 10 percent limitation in section 13. With respect to the prohibition of bank fiduciary holdings of own stock, I have some reservations. Section 13(2) seems unduly restrictive. Why not merely prohibit banks from acquiring their own stock by purchase? Is it the intention of this subsection to force banks to terminate their relationships with all personal trusts that include the bank's stock even where the bank has no voting rights? Wouldn't the stock of bank A owned by bank B in fiduciary trust accounts pose a greater threat than own stock held by bank A?

I think that last is a fairly important point. This bill does not deal explicitly with a very important group of cases in the bank trust field, namely, cases where one bank in a city owns stock in other banks in the city. In many cases on the buy list of a bank in a major city are the stocks of other banks in that city.

It seems to me that the acquisition in fiduciary trust accounts of stock of competitors is far more important than stock held of the bank itself, especially in fiduciary trust accounts, that are personal trusts where the bank has no control.

That concludes my statement, Mr. Chairman.

I would be happy to try to answer any questions that you may have at this time.

The CHAIRMAN. Thank you, sir.

Your prepared statement will be placed in the record at this point.

(The prepared statement of Professor Herman follows:)

PREPARED STATEMENT OF EDWARD S. HERMAN, PROFESSOR OF FINANCE, WHARTON SCHOOL, UNIVERSITY OF PENNSYLVANIA

I have divided my statement into three parts, the last two of which overlap rather substantially: First, I have summarized several parts of my study on Conflict of Interest in the Savings and Loan Industry, published by the Federal Home Loan Bank Board, (FHLBB), in 1970, which seem most relevant to the

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matters covered in H. R. 5700. Second, I have put together some general comments on the problems involved in regulating interlocks. Finally, I make a few very specific comments and suggestions on the Bill.

I. SAVINGS AND LOAN INTERLOCKS WITH OTHER FINANCIAL INSTITUTIONS

One of the most striking features of the savings and loan industry is the extent to which associations are interlocked with other financial institutions, especially commercial banks. An internal FHLBB study of 1965 found that two out of three associations were interlocked with at least one other financial institution, and that one out of three associations has at least one officer interlocked with another financial institution. In a large random sample of 805 associations which I prepared on the basis of 1968 data, 451, or 56% of them, had one or more commercial bank interlock. The breakdown by number of bank interlocks is shown in Table I, which is reproduced here from the Study. One can see, for example, that 153 associations had three or more interlocks with commercial banks. Many associations, of course, had more than one interlock with the *same* bank. Thus, Table II, also taken from the Study, shows that 173 of the 805 sample associations had two or more interlocks with the same bank.

TABLE I.—NUMBER OF COMMERCIAL BANK INTERLOCKS OF 805 SAVINGS AND LOAN ASSOCIATIONS IN 1968

Number of interlocks	Associations		Number of interlocks	Associations	
	Number	Percent		Number	Percent
0	354	44.0	7	1	.1
1	195	24.2	8	1	.1
2	103	12.8	9	1	.1
3	65	8.1	17	1	.1
4	44	5.5			
5	25	3.1	Total	805	100.0
6	15	1.9			

TABLE II.—NUMBER OF COMMERCIAL BANK INTERLOCKS OF 805 SAVINGS AND LOAN ASSOCIATIONS IN 1968, CLASSIFIED BY THE HIGHEST NUMBER OF INTERLOCKS WITH ANY ONE BANK

Highest number of interlocks with any 1 bank	Associations		Highest number of interlocks with any 1 bank	Associations	
	Number	Percent		Number	Percent
0	354	44.0	5	10	1.2
1	278	34.5	6	2	.2
2	105	13.0	9	1	.1
3	39	4.8			
4	16	2.0	Total	805	100.0

My own assessment of these data is that, on a very conservative estimate, at least 20% of the sample associations were under common control with a commercial bank in 1968. In many instances this had come about as a result of bank interests being permitted to organize a *de novo* savings and loan association, although in quite a few cases the fusion of interests occurred subsequently to organization. In any event, this structure of interlocks and extensive common control would seem on its face unhealthy, because banks and savings associations can and do compete for savings deposits and mortgage loans. Furthermore, especially when the association is a mutual organization, control by a bank organized as a stock company holds open the possibility of various other kinds of abuse, such as fee allocations favorable to the bank, and the use of the association as a dumping ground for unwanted loans.[1]

[1] In my study I discussed a number of cases where bank domination of savings associations seemed to have had an adverse effect on competition, or damaged the association in other ways. It should be pointed out, however, that no significant adverse effects of bank affiliation were found in the aggregative statistical analysis that I conducted. This may have been a result of some serious weaknesses in the data. The author has urged the FHLBB to attempt a more refined analysis of the effects of bank and association links.

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The justification usually given for this state of affairs has been two-fold: (1) an association under bank control is better (and will produce more local mortgage loans) than no association; and (2), in many cases, especially in small towns, technical expertise is in short supply, and must be met from the local financial community, including banks. I am sure that these justifications are valid in some cases, but my impression is that the proportion of bank interlocks that can be adequately defended by such considerations is not very large. In some cases, also, the first justification only applies in the short-run; i.e., the bank may only speed up the date of formation of the association. But the bank-sponsored association may then preclude a new independent entrant more or less indefinitely.

It seems to me that the advantages of this great proliferation of bank-association interlocks and the establishment of control relationships between them, especially at this stage in the development of the savings and loan industry, are far outweighed by their negative potential. These relationships seem to me contrary to public policy in at least three respects: (1) They are likely to impair competition, an outcome that can be observed in some cases in the form of less aggressive and non-competitive behavior by the controlled association; (2) they may involve fee an asset allocations and transfers detrimental to the interests of the association; and (3) they enhance the burden of regulation, which cannot assume arms-length bargaining in transactions between the interlocked firms. Remedial action in the area of bank-association interlocks seems to me long overdue.

Another finding in the savings and loan conflict study that is worthy of the Committee's attention is the extent of, and lack of control over, reciprocal lending. This is a method of evasion of the prohibition of lending to officers and directors of associations, whereby the officials of one association borrow from anther and reciprocate by lending to the officials of the association from which they borrow. Banks may enter into this system of reciprocal lending with associations. In a late 1968 compilation by the supervisory authorities, 14 associations in the Houston area were found to have 54 loans outstanding to officers and directors of other associations, with an aggregate volume of $14.6 million. This does not include loans from banks, which are heavily interlocked with savings associations in the Houston area. (Table III, reproduced from the Study, shows the extraordinary network of interlocks among financial institutions in the Houston area.) This practice seems to me to need much greater legislative and regulatory attention than it has received up to now.

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TABLE III.—INTERLOCKING DIRECTORSHIPS IN CERTAIN HOUSTON, PASADENA, AND SAN JACINTO AREA FINANCIAL INSTITUTIONS, 1968

Name	AA savings association	AAA State bank	BBB State bank	CCC bank	DDD State bank	BB savings association	EEE bank and trust	FFF bank	CC savings association	GGG national bank	HHH bank
A	Director			Director							
B	do			Pres/Director							
C	do	Director									
D	do	do									
E	do		Director								
F	do	Director									
G	do	do									
H	do				Director						
I	do			Director							
J	do			do	Director						
K	do	Director									
L	do		Director								
M	(1)			Director		Director	Director				
N				do		do	do				
O				do		do					
P				do		do		Director			
Q				do		do					
R			Director						Director		
S			do						do		
T			do						do		
U		Director							do		
V									do	Senior V/P	
W									do		Director.

[1] Member of proxy committee.

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II. CONTROLLING INTERLOCKS

I have a great deal of sympathy with the purposes of H.R. 5700 and agree with the specifics of some of its most important provisions, especially those placing limits on horizontal interlocks. Their passage would represent a constructive step in the continuing effort to preserve a competitive financial system. Nevertheless, I feel that it is important to call attention to some of the difficulties and weaknesses in an attack on interlocks, and especially vertical interlocks.

It should be recognized that interlocks are of secondary importance in comparison with close-knit combinations in determining the distribution of economic power. They may cement alliances, and they can serve as a mechanism for facilitating coordinated behavior, but they can hardly be put in the same class of importance with, say, a series of bank mergers that reduce the number of rivals in an area by two-thirds and triple the average size of banks. It is a classic case of trying to shut the barn door long after the mare and all the little colts have been swallowed and digested, to try to deal with bank lending and trust department power *after* the great wave of mergers that were permitted to take place since 1945.

Great aggregations of capital and assets mean great capacity to buy, sell, lend and borrow; in a word, primary economic power. That power will be felt and it will be employed. Prohibiting *vertical* interlocks with borrowers or portfolio companies would, I suspect, have little value in limiting the extent and exercise of power. The views of real power holders can be made known and their interests can be protected by means other than through directorships. Interlocks may contribute a marginal addition to power, but they are not likely to add very much, especially where there is a single interlock and the firm in question is reasonably large and important. The power that comes from lending is not eliminated by prohibiting board representation to the lender; in fact, insofar as the lender regards his capacity to protect his interests as weaker, he might feel compelled to exact more onerous terms, including greater restrictions on managements incorporated into the credit agreements themselves.

This skepticism does not apply with equal force to an attack on horizontal interlocks among financial institutions, although there too constraints on primary structural change in the form of increased concentration would seem considerably more important than control over interlocks. In the case of horizontal interlocks, however, the potential for damage to competition among institutions whose functions have increasingly tended to overlap, and who are therefore both actual and potential competitors, seems more substantial. In the savings and loan case, also, the interlock seems to be a fairly important vehicle for establishing and maintaining common control. This is a consequence, in part, of the relatively small size of many associations; in part it results from the mutual form, which increases the importance of officer-director positions (versus stock ownership) in control maintenance.

Returning to the greater importance of close-knit combinations than looser alliances, there is a further question to be considered. If companies want to affiliate with one another, and this is prohibited in looser-knit firms, they may be inclined to combine more closely if this option is open. H.R. 5700 in this respect encourages the fusion of, say, title and real estate companies, into holding company systems, as they are no longer permissible private affiliates. This is defensible as a means of eliminating open conflict of interest situations, but it should be recognized that it involves stimulating larger more diversified power entities.

III. SPECIFIC COMMENTS ON H.R. 5700

a. I have already indicated my basic support of the limitations on horizontal interlocks, and my reservations on the desirability and feasibility of limiting vertical interlocks in Secs. 7, 8 and 9.

b. Sec. 11 seems to me to be unworkable in that "intent" and "understandings" regarding officer conduct are too fuzzy, elusive, and impossible of proof to constitute appropriate legislative raw material. Absolute prohibitions on officer-director loans from company banks would be more workable but would suffer from other serious difficulties.

c. Sec. 13(2) seems unduly restrictive. Why not merely prohibit banks from acquiring their own stock by purchase? Is it the intention of this subsection to force banks to terminate their relationships with all personal trusts that include the bank's stock even where the bank has no voting rights? Wouldn't

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the stock of Bank A owned by Bank B in fiduciary trust accounts pose a greater threat than own stock held by Bank A?

The CHAIRMAN. We will next hear Mr. Angus McDonald. Mr. McDonald is a consultant from Mid-West Electric Consumers Association. He was for many years the legislative representative and director of research for the National Farmers Union. He has for a long time had a deep interest in the problems of interlocking relationships among various types of corporations.

Mr. McDonald, we appreciate your testifying before the committee today. The members of this committee have a high regard and great respect for you, and they value your testimony. We have heard you on many subjects, and you always make a good, forthright, honest, sincere witness. And we appreciate the fact that your are before us today. You may proceed in your own way in presenting your statement to us today.

STATEMENT OF ANGUS McDONALD, CONSULTANT TO THE MID-WEST ELECTRIC CONSUMERS ASSOCIATION

Mr. McDONALD. Thank you, Mr. Chairman. I appreciate that introduction very much.

Prior to my association with the Mid-West Electric Consumers Association, as the chairman has indicated, I was employed by the National Farmers Union during a period of approximately 22 years. During that period I handled legislation in which the Farmers Union had an interest involving the Sherman Act, the Clayton Act, the Robinson-Patman Act, the Federal Trade Commission Act, and the Reclamation Act of 1902. In short, I handled all legislation involving so-called monopoly problems.

I will address myself at this hearing to only the interlock provisions of the bill.

My interest particularly in the interlock situation stems in part from the fact that the consumers association with which I am associated employed me to make a survey of all the interlocking relations of all the power companies in the United States. The task is not yet completed, I would say about 95 percent.

I have for the information of the committee—and I would appreciate, Mr. Chairman, being allowed to make a few corrections in this document—I have here a 30-page document which lists alphabetically the power company executives who may have conflicts of interest in their financial corporate relationships.

The CHAIRMAN. Without objection, the statement may be inserted, with the understanding that Mr. McDonald will have the privilege when he looks over the transcript to make any corrections that he desires to make. You may summarize your statement if you desire, and this will all be in the record.

Mr. McDONALD. Thank you, Mr. Chairman.

I will now enumerate a few of the most important interlocks.

The Chemical Bank of New York has 12 interlocks with seven commercial banks, five with four savings institutions, 18 with 13 insurance companies, and six with miscellaneous financial institutions.

The commercial banks include the Continental Illinois National Bank & Trust, the First Pennsylvania Bank, Fidelity Union Trust,

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the First National Bank of Jacksonville, the First Merchants National Bank of Richmond, and Wilmington, Del., Trust Co.

The savings institutions include the Seamans Bank for Savings, the Harlan Savings Bank, the Empire Savings Bank, and the Western Savings Fund.

Insurance companies linked with the Chemical Bank of New York are as follows: New York Life Insurance, Life Insurance Co. of America, Equitable Life Assurance Society of the United States Mutual Life Insurance, Peoples Home Life Insurance of Indiana, Mutual Assurance, Pennsylvania Mutual Life Insurance, Home Insurance, Home Indemnity, Atlantic Mutual Insurance, Royal Globe Insurance, and Stock Insurance Co. of the Green Tree.

Morgan Guaranty Trust Co. is interlocked with the Hartford National Bank & Trust and the Bank of Montreal and with the Seamans Bank for Savings.

It has interlocks with 15 insurance institutions which include: Aetna Casualty & Insurance, Aetna Life Insurance, Aetna Life Assurance, Canada Life Assurance, Insurance of America, National Reinsurance Co., Standard Fire Insurance, Producers & Citizens Life Insurance, New York Life Insurance, Pennsylvannia Mutual Life Insurance, Metropolitan Life, Continental Insurance, Fidelity Insurance, Fidelity-Phoenix & Casualty, and Excelsior Life.

First, National City Bank of New York is interlocked with the Mercantile Bank of Canada, Hartford Bank & Trust and the Wilmington Trust Co. Interlocks with savings institutions include the Rochester Savings Bank, the Dry Dock Savings Bank, and the Seamans Bank for Savings.

Insurance interlocks include the following companies: New York Life Insurance, Northwestern Mutual Life Insurance, Teachers Insurance & Annuity Association, Connecticut Mutual Life Insurance, J. C. Penney Insurance, J. C. Penney Life Insurance, Global Life Insurance, Global Reinsurance, Global General Insurance, National Reinsurance, Mutual Life Insurance, All State Insurance, Metropolitan Life Insurance, Federal Insurance, Vigilant Insurance, Colonial Life Insurance, Pacific Indemnity, Atlantic Mutual Insurance, Centennial Insurance, and Prudential Insurance.

Now for Chase. The Chase Manhattan Bank of New York is interlocked with six other commercial banks, including the First National Exchange——

The CHAIRMAN. Mr. McDonald, I think it would be more impressive for us to get the real meaning of this than to recite them all by name. Give us the point that is involved and put the others in the record, if you please.

Mr. McDONALD. I appreciate that Mr. Chairman.

Chase has six interlocking with commercial banks, and seven interlocks with six insurance companies.

Interlocks among financial institutions in the Midwest and West occur much less frequently than in New England and New York. The Continental Illinois National Bank & Trust Co. has only two bank interlocks, one is with Chemical of New York and the other is with Northwest Bancorporation, Continental has only six interlocks with insurance companies, four of which are subsidiaries of the parent company.

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First Bank System is of special interest. This group of banks which dominates financial concerns in the area controls 88 active banks and trust companies with 107 offices in Minnesota, Montana, North Dakota, South Dakota, and Wisconsin.

First Bank is interlocked seven times in four banks: the First National Bank of St. Paul—I will not name the banks, it has interlocks with seven insurance companies.

Incidentally the First Bank Corp. is interlocked with the Northwest Bancorporation.

Now, I turn, Mr. Chairman, to a brief discussion of New England. And the members will notice that there are several pages of material here in which I discuss in some detail the directorships in the seven power companies which supply the New England area with electric power.

The CHAIRMAN. If you will summarize them, then we will have an opportunity to ask you questions and probably bring out the points you have in mind. In the event they are not brought out, you have permission to extend your remarks and bring in the points you wish.

Mr. McDONALD. I appreciate that.

In accordance with that suggestion, Mr. Chairman, I do not think that I will read this material. The members have a copy. I spelled out in detail the names of individuals——

The CHAIRMAN. That is what we would like.

Mr. McDONALD. The names of individuals, you will find quite a few listed here, with all of their financial interlocks.

I want to emphasize this point. This includes only power company interlocks with financial institutions. Doubtless there are many more with other industrial groups.

I have one final suggestion for the bill. I suggest that a provision be inserted prohibiting directors of competing companies from serving as directors of the same bank. The questions of economic survival are decided every day at bank directors' meetings. It seems obvious that common bank directors of competing firms set the stage for tacit valuation of the antitrust laws.

And then there is the question of conflict of interest, which is probably more responsible for the weakening and elimination of competition in the economy than any other factor.

I mention Mr. Chairman, in my prepared statement just a few of the interlocks of companies, competing companies which are sitting on the same bank board. Among those are Montgomery Ward, Sears-Roebuck, oil companies, and so forth.

One final point. My attention was recently called to an article in the Washington Monthly entitled "Ostracism, Blindness on the Bank Board." The author if this article suggested that Tony Boyle, Edward Carey and Thomas Ryan, directors of the National Bank of Washington, because of a conflict of interest, were finding it difficult if not impossible to act as dedicated stewards of the United Mine Workers of America.

I realize that that last point is off the subject, but I did want to call the committee's attention to that situation in regard to dues paying organizations and their involvement with financial institutions.

That concludes my statement.

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The CHAIRMAN. Thank you very much, sir.
(The prepared statement of Mr. McDonald follows:)

PREPARED STATEMENT OF ANGUS MCDONALD, CONSULTANT TO THE MID-WEST ELECTRIC CONSUMERS ASSOCIATION

Mr. Chairman and Members of the Committee, I appear here in support of H.R. 5700, which I believe will encourage competition and prevent abuses and restrict devices and practices which prevent competition. I do not at this time represent any group, although I have been retained by the Mid-West Electric Consumers Association to make a study of electric power company interlocks and keep the association apprised of legislative developments here in Washington. Prior to my association with the Mid-West Electric Consumers I was employed by the National Farmers Union for a period of approximately 22 years in the capacity of legislative assistant, Associate and Research Director. I handled all legislation pertaining to monopoly, restraint of trade affecting agriculture and small business. I have appeared before Congressional committees many times on legislative problems involving enforcement and implementation of the Clayton Act, the Robinson Patman Act and the Capper Volstead Act.

During my service with the Farmers Union I acquired some expertise in regard to the basing point system and its effect on industrial development in the South and West. I became convinced it was a child of eastern bankers designed to secure and retain financial and economic control of our economy. The basing point controversy, revelations by the House Small Business Committee, and evidence developed by the Department of Justice prior to the enactment of the Bulwinkle bill in 1948 and the Supreme Court decision in the cement case convinced me that banker control of the railroads and to a great extent of the rest of the economy resulted in a multitude of conflicts of interest, inefficiency and ultimately to bankruptcy and recessions. Several years ago in a brilliant analysis the staff of this Committee related three instances of banker intrusion into the normal functioning the competitive system. One involved a railroad, another a newspaper and the third a bank.

The need for this legislation is documented in these studies. Numerous authorities including the Chairman of this Committee, a former chairman of the Federal Reserve Board, the present Chairman of the Board and others presented facts and material which suggest early enactment of H.R. 5700.

Looking at the interlocks of a few banks it is apparent that hundreds of conflicts of interest make competition almost impossible among financial institutions. Conflicts of interest seem to be concentrated in the East, especially in New York City and New England.

The Chemical Bank of New York has 12 interlocks with 7 commercial banks, 5 with 4 savings institutions, 18 with 13 insurance companies and 6 with miscellaneous financial institutions.

The commercial banks include the Continental Illinois National Bank and Trust, the First Pennsylvania Bank, Fidelity Union Trust, the First National Bank of Jacksonville and the First Merchants National Bank of Richmond, and Wilmington, Delaware Trust Company.

The savings institutions include the Seamans Bank for Savings, the Harlan Savings Bank, the Empire Savings Bank and the Western Savings Fund.

Insurance companies linked with the Chemical Bank of New York are as follows:

New York Life Insurance
Life Insurance Co. of America
Equitable Life Assurance Society of U.S.
Mutual Life Insurance
Peoples Home Life Insurance of Indiana
Mutual Assurance
Pennsylvania Mutual Life Insurance
Home Insurance
Home Indemnity
Atlantic Mutual Insurance
Royal Globe Insurance
Stock Insurance Company of the Green Tree

Chemical is also interlocked with Adela Investment, Southeastern Investment, Euro Finance, Commonwealth Fund, Christiana Securities and Sears Roebuck Acceptance.

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Morgan Guaranty Trust Company is interlocked with the Hartford National Bank and Trust and the Bank of Montreal and with the Seamans Bank for Savings.

It has interlocks with 15 insurance institutions which include:

Aetna Casualty & Insurance
Aetna Life Insurance
Aetna Life Assurance
Canada Life Assurance
Insurance of America
National Reinsurance Company
Standard Fire Insurance
Producers & Citizens Life Insurance
New York Life Insurance
Pennsylvania Mutual Life Insurance
Metropolitan Life
Continental Insurance
Fidelity-Insurance
Fidelity-Phoenix & Casualty
Excelsior Life

National City Bank of New York is interlocked with the Mercantile Bank of Canada, Hartford Bank and Trust and the Wilmington Trust Company. Interlocks with savings institutions include the Rochester Savings Bank, the Dry Dock Savings Bank and the Seamans Bank for Savings.

Insurance interlocks include the following companies:

New York Life Insurance
Northwestern Mutual Life Insurance
Teachers Insurance & Annuity Association
Conn. Mutual Life Insurance
J. C. Penney Insurance
J. C. Penney Life Insurance
Global Life Insurance
Global Reinsurance
Global General Insurance
National Reinsurance
Mutual Life Insurance
All State Insurance
Metropolitan Life Insurance
Federal Insurance
Vigilant Insurance
Colonial Life Insurance
Pacific Indemnity
Atlantic Mutual Insurance
Centennial Insurance
Prudential Insurance

The Chase Manhattan Bank of New York is interlocked with 6 other commercial banks including the First National Exchange Bank of Virginia, the First Pennsylvania Banking and Trust, Wachovia Bank and Trust, Hartford National Bank and Trust, the First National Bank of Chicago and Trust Co. of Georgia. Savings bank interlocks include the Phil. Savings Fund and Bowery Savings Bank.

Chase has 7 interlocks with 6 insurance companies which include the Equitable Life Assurance Society, Jefferson Standard Life Insurance; Metropolitan Life, Travellors, Travellors Indemnity and Hartford Fire.

Interlocks among financial institutions in the midwest and west occur much less frequently than in New England and New York. The Continental Illinois National Bank and Trust Company has only two bank interlocks, one is with Chemical of New York and the other is with Northwest Bancorporation. Continental has only 6 interlocks with insurance companies, 4 of which are subsidiaries of the parent company.

First Bank System is of special interest. This group of banks which dominates financial concerns in the area controls 88 active banks and trust companies with 107 offices in Minnesota, Montana, North Dakota, South Dakota and Wisconsin.

First Bank is interlocked 7 times in four banks: the First National Bank of St. Paul, the First Trust Co. of St. Paul, the First National Bank of Minneapolis and the Pacific National Bank of Seattle. It is also interlocked with

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the Farmers and Mechanics Savings Bank. The First Bank System is interlocked with 7 insurance companies: Minnesota Life, Northwestern National Life, Minnesota Mutual Life, Mutual Life, Title Insurance of Minnesota, Northwest Life and Northwestern Life.

The Northwest Bancorporation controls 78 commercial banks and trust companies with 29 offices in the States of Minnesota, North Dakota, South Dakota, Iowa, Nebraska, Montana and Wisconsin. This institution has 5 interlocks with commercial banks, 11 with insurance companies and one with a savings institution.

Interlocked banks are: the Northwestern National Bank, Northwest International Bank, Northwestern National Bank of Minneapolis and the Farmers and Mechanics Savings Bank of Minneapolis.

Interlocked insurance companies are: Northwestern National Life Insurance, Title Insurance of Minnesota, North Atlantic Life Insurance of America, All Star Insurance, Central National Insurance Group of Omaha.

During the past few months I have been making an intensive study of interlocking directorates of all the power companies of the United States. The most significant fact that I have uncovered in this investigation is that almost wtihout exception power companies are invariably linked with banks. Banks and other financial institutions, I suspect, in most instances determine and prescribe power company policy which is to prevent at any cost competition by nonprofit utilities.

I call attention to seven New England power companies which are as follows:

1. The New England Electric System Holding Company which controls 5 electric companies and 9 gas companies. It serves Mass., Rhode Island and part of New Hampshire.

2. The Northeast Utility Holding Company which controls 3 electric companies and one realty company. It serves about 3 million people.

3. The Boston Edison Company which operates around Boston and which has acquired 21 smaller companies over a period of years.

4. The Central Maine Power Company which supplies ⅔ of Maine's population and has acquired many small companies.

5. The Eastern Utility Associates holding company which owns several operating companies and has participated in atomic energy plans and operations.

6. The New England Gas and Electric Association which owns 8 electric and gas companies and serves 182,970 customers in Massachusetts.

7. The Central Vermont Public Service Corp. which serves substantial portions of Vermont.

Nine executives of these seven companies are on the Boards of 21 conventional electric power companies, 8 of which are subsidiaries of the group of seven companies.

Seven of the nine are interlocked with Conn. Yankee Atomic Power Company. Eight of the nine are interlocked with the Yankee Atomic Electric Power Company. *Five* are interlocked with the Maine Yankee Atomic Power Company. *Two* are interlocked with the Vermont Yankee Nuclear Power Company. *Two* are interlocked with the Conn. Atomic Power Company and *one* with the atomic Industrial Forum.

The nine directors are interlocked with 12 financial institutions, 6 of these are commercial banks, 3 are savings banks and three appear to be investors fund houses.

The nine directors are interlocked with nine insurance companies which include 4 mutuals, 2 fire insurance companies, 2 accident companies, and one general insurance company.

The nine directors have ties with 25 other groups which include civic associations, educational institutions, hospital, economic and cultural associations. Included are 5 colleges and universities, several educational and scientific associations, a television education broadcasting corporation and a newspaper association, a newspaper chain and the Western Union Telegraph Corporation and 4 hospitals.

The nine executives are corporately related to a miscellaneous group of corporations, including the Rand Corporation, Arthur D. Little, Mohawk Airlines and 8 others. In all eleven.

Summarizing: These 9 men are directors of 21 conventional power companies, have 17 interlocks with atomic energy corporations. Seven are interlocked with 12 financial institutions. It would appear that conflicts of interest would be inevitable. For example, Mr. Charles F. Avila is interlocked with one bank, one savings institution and 2 insurance companies. All four of these institutions are

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supposed to compete in the money market for the business of both lenders and borrowers.

Mr. Avila is on the boards of 23 corporations including several power companies and utility publications. It is easy to see why he would not look with favor on any proposal to build a public power facility which might have the effect of reducing the highest power rates in the Nation in an area which suffers periodically from blackouts, brownouts and power shortages which may in the near future paralyze the Eastern United States.

Mr. William H. Dunham, as President of the Central Maine Power Company and director of 4 other power companies and the Electric Council of New England, would probably take a similar position since the proposal is repeatedly made in Congress to build a public power project in his state. As a director of Bates College, the Higher Education Assistance Foundation and the WCBB Educational Telecasting corporation, he has an opportunity to make his views known regarding such "socialistic" proposals which are unavailable to most groups.

Interlocking directorates of the 3 leading New England power companies with financial institutions may be of interest. Members of the Board of the *New England Electrical System* have interlocks with the Mechanics National Bank, the People Savings Bank, the First National Bank of Boston, the Industrial National Bank, the Federal Reserve Bank of Boston, the Old Colony Trust Company, and the Fiduciary Trust Company of New York.

Members of the Board of this Company are linked with Mass. Bay Insurance Co., Hanover Insurance, Worcester Mutual Fire Insurance, State Mutual Life Insurance, the Merchants Mutual Insurance, the American Variable Life Insurance, the Guaranteed Mutual Insurance, and the Employers Fire Insurance.

They also have links with the Merrimack County Savings Bank, the Second Federal St. Fund, the Federal Street Fund and the State Research and Investment Corporation.

Seven men on the Board of New England Electric System serve on the boards of 21 financial institutions all supposed to be competing against each other. Four of the seven appear to have conflicts of interest. Francis H. Burr is interlocked with the Employers Fire Insurance, the Old Colony Trust, and the Fiduciary Trust of New York, Dudley Wainwright Orr is interlocked with the Mechanics National Bank, the Merrimack County Savings Bank, Merchants Mutual Insurance, and United Life and Accident Insurance.

Paul Revere O'Connell is interlocked with the Peoples Savings Bank, the State Mutual Life Assurance Co., the American Variable Annuity Life Assurance Co., Guaranty Mutual Insurance, Worcester Mutual Fire Insurance, Hanover Insurance, Hanover Life Insurance, and Mass. Bay Insurance.

George F. Bennett is interlocked with the State Street Research and Investment Corp., the Federal St. Fund, John Hancock Mutual Life Insurance, the Second Federal St. Fund, and the U.S. and Foreign Securities Corp.

Seven men on the Board of the *Boston Edison Company* are interlocked with 3 banks, 5 savings banks and 7 insurance and mutual companies. The banks include the Boston Safe Deposit and Trust Company, the State Street Bank and Trust, and the First National Bank of Boston.

The insurance companies and mutuals include Liberty Life Assurance, Liberty Mutual Insurance, John Hancock Mutual Life Insurance, Liberty Mutual Fire, Liberty Mutual Protection and New England Mutual Life Insurance.

The savings banks include Provident Institution for Savings, Union Warren Savings, Boston Five Cents Savings and Newton Savings Bank. Interlocks among financial institutions which might result in lessening of competition are as follows:

Charles F. Avila (mentioned above): National Shawmut Bank of Boston, Liberty Mutual Insurance Co., Boston Five Cents Savings Bank and John Hancock Mutual Life Insurance Company;

Edward F. Hanify: State Street Bank and Trust, John Hancock Mutual Life Insurance, and Provident Institution for Savings;

Sidney R. Robb: Boston Safe Deposit and Trust, Liberty Mutual Fire Insurance, Liberty Mutual Protection Co., and Johnson Mutual Fund;

Frank L. Farwell: First National Bank of Boston, Liberty Mutual Insurance, Liberty Mutual Fire Insurance, Life Assurance of Boston and Newton Savings Bank;

Thomas J. Galligan, Jr.: First National Bank of Boston and Union Warren Savings Bank.

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Directors of *Northeast Utilities* are interlocked with four banks, 11 insurance companies and 4 savings institutions. The banks include: Connecticut Bank and Trust, Colonial Bank and Trust, New Britain National Bank and Third National Bank of Hampton County.

The insurance companies include: Hartford Accident and Indemnity, Travellors Insurance, Monarch Life Insurance, Springfield Life Insurance, Hartford Fire Insurance, Hartford Steamboiler Inspectors Insurance, National Fire Insurance, Phoenix Mutual Life Insurance, Connecticut Mutual Life Insurance, Liberty Mutual Insurance and Swiss Reinsurance.

Savings institutions include: Springfield Institution for Savings, Burritt Mutual Savings Bank, Savings Bank of New Britain and Mechanics Savings Bank.

Interlocks which might have lessened competition are as follows:

David L. Coffin: Conn. Bank & Trust Co., Conn. Mutual Life Insurance Co. and Liberty Mutual Life Insurance Company;

Donald W. Davis: New Britain National Bank, Phoenix Mutual Insurance, Burritt Mutual Savings Bank and Savings Bank of New Britain;

Sherman R. Knapp: Conn. Bank and Trust, Hartford Accident and Indemnity, Hartford Fire Insurance and Hartford Steamboiler Inspection Insurance;

S. Dwight Parker: Third National Bank of Hampton County, Monarch Life Insurance Company, and Springfield Institution for Savings;

Richard B. Haskell: National Fire Insurance, Phoenix Mutual Life Insurance;

Malcolm Baldridge: Colonial Bank and Trust, Conn. Mutual Life Insurance and Swiss Reinsurance;

Edward B. Bates: Conn. Bank and Trust and Conn. Mutal Life Insurance.

Although not included in the bill, I suggest that a provision be inserted prohibiting directors of competing companies from serving as directors of the same bank. Questions of economic survival are decided every day at bank directors meetings. It seems obvious that common bank directors of competing firms set the stage for tacit violation of the antitrust laws. Then there is the question of conflict of interest which is probably more responsible for the weakening and elimination of competition in the economy than any other factor.

Directors of U.S. Steel, American Smelting and Refining, Allegheny Ludlum Steel, Pioneer Aluminum and Titanium Metals sit together on the Board of the Chase Manhattan as do directors of Atlantic Richfield, Standard of New Jersey and Standard of Indiana. A director of General Motors and a director of Chrysler also sit on this Board.

A director of Standard Oil of Indiana sits on the Board of Continental Illinois National Bank and Trust with a director from Universal Oil Products, Pure Oil and Union Oil. A director of Montgomery Ward and Company sits on this Board with a director of Sears Roebuck.

Representatives of three oil companies—Atlantic Richfield, Continental and Standard of New Jersey—sit on the Board of Morgan Guaranty along side a director of U.S. Steel, a director of Bethlehem Steel, a director of Ford and a director of General Motors.

Perhaps the Committee should give some study to ties between banks and national dues receiving organizations. Officers and Boards of such organizations are supposed to devote their entire energy for the benefit of their members in accordance with their By Laws and policy programs adopted at general membership meetings.

Recently my attention was called to an article in the November 1970 issue of *The Washington Monthly*, titled "Moral Ostracism: Blindness on a Bank Board," by John Rothchild. The author of the article suggest that Tony Boyle, Edward Carey and Thomas Ryan, directors of the National Bank of Washington, because of a conflict of interest, were finding it difficult if not impossible to act as responsible dedicated stewards of the United Mine Workers Union.

Conflicts of interest may well be the cause of most of the troubles today. Conflicts of interest not only perpetuate old and archaic schemes and organizations and obsolescent machinery, they stifle economic development, destroy initiative and weaken morality. Conflicts of interest are an insidious poison that eats away the moral fiber of men.

Jesus said in the 24th verse of the 6th Chapter of Matthew:

"No man can serve two masters: for either he will hate the one, and love the other; or else he will hold to the one and despite the other. Ye cannot serve both God and mammom."

He thought this admonition was so important that he repeated it again in the 13th verse of the 16th Chapter of Luke.

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Power Company Executives Who May Have Conflicts of Interest in Their Financial Corporate Directorships

Acker, T. E. Southwestern Electric Service Company. Jacksonville Building & Loan Association. Texas Bank & Trust Company.

Adam, R. B. New York State Electric & Gas Corporation. Erie County Savings Bank. Manufacturers & Traders Trust Company.

Adams, Allan W. Wisconsin Power & Light. Beloit State Bank. National Mutual Benefit Life Insurance.

Amsterdam, Gustane G. Philadelphia Electric Company. Juniper Securities Company. Western Savings Ford Society of Philadelphia. First Pennsylvania Bank & Trust Company. Land Title Building Corporation. Bankers Bond & Mortgage Guaranty Company of America (Chairman). Bankers Bond & Insurance Company. Bankers Securities Corporation (Chairman).

Arnold, Duane. Iowa Electric Light & Power (President, Chairman). Perpetual Savings & Loan. Merchants National Bank. Banks of Iowa.

Avila, Charles F. Boston Edison Company. National Shawmut Bank of Boston. Liberty Mutual Insurance Company. Boston Five Cents Savings Bank. John Hancock Mutual Life Insurance Company.

Baldridge, Malcolm. Northeast Utilities. Colonial Bank & Trust Company. Connecticut Mutual Life Insurance Company. Swiss Reinsurance Company.

Barrett, Robert E., Jr. Connecticut Light & Power. Berkshire Life Insurance Company. Springfield Community Savings Bank. Third National Bank of Hampshire Co.

Bates, Edward B. Northeast Utilities. Connecticut Mutual Life Insurance Company (President). Connecticut Bank & Trust Company.

Baylis, Chester, Jr. Baltimore Gas & Electric. National Union Bank. Glen Falls Insurance Company. Bankers Trust Company (New York).

Beck, Burton E. Indianapolis Power & Light. American United Life Insurance Company, Merchants National Bank & Trust.

Bell, Joseph M., Jr. New York State Electric & Gas Corporation. Security Mutual Life Insurance Company. First City National Bank. Utility Mutual Insurance Company. Lincoln First Banks, Inc.

Bennett, George F. Middle South Utilities. Florida Power & Light. John Hancock Mutual Life Insurance Company. State Street Research & Investment Corporation. Federal St. Fund, Inc. Second Federal St. Fund, Inc. New England Electric System. U.S. & Foreign Securities Corporation.

Bickmore, J. Grant. Idaho Power Company. Commercial Security Bank. Guaranty Federal Savings & Loan Company. Idaho Bank & Trust Company (President).

Black, Fischer S. Tampa Electric Company (President). Florida Investment Realty Security Trust (Chairman). Founders Life Insurance Company of Florida. Capital National Bank.

Bower, George A. Sherrard Power System. Midland Mutual Life Insurance. American Fletcher National Bank & Trust Company.

Brookfield, Dutton. Kansas City Power & Light. N.W. Mutual Life Insurance Company. First National Bank.

Brown, George H., Jr. Philadelphia Electric Company, Potomac Insurance Company. General Accident Fire & Life Assurance. Fidelity Mutual Life Insurance Company. Camden Fire Insurance Association. Commonwealth Land Title Insurance Company (Philadelphia). Western Savings Fund Society. Gisard Trust Bank (Chairman).

Burgin, C. Rogers. Sierra Pacific Power Company. Fidelity Groups (Mutual Funds). Arkansas Boston Mutual Insurance Company. Quincy Savings Bank. Cunningham Park Trust. Hartford Life Insurance Company. Quincy Mutual Fire Insurance Company. New England Merchants National Bank.

Burr, Francis H. New England Electric System. Fiduciary Trust Company of New York. Old Colony Trust Company. Employers Fire Insurance Company.

Cabaniss, W. J. Southern Company. First National Bank of Birmingham. Protection Life Insurance Corporation.

Calhoun, David R. Union Electric Company. Equitable Life Assurance Society of U.S. First National Bank St. Louis Union Trust Company.

Cameron, Olin C. Hawaiian Electric Company. Bishop Trust Company. Maui Savings & Loan Association.

Carey, H. Bissell, Jr. Connecticut Light & Power. Connecticut Bank & Trust Company. Hartford Fire Insurance Company.

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Carmichael, James V. Southern Company. Trust Company of Georgia. Georgia International Life Insurance Company.

Carter, Edward W. Southern California Edison Company. Western Ban Corporation. United California Bank. Pacific Mutual Life Insurance.

Chapman, Richard P. Tampa Electric Company. New England Merchants National Bank. New England Mutual Life Insurance Company. Lumber Mutual Life Insurance Company. Mutual Boiler & Mach. Insurance Company. Arkwright Boston Mfg. Mutual Insurance. New England Merchants Bank International (Chairman).

Coffin, David L. Northeast Utilities. Liberty Mutual Insurance Company. Connecticut Mutual Life Insurance Company. Connecticut Bank & Trust Company.

Cook, D. C. See American Electric Power System.

Cooper, Edgar W. New York State Electric & Gas Corporation. Security Mutual Life Insurance Company. First City National Bank (Binghamton)—Chairman.

Cooper, William J. United Illuminating Company. First New Haven National Bank. New Haven Savings Bank.

Coquillette, S. E. Iowa Electric Light & Power Company. City National Bank. Iowa National Mutual Insurance Company. Merchants National Bank.

Cisler, Walker L. Detroit Edison Company (Chairman). Detroit Bank & Trust. Equitable Life Insurance Society of U.S. Chemical Bank of New York.

Costello, Charles H. United Illuminating Company. Life Insurance Company of Connecticut. Connecticut Saving Bank. Tradesman National Bank, New Haven.

Crawford, William C. Iowa Electric Light & Power Company. Peoples Bank & Trust Company. First Federal Savings & Loan Association. Iowa National Mutual Insurance Company.

Cuddeback, Samuel M., Jr. Orange and Rockland Utilities. Port Jervis Savings & Loan Association. Empire National Bank (Middleton).

Davis, Donald W. Northeast Utilities. Savings Bank of New Britain. New Britain National Bank. Phoenix Mutual Life Insurance. Burritt Mutual Savings Bank.

Davis, Jess H. Public Service Electric & Gas Company. First Jersey National Bank. Prudential Insurance Company of America.

Day, Huntington T. United Illuminating Company. New Haven Savings Bank. Union and New Haven Trust Company.

Drake, Francis E. Jr. Rochester Gas & Electric Corporation (Chairman). Lincoln Rochester Trust Company. Utility Mutual Life Insurance Company.

Driver, William Raymond. New England Gas & Electric. Suffok-Franklin Savings Bank. Provident Institute for Savings. Brown Brothers Harriman & Company.

Duffy, Edward C. Long Island Lighting Company (President). Long Island Trust Company. Green Point Savings Bank. Utilities Mutual Insurance Company.

Dunn, R. Roy, Potomac Electric Power Company (Chairman), Riggs National Bank, Acacia Mutual Life Insurance.

Eaton, Allen O. Central Utility Public Service Corporation. Winchester National Bank. Winchester Savings Bank.

Eaton, Frederick M. Consolidated Edison Company of New York. New York Life Insurance Company. First National City Bank.

Eberle, Edward R. Public Service Electric and Gas Company. First Jersey National Bank. Firemans Insurance Company of Newark. Commercial Insurance Company of Newark. Washington General Insurance Corporation.

Echols, John E. Houston Lighting and Power. Citizens of Texas Savings and Loan Association. Citizens National Bank and Trust Company.

Edison, Irving. Union Electric Company. General American Life Insurance. Boatmans National Bank.

Eisenhart, M. Herbert. Rochester Gas and Electric Corporation. Security New York Corporation, Rochester Savings Bank—Trustee.

Elliott, Byron K. Boston Edison Company. First National Bank of Boston. Provident Institution for Savings.

Engelhard, Charles W. Public Service Electric and Gas Company. National Newark and Essex Bank. Prudential Insurance Company of America.

England, Bayard L. Atlantic City Electric Company. Prudential Insurance Company. Federal Reserve Bank of Philadelphia (Deputy Chairman).

English, George W. First National Bank, Fort Lauderdale, Florida (Chairman). First Federal Savings Association of Broward Co. First National Bank, Margate. First National Bank, North Broward. First National Bank, Pompano

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Beach. Guarantee National Bank, Fort Lauderdale. Plantation First National Bank.

Epply, Joseph W. Public Service Company of New Hampshire. Amoskeag National Bank. New Hampshire Insurance Company. Amoskeag Trust Company. American Fidelity Insurance Company. Granite State Insurance Company.

Ewald, Earl. Northern States Power Company (Chairman). First Bank System. St. Paul Fire and Marine Insurance Company.

Falk, Harold Frank. Wisconsin Electric Power. Marshall & Ilsey Bank. Marshall & Isley Stock Corporation. Employees Insurance of Wausau. Northwestern Mutual Life Insurance Company.

Farwell, Frank L. Boston Edison Company. Newton Savings Bank. First National Bank of Boston. Liberty Life Assurance Company of Boston. Liberty Mutual Fire Insurance Company. Liberty Mutual Insurance Company.

Feigel, L. F. Southern Ind. Gas & Electric Company. Thrift, Inc. Merit Life Insurance Company (President). Evansville Morris Plan Company. Credit Thrift Financial Corporation (Chairman).

Fitzwater, Ottis T. Indianapolis Power & Light. Merchants National Bank & Trust Company. Indianapolis Life Insurance Company.

Flynn, Streeter B. Oklahoma Gas & Electric Company. First Oklahoma Bank Corporation. American First Title & Trust Company. First National Bank & Trust Company (Oklahoma City).

Flynn, William P. Indianapolis Power & Light. State Life Insurance Company. Indiana National Bank.

Frenzel, Otto N. Indianapolis Power & Light. American United Life Insurance Company. Utility Insurance Company. Sentinel Indemnity Insurance Company. Superior Insurance Company. American Econ. Insurance Company. Merchants National Bank & Trust.

Galligan, Thomas J., Jr. Boston Edison Company (President and Directors). Union Warren Savings Bank. First National Bank of Boston.

Gilkes, Robert F. Philadelphia Electric Company (President). First Pennsylvania Bank & Trust Company. Pennsylvania Mutual Life Insurance Company.

Griffin, William M. Texas Utilities. Hartford Fire Insurance Company. Connecticut Bank & Trust Company.

Gunlocke, Howard W. New York State Electric & Gas Corporation. Utica Mutual Insurance Company. Steuben Trust Company. Graphic Arts Mutual Insurance Company.

Gussett, N. Bernard. Iowa Power & Light. Equitable Life Insurance Company of Iowa. Iowa Des Moines National Bank.

Hagemann, H. Frederick, Jr. Southwestern Public Service Company. New England Mutual Life Insurance Company. Provident Institution for Savings. State Street Bank & Trust Company.

Hale, Stanton G. Southern California Edison Company. United California Bank. Western Bank Corporation. Pacific Mutual Life Insurance Company (President).

Hall, Howard Iowa Electric Light & Power. City National Bank (Chairman). Iowa National Mutual Insurance Company. Merchants National Bank.

Hallis, Franklin Exeter & Hampton Electric Company (Interlocked with Concord). Concord Savings Bank (See Concord).

Hamilton, William. United Illuminating Company. Second National Bank of New Haven. Connecticut Savings Bank.

Hanify, Edward B. Boston Edison Company. State Street Bank & Trust. John Hancock Mutual Life Insurance Company. Provident Institution for Savings.

Hansberger, R. V. Idaho Power Company. First Security Corporation. Penn. Mutual Life Insurance Corporation.

Hartil, Albert V. Otter Tail Power Company (President). Pioneer Mutual Life Insurance Company. Security State Bank.

Harton, Jack King. Southern California Edison. Pacific Mutual Life Insurance. United California Bank.

Harvey, Lester S. Public Service Company of New Hampshire. New Hampshire Insurance Company. Merchants Savings Bank (President). Merchants National Bank.

Harvin, Lucius H. Carolina Power & Light. Citizens Bank & Trust Company. State Capital Life Insurance Company.

Haskell, Richard B. Northeast Utilities. Phoenix Mutual Life Insurance Company. National Fire Insurance Company. Mechanics Savings Bank (President).

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Hatch, Edwin I. Southern Company. Foundation Life Insurance Company. Federal Reserve Bank of Atlanta (Chairman). Home Insurance Company.

Hay, Stephen J. Texas Utility Company. Great National Life Insurance Company. American Savings & Loan Association.

Heard, Marston. Public Service Company of New Hampshire. New Hampshire Insurance Company. Amoskeag Savings Bank. Amoskeag Trust Company. Amoskeag National Bank.

Hunt, Reed O. Pacific Gas & Electric Company. Canadian Imperial Bank of Commerce. General Reassurance Company. Crocker Citizen National Bank. Pacific National Bank, Seattle.

Hurson, Daniel L. Potomac Electric Power. National Savings & Trust Company. Acacia Mutual Life Insurance Company (Chairman).

Hyer, Daniel B., Jr. Central Telephone & Utility Corporation. Minnequa Bank of Pueblo. Railway Savings & Loan Association.

Jackson, Glenn L. Pacific Power & Light. Standard Insurance Company. U.S. National Bank of Portland.

Jeffery, Walter J. Baltimore Gas & Electric Company (Director) Savings Bank of Baltimore. Fidelity & Guaranty Insurance Underwriters Insurance (President). Mercantile-Safe Deposit & Trust Company. Fidelity Insurance Company of Canada (Chairman). Fidelity & Guarantee Life Insurance Company (Chairman). U.S. Fidelity & Guarantee Company (Chairman).

Jeffrey, Balfour S. Kansas Power & Light (President). First National Bank of Topeka.

Jennings, Lewellyn A. Potomac Electric Power. Metropolitan Life Insurance Company. Riggs National Bank (Chairman).

Johnson, William J. Northern Indiana Public Service Company. Salem Insurance Agency. Salem Bank & Trust Company.

Kaiser, Paul R. Philadelphia Electric Company. Central Penn. National Bank. Penn. Lumbermans Mutual Casualty Insurance. Fidelity Mutual Life Company.

Kasten, George F. First Wisconsin National Bank. First Wisconsin Trust Company. First Wisconsin Bankshares Corporation. Northwestern National Insurance Company. First Wisconsin National Bank of Milwaukee First National Bank of Madison.

Kemper, Rufus Crosby United Utilities, Incorporated. Old Security Life Insurance Company. Kansas City Life Insurance Company. Businessmens Assurance Company. Kansas City Fire & Marine Insurance Company. City National Bank & Trust.

Kennedy, Charles F. New York State Electric & Gas Corporation. Security Mutual Life Insurance Company. Marine Midland Trusts of Southern New York.

Knapp, Sherman R. Northeast Utilities (Chairman + 7 other). Hartford Accident & Indemnity Company. Hartford Fire Insurance Company. Hartford Steam Boiler Inspection Insurance Company. Connecticut Bank & Trust Company.

Koch, Robert L. Southern Indiana Gas & Electric Company. Citizens Realty & Insurance Company. Citizens National Bank.

Kuhns, William W. General Public Utilities Corporation, Marine Midland Grace Trust Company of New York. Home Life Insurance Company.

Lane, C. Howard. Pacific Power & Light. First National Bank of Oregon. Standard Insurance Company.

Lanotte, Lloyd M. Southwestern Public Service Company, Transport Insurance Company of Dallas. First National Bank of Lubbock.

Larkin, Frederick G., Jr. Southern California Edison Company. Western American Bank (Europe) Ltd. Pacific Mutual Life Insurance. Security Pacific National Bank (Chairman).

Lay, Herman W. Southwestern Life Insurance Company. First National Bank in Dallas. Third National Bank in Nashville.

Leach, Ralph. Niagara Mohawk. J. P. Morgan & Company. National Reinsurance Company. Morgan Guaranty Trust Company.

Lewman, J. Wilson. Consolidated Edison Company of New York. Chemical Bank of New York. Mutual Life Insurance Company of New York. Atlantic Mutual Insurance Company.

Lindseth, Elman L. Cleveland Electric Illuminating Company. Equitable Life Assurance Society of U.S. National City Bank of Cleveland.

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Lloyd, John A. Cincinnati Gas & Electric Company. Central Ban Corporation. Central Trust Company. Union Central Life Insurance Company (President).

Luce, D. C. Public Service Electric & Gas Company. Howard Savings Institution. Fidelity Union Trust Company. Prudential Insurance Company.

Lyon, William A. Allegheny Power System, Inc. Savings Bank Life Insurance Fund. Drydock Savings Bank (Chairman).

McAfee, J. W. Union Electric Company. St. Louis Union Trust Company. General American Insurance Company. First National Bank of St. Louis.

McCall, Howard W. Ebasco Services. Chemical Bank (President). Chemical International Banking Corporation. Mutual Life Insurance Company.

McDaniel, Thomas M., Jr. Southern California Edison Company (President). American Mutual Fund. Bank of America. Bank America Corporation.

McDevitt, V. P. Philadelphia Electric Company. Beneficial Mutual Saving Bank. Continental Bank & Trust Company.

McNealy, John Lawrence. (See Columbus & Southern).

MacFarlane, Robert Stetson First Bank System. First National Bank of St. Paul. First Trust Company of St. Paul,, Minn. Mutual Life Insurance.

Mallary R. Dewitt Central Vermont Public Service Corporation. Valley Bank & Trust Company. Massachusetts Mutual Life Insurance Company.

Mansfield, D. Bruce. (See Ohio Edison).

Margetts, Walter T., Jr. UGI Corporation (Pension Finance Chairman). Franklin Bank Company. American Mutual Liability Insurance Company. Security National Bank. Foundation Life Insurance Company of America.

Martin, Alfred Delvach Missouri Utility Company. American Hospital & Life Insurance Company. Security Life & Accident Company. First National Bank of Dallas. Exchange Savings & Loan Association. Trinity National Bank. Allied Bankers Life Insurance. Public Savings Insurance Company.

Martin Bennett Central Telephone & Utility Corporation. First Continental National Bank & Trust Company. Fidelity Title Insurance Company (Chairman).

Mathershed, Wilson Indianapolis Power & Light. Indiana Life Insurance Company. Indiana Water Insurance Company. Indiana National Bank (Chairman).

Maull, Baldwin. Niagara Mohawk Power. Utica Mutual Insurance Company. Marine Midland Trust Company of Western New York. American Reinsurance Company. Marine Midland Banks. Marine Midland Grace Trust Company.

Maxwell, Arthur F. Central Maine Power Company. First National Bank (Chairman)—Biddeford. Biddeford Savings Bank (President).

Meredith, L. Douglas. Central Vermont Public Service Corporation (Chairman). Vermont Mutual Fire Insurance Company. Northern Security Insurance Company—check. Chittenden Trust Company. National Life Insurance Company.

Morrison George L., Jr. UGI Corporation. Commonwealth National Bank—Harrisburg, Pa. Amer-Sentinel Insurance Company.

Mosher, Edward J. Houston Lighting & Power Company. Bank of the Southwest. Texas Employers Insurance.

Mumford, Milton C. Consolidated Edison of New York. Equitable Life Assurance Society of U.S. Federal Reserve Bank of New York.

Murphy, Morgan F. Commonwealth Edison Company. Talman Federal Savings & Loan Association of Chicago. Central National Bank of Chicago.

Neal, Julian S. Baltimore Gas & Electric Company. Savings Bank of Baltimore. American General Insurance Company. Maryland Life Insurance Company. Maryland National Bank. Fidelity Deposit Insurance Company of Maryland (President).

Newton, Blake T., Jr. Allegheny Power System. Chemical Bank of New York—Trustee. Institute of Life Insurance (President).

Norris, John W. Iowa Electric Light & Power Company. Iowa Des Moines National Bank. Bankers Life Insurance.

O'Connell, Paul Revere. New England Electric System. State Mutual Life Assurance Company. Peoples Savings Bank. American Variable Annuity Life Assurance Company. Guaranty Mutual Insurance Company. Worcester Mutual Fire Insurance Company. Hanover Insurance Company. Hanover Life Insurance Company. Massachusetts Bay Insurance Company.

O'Donnell, H. G. Iowa Ill. Gas & Electric Company. Guaranty Bank & Trust Company, Cedar Rapids, Iowa.

Ogden, Squire R. Kentucky Utilities. Commonwalth Life Insurance Company.

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Oliver, William F. Allegheny Power System, Inc. Dry Dock Savings Bank—excom.

Olson, Robert A. Kansas City Power & Light (President). National Fidelity Life Insurance Company. Employers Reinsurance.

Orr, Dudley Wainwright. New England Electric System. United Life and Accident Insurance Company. Merchants Mutual Insurance Company. Merrimack County Savings Bank. Mechanics National Bank.

Ott, Elmer B. Madison Gas & Electric Company. First National Bank (Madison, Wisconsin).

Parker S. Dwight. Northeast Utilities. Third National Bank of Hampton County. Springfield Institute for Savings, Springfield Life Insurance Company. Monarch Life Insurance Company.

Patterson, George Vaughan. (See American Electric Power Company.)

Patterson, William P. Third National Bank & Trust Company. State Fidelity Federal Savings & Loan.

Paynter, Richard K., Jr. Consolidated Edison of New York. Seaman's Bank for Savings. Chemical Bank. New York Life Insurance Company. Life Insurance Association of America.

Perera, Guido Rinaldo. Eastern Utility Associates. Massachusetts Investors Stock Growth Fund. Massachusetts Investors Trust.

Peterson, Lloyd L. Interstate Power Company. First National Bank—Clinton, Iowa.

Phipps, Gerald H. Southern California Edison Company. First National Bank of Denver. First National Bank Corporation. Western Federal Savings & Loan Association.

Porter, Joseph Franklin, Jr. Kansas City Power & Light Company. Mutual Interests, Inc.

Pratt, J. Scott B. Hawaiian Electric Company. Hawaiian Trust Company, First Insurance Company of Hawaii.

Pyne, Eben W. Long Island Lighting Company. First National City Bank. U.S. Life Insurance Company of New York. Phoenix Assurance Company. U.S. Life Holdings Corporation. Bankers & Shippers Insurance Company.

Rabb, Sidney R. Boston Edison Company. Johnston Mutual Fund. Liberty Mutual Protection Company. Liberty Mutual Fire Insurance. Boston Safe Deposit & Trust.

Rabel, Irvin Brownell. Puget Sound Power & Light. Pacific National Bank.

Rauch, R. Stewart, Jr. UGI Corporation. General Accident Fire & Life Assurance. Philadelphia Contributionship for the Insurance of Houses from loss of fire. Pennsylvania Mutual Life Insurance Company. Pennsylvania General Insurace Company. Pennsylvania Contributionship Insurance Company. Potomac Insurance Company. National Association Mutual Savings Banks. Camden Fire Insurance. Philadelphia Savings Fund Society.

Reeves, Dick W. Public Service Company of New Mexico. First National Bank of Farmington. Albuquerque Federal Savings & Loan Association. First National Bank, Albuquerque.

Renchard, William S. Consolidated Edison of New York. New York Life Insurance. Chemical Bank of New York (Chairman)—check. Chemical Bank of New York Corporation. Chemical International Banking Corporation. Chemical Overseas Financial Corporation.

Rice, F. Lee, Jr. See Allegheny Power System.

Rich, John F. New England Gas & Electric Association (President). Liberty Mutual Insurance Company. Home Savings Bank. Harvard Trust Company.

Rincliffe, Roy G. Philadelphia Electric Company. Philadelphia National Bank. Philadelphia Savings Fund Society.

Robins, Edwin Claiborne. Virginia Electric & Power Company. Central National Bank. Life Insurance Company of Virginia.

Robinson, Dwight P., Jr. Central & Southeast Corporation. Boston Five Cent Savings Bank. Suffolk-Franklin Savings Bank. John Hancock Mutual Life Insurance.

Root, Gilbert W. Hawaiian Electric Company. Pacific Insurance Company. First Hawaiian Bank & Trust Company.

Samins, W. H. (See Ohio Edison).

Sandheim, Walter, Jr. Baltimore Gas & Electric Company. Baltimore Life Insurance Company. First National Bank. Provident Savings Bank.

Schachte, J. Edwin, Jr. South Carolina Electric & Gas Company. American Agency Life Insurance Company. Citizens & Southern National Bank of South Carolina.

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Schubert, Arthur W. Cincinatti Gas & Electric Company. Ohio National Life Insurance Company. First National Bank of Cincinatti.
Seifreid, D. B. Orange & Rockland Utility (President). Savings Bank of Rockland County. First State Bank of Rockland County.
Shook, Alfred M., III. Southern Company. First National Bank of Birmingham. Appalachian National Life Insurance Company.
Shutz, Byron Theodore. Kansas City Power & Light. First National Bank of Kansas City. Employers Reinsurance Corporation.
Slichter, Donald C. Wisconsin Electric Power Company. First Wisconsin National Bank. First Wisconsin Bank Shares Corporation. Northwestern Mutual Life Insurance Company.
Starr, H. Danforth. Central and Southwest Corporation. American Reinsurance Company. Dry Dock Savings Bank.
Stauffacher, Charles B. General Public Utilities Corporation. American Mfg. Mutual Insurance Company. Chase Manhattan Bank. Lumbermans Mutual Casualty Company.
Stevens, Raymond. Eastern Utilities Associates. Wilmington Trust. Wyman Street Trust.
Stillman, W. Paul. Public Service Electric & Gas Company. U.S. Savings Bank of Newark. Mutual Benefit Life Insurance Company. First National State Bank of New Jersey (Chairman).
Stuart, James M. Dayton Power & Light Company. Winters National Bank & Trust Company. State Fidelity Federal Savings & Loan Association.
Tait, Watson F., Jr. Public Service Electric & Gas Company. U.S. Savings Bank. Mutual Benefit Life Insurance Company. First National State Bank of New Jersey—check.
Talbolt, Philip M. Potomac Electric Power Company. Northern Virginia Bank—Springfield. Suburban Savings & Loan Association—Annandale, Virginia.
Tenney, C. H., II. See Concord.
Tenney, Rockwell C. See Concord Electric.
Thompson, A. Paul. Iowa Power & Light (Chairman). Bankers Trust Company. National Travellers Life Insurance Company. Hawkeye Ban Corporation Investment Management.
Tuepker, D. J. Central and Southwest Corporation. First National Bank & Trust Company. Atlas Life Insurance Company.
Tuohy, John J. Long Island Lighting Company. Utility Mutual Insurance Company. Franklin National Bank.
Turner, W. O. La. Power & Light. Whitney National Bank. La. & Southern Life Insurance. Continental Building & Loan Association.
Uihlein, Robert A., Jr. Wisconsin Electric Power Company. First Wisconsin National Bank. First Wisconsin Bankshares Corporation. Northwestern Mutual Life Insurance Company.
Utermohle, C. Edward, Jr. Baltimore Gas & Electric Company (President). First National Bank of Maryland. United State Fidelity & Guaranty Company. Savings Bank of Baltimore.
Wallace, Anthony E. Connecticut Light & Power. Connectitcut Mutual Life Insurance Company. Society for Savings.
Watlington, John F., Jr. Carolina Power & Light—check. Bank of Reidsville, N.C. Mass. Mutual Life Insurance Company. Wachoria Bank & Trust (president).
Wehr, Frederick L. Baltimore Gas & Electric Company. Baltimore Equitable Society. Title Guarantee Company. First National Bank. Monumental Life Insurance Company.
Wilhite, Richard D. See Concord.
Wills, S. Hayward. Pa Power & Light. Franklin National Bank of Allentown. Equitable Savings & Loan Association (Chairman). Eastern Industries Insurance. Trans Oceanic Insurance Company (Chairman). Tran Oceanic Life Insurance Company (Chairman). Stuyvesant Life Insurance Company (Chairman).
Wilson, Herbert H. Kansas City Power & Light. City National Bank & Trust Company. Safety Federal Savings & Loan Association.
Wilson, Joseph C. Rochester Gas & Electric Corporation. Mass. Mutual Life Insurance Company. First National City Bank, New York. Rochester Savings Bank. Lincoln Rochester Trust Company.
Wood, Henry A., Jr. Eastern Utility Associates. Suffolk Franklin Savings Bank. Equitable Fire Insurance.

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Woodson, Benjamin N. Houston Lighting & Power. American General Insurance Company. American General Life Insurance Company. Hawaiian Life Insurance Company. Pataios Life Insurance Company. Lincoln American Life Insurance Company. Maryland Casualty Company. Northern Insurance Company. Maryland General Insurance Company. Maine Banking & Casualty Company. American General Life Insurance Company (Del.). National Standard Insurance Company. Bank of the Southwest. Life and Casualty Insurance Company. Fidelity & Deposit Insurance Company. Title Insurance Company.

Wright, Cyrus Gordon. Otter Tail Power Company (Chairman). First National Bank of Fergus Falls.

The CHAIRMAN. I will reserve my time and yield to Mrs. Sullivan for her convenience.

Mrs. SULLIVAN. Thank you, Mr. Chairman. And my questions are for Professor Herman.

Professor, your statement this morning gives a concise explanation of the interrelationships between savings and loans and banks, and is narrowly directed to specific issues in Chairman Patman's bill. But it gives us none of the flavor of the very comprehensive study you made for the Home Loan Bank Board several years ago into the details of savings and loan conflicts of interest. I believe your study was published as part of the four-volume Friend report. But I am sure that very few members of this committee have read, or even seen, that voluminous report. In your part of the Friend report, you document many instances in which savings and loan boards were dominated by a small group of real estate dealers, title company executives, builders, speculators, bank officials, settlement lawyers, insurance dealers, and so on, many of them using the mortgages orginated in the savings and loan as an important adjunct to their own private businesses, and profiting very handsomely thereby.

But before I ask you any question on that, would you tell us, if you know, how many copies of this report were ever printed, and how they were distributed, and whether they are available in any form to the libraries or universities, and to the general public.

Mr. HERMAN. I do not know how many were published, but there were thousands. And they are available at a price from the Superintendent of Documents. The four-volume set, I think, costs $7.50 or $8. I don't think they were published in separate form. I personally have about 40 copies left of the conflict-of-interest study as a separate volume. And in fact the Federal Home Loan Bank Board is using that as an educational device for its own examiners. I think they have several hundred copies. I am sure it is in libraries. I am sure this thing has been fairly widely disseminated.

Mrs. SULLIVAN. But they are available through the Government Printing Office, so they could be able to answer that question for me. I will find out.

In view of the fact that I am only allowed 5 minutes for questioning, I would like you to summarize in perhaps 2 to 3 minutes of my 5 just how a typical conflict-of-interest situation has operated—who does what, how does it pay off to insiders, and what does it do to the individual who comes to the savings and loan for a mortgage. I am sure you could speak for hours on this, but if you could just give us the flavor of it, and then, if you like, expand your remarks later in writing when you look over your transcript, citing some of these excellent specific illustrations used in your report.

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Mr. HERMAN. The problem with that, Mrs. Sullivan, is that you could do it for any particular kind of conflict. Would you like me to do it, for example, for the bank interlock or some other kind of transaction?

Mrs. SULLIVAN. We are going into both banks and savings and loans so will you take either one and just give us, as briefly as you can, an example.

Mr. HERMAN. What happens in the case of the bank domination, to give you an illustration—which I could multiply by maybe 10 or 15 from my own specific knowledge—if a bank is dominant in a complex which includes a savings and loan association, especially mutual savings and loan association, the people who control the mutual are not able to get profits out of the mutual, because as you undoubtedly know, the mutual does not pay anything but a dividend to its owners and shareholders which is a standard dividend, and therefore any net income which is not paid out to the owners simply accrues in the association as a surplus, whereas for the bank, which is a stock company, if it is able to make more money it can raise dividends, the stock can rise in value too, the equity of the bank. So if you own a mutual savings and loan association and a bank, if you channel the profits into the bank you can get rich. If they stay in the mutual you do not gain much by it.

Mrs. SULLIVAN. Is there anything wrong in that?

Mr. HERMAN. There is nothing wrong in it except that if there is that joint domination by a single control group, then they might very well exploit the mutual, in other words, they would channel the funds. For example, if there was a construction loan and there were fees to be got out of the construction loan, if it were to be taken by the mutual then it would be out of the hands of the control group, but if they could channel that fee, even though legally the mutual association was entitled to it, if they could channel the fee to the bank, then it would enhance bank profits, and they would really make a substantial gain from it.

Mrs. SULLIVAN. Could they do that because they might control the construction company?

Mr. HERMAN. No; they would do that as the lenders, they would be able to instruct the construction company as to where the fee should go. They could say, although the fee would seem to be the property of the savings and loan, we would like you to pay it to the bank. It would not be that crude, but if you control the loan, you have the power to determine where the fee will go.

Now, you could say that is not damaging anything. But if systemically a control group sees to it that fees go to the bank and not to the savings and loan, what happens is that the savings and loan has a very small surplus, a protective element for any risks that are undertaken. And if the savings and loan company should run into difficulty and fail, then ultimately what would happen is that the Federal Savings and Loan Insurance Company would have to shell out a lot of money, which means that the taxpayer would have to shell it out. In other words, the protective margin might be minimized in the interest of the profits of this control group that had the control over the association and the bank.

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Mrs. SULLIVAN. In channeling the profits to the bank, would this deprive the mutual shareholders in the savings and loan from getting a better run on their money?

Mr. HERMAN. Not really, because that is already controlled by regulations. So that this might make the institution a little weaker unless capable of making mortgage loans.

Mrs. SULLIVAN. I understand that.

Mr. HERMAN. Another thing that could happen and which has happened in a significant number of cases is that the bank may transfer assets to the association that are weak assets, or it may make loans and take the more profitable loans and leave the less profitable loans to the association. So the association may build up a weak portfolio.

Again, that is not going to affect the borrowers or the depositors, but it is going to make the institution weaker, and if we ever had a serious financial situation and these institutions started to fail, ultimately the American taxpayer, you see, through the FSLIC is undertaking the risk.

Mrs. SULLIVAN. Mr. Chairman, in view of the fact that there are only a few here, may I ask unanimous consent——

The CHAIRMAN. May I suggest that we extend the time for all who are here now. Under the new rules of the committee we can recognize those who are present at a certain time first. And that being true, we can extend the time for each one of us. Suppose we extend it, say to 8 or 10 minutes. And that includes Mrs. Sullivan and Mr. Widnall and Mr. Brown.

Mr. ARCHER. Mr. Chairman, inasmuch as there are so few of us today, why don't we go on and keep the 5-minute rule. We can all get through and then get back to the unlimited time.

The CHAIRMAN. That will be all right.

Mrs. SULLIVAN. I will abide by that.

The CHAIRMAN. Mrs. Sullivan is compelled to leave. Could we ask unanimous consent for her to proceed for a certain length of time?

Mrs. SULLIVAN. Five minutes.

The CHAIRMAN. Under the circumstances Mrs. Sullivan asks unanimous consent to proceed for 5 minutes.

Is there objection?

The Chair hears none. Go ahead.

Mrs. SULLIVAN. The thing I wanted to bring out, Professor Herman, was that in some of your studies did you not find that some of the savings and loans—the officers of them rather—were funneling loans to businesses of their own that would bring money back into the savings and loan, of course, but they profit themselves in a greater way because of businesses they own that are not tied to the savings and loan?

Mr. HERMAN. Yes, undoubtedly this is true. There have been construction companies that have been owned by officers or directors or their families, and they have gotten privileged loans. But this has not been anywhere near as important as ordinary realtor relations with savings and loan associations, that is far more important, because it is illegal according to the regulations for a member of the board or an officer of a savings and loan association to get a loan for his own construction company.

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There are several exceptions. If he has a very small percentage of the stock in that company, and there have been violations of the law, you can do it legally through family members, which is not included in the law or the regulations. So it does exist, that kind of funneling. But it has not been quantitatively anywhere near as important as the use of associations by real estate agents as a means of financing loans which they want to make.

Mrs. SULLIVAN. I wish in the transcript you would enlarge upon that so that we can have an explanation of these situations right in the hearings, because I doubt if we could get permission to print the entire report that you made. These are the things that we need to have something definite on, in case the members cannot go back to the original study.

Mr. HERMAN. One thing I might do is, there is a little summary in the last chapter of this report that summarizes the whole thing. It is about 8 pages long. It gives a summary of the conflict study in general. I could put that in as an appendix to my paper if you think that would be useful.

Mrs. SULLIVAN. For something that short, if the chairman would give us permission I think it would help.

The CHAIRMAN. Without objection go ahead and put it in.

(The summary referred to by Mr. Herman follows:)

CONFLICT OF INTEREST REFORM

INTRODUCTION AND SUMMARY

Although conflict of interest is a pervasive characteristic of private (and public) enterprise, it is perhaps more deeply embedded and institutionalized in the savings and loan business than in most other industries. What makes this extensive development of conflict particularly worthy of attention is the fact that the savings and loan industry is regulated by the Government, which has given he industry special privileges and protection in order to encourage its accomplishment of certain defined objectives.

The enormous growth of the industry, and in the size of the individual firm, has tended to professionalize management and reduce the need for ancillary business income and thus one basis for dependency on outside enterprises. This conflict-reducing factor has been offset by the rise of promotional interest in savings and loan associations, most prominently manifested in the influx of speculative groups into Chicago and Maryland and in the holding company boom of the 1955–65 decade. The promotional association and its rapid development constituted what was probably the most serious conflict-relaetd threat to association solvency and stability in the past-World War II period, and the passage of holding company containment legislation in 1959 and 1967 was the most notable FHLBB achievement in the area of conflict-of-interest regulation.

While there has been some tightening up of regulatory standards on self-dealing, especially in the insurance conditions required of newly insured associations, regulatory policy has made little progress in breaking down the traditional patterns of extensive interlocking relationships with both competitive and complementary outside businesses. A great many associations are still affiliated with (and sometimes captives of) banks, insurance agents, and assorted other ancillary interests. The regulatory authorities have been content, or forced by pressures and restricted powers, to confine themselves to trying to prevent a further enlargement of the already extensive structure of outside relationships.

Although the resurgence of the promotional association was partially contained by holding company legislation, a major regulatory gap still exists because of limited supervisory powers over entry via acquisition. Only recently did the Federal authorities obtain the power to require notification of changes in control of an association, after the fact. This situation would be alleviated by permitting

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the insuring authority to pass on transfers of ownership of substantial blocks of permanent stock.[1]

Builder-developer financial connections with managements of savings and loan associations have long been an important source of the more acute and sometimes disastrous conflicts of interest. The central characteristics of these conflicts is the acceptance of large and uncompensated risks by the association in the interest of windfall profits prospectively accruing to an outside venture of an affiliated person. This type of conflict is not easy to keep in check, because the inducements to management involvement in development are strong, and participation (as in the form of kickbacks) tends to go underground in response to more severe restrictions. We have seen that existing regulations in this area are weak, but together with moral suasion and regulatory leverage they have enabled the authorities to exercise some restraint over management involvement in such ancillary activities. There are some pressing changes needed in the regulations, discussed in the following section, that would improve these constraints.

Although commercial banks compete with savings and loan associations for savings deposits and mortgages, a majority of associations have at least one officer or director in common with a bank and many have multiple interlocks strongly suggestive of common control. A substantial number of associations are interlocked with mortgage brokers, finance companies, and with other savings and loan associations. These interlocks may sometimes contribute managerial talent in places (especially small towns) where this is in short supply. At the present stage of development of the industry, however, this factor would seem to be overbalanced by the fact that these extensive interlocks, with built-in conflict characteristics, are contrary to public policy in at least three major respects: (1) They are likely to impair competition, an outcome which can be observed in some cases in the form of less aggressive and noncompetitive behavior by the controlled association; (2) they may involve fee and asset allocations and transfers detrimental to the interests of the association, and (3) they enhance the burden of regulation, which cannot assume arm's-length bargaining in transactions between the interlocked firms.[2] Although overall conflict damage resulting from financial interlocks has not been demonstrable on the basis of our limited data and resources, it is my judgment that this is an area deserving priority in conflict-of-interest reform.

Real estate, insurance, and attorney interlocks with savings and loan association managements are of long standing and remain of considerable importance.[3] A great many associations are controlled by individuals with one or more of these ancillary business connections. In the larger associations there is some tendency to abandon these outside activities, or at least to relegate them to a position of income-generating "side-cars" handled mainly by others. These types of ancillary interests on the part of top management do not often generate critical problem cases, although this is not unheard of. More frequently their damaging effects are more subtle and long term, resulting from management inattention, high operating expenses,[4] a diversion of income that might have been taken into the association but which flows instead into insurance and realty affiliates and legal fees,[5] and sometimes losses reflecting risk transfers to the association offset by loans profitable to an outside affiliate.[6] These ancillary linkages are also

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[1] It is unreasonable that the FSLIC is compelled to insure the accounts of an association whose control has been taken over by someone they would strongly disapprove if they had any choice (as they do on the case of a de novo applicant for insurance).

[2] These points are discussed further in secs. 5 and 7.

[3] See secs. 5 and 6.

[4] Exceptionally high operating expenses are related to real estate financial affiliations, reflecting both relatively high compensation and fixed asset expense. The fact that associations with affiliated persons in both land ownership and development (subclass 2) and real estate finance and investment (subclass 5) have significantly higher fixed asset expense suggests that in the handling of association-occupied real property what we might call the "expert advice effect" is not offsetting the "conflict-of-interest effect."

[5] For the most part, management groups with real estate brokerage, insurance, law, and other ancillary connections and skills, are content to use their strategic position with sufficient restraint to pose no threat to association solvency. The discussion and illustrations of compensation arrangements in sec. 8 (and app. C) indicate that, especially in sizable associations, managerial self-dealing can be pushed rather far without posing any such threat.

[6] Our regressions show high risk to be related to holding company affiliations, multiple ancillary interests of association management, and class IV type of ancillary relationships, which include insurance and the law. The risky loan may have permitted a high-priced sale made by a realty affiliate, or the sale of a fat insurance package by an officer's insurance agency, or the accommodation of long-standing client of the dominant attorney.

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socially detrimental in their effect of reinforcing rather than countervailing the power of quasi-monopolistic groups in other sectors, especially in insurance and the law.

Management involvement in ancillary activities carried on outside the association appears to be more extensive in stock than in mutual associations. This is offset at least in part by the fact that these ancillary activities involve a more clear-cut conflict of interest, with fewer apparent correctives against abuse, in the mutual sector.[7] Diversion of income into an affiliate, at the expense of the net worth of a mutual association, is pure gain to a manager who owns the affiliate. Furthermore, the shareholders are not informed of this diversion and are generally not in a position to assert their legal claims to such income. The manager of the stock company drains the association at the expense of a reduction in value of the permanent stock, of which he is likely to be a substantial holder.[8] Other permanent stockholders also tend to be alert to their interests, so that at least some protection against management diversion exists in a stock company. This is not to say that dominant owners of permanent stock will not find it advantageous to utilize the association for some outside venture;[9] in fact, as evidenced by their somewhat lesser involvement in ancillaries, and the lower risk level associated with mutuality, the conservative forces influencing the managements of mutuals[10] have apparently outweighed the effects of these weaker shareholders constraints and the absence of any management claim on net worth.

In spite of this mitigating effects of conservatism, it seems evident that the structure of power, rights, and incentives in the mutual sector of the industry involves a vast gap between theory and reality and is in serious need of reassessment. Power is in the hands of small management groups with minimal ownership and with control depending almost exclusively on strategic position. These groups in theory are fiduciary representatives of the mutual shareholders, who possess the legal rights to control the organization, to receive its net income, and to obtain a pro rata share of net worth in the event of a liquidation. In fact, the mutual shareholders generally function as wholly non-participating depositors; and mutual managers give every indication of being in business mainly for personal gain, although certain structural and selection characteristics of the mutual form has tended to make them less aggressive profit-seekers than the leaders of permanent stock companies. But the spirit of mutuality is of little force, and in the context of extreme shareholder exclusion from information and power, and the absence of any system of trusteeship limitations and responsibilities, many mutual managers come to regard the association as their personal property.[11] This has contributed to the relatively more extensive nepotism found in the mutual sector, to the higher levels of compensation and other expenses, to the frequent diversion of income into officer-director owned affiliates, and to under-the-table sales of mutual associations. Briefly, the system of mutual organization of savings and loan associations does a poor job both in the establishing of appropriate incentives and in gearing together legal rights and interests and the locus of actual power.

The weakness of the structure of power and responsibilities in mutuals has been enhanced by regulatory policy, which not only has cooperated in the almost total elimination of the shareholder as a participant in association affairs. but has also contributed to reducing the shareholder to creditor status by its policies toward dividend rates. Instead of permitting them to be increased where net income is high (as is done with real dividends) the authorities have tended

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[7] There is, theoretically, less conflict where ancillary income is captured by a permanent stock owner who would have obtained a good part of such income anyway as association stock owner. This overlap may be far from complete, however, and even if it is complete there remains a potential conflict of interest between the permanent stock holder and the risk-bearing FSLIC. These matters are discussed more fully in sec. 8.

[8] The point may be illustrated as follows: If a bank is under common control with a mutual association, since the net income and net worth of the association accrue to the advantage of the mutual shareholders, policies discriminating in favor of the bank (say taking a disproportionate share of loan fees into the bank) benefit the controlling stockholders of the bank without at the same time reducing any asset value in the mutual association that can be legally claimed by the common control group.

[9] It is mainly other people's money they are risking, of course, and the outside endeavor or institution may be far more important than their investment in the association. The whole point of their control over the association may be to use it as a tool of other activities.

[10] Discussed in sec. 8.

[11] They may in fact have bought control of the association from an earlier control group.

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to look at them as a competitive weapon, to be constrained and kept in line. They have been widely standardized, and a ceiling has been imposed, all of which are incompatible with the idea that the mutual shareholder is entitled to receive the association's residual income. If the shareholder is a creditor, with a ceiling income, his moral claim to net income and net worth becomes further compromised.

While the present state of mutuality is the best argument for the stock form of organization, the latter has been the vehicle for the most aggressive promoters in the industry, and the most acute conflicts of interest. Furthermore, in spite of the seemingly more powerful incentives for mutual managers to divert potential association income to outside affiliates, in fact there seems to be at least as extensive use of (and diversion of income to) external interests in stock companies as mutuals. A stock dominated industry would be likely to grow more rapidly, but it would also probably be more sensitive to unfavorable general developments than an industry of mutuals; and while it would probably be more responsive to economic change, it might also be over-responsive and less readily subject to regulatory constraint, which would contribute to a higher level of ancillary activities and conflicts of interest.

Mrs. SULLIVAN. Professor, are you familiar with the investigation which my ad hoc subcommittee on home financing practices and procedures conducted here in the Nation's Capital in the last Congress, and our recommendations for legislation?

Mr. HERMAN. No, I am not. Sorry.

Mrs. SULLIVAN. We will see that you are given one of these reports.

Mr. HERMAN. I would like to have that. Thank you.

Mrs. SULLIVAN. Some of our recommendations were enacted as a part of the Housing and Urban Development Act of 1970, and some were not, including the provision we recommended to expand the Home Loan Bank Board's authority for the regulation of conflicts of interest.

We also called for regulation of the use of straw parties in government-related mortgage transactions, and for requiring full disclosure on the face of any such mortgage of the actual purchase price.

This year I have again introduced, as H.R. 7440, the amendment of last year on savings and loan conflicts of interest, to provide added authority to the Home Loan Bank Board to regulate the practices we found and which you also found. Chairman Patman's bill would outlaw some of them entirely. Do you think we can write a bill which is sufficiently clear and effective to prohibit all questionable practices, or should we leave it up to the regulatory agency to deal with these various practices by regulation and enforcement? I would like to have your view—but I think that you could give it to us in correcting your transcript. One approach would be by a law prohibiting specified practices and the other would be by regulation.

Mr. HERMAN. I can give you a very brief answer to that now.

Mrs. SULLIVAN. All right.

Mr. HERMAN. I would say that on something like interlocks the law would be a feasible solution, because that requires a simple cutting of the Gordian knot. But for an awful lot of the detailed regulation on kinds of loans that can be made, you have to do it by regulatory process.

Mrs. SULLIVAN. One of the witnesses scheduled for yesterday who did not appear indicated in his prepared statement that he wants to see the mutual savings and loans given the opportunity to convert themselves into stock companies. I had intended to ask him—and I will

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also ask you now—whether a federally insured savings and loan should be regarded under the law primarily as a private business, obligated only to provide honest loans to those to whom it chooses to lend, or as an institution endowed by Federal benefits and protections and thus having special responsibilities to the public, in the public interest. If that is too much to digest, you can answer it later in writing.

Mr. HERMAN. I agree with the last part of the statement, that this very significant insurance proviso does make them public interest bodies to a significant degree.

Mrs. SULLIVAN. Thank you.

If I still have time, the staff just gave me as an example of a conflict of interest described in a letter sent to one of the Congressmen. It says:

> My work in home building has brought me into contact with a situation that requires attention. Some officials of building and loan associations have interests in lumber yards. When a member of the public wants to build a house with a company other than the interested lumber yard, they are effectively prevented from doing so through the use of various stratagems and subterfuges. In the course of my years of traveling in the home building businesses I have encountered this situation several times. Since savings and loan associations operate under a Federal charter, it would seem to me that the matter is properly a subject for attention at the Washington level.

So here is an example of a conflict of interest that prevents a legitimate businessman from doing business with people who want to build a house but who are directed to deal with someone else in order to get a mortgage.

Thank you very much, Mr. Chairman, for giving me the extra time, and I also thank the other members for their forebearance.

The CHAIRMAN. Mr. Widnall.

Mr. WIDNALL. Thank you, Mr. Chairman.

I would like to welcome both of the witnesses before the committee. You are making a constructive contribution toward the work of the committee. And I am sure it will help us to get the sound findings that we hope to arrive at out of these hearings.

On the interlocks, Professor Herman, I think you have commented mostly on the personnel interlocks, isn't that so?

Mr. HERMAN. Yes—personnel interlocks? Yes.

Mr. WIDNALL. How about interlocking through ownership of voting shares?

Mr. HERMAN. I comment on that too, Mr. Widnal. In fact, one of my main themes is that that is more important in fact than personnel interlocks, that that really amounts to structural transformation that is permanent, and involves real power, I call that primary power. So I consider that even more important than personnel interlocks, which are looser and in fact can be gotten rid of by rather easier tactics, I believe, than structural change which would be involved in stock ownership.

Mr. WIDNALL. I think that this is what has impressed me in consideration of the problem, that it is more important to control the voting shares than the board. I note in both of your statements that you comment on page 4 of your statement, for instance, you say:

> In my study I discussed a number of cases where bank domination of savings associations seemed to have had an adverse effect on competition or damaged the association otherwise. It should be pointed out, however, that no significant

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adverse effects of bank affiliation where found in the aggregated statistical analysis that I was conducting. This may have been a result of some serious weaknesses in the data.

You have supposed certain things, but you are not sure.

Mr. HERMAN. That is scientific caution. I am really quite convinced that there are several dozen bank cases where the bank relations are demaging—in this world, as you undoubtedly know, absolute proof is almost never possible. And if I find a little association in Mississippi which I have information on which has been dominated by a bank since 1934, and spends $20 a year advertising, and has the same assets as another association 50 miles away that was formed 3 years ago, one gets the very strong impression that this association is not competing aggressively with the bank and the other institutions of which it is a subordinate member. But absolute proof would really be quite impossible. In fact, even if the president of the bank said, we have been oppressing the savings and loan, he could be lying. It is scientific caution. I do not think there is any question but what there are a couple of dozen bank association relationships where the association has been damaged. But the proof is not absolute. In the aggregate you are quite right. But frequently even on stock ownership it is extremely hard to show effects. It is a very complex financial system under continuous change. And one of the reasons why it is extremely difficult to study these things effectively is that the authorities have never really even collected very good data on these questions, so one is working with very crude information. So I think the board may be going to carry out a more serious study that would use more adequate data.

I agree with your point. I am not contesting it at all. I was unable to give what I would consider definitive proof on an aggregated basis. I have a fair number of individual cases that seem to me that any reasonable man would consider cases in which a bank association had damaged the association and caused it to behave very uncompetitively.

Mr. WIDNALL. I am personally deeply disturbed about the attitude of the American public and their reactions, and sometimes they are well justified. But actually their fears are being played upon today in so many directions that they are losing their faith and confidence in all kinds of institutions in business and government. They are told that the politician is a crook, or the banker is a crook, or the savings and loan man is a crook. Who do you get to serve on a board of directors?

If somebody could lay down the rule as to who you pick to be on a board of directors or board of trustees, who you could have absolute faith and confidence in, who would not have warped judgment in one direction or another, I am sure that the committee would be grateful to have the suggestions along that line. As long as you have human beings with a little bit of fallibility, it is going to be pretty difficult to get somebody who is 100 percent perfect.

Mr. McDonald, I was noting in your own testimony the same type of approach which I just commented on with Dr. Herman. On page 6 you speak about "The most significant fact I have uncovered in this investigation is that almost without exception power companies are invariably linked with banks. Banks and other financial institutions, I suspect,"—you say "I suspect"—"in most instances determine and prescribe power company policy, which is to prevent at any cost competition by nonprofit utilities."

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On page 11, I think, is the next reference point. You speak about "interlocks which might have lessened competition are as follows." The inferences are there, but there are no direct accusations and no direct reference material there as proof in this direction. Do you think the committee ought to subpoena people and get them in there and direct questions on this, do you think that would be helpful?

Mr. McDonald. I am sorry, I missed the last few words, sir.

Mr. Widnall. Do you think a subpoena should be issued by the committee to get people in to answer questions directly on this?

Mr. McDonald. No, sir. I believe the approach of this bill would solve the problem.

Of course, it has been pointed out in these hearings that it might result in some hardship in various instances. But I believe if you divorce these financial institutions, these interlocks, that you would go a long way toward removing the possibility of abuse of power, and you certainly would remove the conflict of interest which is really the crux of the problem.

I do not think that this is a matter of dishonesty so much, it is a matter of interest. If a man has a bank, an insurance company, a savings institution, the same man, then he is going to have to make a decision as to who is going to get the best deal. And in many instances I would, as I say, suspect that competition is eliminated because the individual is wearing at least three hats, two or three or four hats. And I agree with the professor that it is impossible to prove it. That is the reason I did not want to get out on a limb here and say that there were violations, or would be under this bill, because I do not know.

Mr. Widnall. My time is up. Thank you.

The Chairman. Wth the tolerance of the committee, I would like to ask Mr. Herman to comment on the question Mr. Widnall raised about where we will find the directors.

Mr. Herman. I think he raises a question of the integrity or honesty of the people, which I believe is really totally irrelevant to the issue now, because the bill addresses itself to preventing interlocks among people who are supposed to be competing, and all that we are talking about, therefore, is not prohibiting people who are honest or dishonest, but affecting the structure in a way that will prevent competitors or people who do significant business from aligning themselves in cases where the structural situation itself is likely to have damaging results. So it seems to me that in no sense is it a question of honesty and integrity, it is a question of preventing structural change or structural relations that would appear to be highly inconsistent with the competitive regime. It is a negative—the provisos are negative, they are saying, pick any honest, competent man except one who has a vested interest for which there would be a conflict if he was on the board of directors.

That leaves a lot of people, Mr. Chairman.

The Chairman. Mr. Mitchell, Mr. McKinney has to leave to meet some high school students.

Mr. McKinney. I have to leave, Mr. Chairman.

The Chairman. Without objection we will permit Mr. McKinney to question next.

Mr. McKinney. Professor, it seems to me that we are swatting a mosquito with a sledge hammer in this bill. And we have been ban-

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dying back and forth, I think, in all the testimony in front of this committee, very loosely the terms officer interlock, director interlock, stock ownership interlock. It would seem to me that we have to make a very clear, definitive definition of the difference between the officer of a corporation or bank and a director; wouldn't you say so?

Mr. HERMAN. Yes, I think that is an important distinction.

Mr. McKINNEY. Now, officers are normally very highly paid employees of a corporation; correct?

Mr. HERMAN. Yes, I think that that is true.

Mr. McKINNEY. And therefore we would obviously have a total and complete interest in any competitive advantage they could get by being interlocked into another corporation that would reduce competition for the corporation of which they are an officer. I would agree with you on that.

Mr. HERMAN. Yes, I think that is true, I think that would be far more important than a director interlock.

Mr. McKINNEY. This is the problem I come to. A director interlock—if we look at an insurance company, most of the directors in insurance companies are basically responsible for reviewing officers' decisions and investments and in the growth of the portfolio of the insurance companies which insures its solvency; correct?

Mr. HERMAN. Yes.

They are policymakers, too, Mr. McKinney. That is usually defined as one of the functions of the board, to make broad policy.

Mr. McKINNEY. Could we agree that they are policy reviewers for the officers, more than likely, rather than makers?

Mr. HERMAN. It varies a little, but in fact that is frequently the case.

Mr. McKINNEY. Wouldn't you also agree that this is the job of a mutual savings bank or a savings and loan association board of directors also?

Mr. HERMAN. Frequently, yes.

Mr. McKINNEY. The problem I have, quite frankly, that I want to ask you about is, I think we are assuming in this bill that everybody is corrupt. I do not believe that.

The other problem I have is, I have been intricately involved in the business world in the past 20 years. And I have absolutely no intelligence, no brains as far as stock portfolios, the investment world, or that part of the business world. It would seem to me that insurance companies, bank, power companies, which are heavily capitalized businesses, need the financial expertise in the investment world that only people who are cognizant of this world can supply. Would you agree with that or not?

Mr. HERMAN. No, I would not agree with that. But the first point seems to me much more important. I myself am very averse to taking a moralistic view of these matters and looking upon it as a question of whether we are saying that these directors who are interlocked are scoundrels and therefore are going to do something bad. It seems to me the fundamental point is that directors are not likely to be scoundrels, they are likely to be gentlemen. And gentlemen respect other gentlemen with whom they are closely associated. And that is far more profound a problem than scoundrelism. The problem is that

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if gentlemen associate on boards, they are not likely to do something really hostile to the interests of the other gentlemen with whom they were associated. It is in fact that gentlemanly relationship which may constrain a board member, for example, from voting for a policy that would involve committing competitive violence against somebody else with whom he is associated.

So it seems to me that it is begging the question to put it in that moralistic framework, that that is really illegitimate, and that the fundamental issue is that if people associate closely and develop personal ties, this is not going to constrain them from really behaving in the highly hostile fashion which is supposed to be the normal practice in the competitive system.

Mr. McKinney. That is fundamental.

Let me bring you to a case which interests me. Say you are serving on the board of a mutual savings bank. You have two responsibilities, since it is a nonprofit organization. One is that you put the maximum amount of money into good real estate investment within a community, since the State law—at least in our State—limits you on that field of operation.

The other one is that you increase the worth of the bank so that it can therefore put even more money out.

Now, if you do not have on your board real estate expertise, investment expertise, you must at that point, then, as the institution, buy that advice, is that not correct?

Mr. Herman. You either pay for it or you try to get it from sources that will provide it at nominal prices.

Mr. McKinney. We are eliminating the voluntary sources in this bill, because we are eliminating the brokerage people, the people that supply this expertise for insurance companies, the people that supply it for commercial banks, they are eliminated.

Mr. Herman. You are not right there, because there are tremendous number of potential volunteers outside of these institutions. For example, in the universities, the CREF brought in this gentleman Roger Murray, who is a professor of finance at NYU, or something like that, who is a very competent investment person. And all through the investment system, in fact right at the Wharton school we have some very competent people who train people to go out in the brokerage communities. In fact, many of them are now onboard. And that potential has hardly been tapped for reasons that the existing system does not put a premium merely on quality of personnel, it puts a premium on other kinds of relationship.

Mr. McKinney. My time has expired. But it seems to me that it is far more dangerous for these institutions to buy this type of advice than it is to have it given voluntarily by people who are involved in it.

The Chairman. Mr. Mitchell.

Mr. Mitchell. I am delighted to meet both of you gentlemen. I have come across your names many times in the reading, which I have done. I am delighted to meet you and welcome you to the committee.

I have three questions, I possibly can only get two into my 5-minute time, but I will try.

My first question is to you, Professor Herman.

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You say that interlocks between commercial banks and savings and loan associations are contrary to public policy. What are the areas of public policy you see being violated by these interlocking relationships?

Mr. HERMAN. Well, I think one area of public policy that is violated is that this is an anticompetitive relationship, so that the whole antitrust philosophy, that there should be competition between financial institutions who are potential competitors, is violated where you have these potential and actual competitors coming under the same rule via interlocks.

Another thing that I give a lot of weight to from having worked on this thing in the savings and loan area is that when you have this kind of interlocking relationship, it becomes almost impossible to regulate, because you do not have arm's length bargaining, or at least you cannot assume it, sometimes you do. Sometimes the relationship is not such as to cause phony fee allocations or the dumping of assets, but once you permit companies to start to fuse in this way, the regulatory burden becomes very severe. You cannot assume that if bank A sells assets to association B with whom it is interlocked, that that was an arm's length trade. Therefore the regulators have to go in and appraise it and evaluate it. And if a lot of such transactions occur, it becomes extremely burdensome.

So in order to economize on regulatory efforts you cannot have networks of control systems which make it possible to shunt assets around in roundrobin fashion, it makes for burdensome regulations. And I would say that regulatory policy requires that you have autonomy of the enterprises that are regulated, otherwise you have a regulatory monstrosity.

Mr. MITCHELL. Thank you very much.

My second question is directed to both of you gentlemen. The present administration, in a series of highly publicized statements, has spoken about developing black capitalism and encouraging the development of black-owned banks and black-owned savings and loan associations. The experts appear to be somewhat divided in terms of this black capitalism approach. On the one hand, a man like Prof. Ed Herman would look on the feasibility of these ventures with favor, but Mr. Andrew Brimmer apparently would be skeptical about the success of such ventures. Assuming that we do move ahead with the idea of black-owned banks and black-owned savings and loan associations, given the extensiveness and the pervasiveness of the interlock system, would you give a prognosis about such ventures—either Mr. Herman or Mr. McDonald or both?

Mr. McDONALD. Well, it is almost impossible, at least for me, to answer that question. I can speculate a little bit, if you wish.

Now, the body of American capitalism is made up of white men—mostly men, not even women. They are on these boards. And I would say that it would be very difficult to set up a black institution. As has been pointed out, these are gentlemen, and gentlemen friends of gentlemen, on the board. And when you start a new institution, I presume, a new business, you apply to a bank in the vicinity. And doubtless there are many applicants. The gentlemen who are friends of the gentlemen who are on the white board would be inclined to con-

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sider more favorably the white applicant if he were setting up the kind of a business which the black applicant had in mind.

Now, this is sheer speculation. But it seems to me that, as has been pointed out, these boards tend to perpetuate themselves, the practices tend to perpetuate themselves, prejudices tend to perpetuate themselves.

Now, we are in a great era of liberalism; but when it comes down to actually getting money out of banks, I would speculate that the white applicant would have a better chance to start a new business.

Mr. MITCHELL. Thank you, Mr. Herman.

Mr. HERMAN. That is a very difficult question to talk about intelligently, because I suspect that the structure and the kind of criteria that are used for making loans and supporting other institutions is such that anything on the outside has a tough time breaking in. So that there is an inherent bias as against the development of black capitalism in this structure as well as other outside——

Mr. MITCHELL. Excuse me. But more specifically would you say that the interlocking system itself makes it even tougher for new entrepreneurship developments in this area?

Mr. HERMAN. Yes, sir; I think so, because it means a community of spirit; and that as long as certain attitudes prevail, they prevail even more widely.

Of course, there is the possibility that it will be felt by this community that we are speaking of, the community of interlocking gentlemen, that black capitalism is necessary, and it is desirable, and ought to be stimulated and sponsored, for whatever reason, moral, or public relations, or strategic or because of economic viability. And if that decision were made, then it would facilitate such development.

Mr. MITCHELL. Thank you.

I have a third question. Do I have time, Mr. Chairman?

The CHAIRMAN. One minute.

Mr. MITCHELL. I can get it in this 1 minute.

Again to you, Professor Herman, on page 5 of your statement you say:

> Prohibiting vertical interlocks with borrowers or portfolio companies would, I suspect, have little value in limiting the extent and exercise of power.

How would you suggest that the Congress, if it should choose to do so, limit the extent and exercise of such power?

Mr. HERMAN. The part of my statement that really bears on that, Mr. Mitchell, is the statement on close knits; my argument is that this is dealing with subsidiary, less important developments, as Mr. McKinney was saying, and as Mr. Widnall was saying, too, that the fundamental changes are basic structural changes that pertain to ownership, and the development of power entities, and that therefore the way that Congress must handle this situation is to put some constraints on close-knit combinations, meaning mergers, stock ownership, and the development of huge aggregates that are capable of exercising what I call primary economic power. I think this must be the fundamental approach.

Mr. MITCHELL. Thank you very much. My time is up.

The CHAIRMAN. Mr. Brown.

Mr. BROWN. Thank you, Mr. Chairman. And thank both of you for being here this morning.

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Professor Herman, it seems to me that following your testimony to its utlimate conclusion would require a divorcing of financial and commercial and certainly the intrafinancial relationships which exist. And to do this it seem to me we would always have to turn to campuses of this Nation to acquire the competence, the personnel with the competence, that would be necessary to be able to give to our financial institutions the guidance and the background and so on that they now get by having people in directorships, who are also engaged in commerce or finance.

If I may be facetious for a minute. I would ask, do you think that possibly, therefore, you have a conflict of interest here this morning?

Mr. HERMAN. That is a nice question.

Mr. BROWN. But more seriously, Professor Herman, why have director interlocks especially become so prevalent today? Has there been a conscious effort to accumulate control and domination over other conflicting economic pursuits?

Mr. HERMAN. No; I do not think that is what has done it. I think it is partly a desire on the part of powerful institutions to know, they want to know, they want to keep close tabs on institutions with which they have relations, they may own stock, they may be lending. They get privileged information. They also get to know much more profoundly the managements that they have to deal with, and that is good to know, because a lot of them put very heavy weight on the quality and the character of management, and they would like to be on very intimate terms with them so that they are absolutely on top of the picture where any changes occur. And it also gives them some little special additional power position that they can exercise.

Also I think the system tends to gravitate toward putting on boards people that you already have relations with. And unless therefore the Congress steps into the picture and says that you cannot push this to the limit, the system itself pushes to the limit bringing into boards people with whom you have already extensive contact. So if a bank lends to a customer and has a relationship with it, then it is a very simple device to get on boards people you already know and have relationships with and have some kind of community of interest and trust with so that you bring them further into the picture. So the system, it seems to me, has evolved in a much more complex way, not through—I do not think you were suggesting that was true—not through the conscious striving for control, but through a process of wanting to know and wanting to be really on top of the facts, and also the natural gravitation toward one's friends and business associates as allies on boards.

Now, let me just make one further side comment here that pertains to what you are saying initially about who we would get for the board. An awful lot of people who are put on boards in this way do not do much, they do not contribute much. They are there because you want your friends and colleagues and people with whom you can talk and communicate effectively there on the board. I would not by any means say that these people are not frequently able and do not contribute ideas, but often that is not the dominant consideration. You need somebody, why not have Joe, whom you know, and who is your banker, and with whom you already have relationships?

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Mr. BROWN. You would certainly agree, then, that there is a contribution made, a benefit derived by having people with special expertise and experience, and so on, in the field of finance sitting on the board of maybe more than one financial institution. Your statement and testimony would seem to say that there is no benefit derived whatsover by having some of these people on the board when they are directors of other boards, but only that there is a detriment and abuse.

Mr. HERMAN. I agree with you that there is some possible benefit, that in many cases the people who are interlocked are very competent people and maybe lending real expertise. I think that this not an all-or-nothing proposition, it is a problem of balancing different weighted things.

Mr. BROWN. And you do not believe that legislation can be enacted that would take care of the instances of abuse which sometimes occur? The only way you can attack the problem according to your statement, as I understand it, is through prohibiting of the occurence of the relationships so that the instance could not occur, is that it?

Mr. HERMAN. I see no rational basis that would not be absolutely arbitrary that would distinguish between cases where competition was going to be reduced, where you had competitive institutions with interlocks, or where power was going to be enhanced and exercised in the case of vertical interlocks. It seems to me that it really is a fantastic technical problem. It would be ideal, as you are suggesting, if you could only segregate somehow those interlocks which were detrimental and those which are not. But I do not see any possible ——

Mr. BROWN. You do not think there is anything wrong per se with an interlocking directorate ——

Mr. HERMAN. No; except insofar as it has these structure implications where it has competitors. There is something wrong with interlocks in themselves if the interlocks are between firms that are supposedly competing, I would say, a priori there, yes. But if you say, is there anything wrong with interlocks between two firms that are not competitive, or do not have any relations with one another, I would say there is not.

Mr. BROWN. Your study sometime back, does it go into the actual instances of what you would consider the evil arising out of interlocks, or the categorizing of them as to what they are and how they occur? For instance, the thing you mentioned to Mrs. Sullivan this morning about a bank taking the fees, et cetera, from what I assumed were services performed by personnel of the savings and loan, now, I cannot feature that happening. I would like to see some of the actual cases of that occurring, because it seems to me that you have got a clear case there of an improper diversion of profits or fees or income.

Mr. HERMAN. That has happened. The difficulty is, where you have fees and where you have asset transfers, it is extremely difficult for outsiders to appraise their value. Usually on the construction loan cases where the fees come into question, what happens is that the bank makes loans for construction, and it gets a commitment from the association, and there is a whole set of fees for getting the commitment and for taking the loan. And it is not easy to follow all these accounts.

Also, if you tried to regulate them, it would be extremely easy, I believe, to cover them up, to hide them somewhere. And if you sell

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assets from one controlled institution to another, again it would take some very, very extensive regulatory work to figure out what the worth of a mortgage was that was sold from the bank to the savings and loan association. Of course, we are talking about extreme cases. I would not ask that interlocks even among competitive institutions would usually result in this kind of abusive behavior.

Mr. Brown. My time has expired. But you now are getting back to what I was talking about at first. If we are talking about very extreme cases, I think we have got to look at the benefit side of what is contributed by directors, and so on, even though they may be interlocking.

Thank you, Mr. Chairman.

The Chairman. Mr. Archer.

Mr. Archer. Dr. Herman, you primarily, as I understand the thrust of your testimony to the committee today, are concerned about impediments against a free competitive process, is this basically a correct statement? This is your primary concern?

Mr. Herman. That is correct.

Mr. Archer. And what do you think that this bill will help to remove as far as the potential threat to a competitive situation?

Mr. Herman. Yes.

Mr. Archer. Now, are you testifying, then, that these interlocking directorships are reducing competition between banks? Does your testimony basically state that, or has the potential of reducing competition between banks, one to another?

Mr. Herman. Insofar as these are interlocks between banks yes.

Mr. Archer. Thank you.

I notice you also cite some figures in your presentation relating to Houston, Tex., which is my home. And so I am a little bit interested in that. You of course are familiar with the fact that we do not have branch banking in Texas?

Mr. Herman. Yes.

Mr. Archer. And as a result, there are interlocks, that is, personnelwise, between banks there. Are you saying that this presumes a threat to the competition, that one of these banks will therefore not compete with the other bank?

Mr. Herman. Yes, if they are in the same competitive area. I think that that possibility is there.

Mr. Archer. I happen to be personally familiar with a number of these instances, and I can tell you that the competition is intense. Now, I do not know whether you have been down to Houston and checked the actual facts in relationship between the competition of banks, but I have seen absolutely no instance of a failure to compete aggressively for the benefit of the individual bank even though there have been members on the board of one bank that are members on the board of another bank.

Mr. Herman. I think that that may very well be the case, that in particular instances board interlocks do not damage competition. But I think there would seem to be a very unhealthy state of affairs when you have multiple interlocks between companies that are supposed to compete.

Mr. Archer. You do not see any offsetting benefits on the basis of a bank being out in a neighborhood trying to serve the needs of that

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area and being unable to perhaps take care of a loan of significant size, and being able to have a participation with another bank which is facilitated through these interlocking directorships?

Mr. HERMAN. I do not think interlocking directorates are necessary to get participation.

Mr. ARCHER. No, they are not necessary, but you do not feel that there is any beneficial effect from this of a cooperative effort?

Mr. HERMAN. Certainly, yes, I think that is highly desirable.

Mr. ARCHER. Don't you think that it also contributes to the efficient management of the bank by virtue of having some sort of connection with a bigger bank to use computers and other expensive pieces of equipment which are not available to smaller banks today?

Mr. HERMAN. I think that is highly desirable, Mr. Archer.

Mr. ARCHER. So really there is no positive proof that there has been any sort of diminishment of competition between banks by virtue of the fact that an individual, or two or three individuals, perhaps, in the most expanded situation, being on one bank board?

Mr. HERMAN. In many cases it is not legal now. And section 8 of the Clayton Act does prohibit a fair number of interlocks in competitive areas. So I think this bill is directed more at interlocks outside of the banking sphere.

Mr. ARCHER. The same situation would apply basically?

Mr. HERMAN. I think the original Clayton Act, section 8, was passed because there was some pretty solid evidence in the Pujo——

Mr. ARCHER. That issue has already been taken care of by statute, where you have a basic competitive area that is occupied by more than one bank or lending institution, or financial institution, the Clayton Act has struck directly at that, has it not?

Mr. HERMAN. I am not sure of the details of the Clayton Act, but I think it only deals with national banks, member banks, so it would not deal with other cases. And of course it only deals with interbank competition. It does not extend as far as the sections of the present bill. The present bill is not competitive with the Clayton Act.

Mr. ARCHER. Also you seem to have stated that because it would be difficult to regulate, that a statutory prohibition would therefore accomplish the job. And I am just wondering, whether you are talking about this phase, and how difficult it is to prove it, how you feel that a statutory prohibition would be enforceable. Wouldn't you need a massive number of enforcement personnel?

Mr. HERMAN. No. That is the beauty of the bill. The beauty of the bill is that it is extremely easy to force abandonment of interlocks. What is impossible is to enforce the regulation as to transfers of assets between companies which may appear to be independent, as you suggest, but may not be. So that what you do is, if you do not have this kind of prohibition, you ask for big bureaucracy to regulate relations between companies that may or may not be independent. I would say that this is an antibureaucratic bill.

Mr. ARCHER. I will have to say that I am opposed to the growth of the bureaucracy. Is this bill, in your estimation, the best way to bring progressive accomplishment in America? Is this the best tool that we can use to get at a potential defect, considering how it circumscribes more admitted advantages and benefits?

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Mr. HERMAN. I suggested that the best way would be to prevent close-knit combinations. But it seems to me that, apart from that, it seems to me that the advantages of interlocks among financial institutions, competitive financial institutions, is not great. I would concede your point, that where you have a lot of little banks—I, in fact, would be in favor of a branch banking law that would permit those banks to be incorporated into larger system—but where you have supposedly competitive institutions, and where the intent is that they be competitive, it seems to me that the innerlock system is an unhappy one.

Mr. ARCHER. But I would like, if I may, to have a specific answer from you related to the terminology and the impact of this particular bill. Do you think this, as written, is the best way to accomplish it, or would you recommend changes?

Mr. HERMAN. I will have to repeat my statement with a little emendation. I would say that control of bank mergers is more fundamental. Given the structure, the basic structure of primary power, it seems to me that this bill is the next best thing. I am speaking now of interlock control, not the other parts of the bill.

Mr. ARCHER. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Widnall would like to ask a question.

Mr. WIDNALL. Thank you, Mr. Chairman.

Professor Herman, when I talked with you a few minutes ago, you indicated your feeling that direct control through stock ownership was worse than the possible abuses of personnel interlocks. In H.R. 5700, the bill we are considering, you will note that unlimited interlocks are permitted to financial institutions and others within a holding company complex. A number of people have indicated to us that absolute prohibition against interlocks proposed by this bill, as opposed to administrative review and approval as proposed by many witnesses, would stimulate the formation of holding companies. If this is so, wouldn't you prefer the approach of administrative flexibility?

Mr. HERMAN. I do make that point myself, as you notice, Mr. Widnall, that is a valid criticism of the bill, but only with respect to those areas where the bill would encourage close-knit combination, that is, for things like real estate companies and title companies, which would be precluded from entering into interlocking relations with independent institutions. And then if you really wanted to have them integrated into a single system, the loose-knit combination not being legal, you could do it by a holding company. So it is true that for those peripheral activities the bill would encourage close-knit combinations. But it would not encourage them, I believe, for combinations between major financial institutions. And it is possible that the bill—I would have to think about this, but I think I might be in favor of some emendation along the line that you are hinting at, although I do not think that really gets at the heart of the bill.

Mr. WIDNALL. Mr. Chairman, I would like to ask unanimous consent to give Professor Herman the opportunity to give his further thoughts on this and submit them for the record.

The CHAIRMAN. Without objection, it is so ordered.

Mr. WIDNALL. That is all.

The CHAIRMAN. Mr. Mitchell, do you have a question at this time?

Mr. MITCHELL. Just one last comment, Mr. Chairman.

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The CHAIRMAN. And then we will conclude.

Mr. MITCHELL. Just one brief comment.

Mr. Herman, in your response to my colleague, Mr. Brown's question, I just want to put in the record that despite your earlier testimony, you have really heightened my suspicion that the interlocks cannot help but adversely affect the potential for or the future growth of black-owned banks and black savings and loan associations. I think in your response you made it very, very clear that the negative possibilities are far stronger than the positive possibilities.

Mr. ARCHER. Could I ask one or two short quick questions?

The CHAIRMAN. Go right ahead.

Mr. ARCHER. Dr. Herman, I do not say this facetiously, but do you think there should be a limitation if this bill passes, do you think there should be an inclusion that would prevent a college professor from serving on more than—I mean this seriously—on more than one board which could in effect be an interlocking type of situation?

Mr. HERMAN. Yes, I think that would be sound. I think they should not be serving on competitive institutions. If a college professor was serving as an adviser to one mutual fund, it would seem to me extremely contrary to sound public policy that he also be on another that was competing with it.

Mr. ARCHER. Let me ask you one other quick question. You mentioned in here two factors, interlocking directorates and control situations. And you seem to distinguish between the two. Do you think that it is more important to treat the control situation than the mere instance of maybe one director? Wouldn't you distinguish and say that this control situation is far more important than the mere fact that you have got one person that serves on more than one board?

Mr. HERMAN. Control is more important than what you might call community of interest. But you might have a community of interest that would be detrimental to competition in the long run, although I would concede your point, that in some circumstances interlocks might be consistent with pretty vigorous competition. But in the long run, community of interest and common directorships are not conducive to very aggressive competition.

Mr. ARCHER. Thank you very much.

The CHAIRMAN. Thank you, Dr. Herman and Mr. McDonald. We appreciate your testimony. I am sure it will be helpful to the committee.

The committee will stand in recess until 10 o'clock on Monday morning, at which time Dr. Burns, Chairman of the Federal Reserve Board, will be the witness.

Thank you. The committee is now adjourned.

(The following letter was received by Chairman Patman from Mr. McDonald for inclusion in the record:)

WASHINGTON, D.C., *April 28, 1971.*

Representative WRIGHT PATMAN,
Chairman, Banking and Currency Committee, House of Representatives, Washington, D.C.

DEAR MR. PATMAN: As indicated the material I presented to your committee on April 23rd of the Hearings on H.R. 5700 was almost entirely addressed to that part of the bill relating to interlocking directorates of financial institutions. Since my survey of interlocking directorates took all my time I was not able to analyze other parts of the legislation.

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I would like to respond to your invitation to "extend" my testimony to section 14, which was the subject of much discussion at the hearing today, and to one general comment.

It would appear that "equity kicks" or "equity participations" are a rather blatant attempt to extort additional tribute from homeowners and those who pay rent to institutional lenders and others, who arrange for a percentage of gross income to be paid to the money lender. I am in complete accord with the statement of John A. Stasny, President of the National Association of Home Builders, who quoted the statement of policy of his organization which called on Congress "to investigate the rapacious practice—now standard in insurance company lendings and spreading to other institutions (including pension funds)—of demanding a share of property income in addition to astronomical interest and fees."

My general comment is this: Your bill is an interest rate bill. It seeks to introduce competition in the market place, by prohibiting interlocks which because of their nature and location put the money borrower and the money saver at the complete mercy of a small group whose actions have proved that their sole purpose is to extract every possible drop of money from the defenseless consumer, investor and producer.

This small group of self-perpetuating financiers have done the Nation incalculable harm. They have exploited farmers and small business. They have dried up resources for housing. They have brought on every recession and depression in U.S. history. There are three ways of alleviating this tragic situation. One is to socialize money and to set up a bank which would make funds available at a very low rate of interest. The other is for Congress to appropriate funds or to force the Federal Reserve Board to make funds available. Such authority of the Board resides in laws passed by the Congress. The third way to bring about reasonable interest rates is to enact your bill. I do not believe there is any way under the sun to bring about a socialization of money or to persuade Congress to provide the billions needed for small business, small agriculture and housing. Nor do I believe that the Federal Reserve Board can be persuaded to allocate credit to those parts of the economy suffering from depression in the midst of inflation.

The only practicable solution is your bill which if enacted would free financial institutions from the shackles of interlocking directorates which constitute the greatest and most pervasive monopoly in the world. Free competition in money would work wonders. It would (since the Board at least for the time being had abandoned its tight money policy) bring down interest rates over night. Your bill is the only way out of the financial prison which the money changers have fashioned for the American people.

That is one reason why I have been surprised that no farm, no labor and no consumer organization has shown the slightest interest in H.R. 5700. During the past few years I have been involved with various individuals and groups who organized campaigns, published articles, made speeches and viewed with alarm the skyrocketing interest rates which they called a great crime against the American people, etc.

I wonder where these individuals and groups are today. Yesterday they were in a lather over interest rates. They were almost ready to picket and join with the other demonstrators. I wonder where they are now?

The comments in this communication which I would like made part of the record are not necessarily the views of those with whom I have been associated.

Sincerely yours,

ANGUS MCDONALD.

(Whereupon, at 11:40 a.m. the committee recessed, to reconvene at 10 a.m., Monday, April 26, 1971.)

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THE BANKING REFORM ACT OF 1971

MONDAY, APRIL 26, 1971

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
Washington, D.C.

The committee met, pursuant to recess, at 10:45 o'clock a.m., in room 2128, Rayburn House Office Building, Hon. Wright Patman (chairman) presiding.

Present: Representatives Patman, Barrett, Sullivan, Reuss, Moorhead, Stephens, Gettys, Rees, Griffin, Koch, Mitchell, Widnall, Johnson, Stanton, Blackburn, Brown, Williams, Rousselot, McKinney, and Archer.

The CHAIRMAN. The committee will please come to order.

This morning we are pleased to have before us Dr. Arthur Burns, Chairman of the Federal Reserve Board, to give us the view of the Federal Reserve Board on H.R. 5700 and related bills.

I think it may be helpful to both the new members of this committee, as well as to those who served on the committee in the last Congress, to very briefly review how one of the most important issues before us in this legislation came to be embodied in the Banking Reform Act of 1971. I refer to the provisions involving interlocking personnel among financial institutions.

Although the weaknesses in section 8 of the Clayton Act had been discussed by myself and others for many years, the issue was specifically raised in a letter from me to Dr. Burns on April 2, 1970, involving a question of the possible violation of section 8 of the Clayton Act concerning an individual who was serving at the same time on the board of directors of a major New York City bank and the board of a major New York-based bank holding company.

Dr. Burns had a thorough investigation of this case carried out and on May 18, 1970, Dr. Burns informed me that the Federal Reserve Board had the previous week submitted for publication in the Federal Register an interpretation of section 8 of the Clayton Act which stated, in effect, that it was a violation of interlocking directorate provisions for an officer, director, or employee of a member bank of the Federal Reserve System to serve at the same time, as an officer, director, or employee of a bank holding company where the interlocked two banking entities are located in the same, contiguous, or adjacent cities, towns, or villages.

Dr. Burns further informed me that the questionable interlock which I had referred to him in April had been terminated as illegal even though the interlock had existed for over 5 years.

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On June 1, 1970, I wrote Dr. Burns stating that in light of the Federal Reserve action, I felt the Board should make a thorough and exhaustive examination of all such interlocking directorships to determine whether other violations of the law were also continuing. I also asked that the Board study the adequacy of present provisions barring interlocking directorships among competing financial institutions.

The Board did agree to make this investigation, and on December 16, 1970, informed me by letter that their review disclosed 12 additional cases of interlocks in violation of section 8 of the Clayton Act and that they had taken steps to dissolve these prohibited relationships.

Dr. Burns also informed me that the Board did consider that present law was inadequate in several respects and that the Board recommended new legislation in this area.

Subsequent to this exchange of correspondence, I had legislation drafted which considered this issue as well as others embodied in H.R. 5700.

In order to have the record complete it seems to me that it would be valuable to have the correspondence between Dr. Burns and myself placed in the record at this point and I ask unanimous consent to do so.

Is there objection?

The Chair hears none. And it will be entered.

(The correspondence referred to follows:)

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
April 2, 1970.

Hon. ARTHUR F. BURNS.
Chairman, Federal Reserve Board,
Washington, D.C.

DEAR MR. BURNS: Enclosed please find a copy of a letter sent to me from Stuart H. Johnson, Jr., as well as a copy of a letter that Mr. Johnson sent to Richard McLaren, Assistant Attorney General for Antitrust of the U.S. Department of Justice.

It would be appreciated if you would have your staff look into the question of whether there is a violation of Section 8 of the Clayton Act as regards the situation disclosed in Mr. Johnson's letter.

Sincerely yours,

WRIGHT PATMAN,
Chairman.

CHAIRMAN OF THE BOARD OF GOVERNORS,
FEDERAL RESERVE SYSTEM,
Washington, D.C., April 8, 1970.

Hon. WRIGHT PATMAN,
Chairman, Committee on Banking and Currency, House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: With your letter of April 2 you enclosed a copy of a letter of March 30 to you from Mr. Stuart H. Johnson, Jr., and a copy of Mr. Johnson's letter of the same date to Assistant Attorney General McLaren. In this correspondence, Mr. Johnson, a Washington, D.C., attorney, inquires whether interlocking relationships involving First Midland Banks, Inc., might involve violations of section 8 of the Clayton Act and the regulations of the Board issued pursuant to that Act.

The Federal Reserve Bank of New York is being asked to make a report to us relative to the matter raised by Mr. Johnson. We will be in further communication with you upon receipt of the Reserve Bank's report to us.

Sincerely yours,

ARTHUR F. BURNS.

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CHAIRMAN OF THE BOARD OF GOVERNORS,
FEDERAL RESERVE SYSTEM,
Washington, D.C., May 18, 1970.

Hon. WRIGHT PATMAN,
Chairman, Committee on Banking and Currency, House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: With your letter of April 2, 1970, you enclosed a copy of a letter of March 30 to you from Mr. Stuart H. Johnson, Jr., concerning the applicability of section 8 of the Clayton Act to an interlocking relationship involving Marine Midland Banks, Inc., a registered bank holding company, and First National City Bank, New York City.

I am enclosing a copy of an interpretation, adopted by the Board of Governors on May 12, 1970, that has been submitted for publication in the Federal Register. Mr. J. Peter Grace will be advised to terminate his interlocking relationship with these institutions as soon as practicable.

Sincerely yours,

ARTHUR F. BURNS.

TITLE 12—BANKS AND BANKING

CHAPTER II—FEDERAL RESERVE SYSTEM—SUBCHAPTER A—BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM [REG L]

Part 212—Interlocking Bank Relationships Under the Clayton Act

Applicability of Section 8 of the Clayton Act to Bank Holding Companies

§ 212.102 Applicability of Section 8 of the Clayton Act to bank holding companies

(*a*) The Board recently was asked whether section 8 of the Clayton Act (15 U.S.C. 19) and Federal Reserve Regulation L "Interlocking Bank Relationships Under The Clayton Act," (12 CFR 212) prohibit an officer, director, or employee of a member bank from serving at the same time in any such capacity with a holding company the principal activity of which is the ownership and control of banks, where such interlocking service between the member bank and a bank in the holding company system would be prohibited.

(*b*) Section 8 and the Board's Regulation L, with certain exception, prohibit any person who is a director, officer, or employee of any member bank from serving in any such position with "any other bank, banking association, savings bank, or trust company" where the two banks are located in the same, contiguous, or adjacent cities, towns, or villages.

(*c*) In a similar situation involving section 32 of the Banking Act of 1933 (12 U.S.C. 78)—which prohibits interlocking personnel relationships between member banks and securities companies—the Board expressed the view that where the principal activity of a holding company is the ownership and control of a bank or banks, the holding company and each member bank subsidiary should be considered as constituting together a single entity for the purpose of that statutory provision. Accordingly, the Board concluded that section 32 prohibits a person who is primarily engaged in section 32 business, or associated as specified in that section, with an organization so engaged, from serving also as an officer, director, or employee of such a holding company (1969 Federal Reserve Bulletin 52; 12 CFR 218.114). In that interpretation, the Board stated: ". . . the affairs of the member bank and the holding company would be so closely identified and functionally related that the same possibilities of abuse which section 32 was designed to guard against would be present in the case of a director of the holding company as in the case of a director of the member bank. To give cognizance to the separate corporate entities in such a situation, would . . . partially frustrate Congressional purpose in enacting the statute." Likewise, the Board recently determined that concurrent service by an individual as a director of a wholly-owned credit card subsidiary of a national bank and as director of another member bank in a contiguous municipality was prohibited by section 8 of the Clayton Act, since, in the Board's opinion, the credit card subsidiary was essentially a department or division of its parent bank (1970 Federal Reserve Bulletin 344; 12 CFR 212.101). Furthermore, in enforcing other provisions of section 8 relating to non-bank corporations, the courts have gone beyond the specific language of that section in order to effectuate Congressional purpose. *U.S.* v. *Sears Roebuck and Co.*, 165 F. Supp. 356 (1958).

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(*d*) With respect to the instant question, the Board was of the view that considerations similar to those just discussed were persuasive and that, therefore, a holding company whose principal activity is the ownership and control of banks, and each of its bank subsidiaries, should be considered as constituting together a single entity for the purposes of section 8. Accordingly, the Board concluded that, if an interlocking relationship between two banks is prohibited by section 8 (none of the exceptions specified in the statute or Regulation L being applicable), such a relationship is also prohibited between a parent holding company of one of the banks and a bank not a member of the holding company group. The Board concluded also that interlocking service between parent holding companies is prohibited by section 8 if it is prohibited between any of their respective bank subsidiaries.

(Interprets and applies 15 U.S.C. 19.)

By order of the Board of Governors, May 12, 1970.

[SEAL]

ELIZABETH L. CARMICHAEL,
Assistant Secretary.
(Signed) Elizabeth L. Carmichael

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
Washington, D. C., June 1, 1970.

Hon. ARTHUR F. BURNS,
Chairman, Board of Governors, Federal Reserve System,
Washington, D.C.

DEAR CHAIRMAN BURNS: On April 2, 1970, I forwarded to you a copy of a letter from a Washington attorney pointing out a possible violation of Section 8 of the Clayton Antitrust Act as a result of interlocking directorships between the First National City Bank, the nation's second largest commercial bank, and Marine Midland Banks, Inc., the country's fourth largest registered bank holding company, both headquartered in New York State. These institutions directly compete in the commercial banking field in New York City.

On April 8, 1970, you informed me that you were asking the Federal Reserve Bank of New York to make a report relative to this possible violation of Section 8 of the Clayton Act. On May 18, 1970, you informed me by letter that the Board of Governors of the Federal Reserve Board on May 12 submitted for publication in the *Federal Register* an interpretation of Section 8 of the Clayton Act which stated, in effect, that it was a violation of interlocking directorate prohibitions for an officer, director or employee of a Member Bank of the Federal Reserve System to serve at the same time as an officer, director or employee of a bank holding company where the two banking entities are located in the same, contiguous or adjacent cities, towns or villages.

You further stated that as a result of my original inquiry of April 2, Mr. J. Peter Grace, who is a director of both the First National City Bank and the Marine Midland Banks, Inc., was to be advised to terminate this illegal interlocking relationship.

First of all, let me commend you and the other Members of the Federal Reserve Board for your prompt and vigorous action in regard to this matter. The Board under previous chairmen has not shown an equal degree of responsiveness to such questions.

It is interesting to note, however, that Mr. J. Peter Grace has been on the Board of Directors of First National City Bank for over 11 years, since 1959, and has served on the Marine Midland Banks, Inc. Board since 1965. Therefore, he has been in violation of section 8 of the Clayton Antitrust Act for over 5 years.

In light of this, it seems to me that the Federal Reserve Board should make a thorough and exhaustive examination of all such interlocking directorships to determine whether many other violations of the Clayton Act are also continuing to occur because of lax enforcement of the law in the past on the part of the Federal Reserve.

This episode also raises again the question of the adequacy of the Clayton Act provisions barring interlocking directorships among commercial banks, as well as between commercial banks and other competing financial institutions. As you know, over the past few years the staff of the House Banking and Currency Committee has done extensive work in this field, revealing the widespread existence of interlocking relationships among competing financial institutions.

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The significance of corporate interlocks has been stressed in other reports and studies as well. In fact, the Antitrust Subcommittee of the House Judiciary Committee published an entire 270-page study on the subject in 1965 entitled "Interlocks in Corporate Management." This study touched on the problem of interlocks among some financial institutions, but did not go into great detail in this area. The subcommittee chairman, Mr. Celler, who is also chairman of the full House Judiciary Committee, has recommended legislation in this area to restrict corporate interlocks among various types of corporations, including banks and other types of financial institutions.

Of equal significance was the recommendation of the Advisory Committee on Banking to the Comptroller of the Currency in 1962. This committee, chaired by Frank E. McKinney, chairman of the board of American Fletcher National Bank & Trust Co. of Indianapolis, Ind., had 24 members, 22 of whom were officers of commercial banks. This committee's report had the following to say about the problem of interlocking directorates:

The financial structure of the Nation needs to be guarded against conflicts of interest. This means that the law and its application by the supervisory authorities should restrict interlocking directorates, and not only between competing banks and certain other types of competing financial institutions, notably, mutual savings banks and savings and loan associations. As presently interpreted, the law prohibits various specific types of interlocking directorates as between member banks but does not similarly restrict interlocks involving other classes of financial institutions to the extent desirable. Hence, there is a clear need for legislation dealing with this problem.

This committee went on to recommend that——

"The prohibitions of the present law on interlocking directorates should be made applicable between banks, whether chartered under Federal or State law."

This recommendation received renewed support when the Annual Report for 1965–66 of the Comptroller of the Currency stated:

"This office has consistently taken the view that conflicts of interest in the financial structure should be removed and that laws regarding interlocking directorates should be clarified and strengthened."

As the above-quoted statements imply, present law prohibiting corporate interlocks among banks and other competing financial institutions is clearly inadequate.

The present provisions of the Clayton Act prohibit any officer, director, or employee of a member bank of the Federal Reserve System from serving at the same time as a director, officer, or employee of either a federally chartered or a State-chartered bank. However, of the eight statutory exceptions, there are three very broad and important statutory exceptions to this general prohibition: (1) The Federal Reserve Board may by regulation permit a director or employee of a bank to serve in a similar capacity with one other bank; (2) the prohibition does not apply where a National- or State-chartered bank is located outside of or is not contiguous with or adjacent to the city, town, or village in which the Federal Reserve member bank has its main or a branch office; and (3) the prohibition does not apply to mutual savings banks having no capital stock.

In addition to the above-mentioned exceptions, there is another very significant but silent exception found in present law. The Clayton Act provisions only apply where at least one of the banks is a member bank of the Federal Reserve System. Any of the more than 6,000 State-chartered banks that are not member banks can have as many interlocks as they want without violating the law. The law also does not apply to interlocks betweeen commercial banks and competing financial institutions, such as mutual savings banks, insurance companies, and small loan companies. Therefore, because of the statutory exceptions, as well as the loopholes created by omissions in the coverage of the law, the present statutory prohibitions against corporate interlocks in this area are to a great extent ineffective.

As a result of these studies, in February 1969, I introduced legislation as part of the Bank Holding Company Act Amendments (H.R. 6778) to tighten provi-ion of present law on this subject. Your predecessor, William McChesney Martin, among others, supported these provisions. However, because it was necessary to give greater consideration to parts of H.R. 6778 directly relating to the alarming one bank holding company issue, the Committee at that time did not consider in depth the serious weaknesses in present interlocking directorate prohibitions.

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Because of the growing seriousness of this problem, I believe it is time for Congress to make a thorough re-examination of the adequacy of present law pertaining to interlocking directorates among all financial institutions. In preparation for this undertaking, I would like to request the Federal Reserve Board to study this matter thoroughly and report its position on the adequacy of present law in this field.

Your cooperation in this matter will be greatly appreciated.

Sincerely yours,

WRIGHT PATMAN,
Chairman.

CHAIRMAN OF THE BOARD OF GOVERNORS,
FEDERAL RESERVE SYSTEM,
Washington, D.C. December 16, 1970.

Hon. WRIGHT PATMAN,
Chairman, Committee on Banking and Currency, House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: I am writing in further reply to your letter of June 1, 1970 concerning interlocking relationships with member banks under section 8 of the Clayton Act (15 U.S.C. 19).

Affiliations of officers, directors, and employees of member banks that might conflict with section 8 of the Clayton Act are regularly reviewed by the Federal Reserve System as part of the examinations of State member banks, and by the Comptroller of the Currency with respect to national banks. This is a continuing process, and where violations are found to exist the parties concerned are requested to terminate the prohibited relationships.

On receipt of your letter, we asked the Federal Reserve Banks to make a special review of interlocking personnel relationships in their Districts in order to ascertain if any existed that were not permissible or were of questionable legality. This review disclosed twelve cases of interlocks in apparent violation of section 8. Two of these cases were already in the process of investigation as part of the Reserve Banks' general review process, and five had arisen shortly before the special review as a result of an interpretation concerning interlocking relationships with bank holding companies that the Board issued May 12, 1970. Steps have been taken to dissolve the prohibited interlocking relationships, by the Reserve Banks directly where State member banks are involved, and through the Comptroller of the Currency's office where national banks are involved.

In accordance with your request, the Board has also considered the adequacy of the present provisions of the Clayton Act affecting interlocking relationships.

The statutory prohibitions against interlocking relationships in section 8 involve two sets of considerations. On the one hand, interlocking relationships may seriously impair competition between firms in the same line of business. On the other hand, economic benefits flow from a high standard of performance by corporate boards of directors. This entails a free interchange of advice, ideas, and experiences among directors of varied backgrounds. Bankers often have experience and expertise that qualify them to render valuable service in this role. Interlocking directorates, in other words, are not inherently wrong. They may be good for the corporations involved and the public they serve. The problem is to define those situations where the risk of abuse outweighs the expectation of benefit.

Section 8 now prohibits interlocks betwen two ordinary business corporations where they are competitors by virtue of their business and location, so that elimination of competition between them by agreement would violate the antitrust laws. In prohibiting interlocks between a member bank and another bank, section 8 employs a test that is more easily applied—where the two banks are in the same adjacent, or contiguous cities, towns, or villages—for the same purpose of identifying market situations where interlocks might pose too great a threat of diminishing competition.

We see no reason to suppose that this risk of diminishing competition is any greater where an interlock involves a member bank than where it involves any other insured bank, and we would therefore recommend broadening the statute so that it applies to insured commercial banks, not just to member banks.

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We also believe that the types of interlocking service that are prohibited should be re-examined. For member banks, section 8 now prohibits interlocking service as a "director, officer, or employee" whereas for other corporations the prohibition applies only to service as a director. In order to confine the prohibition to those banking situations that raise serious questions about diminishing competition, the Board recommends adoption of the approach advanced in 1965 by Representative Celler. His bill, H.R. 11572, 89th Congress, would have amended section 8 to apply to service as "a director, officer, or employee with management functions," and to "representatives or nominees" of such persons.

Section 8 now exempts interlocks between banks under common control. Obviously, there is no threat to competition in such instances. But this exemption as presently written is too broad, since it applies wherever the same "persons" own 50 per cent of the stock of each institution and the statute fails to give any specific content to the term "persons". As a result, to take the simplest example where one person owns 90 per cent of the stock of Bank A and another owns 90 per cent of the stock of Bank B, the two may exchange single shares of stock of their respective banks and thereby come within the statutory exemption, since together they are "persons" owning 50 per cent or more of the stock of both banks. Thereafter, under the present law, there may be interlocks between the two banks even if they are located across the street from each other and in direct competition. This loophole should be eliminated.

The Board recommends, further, that the prohibitions relating to interlocks between commercial banks should be broadened to cover all depository institutions—commercial banks, savings and loan associations, savings banks, building and loan associations, homestead associations, and cooperative banks. While there are some lines of activity in which institutions in one class do not compete with those in another, there is sufficient overlapping of functions among all kinds of depository institutions to support a general presumption that those in the same community are in competition, particularly in view of the increasing powers of savings and loan associations.

In this connection, you may wish to consider extending coverage to all depository institutions, whether insured or not. Exempting uninsured institutions has little effect for commercial banks, since less than 200 banks with less than 1 percent of total deposits are uninsured. About a third of all mutual savings banks and a fourth of all savings and loan associations, however, are uninsured, and they hold about 18 percent and 4 percent, respectively, of total deposits. Some of these noninsured institutions are, or could be, significant, competitive forces in their local areas.

The fifth clause in section 8 presently exempts from the statute's coverage interlocking relationships between banks not in the same, contiguous, or adjacent cities, towns, or villages. Although the exemption is believed to have been intended to recognize the generally regional nature of banking which existed in 1935 (the date of the last amendment to the statute), interlocking relationships between and among several of the larger banks, which compete on a nationwide basis, may also come within this exemption. In the Board's judgment such interlocking relationships seem questionable.

We are not persuaded that a case has been made for further broadening of the restrictions in section 8 on interlocks with banks. It should be borne in mind that in addition to the provisions specifically relating to banks, section 8 includes a general prohibition against interlocking directorates between corporations engaged in commerce which are "by virtue of their business and location of operation, competitors, so that the elimination of competition by agreement between them would constitute a violation of any of the antitrust laws." Although its applicability in the case of interlocks between banks and nonbank businesses is not entirely clear, this provision would seem to offer additional protection against such interlocks where the anti-competitive effects are sufficiently strong. In considering any further tightening of the prohibitions of section 8, Congress should use caution, so as not to inhibit corporations—particularly the newer and smaller ones—in their search for directors of the highest caliber available.

Finally, the Board recommends that any legislation amending the statute along the lines suggested in this letter should provide that individuals who now serve in capacities that would be prohibited by the new legislation may continue to serve for a five-year period to allow a gradual phasing out of prohibited interlocks. In view of the difficulties of finding replacements, it could prove needlessly disruptive to concentrate the search within a shorter period.

Sincerely yours,

ARTHUR F. BURNS.

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The CHAIRMAN. It has generally been agreed by most witnesses that have appeared before the committee thus far that some strengthening of the Clayton Act prohibitions against interlocking directorates as they relate to competing financial institutions should be enacted into law. A number of technical questions relating to the scope of the coverage have been raised by several witnesses.

Two of the most important of these questions are:

(1) How to define the market areas in which these various financial institutions compete, and

(2) What should be included in the definition of financial institutions.

On the first question relating to market area, it seems to be generally agreed that the definition in the Clayton Act is far too narrow for the 1970's, though it might have been appropriate in 1914 or 1935. Many financial institutions, especially the major ones, compete on a nationwide basis. Others compete on a regional basis often composing several States. Many compete only on a more or less local basis.

The question is how to define the area of coverage so that all serious anticompetitive relationships are prohibited while not outlawing ones that will have very little anticompetitive impact. Dr. Burns discusses this problem in his statement.

An interesting suggestion has been made in a letter to me from Robert P. Mayo, former Director of the Bureau of the Budget and now President of the Federal Reserve Bank of Chicago. He suggests that the prohibition be applied nationwide to financial institutions of greater than a certain asset size, while applying a narrower geographic test to smaller institutions.

(The letter referred to from Mr. Mayo by Chairman Patman follows:)

FEDERAL RESERVE BANK OF CHICAGO,
April 12, 1971.

Hon. WRIGHT PATMAN,
Chairman, Banking and Currency Committee,
U.S. House of Representatives,
Washington, D.C.

DEAR MR. CHAIRMAN: I am pleased to offer my personal view on H.R. 5700.

The prohibition of interlocks between financial institutions that stand in a competitive relationship to one another seems to be a desirable reform. The public has every reason to expect institutions that are independent in form to be independent in fact as well.

I do not believe, however, that the prohibition on interlocks should extend to financial institutions which bear no substantively competitive relationship to one another, as would be the case under Sections 2–4 of the Bill. Unless there is some real chance of an anti-competitive effect or obvious conflict of interest, the hardships imposed on financial institutions searching for capable directors could well outweigh the very limited protection from abuses the prohibition would provide. A possible alternative to avoid both excessive administrative costs of determining whether two financial institutions are competing and what I believe to be the undue restrictiveness of the proposed limitation might be to incorporate in the statute specific size and distance criteria to exclude from further consideration cases where the institutions would obviously be likely not to be in close competition with one another. Such statutory definitions would, however, tend to be arbitrary.

I have serious misgivings about Section 9, which would prohibit a "director, trustee, officer, or employee" of an insured bank, insured savings and loan association, or mutual savings bank from serving on the board of directors of any corporation with which such institution has a substantial and continuing relationship with respect to the making of loans, discounts, or extensions of credit." This strikes at the essence of banking. Granting the possible conflicts of interest, opportunities for favoritism, and potential for abuse which such a situation

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presents, I would argue on the basis of my experience that it is indispensable for banks to have informed businessmen as members of their boards of directors. The continuing flow of information which such a liaison can provide is invaluable to the bank in making these critical decisions that determine how society's scarce capital shall be allocated—decisions that affect vitally the safety of depositors' funds. To deny banks access to information which these directorships provide would be to require that such decisions be made on the basis of information that is less than the best available. Furthermore, I believe a serious downgrading of the present high quality of bank boards of directors would take place, with greater opportunities for the creation of mediocre, "rubber-stamp" boards which would have neither the ability nor the willingness to challenge management recommendations. I submit that the business of banking entails certain risks of abuse against which the only protections are the integrity of individual bankers and the alertness of the regulatory agencies. To curtail such risks by eliminating the working relationships that give rise to them is, to use a trite but appropriate phrase, "to throw out the baby with the bath water."

In contrast to the above provision—which I believe would unreasonably interfere with the fundamentals of banking—are Sections 8 and 12 through 18, which are designed to keep lenders "in the business of lending money, and not (of) the control and management of other corporations." A case can be made that this was one of the principal purposes of the Bank Holding Company Act Amendments of 1970. The prohibitions of equity participations and the limitations on trust department's aggregate holdings of the stock of any one corporation are provisions that demand no more than what prudence should already have dictated. I can see no legitimate grounds for objection to their general import. Compliance with these requirements is logically met through the regulatory authorities in their regular reports and examinations. I have some reservations about the value of making available for public inspection the contents of all lists and reports filed under the proposed new subsection to the Federal Deposit Insurance Act. Broad differences in fiduciary arrangements in terms of bank control can make such summations very misleading.

I have an important reservation about another aspect of Section 14, which prohibits lenders from acquiring equity participations. As paragraph 14(c) is now worded, all penalties for violation of Paragraph (b) of the Section would be placed on the lender to the windfall benefit of the borrower. This approach seems to presuppose that such arrangements constitute an exploitative imposition on the borrower. The truth of the matter, I believe, is that they are a necessary protection for the lender from the hazards of extending long-term credits under conditions of uncertainty regarding the purchasing power of money. The proof of this is to be had in the proliferation of such agreements during extended periods of inflation as opposed to their virtual absence in periods of price stability. If equity participations are to be prohibited—and I believe there is a good case for doing so on the grounds of preserving arms-length dealings between borrower and lender—the justification should be the contribution of such a restriction to sound banking, not an uwarranted inference that such agreements are one-sided extractions of tribute from the borrower. Therefore, the onus for violation of the prohibition should fall equally on both parties to the transaction.

Regarding the provision of the bill that would prohibit the payment of bribes to a firm's officer, director, or employee to influence his conduct with respect to business transacted with a financial institution I have no basic objections, but only a suggestion. As the provision now stands, an employee of a corporation soliciting or accepting such a benefit would be imprisoned up to one year, while the maximum punishment applicable to the financial institution conferring or offering such a benefit would be a fine of $25,000. As a matter of equity, it would seem that the responsible officer or employee of the financial institution should be subjected to the same jeopardy of loss of freedom as the recipient of the bribe.

Finally, I endorse those provisions of the bill prohibiting brokered deposits and the offering of premiums to attract deposits. I agree with the statement made on the floor of the House that whatever improvements in the efficiency of the financial system that brokering of deposits may be responsible for "are far outweighed by the dangers created by this practice." Again, however, I suggest that the penalties applicable to the responsible bank official should be symmetrical with those applicable to the broker. The practice could not exist without the agreement of both parties.

So far as premiums to attract deposits are concerned, I might only observe that they are the by-product of attempting to substitute regulation for the mar-

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ket place in the determination of interest rates on deposits. In my opinion, the structure of ceilings as now constituted discriminates unduly against the small saver with few alternatives to a passbook account. Accepting, for purposes of discussion, the wisdom of the present legislation in this area, I agree that there is little point in allowing competitively enforced barter arrangements to circumvent the purpose of the ceilings. Economically, if not legally, there is little distinction between explicit interest payments and premiums.

These are the thoughts that came most readily to my mind as I read H.R. 5700. I am pleased to have been asked for my views. I might also point out for the record in closing that I was a staff assistant—not a member—of the Comptroller of the Currency's Advisory Committee on Banking.

Sincerely yours,

ROBERT P. MAYO.

The CHAIRMAN. The other question that we must direct our attention to is that of the definition of financial institution. Some witnesses have suggested that the list be broadened to include mortgage bankers, investment advisers and other entities involved in the financial and securities business. Some have and will argue that the list already contained in the bill is too broad and should not include, for instance, insurance companies.

These are two of the more important questions that I believe we should focus on during these hearings.

So, Dr. Burns, we are delighted to have you as a witness. You have a prepared statement. And you may proceed in your own way, sir. We would be very glad to hear you and consider what you have to say.

Dr. BURNS. Thank you very much, Mr. Chairman.

STATEMENT OF HON. ARTHUR F. BURNS, CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Dr. BURNS. I appreciate the opportunity to participate in these hearings, which seek ways to strengthen our financial system and the economy that it supports.

We at the Federal Reserve welcome this inquiry, and want to be as helpful as we can. Among the variety of proposals before you, there are some which would alter established patterns of doing business—not just for banks or other financial institutions, but also for business firms of all kinds, in small towns as well as major financial centers.

Before you act on these proposals you will need to know a good deal about these existing business relationships, in order to assess the consequences, good and bad, of changing them. In testifying for the Board, I am very much aware of the limits of our knowledge about these relationships. Therefore I will not try to comment on all the proposals. Rather, I will offer for your consideration only those judgments that the Board feels reasonably confident are supported by our experience and understanding.

One area with which we are familiar involves interlocks among banks. Section 8 of the Clayton Act deals generally with interlocking relationships and specifically with interlocking bank relationships. The Board is responsible for enforcing section 8 to the extent that it involves member banks of the Federal Reserve System.

Our experience has convinced us that there is nothing inherently wrong about interlocking directorates. On the contrary, corporate boards of directors should be composed of men having diverse backgrounds, so that the corporations they serve may benefit from their

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ideas and experience. I might add that bankers, because of their broad experience, are especially qualified to serve as directors of other corporations, and this accounts for the fact that many serve in this capacity. The cross-fertilization which director interlocks have provided America's corporations has been manifestly healthy for business and the Nation.

Public policy, as embodied in the Clayton Act, has recognized this fact. The Clayton Act was designed to prohibit only those interlocks which tend to diminish or eliminate competition. Aside from this salutary prohibition, interlocks are permitted.

In view of the difficulties involved in determining on a case-by-case basis when banks are in competition with each other, section 8 uses a simple test. Interlocks are prohibited when the two banks are in the same or neighboring cities and towns. In 1935, when this test was adopted, it was believed to be a workable way of confining the restriction on interlocks to those situations where it is really needed to avoid anticompetitive consequences. Generally speaking, the test has worked well over the years.

The risk of thwarting competition within a city is not confined, however, to interlocks involving member banks. We believe therefore that the prohibition of interlocks should cover all insured commercial banks. Indeed, we believe the prohibition should extend to savings banks and savings and loan associations, as well as commercial banks. There is sufficient overlapping of functions among these institutions to support a general presumption that those in the same or neighboring communities compete with each other.

You may wish, as well, to consider covering institutions whose deposits are not federally insured. Exempting uninsured commercial banks may be of minor importance, since only about 200 banks accounting in the aggregate for less than 1 percent of total deposits are uninsured. However, about a third of all mutual savings banks and a fourth of all savings and loan associations are uninsured, and they hold about 13 percent and 3 percent of their respective total deposits.

While H.R. 5700 would exempt interlocks between banks that are owned by the same company, it would prohibit interlocks between those that are owned by the same individuals—so-called chain banking. The exemption should apply to both instances, inasmuch as interlocks cannot reduce competition between banks that are already under common control. Section 8 of the Clayton Act now exempts interlocks between two or more banks where a majority of the common stock is owned by the same persons. We believe a comparable exemption should be written into H.R. 5700.

We also believe that the types of interlocking service that are now prohibited should be reexamined. For member banks, section 8 covers interlocking service as a "director, officer, or employee," whereas for other corporations it applies only to service as a director. It seems needlessly restrictive to cover all employees; we recommend instead that coverage be limited to service as a "director or an officer, or an employee with management functions."

H.R. 5700, would prohibit bank interlocks without regard to the competitive relationship of the banks or their geographic location. The Board recommends, instead, retention of the present geographic test—so that interlocks would be barred only where they involve banks located in the same or adjacent communities—with two exceptions.

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First, we recognize that some banks compete in markets that are nationwide. Nationwide competition for both deposits and loans has been increasing and can be expected to increase further in the future. The Board recommends, therefore, that interlocks be prohibited among all banks over a certain size—perhaps $1 billion in assets—regardless of where they are located. Admittedly, there is an element of arbitrariness in this test, but we think that the alternative of making detailed analyses of competition in various banking markets would be impractical. Provision should perhaps be made for administrative waiverers of this prohibition upon a showing by the banks involved that they operate in separate markets. And it could prove useful to grant authority for changes in the $1 billion figure by regulation.

Second, we suggest a variant of the geographic test for holding company banks, namely, interlocks should be prohibited between a holding company or any of its subsidiary banks, wherever located, and any other bank located in or adjacent to any community served by a subsidiary bank.

In weighing the need for the additional restrictions in sections 2 through 10 of H.R. 5700, it should be borne in mind that section 8 of the Clayton Act now prohibits interlocking directorates between corporations engaged in interstate commerce which are "by virtue of their business and location of operation, competitors, so that the elimination of competition by agreement between them would constitute a violation of any of the antitrust laws."

It would be helpful if the Congress made it entirely clear that this provision applies to interlocks between banks and non-bank businesses. Such action would provide ample protection against interlocks where the anticompetitive effects may be significant. In considering further restrictions, Congress should proceed very cautiously so as not to inhibit banks or other corporations—particularly new or smaller ones—in their search for directors of the highest caliber available.

Let me turn now to sections 12 and 13 of H.R. 5700, which relate to the trust departments of insured commercial banks.

Section 13 prohibits a trust department from holding stock issued by the bank itself or its parent holding company. In such situations, if the bank has sole voting rights there is a risk that the stock may be voted to perpetuate the bank's management in office. Where a national bank holds its own stock as sole trustee, it is not permitted under section 5144 of the revised statutes to vote that stock in the election of directors unless the "donor or beneficiary actually directs how such shares shall be voted." The essential purpose of the prohibition in section 13 against a bank holding its own stock in its trust department can be better served by extending the provisions of section 5144 to insured State banks.

Section 13 would also prohibit a bank trust department from holding more than 10 percent of any class of stock registered under the Securities Act of 1933. The Board doubts the wisdom of such a prohibition. Among other difficulties, it would deny individuals with very substantial holdings in the stock of a corporation access to the services of bank trust departments and thereby practically force them to rely on individual fiduciaries. This could cause serious problems for individuals and families that need or want to rely on an institution with a permanent life.

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Furthermore, if individual bequests naming a bank's trust department as trustee should raise that department's aggregate holdings of some stocks above the 10-percent limit, this bill would force the trust department to sell off some of such holdings even if it were adverse to the investment interests of the beneficiary to do so.

The argument for the limitation is that bank trust departments hold large blocks of stock in major corporations, and thus could exercise influence over them. However, as the SEC's institutional investor study report points out, the "existence of potential power on the part of institutions to influence corporate decisions by reason of their substantial shareholdings does not demonstrate that such influence is in fact exercised." (Summary volume, p. 124) If the Congress concludes, nonetheless, that a 10 percent limit is needed, its potentially disruptive effects could be lessened by applying it only to future purchases made at the initiative of the trust department.

Section 12 of the bill would require bank trust departments to disclose annually a list of all securities held (other than Government securities), indicating the name, class, value, and number of each security held, the authority of the trust department to exercise voting rights, and the manner in which it exercised proxies.

In other words, section 12 would require a public disclosure of all assets, debt instruments as well as equities, small interests as well as large, without regard to the bank's role in acquiring the assets or its ability to exercise voting power. Such a sweeping requirement would result in the disclosure of interests that could be readily associated with trust customers who would consider such disclosure an invasion of their privacy. As a consequence, much of this business may well be transferred to unregulated trustees. Compilation of the vast array of statistics required would also necessitate changes in procedures that could prove too costly for all but the biggest banks.

It would appear that the objectives of section 12—public disclosure of information needed to assess the impact of bank trust investments on securities markets and on economic concentration—could be accomplished with a requirement confining disclosure to holdings where the stock is registered under the Securities Exchange Act of 1934, where the trustee has exclusive voting rights, and where the trustee's aggregate holdings of the stock exceed a specified amount, say, $1 million. The Board also recommends that this disclosure requirement apply to all fiduciaries, not only the bank trust departments.

Section 14 of the bill would prohibit banks, other thrift institutions, and insurance companies from accepting any equity participation in consideration of making a loan. "Equity participation" is defined to include two quite different kinds of economic relationships: first, an ownership interest in any property or enterprise; second, a right to any payment which is linked to the income from any property or enterprise. The first relationship is clearly susceptible of speculative abuse; the second may provide a constructive method for adjusting credit charges to changing economic conditions.

As recent experience has demonstrated, the second form of financing can in fact facilitate extensions of credit to relatively new firms and real estate developers which typically lack ready access to the public capital markets.

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A ban on acquiring of "ownership interests" by banks is not needed, in view of the prohibitions in existing law against bank purchases of stock. However, banks may—and some do—make loans that provide for a return to the bank that varies according to the income of the property or business financed. Heavy concentration in loans with such variable-return provisions could pose a threat to bank safety. While bank examiners are mindful of this risk, the Congress may deem it prudent to limit the aggregate of loans with such provisions to a specified percentage of a bank's total assets or its capital and surplus.

Section 15 of the bill would require each insured bank to report to the FDIC all loans it makes to any of its directors, trustees, officers, or employees, or their families. It would also prohibit the bank from extending credit to any corporation in which such persons (as a group) have as much as a 5 percent stock interest. These provisions would change existing banking practices far more than is wise, particularly in small towns. It is quite common and salutary for a bank to include on its board of directors individuals who have substantial interests in business firms in town. These firms are likely to do business with the bank in a number of ways, including borrowing. To force the bank to choose between cutting off credit to such firms and excluding their principal stockholders from its board of directors could result in stagnant towns or weaker banks.

Still, something needs to be done to provide more protection against unsound loans to insiders. One possibility would be to amend the Financial Institutions Supervisory Act of 1966 to make cease-and-desist orders more readily available to stop these practices when they are discovered in the course of bank examinations. We have in mind a provision that would establish a presumption that it is an unsafe and unsound banking practice for a depository institution to lend to insiders or enterprises controlled by insiders an amount that in the aggregate exceeds a specified percentage of the institution's capital and surplus. If a bank failed to observe this rule the supervisory agency could file a notice of charges, with the bank bearing the burden of establishing that the loans in excess of the limit are safe and sound.

Section 19 of the bill would prohibit insured banks from paying compensation to brokers or others for obtaining deposits for the bank. Brokered deposits at State member banks have not posed serious problems. As of July 31, 1970, according to a survey of State member banks, only 30 out of 1,157 reporting banks held brokered deposits and they amounted to less than 1 percent of total deposits in those 30 banks.

A case can be made that brokers help to channel funds into capital-poor areas. However, in view of the part that loans tied to brokered deposits have played in bank failures in recent years, we are inclined to agree with those who conclude that the benefits of brokering are outweighed by the dangers, and we therefore support section 19. We recommend against enactment of the criminal sanctions provided in section 21, since we believe the civil penalties provided in section 19 plus other remedies available are sufficient for enforcement purposes. Moreover, section 21 as drafted would seem to prohibit legitimate activities such as paying an employee for bringing in new deposits, whereas section 19 meets this problem by authorizing the FDIC to prescribe regulations, which presumably would exempt such activities.

Sections 25 and 26 provide for full insurance of public deposits in institutions insured by FDIC and FSLIC. The Board is concerned

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about the impact of these sections on the markets for Federal and municipal obligations. Banks are now generally required to pledge collateral as security for uninsured public deposits.

A sizable portion of the Treasury and municipal obligations held by banks is pledged under these collateral requirements. For example, according to the latest survey available—1966—over half of the Treasury obligations held by commercial banks were pledged for this purpose; among larger banks the proportion was even higher. Extending insurance coverage as proposed by H.R. 5700 would reduce the attractiveness of such securities as investments for the banks, and thus tend to raise borrowing costs for the Federal, State, and local governments.

Let me turn now to Mr. Gonzalez' bill, H.R. 3287, which would prohibit any insured bank from making a loan to finance the purchase of stock or obligations of another bank. A flat prohibition of this kind would reduce flows of capital into banking and severely restrict ownership of banks, eliminating potential entry by those who cannot afford to buy bank stock without a bank loan.

The Board therefore recommends against enactment of H.R. 3287. Nevertheless, while H.R. 3287 is too restrictive, some additional controls over bank loans on bank stock are needed. We believe Congress should authorize one or more of the regulatory agencies to prescribe regulations applicable to all insured banks, with a view to insuring that loans made to finance the purchase of bank stock meet sound banking standards and are not used as devices to promote the interests of speculators or the lending banks to the detriment of the purchased banks.

In conclusion, let me say that the Board joins fully this committee in its efforts to improve the organization of finance in our country. We can and do suggest numerous provisions of H.R. 5700. We also support the objectives of H.R. 3287. We believe, however, that the legislation before this committee goes beyond what is necessary to achieve the objectives that their distinguished authors seek to promote.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Thank you very much, Dr. Burns, for your very helpful statement. I want to commend you and the rest of the Board for your cooperation in looking into these particular matters over the last year since our correspondence began. We also appreciate the Board's very positive response to this serious problem.

I do not wish to do any detailed questioning at this time. In fact, I will forgo asking any questions at this time. However, I would briefly like to make the following comments on your testimony.

As I read your testimony, you support the following changes in existing law:

(1) Broadening the Clayton Act prohibitions to cover all commercial banks, savings banks, and savings and loan associations that compete in a geographic area.

(2) Broadening the geographic coverage to prohibit interlocking personnel relationships nationwide among banking institutions over a certain size, suggested to be over $1 billion in assets.

(3) Extending the restrictions now applied to national banks on voting their own shares held in trust to all insured banks.

(4) Requiring the disclosure of the aggregate stock-holdings of all trustees where the stock is registered under the Securities Exchange

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Act of 1934, where the trustee has exclusive voting rights, and where the trustee's aggregate holdings of a particular stock exceeds a specified amount, probably $1 million.

(5) Tightening of existing law as it pertains to brokered deposits, insider loans, and loans made for the purchase of bank stock, but somewhat differently than embodied in the legislation before us, H.R. 5700.

In my opening statement, I raised the question that we ought to have a definition that encompasses the current trend of competition in the financial community. On that issue, you did not directly comment. The trend has clearly been toward life insurance companies directly competing more and more with such financial institutions as commercial banks, mutual savings banks, and savings and loan associations. Life insurance companies compete in at least five ways with other financial institutions:

(1) For savings of the public generally.

(2) Providing investment management for individuals, particularly through the operation of mutual funds.

(3) Pension fund management for corporations.

(4) Granting of mortgage loans.

(5) Granting of commercial and industrial loans.

The Federal Reserve Board statistics themselves reveal some of the areas in which life insurance companies compete with other financial institutions, showing, for example, on page A-38 of the March 1971 Federal Reserve Bulletin, the amount of mortgages, real estate loans, and policy loans outstanding of life insurance companies.

We should also consider the tremendous extent to which life insurance companies are interlocked with other financial institutions. The 10 largest life insurance companies in the United States had total assets at the end of 1969 of $114.8 billion, representing 57 percent of the total of all assets in life insurance companies at that time.

The 10 largest commercial banks at the end of 1969 had $113.4 billion in deposits, representing 25.6 percent of the deposits of all commercial banks in the country. We can see from these figures that both industries are heavily concentrated.

These 10 largest life insurance companies have 30 interlocking directorships with the 10 largest commercial banks with which they compete. The most heavily interlocked was Metropolitan Life Insurance Co., which had a total of nine interlocking directorships with six of the 10 largest commercial banks. In total, the 10 largest life insurance companies in the country have 201 interlocking directorships with other financial institutions.

All of this clearly reveals that there are far too many interlocking relationships between one major source of credit in this country—life insurance companies—and the other major sources of credit—banks. Tables illustrating these interlocking relationships between major life insurance companies and other financial institutions will, without objection, be inserted in the record of the hearings at this point.

Is there objection?

The chair hears none.

They will be inserted at this point in the record.

(The material referred to by the chairman for inclusion in the record at this point follows:)

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10 LARGEST LIFE INSURANCE COMPANIES AND 10 LARGEST COMMERCIAL BANKS IN UNITED STATES—1970

Name of life insurance company	Assets as of Dec. 31, 1969 (thousands)	Percent of total life insurance company assets	Name of commercial bank	Deposits as of Dec. 31, 1969 (thousands)	Percent of total deposits of commercial banks
Prudential	$27,749,894	14.0	Bank of America	$22,171,463	5.0
Metropolitan	26,829,862	13.0	Chase Manhattan	18,998,733	4.4
Equitable	14,001,313	7.0	First National City	19,148,025	4.4
New York Life	10,338,572	5.2	Manufacturers Hanover	10,444,505	2.3
John Hancock	9,698,166	4.9	Morgan Guaranty Trust	9,019,296	2.0
Aetna	6,948,733	3.5	Chemical Bank	7,932,587	1.8
Northwestern Mutual	5,909,644	2.9	Bankers Trust Co	7,809,810	1.7
Connecticut General	4,725,633	2.8	Continental Illinois	6,306,858	1.4
Travelers	4,506,414	2.2	Security Pacific National	5,765,547	1.3
Massachusetts Mutual	4,067,866	2.0	First National Bank, Chicago	5,813,104	1.3
Total	114,776,097	57.0		113,409,928	25.6

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INTERLOCKS AMONG 10 LARGEST COMMERCIAL BANKS AND 10 LARGEST LIFE INSURANCE COMPANIES, AS OF DEC. 31, 1969

Name of insurance company	Bank of America	Chase Manhattan Bank	First National City Bank	Manufacturers Hanover Trust	Morgan Guaranty Trust	Chemical Bank	Bankers Trust Co.	Continental Illinois National Bank	Security Pacific National Bank	First National Bank of Chicago	Total
Prudential	1		1				2				4
Metropolitan		2 (1-B)	2 (1-B)	1	1	1				2	9
Equitable		1 (1-I)				1 (1-B)					2
New York Life			1	1	1 (1-I)	3 (1-B)					6
John Hancock										1	1
Aetna					2 (1-I) (1-B)			1			3
Northwestern			1								1
Connecticut General				1							1
Travelers		1 (1-I)		1							2
Massachusetts Mutual			1								1
Total	1	4	6	4	4	5	2	1	0	3	30

Note: I = Principal position with insurance company, director of bank. B = Principal position with bank, director of insurance company.

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INTERLOCKING DIRECTORSHIPS BETWEEN 10 LARGEST LIFE INSURANCE COMPANIES AND COMPETING FINANCIAL INSTITUTIONS—1971

Name of insurance company	Commercial banks	Other insurance companies	Savings banks	Trust companies	Savings and loan	Total
Prudential	8	1	4	1		14
Metropolitan	20	2	1	2		25
Equitable	17	4	4	2		27
New York Life	10	0	2	0		12
John Hancock	9	2	7	2		20
Aetna	6	3	2	0		11
Northwestern	20	2	1	2	1	26
Connecticut General	4	0	4	1		9
Travelers	8	0	2	1		11
Massachusetts Mutual	12	1	6	2		21
Total	114	15	33	13	1	176

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The CHAIRMAN. I would like you to comment on what I have said in these remarks when you examine your transcript for approval.

(The information requested follows:)

Chairman Patman raised two related items in his discussion of the relationship between life insurance companies and commercial banks. First, he said a trend was developing toward more and more direct competition between life insurance companies and such financial institutions as commercial banks. Second, he said there are far too many interlocking relationships between life insurance companies and banks.

To comment first on the latter statement, interlocks should only be of concern, as I indicated in my testimony, if they occur between competing firms. Section 8 of the Clayton Act prohibits interlocking directorates between corporations engaged in interstate commerce which are "by virtue of their business and location of operation, competitors, so that the elimination of competition by agreement between them would constitute a violation of any of the antitrust laws." My prepared statement suggested that Congress should make it entirely clear that this provision applies to interlocks between bank and nonbank businesses. It would be unwise for Congress to go beyond this and prohibit interlocks between banks and insurance companies generally, since the evidence at hand does not support the assumption that they are in close competition.

Chairman Patman cited five areas of possible competition between life insurance companies and commercial banks. In the first of these areas, personal savings it seems clear that individuals' life insurance reserves are not readily comparable with their liquid savings in depositary institutions. Like pension reserves, life insurance reserves are usually not available to their owners except under restrictive conditions. Their primary purpose is to provide financial protection against disability or death. A study by the National Bureau of Economic Research several years ago showed a tendency for other forms of personal savings to increase by more than the buildup in families' pension reserves, indicating that pension reserves complement other savings rather than substituting for them. A similar complementary relationship is likely to exist between the formation of life insurance reserves and the growth of depositary savings.

Another area of possible competition—the mortgage loan market—is segmented. Insurance companies are relatively more active in the multi-family and commercial mortgage area, whereas most bank lending is concentrated in one-to-four family mortgages. Furthermore, much of the bank lending in the commercial mortgage sector is in the form of short-term construction loans, in contrast to life insurance companies, which typically provide permanent mortgage financing for commercial building. It also should be noted that commercial bank mortgage lending is normally limited to a bank's geographic area, which insurance companies tend to be nationwide mortgage lenders which can channel funds to capital-short areas.

Life insurance companies and banks also serve different markets in financing business. For example, banks most often extend short-term credit, and even their term loans generally have maturities in the range of three to seven years. There is, in fact, a whole class of borrowers—the local, high-risk small business firm—which usually can obtain credit only at banks. Life insurance companies, on the other hand, typically make loans with maturities ranging from 20–25 years and to businesses which are likely to be national or regional firms with credit ratings in the middle and lower investment grades. (Business borrowers with higher credit ratings usually meet their long-term credit needs in the public bond market.) Most short-term credit needs of business are met by banks. From a practical standpoint, therefore, the direct competition for business credit between life insurance companies and banks is much less than would be suggested by simply looking at data on aggregate loans to business.

In the other two areas mentioned by Chairman Patman—investment management for individuals and pension fund management—banks and insurance companies serve overlapping markets, although it should be noted that banks cannot operate mutual funds. The available data are not adequate to permit appropriate measurement of the extent of such competition.

Granting that life insurance companies and banks compete in some areas, adequate protection against possible adverse effects of interlocks on such competition would be afforded by clarifying the Clayton Act as I have suggested.

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The CHAIRMAN. Now, I will yield to Mr. Widnall for questioning under the 5-minute rule.

Mr. WIDNALL. Thank you, Mr. Chairman.

Dr. Burns, we again welcome you before the committee. And we appreciate your sound comments and constructive suggestions contained in your statement.

I would just like to ask this question at this time, Mr. Chairman. The minority received copies of Dr. Burns' statement at 10 minutes after 9 this morning. I would like to know——

Mr. CHAIRMAN. Dr. Burns was unable to furnish us his testimony as contemplated under the rules. However, at 2 o'clock Saturday the messenger was on his way. And he was unable to get here because of the transportation being interfered with on the street. And Mr. Gellman, the committee counsel, Benet Gellman, went down Saturday night at 8 o'clock himself and received the testimony and the copies. And they were distributed at the first available time. The first time I received mine was at 7:30 this morning in my office. And I think it was the same with the others. It was something that was interrupted by reason of the large number of people in town, No. 1, and No. 2, the inability of Dr. Burns to complete the statement in time and get it down to us.

Mr. WIDNALL. I would like to point out, Mr. Chairman, that there is something dead wrong with the system we have now, because the majority is always in possession of a witness' testimony in sufficient time in advance to examine it so that questions can be prepared, but the minority in many instances does not receive the testimony until just before the hearings commence. Perhaps we should have an arrangement where a representative of both the majority and the minority go down and get copies of the testimony from the witness before.

Mr. STEPHENS. Would the gentleman yield, please?

The CHAIRMAN. Wait just a moment.

In some instances you might have some just complaint, but in this instance I doubt that you do have. All the copies that we received were mailed to the members, both the majority and the minority, at the same time, exactly the same time. I was in the office this morning at 7:30 to get this testimony because I knew I had not received it and I wanted to receive it. Other members did the same thing. Therefore we had time to look it over before 10 o'clock.

But I do not think, in view of the disturbance caused by the large number of people here, and the stopping of transportation, that that would be enough reason for a different policy at this particular time. If anything else shows up that has more substance to it, and is a real just complaint, I think we should consider it, because we want these statements in on time. It is no advantage to the majority to get them or the minority to get them before the others. Let us all have them at the same time. That is the policy of this committee. Mail them to each member at the same time, and then they all get them at the same time presumably.

Anyway, there was no discrimination in this case, because none of us got them until we got to the office this morning.

Mr. WIDNALL. I just want to point out the disadvantage that the minority has been working under in many instances as to the testimony

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which comes before the committee. You are often in a position to have questions prepared and comments on the testimony prepared, and the minority is actually not ready because they have not seen the testimony.

The CHAIRMAN. If you had been down here at the time I was down here this morning you would have had the same chance I did. And so I recommend that for future consideration.

Mr. WIDNALL. In other words, you want me to have the same opportunity to sleep in the office?

The CHAIRMAN. I did not sleep in the office.

Mr. BROWN. Would the gentleman yield?

The CHAIRMAN. Mr. Widnall has the time.

Mr. BROWN. I was in my office at 7:30, and my copy was not there.

Mr. WIDNALL. Dr. Burns, would you recommend that the Clayton Act be amended to broaden restrictions on personnel interlocks rather than the approach of this bill amending banking and savings and loan statutes as well as writing new law for mutual savings banks?

Dr. BURNS. I would be inclined to amend the Clayton Act. I cannot speak with authority on this question. I am not an attorney. But I think amendment of the Clayton Act would be the simpler procedure.

Mr. WIDNALL. Do you believe that would provide a sound base for what changes should be made?

Dr. BURNS. Yes; to broaden the prohibitions that are now specified in the Clayton Act. I think that is the way I would proceed. But, to repeat. I would need the advice of counsel as to the exact legal instrument.

Mr. WIDNALL. Dr. Burns, will you submit to the committee for our consideration a suggested form of an amendment, after consulting with legal counsel?

Dr. BURNS. I will be very glad to do so.

Mr. WIDNALL. Mr. Chairman, I ask unanimous consent that Dr. Burns have the opportunity to submit a statement on the proposed amendment for consideration.

The CHAIRMAN. Without objection it is so ordered.

(The information requested by Mr. Widnall from Dr. Burns may be found on page 964.)

Most of the witnesses who have testified on H.R. 5700 seem to feel the basic presumption that all interlocks are evil is unjustified, but agree that the law should be clear that we do not condone interlocks which operate to reduce competition. Most would favor administrative procedures for reviewing the conditions in given situations, instead of the inflexible legislative sanctions which would be imposed by H.R. 5700. I take it you are in agreement with those witnesses.

Dr. BURNS. Not entirely, no. I would not want the Federal Reserve Board to analyze these cases of interlocks one by one and try to determine in each individual case whether the interlock militates against effective competition.

If we tried to do that, I am afraid that a Board that is already overburdened would find that it cannot attend to its basic responsibilities. As a matter of fact, I am informed by members of my staff who know much more about many of these things than I do that before 1935 the Board did make administrative rulings on interlocks on a case-by-case basis. And this proved to be almost a prohibitively heavy burden.

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Therefore the Board has suggested to this committee certain changes in legislation. As far as banks which operate on a nationwide basis are concerned, we suggested a mechanical rule prohibiting interlocks between banks having assets above a certain size, say $1 billion.

As we pointed out, there is an element of arbitrariness in this suggestion. But I am afraid there is an element of arbitrariness no matter how we may proceed. From the Board's viewpoint it would be much better to provide a rule of law rather than to proceed on a case-by-case basis, and thereby greatly add to the administrative burden that the Board now carries.

Mr. WIDNALL. On page 3 of your testimony you say:

You may wish, as well, to consider covering institutions whose deposits are not federally insured. Exempting uninsured commercial banks may be of minor importance, since only about 200 banks accounting in the aggregate for less than 1 percent of total deposits are uninsured. However, about a third of all mutual savings banks and a fourth of all savings and loan associations are uninsured.

Do you feel in the overall picture that by doing this you would get a better result than taking it the other way?

Dr. BURNS. Yes, I would amend the Clayton Act so that it would cover not only insured banks, but also the uninsured banks and savings and loan associations and mutual savings banks.

Mr. WIDNALL. That is all, Dr. Burns.

The CHAIRMAN. Mr. Barrett.

Mr. BARRETT. Dr. Burns, it is nice to have you here again.

As I understand your testimony, Dr. Burns, you do not apparently support as complete a disclosure of the trust investment as H.R. 5700 would require. You do apparently support a modified version of disclosure as outlined on page 8 of your statement. Would you say that is correct?

Dr. BURNS. That is correct, yes.

Mr. BARRETT. Why do you limit this disclosure to a situation where the trustees have exclusive voting rights? Isn't it also true that many of the situations where the trustee ostensibly is only a cotrustee he still exerts substantial influence over how the stock is voted?

Let me see if I can give you an example here. The committee staff in its studies has come across some instances where the bank trustee sends a notice saying that if it does not hear from the cotrustee, say, within 10 days, it will vote the bank stock the way it wishes. Would you comment on that.

Dr. BURNS. Let me say first that the Board felt some limitation on disclosure was wise in the interest of limiting the burden that would be imposed on the banks, particularly the smaller banks. The Board also felt that a flood of information going to the FDIC, or possibly the SEC, would overwhelm these institutions and would serve no good purpose. After all, disclosure is wanted for some purpose, as specified in my statement, namely, to assess the impact of bank trust investments on securities markets and on economic concentrations. We felt that a more limited disclosure than is provided by H.R. 5700 would suffice for this purpose.

Now, you have asked me a specific question. You asked why does the Board limit the disclosure to cases where the trustee has exclusive voting rights. And you asked specifically whether we might not want

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to cover under this umbrella a cotrustee. I don't think I would object to including cotrustees.

Mr. BARRETT. One final question. Would you remove the 10-day limitation?

Dr. BURNS. Would I remove the 10-day limitation or would I extend the period? My offhand intention would be to extend the period. Considering the way that I am forced to neglect personal matters in order to attend to official business, a 10-day period might prove too short.

Mr. BARRETT. Thank you.

The CHAIRMAN. Mr. Johnson.

Mr. JOHNSON. Thank you.

Dr. Burns, I too want to welcome you here this morning. I see you are all alone, you haven't any brilliant lawyers or anybody to back you up, and I think that is commendable. You are here facing this committee by yourself.

I want to discuss with you this question of disclosures by trust departments. Under Pennsylvania law I believe if a trust is created by reason of a will, the executor files an account, and he awards certain assets under the will to the trustee, and thus the bank, let us say, as trustee has full title to these securities. Then at the end of 3 years' time the trustee has to file a triennial account in our orphans' court. When he files the account the lawyers will have to receive notice of the filing of the account with an indication that they have 30 days in which to file exceptions to the account, or the account will be confirmed absolute at the end of 30 days. Now, are we to understand that what this bill would require is that trust departments, in addition to filing this triennial account—and maybe in some States it is annually or maybe every 2 years—that bank trust departments would in addition have to file annually a list of the corpus of the various trusts with the FDIC, is that what this bill requires?

Dr. BURNS. That is my understanding—not item by item, but in the aggregate.

Mr. JOHNSON. I can see an avalanche, literally truckloads of reports being filed here in Washington. Would we have a building big enough to take care of all that reporting? The banks have of course many, many trusts, and it would be a tremendously great amount of reporting, would it not, to descend on Washington?

Dr. BURNS. I am afraid of that, yes.

Mr. JOHNSON. And wouldn't the material, say, gather dust, or would we have to establish a huge bureaucracy here to examine each one and make comments as to whether they were not in the public interest, or whatever the law would require? Would you contemplate a big staff here which would analyze this material?

Dr. BURNS. I think that would follow, and I don't see the purpose to be served. I think that the restrictions that the Board has suggested would serve every purpose that we at the Board have been able to recognize. In other words, while we recognize the purpose that this committee may seek to promote, we think that this purpose can be served fully under the kind of limited disclosure which the Board recommends. We would avoid thereby heavy costs to banks, particularly small banks, and the possible building up of a new bureaucratic establishment in this city.

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Mr. JOHNSON. One other question. I want to get into this equity participation. I was interested in your statement that banks cannot hold stocks anyhow, so it is not a question of equity participation by banks. And the chairman read us of the huge assets of insurance companies. Does the Federal Reserve Board have any control over the investment activities of insurance companies?

Dr. BURNS. No, we do not.

Mr. JOHNSON. Who does have any control over the investment activities of insurance companies?

Dr. BURNS. My understanding is that insurance companies are controlled by insurance departments in individual States.

Mr. JOHNSON. Now, you probably had the same experience that I have had. And I am not condoning insurance companes. But if you recall, under the old case of *Paul* v. *Virginia*, insurance was not commerce. But the Supreme Court has later said that insurance is commerce. Don't you think for us to get into the investment portfolios of insurance companies that there must be a recital that what they are doing is deleterious as far as interstate commerce is concerned, and some legal way found that this committee can reach insurance companies?

Dr. BURNS. My understanding and belief is that insurance companies are very thoroughly controlled in practically every State in the country. That certainly is the case in New York. We have the most detailed and exacting regulations of insurance companies in New York State.

Mr. JOHNSON. Your point is that they are controlled on the State level, and the Federal Government has never sought to regulate insurance companies?

Dr. BURNS. That is my understanding. I am not aware of any abuse in this area.

Now, if evidence to the contrary emerges, needless to say I will not be the last one to reconsider my thinking on this subject.

Mr. JOHNSON. Now, my feeling about broker deposits is that a broker deposit standing alone without any tie-in could be a beneficial thing to, let us say, country banks that do not have access to large deposits. And I am just wondering whether we could not apply some rules on broker deposits, not outlawing them as such, but saying that there should be no tie-ins, and also that if the banks use the money in the nature of a tie-in, that that would be illegal. There is nothing inherently wrong per se about a broker deposit, is there?

Dr. BURNS. I think that brokered deposits in many cases are entirely legitimate. I thing you put your finger on the main difficulty, Congressman. When you have a tie-in of brokered deposits with loans, this does pose a definite danger to the safety of a bank. Some of the bank failures in the last several years have been characterized by just such abuses. Another problem raised by brokered deposits is that they are apt to be highly volatile and thus threaten liquidity. I take it the purpose of H.R. 5700, is to guard against these abuses. But less restrictive legislation than that specified in H.R. 5700, would probably accomplish that purpose.

Mr. JOHNSON. It would accomplish the purpose by outlawing broker deposits

Dr. BURNS. No; I would think a more limited provision could be written to accomplish the purpose.

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Mr. JOHNSON. Thank you very much.

The CHAIRMAN. Mr. Reuss.

Mr. REUSS. On the subject of interlocks, Dr. Burns, let us get back to the area where I think all would agree that there should be some prohibition on interlocks. I take it the philosophical reason for that is, if in a given city the banks had all common interlocking directors, they would be anticompetitive because there would be a tendency to divide up the existing business and not compete, isn't that the general philosophy?

Dr. BURNS. I would say that might be the tendency. And since that might be the tendency, a prudent rule is to rely on a prohibition such as section 8 of the Clayton Act.

Mr. REUSS. You also feel that the language in the bill H.R. 5700, which would prohibit the same man from being a director in a small bank in Maine and a small bank in the State of Oregon, is unnecessarily drastic, since the banks do not compete in the same market area at all?

Dr. BURNS. I agree.

Mr. REUSS. Then you say that by and large the existing 1935 language of the Clayton Act seems to meet the need. I have this difficulty with the existing language, that its provision for contiguity of cities, towns, and villages seems a fairly horse and buggy kind of definition. In various other of our banking laws, I think including our holding company legislation, they use the concept of market area. Isn't that really the key criterion as to where interlocking directorates would tend to lessen competition?

Dr. BURNS. Speaking from a strictly philosophic and economic viewpoint, I agree with you.

Mr. REUSS. For example, under the existing Clayton Act language, banks can interlock all over the place as between, say, Greenwich, Conn., New York City, White Plains in Westchester County, and Jersey City in New Jersey, if they are all in the same market area, can they not?

Dr. BURNS. I think that is correct. But while I agree with everything that you say, Congressman Reuss, I do want you to keep in mind the problem that we at the Federal Reserve Board face. We have been given heavy new responsibilities by the Congress that we are glad to try to discharge to the best of our ability. Now, if we had to rule on each interlock, trying to determine whether or not anticompetitive factors were involved, we might be so bogged down that we could not attend properly to the responsibilities that we already have. Therefore, life being imperfect anyhow, and legislation written by the Congress frequently being imperfect as well, I would suggest some mechanical rule of law. One is suggested in my statement and agreed to by the Board.

Let me throw out another rule for your consideration. Instead of having the rule of contiguity, prohibiting interlocks of banks and financial institutions in the same or neighboring cities, instead of proceeding that way, you could step out of the horse and buggy age by specifying a geographic distance between banks and prohibiting interlocks between banks which are, say, less than 25 or 30 or possibly 50 miles apart. That, I think, would accomplish essentially the purpose

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that you have in mind, and yet not subject the Federal Reserve Board to what may be a prohibitive administrative burden.

Mr. REUSS. I am sympathetic to your request for some sort of reasonable semiautomatic rule so that you do not have to bog yourself down. And 50 miles may be it. At least all you need is a compass and a map to determine that. What about the Census Bureau's standard metropolitan statistical area, those 252 areas which are at least constructed on the basis of some economic homogeneity?

Dr. BURNS. I would have to look at some of those metropolitan areas and see what their boundaries are before I could give you a practical judgment. Offhand my impression is that that might work.

Mr. REUSS. Would you help this committee by submitting at this point in the record, when you review your testimony, some suggestions, including a mileage limitation, and standard statistical areas, or anything else which you think would meet the preserve-competition need and minimize the administrative burden on the Federal Reserve?

Dr. BURNS. I will be very glad to try to do that, Congressman.

Mr. REUSS. On page 5 of your testimony you say that it would be helpful if the Congress made it entirely clear that section 8 of the Clayton Act applied to interlocks between banks and nonbank businesses. And I would agree that that would be helpful. Would you include in your addendum that we have just discussed your view on whether that semiautomatic market area concept should apply to other financial institutions too, savings and loan, mutual savings, banks, and insurance companies?

Dr. BURNS. I will be glad to try to expand on that. Thank you.

Mr. REUSS. Thank you, Mr. Chairman.

(The information requested follows:)

As indicated in my prepared statement, the present geographic test in the Clayton Act has worked well, generally speaking, although the Board believes it should be supplemented by a prohibition against interlocks among all banks over a certain size—perhaps $1 billion in assets. Of the alternatives suggested by Mr. Reuss, I would prefer a size-plus-distance standard. For example, interlocks might be prohibited between any billion-dollar bank and any other bank of that size, and between any two banks located within, say, 50 miles of each other.

A distance of 50 miles between the closest offices of banks with interlocking directorates would protect against any important anticompetitive effects from such interlocks, given the fact that commuting patterns largely determine the geographic extent of banking markets. Fifty miles may be more than is required for small banks, say those with total assets of less than $25 million. For such banks, a 25-mile limit would probably be enough to insure against any significant anticompetitive effects.

These or any other comparable criteria, if adopted, should be applied as well to mutual savings banks and savings and loan associations.

I feel that a size-plus-distance standard is preferable to using Standard Metropolitan Statistical Areas (SMSA's) for two reasons. First, a test based on SMSA's would not be useful in dealing with banks outside metropolitan areas. Serious anticompetitive effects can arise anywhere, and it would be undesirable to restrict interlocks only in metropolitan areas. Second, in some areas, particularly in New England, SMSA's tend to be small and contiguous to one another. Banking markets frequently encompass more than one SMSA in these areas, so that interlocks across SMSA's, while permissible under the proposal, could have anticompetitive effects.

The CHAIRMAN. Mr. Stanton.

Mr. STANTON. Thank you, Mr. Chairman.

Dr. Burns, I welcome you this morning.

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I would like to say to the gentleman from Wisconsin that I am intrigued by his particular point that I think he sees in regard to expanding the Clayton Act, where it is now limited specifically to communities. I have thought about this. But once again I would just like to point out our own local situation. You get into such areas where you have Cleveland and Akron is within a 20-mile area in which their business areas are entirely separated. Then you would come out to a community maybe like mine, 30 miles from Cleveland, in which we are basically lake or Cleveland oriented. It should definitely be covered on an areawide basis. But I should be glad to explore with you the problems.

I appreciate you being here, and especially the attitude of the Board in regard to being as helpful as you possibly can.

You also state that you appreciate the opportunity of participating in these hearings which seek ways to strengthen our financial system and the economy that it supports.

Doctor, could you point out to me how H.R. 5700 strengthens our economy?

Dr. BURNS. H.R. 5700 seeks to strengthen our economy. That is the purpose of the bill. I do not think all provisions of the bill would in fact strengthen our economy. Indeed, I think some provisions would unintentionally weaken our economy.

H.R. 5700 seeks to strengthen our economy by fostering greater competition, by seeking to reduce elements of monopoly or quasi-monopoly. That is the purpose. To the extent that that purpose is accomplished, our economy would be strengthened.

H.R. 5700, however, goes too far and may have various deleterious consequences, some of which the Board has tried to point out in the statement that I have presented here today.

I would go one step further. I hope that this committee will spend a good deal of time on this legislation. It is very difficult and complicated. I wish that I had had months to prepare my testimony, months in which I could do nothing else. There are so many matters here that may seem fine, sitting in an armchair and thinking about them; but when you go out to the little towns and the big towns of the country and examine actual business and banking practice, you might well find that things look different than they do to you sitting in an armchair.

So my primary advice to this committee is, proceed very cautiously, and try to be as sure as you can that a factual basis is laid for the legislation that you will write.

Mr. STANTON. Doctor, if you were a member of this committee, would you want to wait, perhaps, before we enact any legislation—I would not say any legislation, but before we enact any farsweeping legislation as contemplated in H.R. 5700—until the President's Commission on Financial Reorganization is completed? Is this a subject which they will be dealing with which would be helpful to us?

Dr. BURNS. I cannot answer that question. I do not know whether the Financial Commission will deal with this subject. I would think that its findings would have some bearing on the work of this committee on this bill, but to what degree I am not in a position to say.

To try to answer your more general question, if I were a member of this committee, I would visit with the chairman, whom, I find, is al-

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ways delightful and constructive. I would try to persuade him to put aside some provisions for the time being, and to enact more limited provisions.

For example, I wrote the chairman a letter about interlocks, and that letter made certain recommendations for legislation. They were based on a fairly careful study by the Federal Reserve Board, and I would therefore feel comfortable about the legislation outlined there. Next, I would say to the chairman, now, let's get a number of very detailed studies underway, not with a view to avoiding action—studies unfortunately often serve that purpose—but with a view to getting the most constructive kind of thinking that we can and then proceeding deliberately step by step. That is the way in which I would try to work if I had the honor and privilege of being a member of your committee.

Mr. STANTON. Doctor, let me assure you that when this committee goes into executive session on this particular bill, your views will be kept very much in mind. There are many of us who generally feel that once again we get into conglomerate legislation, and we are hitting upon such a broad facet of so many institutions, and into the very structure of these institutions, that indeed it is the hope of us that we will take our time and perhaps divide up the subject matter for committee action.

Thank you very much.

The CHAIRMAN. Mr. Moorhead.

Mr. MOORHEAD. Thank you, Mr. Chairman, And thank you, Dr. Burns, for an excellent statement.

Dr. Burns, on page 13 of your testimony, you say, "We can and do support numerous provisions of H.R. 5700." For the record on H.R. 5700, can you tell us section by section whether the Board approves or opposes or the Board thinks amendments are necessary, as you suggested to Mr. Stanton, or should be postponed pending studies.

Dr. BURNS. I would be glad to do that. However, I would be taking the time of this committee needlessly and filling up an unnecessary page on the record, since Chairman Patman has already summarized the positive recommendations of the Board, with great accuracy and completeness. I listened with a sense of admiration to his summary. It is already before you.

Mr. MOORHEAD. For example, section 22 deals with giveaways. Is this covered——

Dr. BURNS. We said nothing about that. The Board had nothing to say about that, for this reason. We on the Board could not agree. We were divided on this issue. And therefore I couldn't say anything about that, speaking for the Board.

And I would have difficulty even to speak for myself. Early in the morning when I think like an economist, I see nothing wrong with these giveaways. But in the evening when I become a moralist, I feel rather unhappy with them.

Mr. MOORHEAD. The Board has, however, adopted some regulations on these giveaways, haven't they?

Dr. BURNS. The Board, along with the other agencies, has adopted a set of rules. And these rules are probably adequate, or so it would seem to most of us. Under the rules that the four regulatory agencies have adopted, a gift is limited to a wholesale value of $5, where the

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deposit is under $5,000, and to a wholesale value of $10, where the deposit is in excess of $5,000.

This rule was adopted by the four regulatory agencies sometime last year.

Mr. MOORHEAD. Dr. Burns, on page 10 of your testimony you comment on section 15 of the bill. In the first sentence you state that the section would require each insured bank to report to the FDIC all loans it makes to any of its directors, trustees, officers, or employees or their familes. Do you favor or oppose that portion of section 15?

Dr. BURNS. The Board is opposed to this section 15.

Mr. MOORHEAD. I beg your pardon, sir?

Dr. BURNS. The Board is opposed to section 15. But the Board does make a recommendation for some additional protection against unsound loans to insiders. The Board recommends an amendment to the Financial Institutions Supervisory Act of 1966 to make cease-and-desist orders more readily available to stop insider loans where they appear to lead to unsound banking.

Mr. MOORHEAD. And you think there is adequate disclosure under existing law?

Dr. BURNS. In view of examination practices, this is the present judgment of the Board.

Mr. MOORHEAD. Regarding section 14 of the bill, which deals with the so-called equity kicker provision, as that is written, do you think it would in effect prohibit the banks from the purchase of, say, a convertible debenture?

Dr. BURNS. The bill does not say anything about convertible debentures. The bill refers to stock, warrants, and shadow warrants—a new financial term for me. Now, a convertible debenture—speaking as an economist, and not as an attorney—belongs to the same family, I would say, as does common stock.

Mr. MOORHEAD. Dr. Burns, you suggest that Congress clarify the existing language of section 8 of the Clayton Act applying to interlocking direct rates generally between banks and nonbanking but competing institutions, is that the thrust of your testimony, sir?

Dr. BURNS. That is the thrust, yes.

Mr. MOORHEAD. Do you think that there is going to be any difficulty enacting this law about interlocking directorates? Do you think there should be any time period during which these interlocks should be eliminated, or can it be done immediately?

Dr. BURNS. In my letter to Chairman Patman the Board recommended that interlocks that are to be prohibited under the new legislation need not be terminated immediately. The financial institutions should have a period as long as 5 years to make the proper adjustment.

Mr. MOORHEAD. Thank you very much, Dr. Burns.

Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Blackburn.

Mr. BLACKBURN. Thank you, Mr. Chairman.

Dr. Burns, I too want to join the others in welcoming you before our committee. I have always found your testimony extremely helpful and well prepared.

Dr. Burns, as a general observation, I have always felt that the Congress should be reluctant to plunge into an area where no critical

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need really existed. In short, we should not scratch places that do not itch. And as I interpret your testimony, you feel that a great number of the provisions in this act as a matter of abstract theory may be desirable, but when you implement the provisions in this act you find that they could create a great havoc in our economic system. Is that a fair interpretation?

Dr. BURNS. That is a fair interpretation, yes.

Mr. BLACKBURN. I am particularly interested in our observations on interlocking directorates. Since our hearings have started it is becoming increasingly evident to me that if a change is necessary in the existing law, it should be in the Clayton Act, and we should not put the Federal Reserve Board in the business of trying to enforce antitrust laws. If a change is necessary it should go under the Clayton Act and not under the banking laws. Is that correct?

Dr. BURNS. As far as the interlocks are concerned, that is the thinking of the Board, yes.

Mr. BLACKBURN. I recall that when we had the one bank holding company legislation before the committee, one of the facts which developed very quickly was that if we extended the provisions of that act very drastically, it would put many of our smaller communities out of business, because they are built around one bank holding companies.

The CHAIRMAN. Mr. Blackburn, would you yield for what I believe should be a correction?

Mr. BLACKBURN. Mr. Chairman, if you won't take my time I will be happy to yield.

The CHAIRMAN. You said that the Federal Reserve did not enforce the Clayton Act as it applies to banks. I think that is incorrect. I think it does enforce the Clayton Act.

Isn't that right, Dr. Burns?

Dr. BURNS. The Federal Reserve Board enforces the Clayton Act insofar as interlocks between a member bank and another bank are concerned.

Mr. BLACKBURN. I see.

Thank you, Mr. Chairman; I appreciate your calling that to my attention.

As I interpret your testimony on page 10 as related to section 15, which would provide rather drastic restrictions on interlocks and loans to employees or directors or officers owning other corporate interests, this would have the same effect with regard to small communities, that is, it would create a drastic problem in our small communities.

Dr. BURNS. That is the judgment of the Federal Reserve Board, and my own.

Mr. BLACKBURN. And so in this specific instance, if we enact a law, which on the face of it has a desirable purpose, it would create more problems for your economy than it would solve, isn't that true?

Dr. BURNS. I agree.

Mr. BLACKBURN. I just want to touch on one other area which you are the first to call to the attention of this committee.

On page 12 where you touch on the requirement for the need for full insurance of public deposits you point out that the banks are using municipal obligations, State obligations, county obligations, perhaps,

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as collateral for these public deposits, and if we should require full insurance under the FDIC, we will deprive the public bodies of an incentive which now makes it desirable for the banks to buy their obligations. Now, if we are dealing with the overall problem of financing our local governments' expansion of capital needs as far as our State and local governments are concerned this provision would be counterproductive, would it not, with regard to making these municipal obligations attractive to banks?

Dr. BURNS. This is the opinion of the Federal Reserve Board.

Mr. BLACKBURN. And in view of the fact that the public funds are protected now by these forms of collateral, the insurance need really does not exist, does it?

Dr. BURNS. Some banks would be in favor of it, of course, because a good deal of effort is involved on the part of a bank in collateralizing these loans.

Mr. BLACKBURN. But so long as these loans are protected by government collateral, they are fairly secure anyway, are they not?

Dr. BURNS. Oh, yes; there is no question about that.

Mr. BLACKBURN. And since as a matter of overall government policy we are doing all that we can to keep these local units of government alive, if we enact this provision we might well end up creating problems for local governments which do not exist?

Dr. BURNS. I think that is true. But in fairness to the truth, I should say that there are communities in the country where the collateral requirement is not a matter of law.

Mr. BLACKBURN. Can we not assume that the States themselves are fairly competent to decide their need in this regard?

Dr. BURNS. I think that most of them, to the best of my knowledge, have attended to this need.

Mr. BLACKBURN. So that would obviate the need for the Congress to take care of the need if the States are doing it on their own?

Dr. BURNS. Unless the Congress wanted to give some relief to the banks, which the Board does not recommend.

Mr. BLACKBURN. Dr. Burns I thank you again for your testimony. I am promptly advised again that my time has expired.

The CHAIRMAN. Mr. Stephens.

Mr. STEPHENS. Thank you, Mr. Chairman.

In your testimony I seem to understand from what you said about the giveaway, and the points that are in H.R. 5700, that your statement or comment did not mean that you favored or disfavored, is that correct, you just did not have any comment to make as to the effects?

Dr. BURNS. That is a correct interpretation.

Mr. STEPHENS. And there should be no implication that just because you had made no comment that you necessarily agree with the provision?

Dr. BURNS. That is correct.

Mr. STEPHENS. Second, I seem to gather from your testimony that you do not agree fully with any of the provisions as made in H.R. 5700. You agree with the principles, and when you say on the idea of brokerage that you do agree, you still disagree with the fact that there should be a criminal penalty. Am I making too drastic a statement?

Dr. BURNS. I believe your statement is correct.

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Mr. STEPHENS. And we Members of Congress have very much the same problem as you have when you say in the morning when you are thinking as an economist you have one idea, and in the evening when you are thinking as a moralist you have another idea. In the morning when we are here and listening to these hearings we are trying to think like statesmen. And then in the evening when we get our mail in we have to think like politicians. So we are in somewhat of the dilemma that you find yourself in, too.

I would like to ask this. This is what is causing difficulty in my mind. When we are talking about interlocking directorates and you talk about the geographic circumstances, and you try to put a limitation like 50 miles on the idea of competition, or any actual mileage, I find myself thinking in this line, that I live in Athens, Ga., and it is 70 miles from Atlanta. Atlanta, Ga., is 550 miles from Washington, D.C. But from the standpoint of time Atlanta is halfway between Athens and Washington, D.C., because it takes the same time to drive from Athens to Atlanta as it does to fly from Atlanta to Washington, so I find that, measuring in miles does not necessarily give a standard that might be as realistic as it would appear to be.

Dr. BURNS. It is partly arbitrary. While you can get from Georgia to Washington rather quickly, it costs you a lot of money. On the other hand, the mileage criterion that I tentatively suggested can be met without a large expenditure of money on the part of citizens who have to get to a bank.

Mr. STEPHENS. In your testimony on page 8 you say that the disclosure requirement of section 12 of H.R. 5700 would be an invasion of the trust customer's privacy, if section 12 were interpreted or made clear to require only a disclosure of aggregate holdings and not those individual accounts, would that still be objectionable?

Dr. BURNS. I interpreted section 12 that way, applying to aggregates. When you are dealing with investment holdings of a closely held corporation of a small town, disclosure of the aggregate could identify the beneficiary to the citizens of that town. And that would be an invasion, or could well be considered an invasion, of that individual's privacy. If you and I were in that position we might not like it.

Mr. STEPHENS. I agree with you. I just wondered if it would make any difference in your opinion on it.

On page 12 in your statement I seem to get an implication that you say that banks buy Government securities chiefly to provide backing for State and municipal deposits. Wouldn't it be more accurate to say that banks buy Government securities chiefly for sound investment purposes? And if that is right, then what would cause a reduction of these holdings if you had 100 percent insurance of public funds?

Dr. BURNS. I think the purposes vary. Certainly, in the larger banks many Government bonds are held simply because of the collateral requirements. In any case, that is my understanding.

Mr. STEPHENS. I have been informed that my time has expired.

But I would like to compliment you on one particular statement that you have made. And that is that our committee should get a first hand view of some of the banking problems by visiting places instead of getting the armchair viewpoint. I think that in order to do that the

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Congress ought to adjourn about the first of July, and every Member of Congress ought to go home and be required to stay in his district for 6 months and learn what the people are talking about.

Dr. BURNS. Congressman, I have long dreamed of the day, particularly now that I am a Government official, when Members of the Congress would adopt an old academic rule and go home for 3 months or 4 months the way we do in our universities. I honestly think that you could spend that time very constructively studying, traveling, and talking problems over with constituents. Now you work too hard, if I may say so. And as a result, some of us in the executive branch and the independent agencies also work too hard.

Mr. STEPHENS. When I first came to Congress, I persuaded my wife to let me run because I said I would be home 6 months out of the year. But since I have been here since 1961, we have met in longer sessions than any time in the history of the country. So I have got to do something to save my face with my wife.

Thank you.

The CHAIRMAN. Mr. Williams.

Mr. WILLIAMS. Thank you, Mr. Chairman.

Mr. BURNS. I certainly appreciate your appearance here this morning. As usual, your testimony is most enlightening.

I listened with some amusement to the dialog between you and Mr. Stephens. The center of my district is only 140 miles from here, and I am home every weekend. I have plenty of time to talk to my constituents. And sometimes I wish I represented a district in California or Georgia or some place of that nature.

Actually, Dr. Burns, when I first read H.R. 5700, I was dismayed. I think we all recognize the fact that financial institutions need regulations. On the other hand, I believe that we have to recognize the fact that they are a very important part of our economy. If we were to pass H.R. 5700, it is my opinion that what we would be doing would be putting our financial institutions into a virtual straitjacket as far as their operations are concerned. Do you agree with that, speaking of H.R. 5700 as written?

Dr. BURNS. If you passed H.R. 5700 as written, I agree with the consequences that you have described.

Mr. WILLIAMS. You also made a comment that we should spend a good deal of time on this legislation. After hearing from you and the heads of our regulatory agencies, it is my own personal opinion that we have already spent too much time on this bill. You further state in your testimony that by amendments to the Clayton Act, and by amendments to the Financial Institutions Supervisory Act of 1966, we could accomplish a more reasonable regulation of our financial institutions; is that correct?

Dr. BURNS. I would say that it would be wise to proceed in that sequence. You can do that prudently. Other parts of the legislation would require more study. I will not express any opinion on whether it would be wise for the Congress to spend more or less time on the legislation. My main thought is that the legislation before us is very complex, and does require much study to be sure of the consequences. The study cannot be done in an armchair. Concrete knowledge of banking and business must be amassed before some of this legislation is acted on.

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Mr. WILLIAMS. On page 7 you state that section 13—you are commenting on section 13—"The Board doubts the wisdom of such a prohibition."

Again on page 10, commenting on section 15 of the bill, you state: "These provisions would change existing banking practices far more than is wise, particularly in small towns."

I would like to note that on page 12 you say: "And we therefore support section 12"—referring to H.R. 5700. I believe you are only doing that because you are inclined to believe that the dangers of brokered deposits outweigh the benefits. Don't you agree that if we separated any loan from any connection a brokered deposits that we have gotten away from the danger?

Dr. BURNS. I think that is probably true; yes.

Mr. WILLIAMS. You say, "sections 25 and 26 provide for full insurance of public deposits in institutions insured by FDIC and FSLIC." Now, we do have 30 States, approximately, that require deposits of public money to be guaranteed by certain specific securities. In most cases they are governmental securities. In those cases I do not believe that any municipality or any county or State has ever lost any money. Are you aware of the fact that some municipalities in States where they do not have this requirement have lost their deposits of public money through bank closings, and these deposits were in the form of brokered deposits?

Dr. BURNS. I do not know. I have no knowledge of that.

Mr. WILLIAMS. If you could make a check of that and furnish it for the record I would appreciate it.

Dr. BURNS. I will be glad to look into it.

(The information requested follows:)

According to a survey by FDIC of the 50 insured banks closed between January 1, 1960, and December 31, 1970, slightly less than $75,000 in public funds had been lost by depositors. It appears that none of the $75,000 represented brokered funds.

Mr. WILLIAMS. I do want to say this, that the municipal county and State bond market is extremely tight. One major municipality very close to my district has failed to get bids on at least two bond issues in 2 years. I do believe that section 25 and 26 would make it even more difficult for municipalities, counties, and States to float their bonds and raise the money they need for necessary projects. It is my opinion that we would be much better off if we had had the other 18 States, or rather 20 States, adopt the same requirement that the 30 States have already adopted relative to posting specific securities to cover public deposits. Do you agree with that?

Dr. BURNS. I would be inclined to agree; yes.

Mr. WILLIAMS. Thank you very much, Mr. Burns.

The CHAIRMAN. Mr. Gettys.

Mr. GETTYS. Thank you, Mr. Chairman.

Chairman Burns, I share the admiration and respect for you that the members of this committee have already expressed. And we thank you for your appearance here today.

Your testimony under discussion this morning has all been related to the competitive factors, it appears, that would result from this bill, although the bill proposes to prohibit certain conflicts of interest and

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encourage competition. One of the factors that concerns me about the impact of this bill are the moral and the ethical and the conflicts of interest aspects. What is a conflict of interest, we ask? And I think that today the banking industry in the United States is in the same boat with the Congress. Our image is at the lowest level in a moral image I think, that it has ever been in the history of our country. I am worried about our attempt here maybe to legislate morals. I do not think you can do it. I think we have got still to rely on industry responsibility, on individual responsibility, on individual character, and that if a man breaks the law, if he is crooked, if he is dishonest, then he should be punished according to the criminal laws of the country. But to start with the presumption that everybody is crooked and base our laws on that type of presumption, I think, is the wrong approach. Would you comment, Dr. Burns, on that?

Dr. BURNS. I have a great deal of sympathy with what you just stated. On the basis of my knowledge and experience—and I have not lived my life entirely in cloistered halls—I would say that businessmen and bankers are preponderantly civic minded and thoroughly honest. And I would proceed on that assumption.

Mr. GETTYS. The whole area of the conflict of interest of course hits us so much. What is a conflict of interest? And on the interpretation of some of the people I talked with today, there is nobody that is competent to serve in the Congress, or to become a member of a board of directors of a bank, or a financial institution. You have got to have a history of having accomplished nothing at all, and being absolutely no good, in order to avoid a conflict of interest. To be able to serve on, say, the Banking and Currency Committee you cannot be a banker or if you are a lawyer you cannot serve on the Judiciary Committee. If you are a farmer you cannot serve on the Agriculture Committee. What is a conflict of interest, when does it start, when does it end? And hasn't everybody prejudice and conflict of interest in any subject if you carry it to an extreme, wouldn't you say that is true?

Dr. BURNS. I think it is substantially true, though I think that even if H.R. 5700 became law you would still find some college professors and ministers who could serve as directors.

Mr. GETTYS. But that would be just about all. And you know that with many college professors and ministers being what they are today, you have to take courses in marching, not in subject matter.

Thank you, Dr. Burns.

The CHAIRMAN. Mr. Rousselot.

Mr. ROUSSELOT. Mr. Chairman and Chairman Burns, I really feel your statement is very complete on the subject of the bill before us. And you have answered some of the questions that I have had as I have listened to others question you. So I really do not think I could comment any further.

I would like your comment on one other subject—and it is not related to this bill, only indirectly—if you wish to make it.

There have been several proposals here in Congress—and since you are here I will ask you—several proposals here in Congress that the basic and complete control of banks be totally transferred to the executive branch of the Government, primarily the Treasury Department. Do you feel that that would enhance competition and credit

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improvement of the market, on the basis of your long experience? I would be interested in your comment as to whatever it would be.

Dr. BURNS. I think Congress, in its wisdom, has set up independent agencies to control this Nation's monetary and banking system. I hope the Congress will leave it that way. If this power were shifted to the executive, I am afraid that sooner or later, and perhaps even immediately, political factors would begin playing a role, and possibly a decisive role, with regard to the Nation's money and with regard to the Nation's banks. These matters are too vital to the Nation's life to get entangled in the political process.

Therefore, if I were a Member of the Congress, I would keep an ever-vigilant eye on what the independent agencies are doing. I might be as militant as the venerable chairman of this committee in keeping everybody on his toes. But I would not transfer those functions to the executive, because the minute you do that there is a great danger that political factors would begin interfering with the administration of the Nation's monetary and banking system.

Mr. ROUSSELOT. Further, following up that line of questioning—and I tend to agree with what you have just said—do you think that Congress has delegated too much authority to the Federal Reserve Board, and therefore we have lost control of our basic constitutional authority that has been given to us to coin and regulate money?

The CHAIRMAN. Mr. Rousselot, would you yield to me for a brief suggestion.

Mr. ROUSSELOT. Certainly.

The CHAIRMAN. There is one important agency now that is in the executive branch. That is the Comptroller of the Currency. And of course to that extent the executive branch is already well represented.

Isn't that correct, Dr. Burns?

Dr. BURNS. The Comptroller of the Currency has an office within the Treasury Department. And to that extent the Comptroller of the Currency is within the executive establishment.

Mr. ROUSSELOT. I understand that.

To follow up on my second question, do you feel that Congress has, in fact, relinquished too much of its responsibility in the field of coining and regulating money, and delegated too much authority to the Federal Reserve Board?

Dr. BURNS. No; that is not my feeling. I think it would be extremely difficult for the Congress to try to take over the functions that the Federal Reserve Board now discharges in administering monetary and credit policy. I think it would be a virtually impossible task. The Congress would have to be in session on this one set of problems continuously to do that.

Mr. ROUSSELOT. I thank the gentleman for his comments.

I really have further questions, but they do not relate to this legislation. So I yield.

The CHAIRMAN. Mr. Mitchell.

Mr. MITCHELL. Thank you, Mr. Chairman.

Dr. Burns, I am delighted to see you. I hope the fact that I am a former college professor who has participated in many demonstrations and marches will not prejudice you against me. I regret that my colleague from South Carolina has departed. I want to emphasize my position as a former college professor activist.

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Dr. BURNS. I am glad to be able to speak to another college professor. I do not do that very often now, Mr. Mitchell.

Mr. MITCHELL. I have two lines of inquiry. Prior witnesses before this committee have indicated insurance companies compete with banks in a number of areas. The chairman of this committee has commented on this. Studies have also shown that the insurance companies are heavily interlocked with banking institutions. My specific question is, do you believe that H.R. 5700 should include within its scope the insurance companies that are so influential in the investment community? More specifically, in your statement at the bottom of page 5 you indicate that it would be helpful if the Congress made it entirely clear that this provision applies to interlocks between banks and nonbank businesses. Are you referring to insurance companies within that category of nonbank businesses?

Dr. BURNS. Yes; that interpretation is valid.

Mr. MITCHELL. Then, more specifically, would you favor the inclusion of insurance companies within the scope of H.R. 5700?

Dr. BURNS. If you mean by that prohibiting interlocks between insurance companies and other financial institutions, my answer has to be in the negative.

Mr. MITCHELL. In the negative. I thank you very much, sir.

The second inquiry. There has been a great deal of emphasis placed by the administration and others upon the development of black entrepreneurship, a great deal of emphasis suggesting the efficacy and the feasibility of black-owned banks and black-owned savings and loan associations. In your opinion would the present interlocking system adversely affect the development of black entrepreneurship in those two areas?

Dr. BURNS. I do not know enough, Congressman Mitchell, to comment on that. As you know, black entrepreneurship is still very limited. Also, the number of Negro banks is very small, and I have not made this an object of special study. Therefore, I do not believe that I can, at this time, comment usefully on your question. But I will be very glad to look into the question and to give you at a later time the best thoughts that I could assemble on that subject.

Mr. MITCHELL. I would appreciate it. And I am certain the other members of the committee would.

Quite frankly, Mr. Burns, based on the testimony of other witnesses who have appeared before this committee, I have the very distinct impression that the present system of interlocks will adversely affect the possibility of black-owned banks developing and black-owned savings and loan associations developing.

Thank you for replying to the questions of a professor who has been an activist.

(The information requested follows:)

The question raised by Congressman Mitchell is difficult to answer, but there are some indications that the effect of decisions by bank boards of directors has been positive rather than negative for new black banks.

With the accelerated rate of chartering of black banks in the last few years has come an intensified effort on the part of many existing banks to help the new banks become profitable. The assistance which existing banks have rendered takes many forms, such as supplying initial capital, lending skilled management personnel, training of the new banks' personnel, assisting in loan analysis and bookkeeping procedures, and participating in larger loans. Obviously, decisions

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to render such assistance are made with the approval of the existing banks' directors; to this extent, at least, the present system of bank directorships has offered substantial assistance to new black banks.

The primary difficulties these banks are encountering seem to lie in other areas. For example, black banks have experienced somewhat higher loan losses than is typical for banks of the same size, their costs of handling deposits often run higher, and they face a shortage of management talent.

The CHAIRMAN. Mr. McKinney.

Mr. McKINNEY. Thank you, Mr. Chairman.

Dr. Burns, it is indeed a personal pleasure and honor for me to listen to you. You have presented, I think, probably the most lucid testimony I have heard since the hearings on this bill started.

I have just one minor question. On page 7 you discuss section 15 of the bill concerning the bank trust departments. I feel that there is an intrinsic danger to a trust department having too large a voting say in any one corporation. But as I read this bill, I think it would produce some incredible moral problems. In other words, if a bank had more than 10 percent of a class of stock in a corporation, and had to relieve itself of stock, whose stock would it sell? Wouldn't, in essence, the smaller stockholder be the one that was discriminated against, or the less important customer of the bank, to put it more bluntly?

I think that a trust department has an obligation and a moral charge, at least I feel we believe so in this committee, to invest in the very best return stock or growth stock that it possibly can. If it were forced to sell this type of stock, particularly in a very large bank with many trusts, would not it mean that in essence that it might have to buy a stock that was not of the value, nor of the growth potential, nor of the return potential of the stock they sold?

I think if you put a prohibition on the trust department having within its massive portfolio an ownership limit, that there is this danger, there is this danger to individuals, to children of deceased people, to churches and hospitals right across the board that use bank trust departments.

Now, what I had in mind was, would not it make much more sense to put a prohibition on the percentage of stock in any one corporation that a bank itself could vote?

Dr. BURNS. Well, I do not think that would solve the difficulty that you have outlined. One limited solution, I think, is provided by the suggestion made in my statement; namely, that a 10-percent limit, or some percentage limit like that, apply only to future purchases that are made at the initiative of the trust department.

The restriction with regard to voting rights would not solve the moral problem which you so well described. And there are other problems. Supposing that a man leaves a substantial sum in the form of common stock to his family, and he does that under a trust agreement. Now, the bank, in accepting that trust agreement, would then have to specify that if this stock will result in a percentage control by the bank which is larger than the percentage allowed by the law, let us say 10 percent, then the bank could not honor that trust agreement. So here is a man trying to provide for his family and he does not know whether he has provided for his family or not.

Mr. McKINNEY. This is the problem I have. I think we put all of these things in a personal nature. And having five children, my only worth to them, I suppose, is if I am on a plane that crashes, because I

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have a great deal of accident life insurance. If I were to leave that money in trust to my children with a bank trust department, and this particular bill would pass, there is a very definite possibility that this bank would not be able to invest that money in what they consider to be the best investment potential, because their limitation would already have been used up in other trusts.

Dr. BURNS. That is correct.

Mr. MCKINNEY. I do not know if you have any solution to the danger or if the Board has any suggestions. I think that even your limitation is difficult under the conditions that I brought forth. But if you have any I would be glad to hear them. Because I think this particular aspect of the bill, section 13, would tend to force a great many institutions and individuals to use the individual fiduciaries which I consider extremely dangerous because they have no continuity.

Thank you very much.

The CHAIRMAN. Mrs. Sullivan.

Mrs. SULLIVAN. Thank you, Mr. Chairman.

Dr. Burns, I think there is great concern in many areas about interlocking directorates and the relationship of persons who serve on boards of financial institutions. But how it is possible to write legislation to improve this relationship without harming our institutions, I think, is the big question. But we have seen, and we are continuing to see, such bad and glaring examples of this conflict of interest that many of us feel that something has to be done. Do you feel, Dr. Burns, that persons who are appointed board members have a legal responsibility to this position as a director, and do they actually carry out those responsibilities?

Dr. BURNS. Well, they certainly have a legal responsibility. As to the discharge of that responsibility, on the basis of my observation, there is a great deal of variation in experience. Some directors are conscientious and hard working, while others treat their membership in the board of directors as if that board constituted a social club.

Mrs. SULLIVAN. I wonder if you could answer this. Should a financial institution fail, what are the responsibilities of the directors serving on that board? They should have been aware of what was happening, but they were not aware of it and just did not pay any attention. Do they have any responsibility when this happens, financial responsibility?

Dr. BURNS. I cannot speak as a lawyer. I am an economist, not an attorney. But I would think that a director who paid little or no attention to a bank, who ignored examination reports by regulatory agencies, who paid no attention to criticized loans, that a director who behaved in that fashion should be liable in a court of law. That would be my personal opinion. On the other hand, I would say a director who performed conscientiously should not be, even though the bank failed.

Mrs. SULLIVAN. There is very little possibility to follow up on that, as to who has been conscientious and who has not, in acting as a member of a board?

Dr. BURNS. That could be established in a court of law.

Mrs. SULLIVAN. They do have, when they accept this responsibility, they really do have a legal responsibility to know what is going on?

Dr. BURNS. Oh, yes; they have a legal responsibility. No prudent man would accept a membership on a board of directors without con-

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sulting his attorney so that he would know precisely what the responsibilities are. Nor would a conscientious man accept membership on a board of directors unless he was in a position to devote some time and energy to the board's activities.

Mrs. SULLIVAN. These are examples of just such a thing that has happened in my own area, where not only stockholder but depositor—this happened to be an insurance company—but people who bought the insurance were left hanging. And the men who sat on the board and the men who were the officers of the company got off scot-free. Now, whether or not stockholders can file suit on this and anything would come out of it I do not know. But I do feel that there needs to be some tightening of responsibilities that they either accept this responsibility or they do not accept the honor, if that is what it is supposed to be, of having been appointed a member of the board of some corporation.

Dr. BURNS. In principle I agree with you entirely.

Mrs. SULLIVAN. In connection with the question Mr. Rouselot asked you, you are not suggesting, are you, Dr. Burns, that Congress should not seriously consider the need for consolidation of the bank supervisory agencies into a single independent agency, are you?

Dr. BURNS. No, I did not mean to express any view on that subject. On the contrary, I would say this is a subject that Congress should consider.

Mrs. SULLIVAN. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Archer.

Mr. ARCHER. Dr. Burns, this legislation we are considering today is entitled, "The Banking Reform Act of 1971." I wonder—and you have responded cogently to the provisions of H.R. 5700—are there any areas outside of this legislation that you feel are importantly in need of consideration today, when we talk about a comprehensive banking reform act?

Dr. BURNS. I must in all honesty say that I felt overwhelmed by the complexity of this legislation. Its scope is so wide and far-reaching that it left little room for my own imagination.

Mr. ARCHER. You cannot think of any specific areas that you think need legislative attention that are not covered in this bill?

Dr. BURNS. Not at this specific hour.

Mr. ARCHER. Let me ask you one other question. Again referring to the fact that you have commented directly on the specific provisions of this bill, if this bill were not in front of you, what specific legislation do you feel is actually needed today in your view within the confines of the area covered by the bill?

Dr. BURNS. At the opening of this hearing Congressman Patman put into the record a letter that he had received from the Federal Reserve Board. That letter outlined some legislation that we at the Federal Reserve Board believe would be wise right now.

Mr. ARCHER. So of your own initiative, then, this is all you would positively sponsor as being needed at this time?

Dr. BURNS. I would go a little further. I think that I would try to frame legislation to control brokered loans a little better. The suggestion made at this hearing on the prohibiting tie-ins between brok-

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ered deposits and loans would perhaps accomplish the purpose. I think I would be in favor of that.

Mr. ARCHER. Thank you very much, Dr. Burns.

The CHAIRMAN. We have finished what they call the first go-around of questioning under the 5-minute rule. And I would like to ask some questions. And then of course other members will be called upon.

Dr. Burns, since I did not ask questions under the 5-minute rule, I would like now to take some time to discuss some of the operations of the Federal Reserve Open Market Committee which are highly disturbing to me and which are very appropriate for discussion at this time, I believe.

The question concerns the more than $63 billion of U.S. Government securities residing in the portfolio of the Federal Open Market Committee in the Federal Reserve Bank of New York. Dr. Burns, the issues surrounding these funds are very simple. However, through the years I have never gotten simple answers from the Federal Reserve chairman concerning these bonds. And I hope that your responses this morning will cut through some of the smoke screen that was thrown up by your predecessor, William McChesney Martin. As you know, Dr. Burns, these are bonds that have been paid for once with the credit and money of the U.S. Government, on which the Federal Reserve continues to charge the Treasury interest. Of course, the Treasury collects it from the taxpayers. In fact, the Federal Reserve is currently receiving more than $4 billion annually in interest on these paid-up bonds.

Dr. Burns, you are also aware that the presence of these bonds and the income you receive from the Treasury Department enables you to dodge appropriations processes of the U.S. Congress, and to operate the Federal Reserve System without audit, and without budgetary review.

Section 9 of Article I of the U.S. Constitution requires that "No money shall be drawn from the Treasury, but in consequence of appropriations made by law."

Dr. Burns, it is my opinion that the operation of the Federal Reserve System through the interest paid on these $63 billion worth of bonds, which have already been paid for, is in violation of this section of the Constitution of the United States. We now have a national debt ceiling of $430 billion, and annually, if not more often the Congress is asked to raise this ceiling so that the Federal Government may continue to carry out its necessary functions. Unfortunately $63 billion of this sum is in the form of paid-up bonds which the Federal Reserve retains in the open market portfolio. If these bonds were retired as they should be, the $63 billion could be subtracted from the national debt. The subtraction of these $63 billion from the national debt would give us a great cushion which would enable the Federal Government to finance the necessary projects, including schools, housing, projects for environmental quality, job opportunities, and the like.

Dr. Burns, I know that you are familiar with the means by which the Federal Reserve has collected these bonds through the years. I realize you had no part in the commencing of these policies that have led to this atrocious situation.

But I want to explain—and I know you are familiar with the means by which this interest is collected—but I want to explain briefly the process for the benefit of the committee and the public. In carry-

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ing out the function and in controlling the money supply the Open Market Committee purchases and sells Government securities in the open market. It makes purchases in the open market from banks holding these securities. It pays for these securities with the credit of the United States.

The bonds are paid for with the credit of the United States. But under the present procedures of the Federal Reserve the bonds are not retired. The Federal Reserve System in short serves as the fiscal agent for the Federal Government in the handling of these bonds. It is representing the Federal Government when it makes the purchase. It seems that any responsible fiscal agent would see that the bonds are retired after it has used the credit of the United States to pay for them.

You know the great enthusiasm that has been demonstrated by people who are in churches where bonded indebtedness has been paid with great appreciation that they have a bond-burning when they pay for these bonds. It is one of the most joyful occasions that they have, probably, over a long period of time.

Now in this case the Government bonds have been paid for. One time I asked Mr. Martin that question and he said yes, the bonds have been paid for once. And of course he never did retract that, because he could not retract it; they have been paid for. Let me quote Mr. Martin before the House Banking and Currency Committee on July 7, 1965:

Mr. MARTIN. The bonds were paid for in the normal course of business.

The CHAIRMAN. That is right.

Mr. MARTIN. And that is the only time they were paid for.

The CHAIRMAN. Just like we pay debts with checks and credits.

Mr. MARTIN. Exactly.

The CHAIRMAN. In the normal course they were paid for once, you will admit that, will you not?

Mr. MARTIN. They were paid for once, and that is all.

The CHAIRMAN. That's right.

In describing the way in which our Government securities have already been paid for at least once, certain basic-technical principles must be understood.

First, it must be understood that the Federal Reserve System of Federal Reserve banks are not agents of the private banks in the country but are agents of the Government, who have been delegated the power by the Federal Government to create and control the Nation's money supply. The Federal Reserve banks, through the activities of the Federal Open Market Committee, are able to acquire Federal Government securities only because their obligations, Federal Reserve notes and deposits (credit), are given monetary status by the Federal Government.

Second, it must be understood that commercial banks can operate as they do only because the Federal Government permits their demand deposits to circulate as money. By permitting demand deposits of commercial banks to be used as money and by the Government itself accepting demand deposits in payment, commercial banks have conferred upon them a status shared by no other financial institution in this country.

The proposal to cancel a portion of the portfolio held by the Federal Reserve System, which consists almost exclusively of Federal Government securities, requires nothing more than a bookkeeping operation.

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As far as the current bookkeeping activity is concerned, the Treasury now shows a liability on the Government securities, and a contingent liability on the Federal Reserve notes that are issued and outstanding. On the other hand, to balance the books, the Federal Reserve banks show the Government securities as assets and the Federal Reserve notes as liabilities. To cancel the Government securities held by the Federal Reserve System requires nothing more than a bookkeeping action which would transfer the liability of the Federal Reserve notes to the Treasury. By such an action all of the other entries, then, would be redundant and, therefore eliminated.

As part of its function in controlling the money supply and interest rates, the Federal Reserve—through its Open Market Committee—buys and sells Government securities in the open market. Using the credit of the United States, the Federal Reserve carries out these dealings through the commercial banking system. When the Federal Reserve buys Government securities, it credits the amount to the reserves of the bank and receives the Government bond in return. As part of the banking system's reserves, this money thus credited expands the Nation's money supply according to whatever reserve requirement is in effect at the moment.

When the Federal Reserve desires to contract the money supply, it sells Government securities in the open market. When a commercial bank buys a bond sold by the Federal Reserve, the amount of the bond is subtracted from the reserve account of the bank. Thus, the money supply of the Nation is reduced as the credit is subtracted from the bank reserves.

This same bond may well be resold by the commercial bank to the Federal Reserve in some later transaction of the Federal Open Market Committee.

In all these transactions, the Federal Reserve System is simply acting as fiscal agent for the Federal Government. The Federal Reserve is not using its own money; it is using the credit of the Nation. The credit recorded on the books of the bank is the credit of the Federal Government.

The Federal Reserve does not own the bonds, it is simply acting as agent for the Federal Government in the purchase of the bonds—with the credit of the United States.

It is true that the Federal Reserve needs a certain amount of bonds in its portfolio to carry out the mechanical functions involved in establishing the money supply. However, testimony before the Banking and Currency Committee indicates that this amount could be less than $10 billion. Certainly there is no reason—no purpose—in the Federal Reserve holding $63 billion worth of bonds.

In addition, there is simply no reason—no monetary purpose served—by allowing interest to be charged on bonds residing in the open market portfolio. The only purpose these bonds have in the portfolio is to carry out monetary functions and these functions are not helped by paying the Federal Reserve interest.

The Federal Reserve banks and Board do not come to Congress for their operating funds and go through the appropriation process as do other agencies of Government. The income which the Federal Reserve System and Board has come almost exclusively from the

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interest received on the securities held within the open market portfolio. For example, in 1970, out of a total income of the Federal Reserve banks of $3.9 billion, $3.8 billion came from interest received on U.S. Government securities.

You may not recall, Dr. Burns, that in 1959 the Federal Reserve Board proposed turning over $15 billion of the then existing Open Market Committee portfolio of $24 billion to the commercial banks. The justification advanced for this proposal was that the portfolio was too big at that time and not needed. If this is so—and I certainly agree that the portfolio was too big at that time—certainly it must be argued that the portfolio is excessively large at this time and much, if not all, of the portfolio should be retired by having the securities within the portfolio canceled.

In my opinion and I believe the opinion of many economists—perhaps including yourself, Dr. Burns—there will never be any use for the vast amount of Government securities held in the portfolio. Furthermore, since we are a growing country and will require, therefore, a growing money supply, and since the money supply is increased primarily through increased bank reserves through Open Market Committee activities, it stands to reason that this portfolio will have to continue to grow ever larger and larger.

The Treasury now shows a liability on the Government securities and a contingent liability on the Federal Reserve notes which are issued and outstanding; the Federal Reserve banks, on the other hand, show the Government securities which they have in their portfolio as assets and the Federal Reserve notes as liabilities. By consolidating these, by eliminating this double accounting, as I have suggested in the past since these Government bonds have been paid for once, we would transfer the liability on the Federal Reserve notes to the Treasury and, therefore, all other entries on the books would become superfluous and, therefore, could be eliminated.

Dr. Burns, as an economist, what real value other than as income-earning assets to the Federal Reserve System do the U.S. securities held within the open market portfolio have? If it is so, as I think must be obvious to all, that the Federal Reserve System used the credit of of the Nation to acquire these Government securities, meaning in effect that we have used one form of Government obligation to acquire another form of Government obligation, haven't we then created the situation whereby we have two obligations outstanding where only one should be outstanding? In other words, by using the Government's credit to acquire a Government security, we have, in fact, paid for that Government security and the bonds, or security purchased, should be canceled or eliminated.

The cancellation of these bonds could be the finest thing for the country right now. Since we are in bad shape we have all kinds of budget demands and demands for all kinds of worthy purposes, education, health, environment, and everything else.

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If we could use this money for the foreseeable future, or the amount of credit that this would entail by reason of the cancellation of the bonds and the reduction of the national debt, it could be one thing that would be of great benefit to this country. The Nation needs huge amounts of money now. It is awfully hard to get. You know—you have heard testimony to the effect that now if you go to get a huge loan, you have only one place to go, and that is the banks on Wall Street in New York. If they do not make it you do not get it. You cannot get that money unless you give a part of the transaction, equity kickers, and high interest.

I think it is clearly wrong, and in some cases, almost against conscience, to say to the poor people who must have homes, for the benefit of themselves and their families to educate their children, and enjoy environmental quality, that in order to buy that home and buying it on credit, they must go into competition with people they cannot possibly compete with. The people cannot compete with the big banks, the loan sharks, the speculators and other fast-buck operators for loans.

Something has got to be done for the homeowner. Although we have a slight reduction on long-term rates for homeowners, the person who buys a home on a 30-year term, a $20,000 home, must still pay over $30,000 interest on that home during the term in order to get a $20,000 home—or $50,000 in all. Now, that is a terrific amount. It almost makes homeownership impossible. It certainly imposes great burdens on the families of this country. And I believe you agree with me that whatever helps the 55 million families of the United States certainly helps the Nation.

Now, I would like if you will, Dr. Burns, to have you comment on what you think should be done. You did not start the system. I am proud of that fact. And I know that you are a fair man. I have confidence in you. I hold you in very high esteem. And I know that you are a good man and want to do the right thing. And since you are not obligated to this bunch that started it, I just wonder if you could not give us a little light of day on what the future would be.

Mr. WIDNALL. Mr. Chairman, would the gentleman yield to me?

I have listened with great interest to your statement just now. And it has been a very broad statement. But I fail to see what it has to do with H.R. 5700, the legislation before us. And I would just like you to know that if you intend to incorporate amendments to the bill on those things, I think that you should advise us at this time as to whether or not you want to do things with the surplus from this Federal Reserve System, and the purchase of bonds. But I do not see anything in this legislation which pertains to any of that. And that has been the bulk of your statement.

The CHAIRMAN. You cannot deal with the operation of banks without involving the Federal Reserve.

And since you have asked me, I would be very glad to tell you, I am going to search for an opportunity to offer amendments to this bill, and also any other bill that comes up from now on, in two respects. One is to change this, and to stop this $4 billion payment of Federal Reserve. And they did pay $100,000 a year of that money to the American Bankers Association, a lobbying organization. The Federal Re-

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serve did pay that, and I think you stopped it. And that was the finest deed that you did to my knowledge. And I congratulate you on it, because it was a terrible thing to think about the Federal Reserve paying the taxpayers' money to lobbying organizations.

I may also offer amendments pertaining to audits of the Federal Reserve. All the other Government agencies are audited except the Federal Reserve.

But I am going to seek opportunity, I will say to the distinguished gentleman from New Jersey, Mr. Widnall, to correct these problems in every sense of the word in any bill that comes before this committee, and especially one to require an audit of the Federal Reserve System.

Now, the Federal Reserve, of course, they claim they audit themselves. I am sure that they tell the truth about that. But who else can rely on a self-audit? I do not know of any corporation that pays income taxes that can just say to the IRS man: "We have already audited our books and here is what we owe, and we do not want you to challenge us on it, we want you to take our audit for it." Well, there has never been an official Government audit of the Federal Reserve System. And I think it would certainly be a revelation to a lot of people in this country, Dr. Burns. And I think the poor people of the Nation generally who have felt the burdens of high and excessive, exorbitant, usurious interest rates and service charges deserve to have just a little relief from you on that. At a minimum we should be able to say that we have done everything possible as Members of Congress.

Dr. BURNS. Would you like to have me answer now or for the record?

The CHAIRMAN. Now. I have been waiting a long time for this answer, Dr. Burns. It took me 30 years to get information from the old Federal Reserve officials including the Chairman of the board. I do not think it will take any 30 years to get it out out of you, and anyway I will not be around that long.

Dr. BURNS. You have paid me a compliment that I do not deserve in suggesting that I know enough to be able to comment authoritatively on the numerous and complex questions that you have raised. Let me therefore merely make a few comments and ask for the privilege of supplementing my remarks later for the record.

Let me say, first of all, that the Federal Reserve Board is a law-abiding agency. We work conscientiously, conforming to every statute of the Congress. And we work conscientiously in responding to every inquiry that comes from you, Mr. Chairman, that comes from members of your committee, that comes from members of other committees in the Congress and other individual Senators and Congressmen. We pay strict attention to the law, and pay conscientious attention to the thinking of Members of Congress, and certainly your own, Mr. Chairman.

Second, let me say that our central bank publishes far more information, reveals far more about its activities, than any other central bank in the world. Besides, I am the only central banker in the world who comes—it is a privilege, and I enjoy doing so—I am the only central banker in the world who ever comes before a legislative committee to explain the activities and transactions of his institution.

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Next, let me say that the Federal Reserve Board does not dodge the appropriations process. Those are your words, Mr. Chairman. I am quoting.

The Chairman. They started a process that amounts to dodging. Of course, I do not really like to say evasion. But it really results in a dodge.

Dr. Burns. Let me say this, that Congress in its wisdom set up the Federal Reserve Board as an independent agency, free from political interference, so that the integrity of the Nation's money could be protected.

The right to expend its own funds was a decision made by the Congress. It was not a decision made by the Federal Reserve. And I think the Congress acted very wisely. I doubt if the Congress would want to change its position. But of course that is a privilege that the Congress has.

I was at a meeting recently with other central bankers, and I compared expenditures. I came away from that meeting with the conviction that ours is the most economically run central bank in the world.

Next, Mr. Patman, you have suggested that the bonds, Treasury notes, and Treasury bills now held by the Federal Reserve Board be retired. Suppose we do that for a moment. Our books would then no longer be in balance. Technically, as far as I could see, the entire Federal Reserve System would by that very act be put in a state of bankruptcy. I doubt if you would want to do that because of the repercussions that would have for the business world, small businessmen and poor people along with the others.

Mr. Chairman, you indicated that if this debt were retired, then the executive establishment would be in a position to spend more money. If $60 billion of additional expenditures were released on our economy in the present climate, I am afraid we would bring on a new surge of inflation that would make the great inflation that we are already suffering from a minor phenomenon by comparison. I do not think you would want to do that. If indeed such a debt-retiring operation were carried out, the first thing that Congress ought to do would be to reduce the debt limit by that amount.

These are very complex things. I think you want to help this Nation's economic system. You have labored over the years to strengthen our economic system and to strengthen our financial system. I do not see anything to be gained by the retiring of $60 billion of Federal Reserve assets and thereby putting the Federal Reserve System in a state of bankruptcy—I do not see how that would accomplish your purpose, Mr. Chairman.

These are my off-hand reflections on your comments. And if you will grant me the privilege of elaborating on them for the record, I shall be glad to do so.

(The following information was subsequently submitted by Dr. Burns for inclusion in the record:)

As I understand it, Chairman Patman argues that the retention of U.S. Government securities as assets on the books of the Federal Reserve amounts to double-counting of the Government's debt, and that payment of interest on such securities constitutes an unnecessary expense to the Treasury and, thereby, to the United States taxpayer.

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I have tried to approach this issue with an open mind uncluttered by past positions, as requested, and my conclusion is as follows. If the Federal Reserve is viewed as having no independent status under the Federal Reserve Act, but is simply thought of as a subsidiary agency of the U.S. Treasury, then there is also no basis for preservation of a separate financial identity. The assets, liabilities, income and expense of the agency might then be consolidated with the parent organization, which in the standard accounting concept of the term means that transactions between the two organizations would be neted out. In this instance, the Treasury's indebtedness to the Federal Reserve Banks would disappear, all Federal Reserve Bank liabilities would become those of the Treasury, the Treasury would not pay interest to the Federal Reserve Banks and the Banks would not pass over their net income to the Treasury. All that would remain would be the expenses of operating the Federal Reserve System, which the consolidated enterprise would have to bear.

If, on the other hand, the Federal Reserve System is thought of as having an identity separate from that of the Treasury, there is no basis for such an accounting consolidation. The Government securities held by the Federal Reserve would then represent *bona fide* indebtedness, on which interest is due, and the Federal Reserve—because of its public character—would be obliged to pay over all income not needed in support of its operations to the Treasury for the public good.

This is, of course, the present situation, and I would argue strongly that it is the correct one. The separation between the Treasury and the central bank function is clearly mandated by Congress in its continued support of the Federal Reserve Act, which establishes the basis for the Board and the Federal Reserve Bank separate and apart from Treasury and other Federal functions lodged in the Executive branch. I think that this arrangement is eminently sound. The power over monetary creation is too large and too pervasive to be subject to day-by-day political pressures. And there may well be, at times, conflicts between the proper conduct of the monetary function and the Treasury's responsibilities. Under the present arrangement, Congress retains very broad powers over the fundamental character of the central bank, while the Federal Reserve must of necessity be responsible to the Congress as well as cognizant of and sympathetic to the problems of the Treasury. If the vital functional distinction between the Federal Reserve and the Treasury is to be preserved, the financial distinction that goes with it must also be preserved.

As a practical matter, the net outcome for the Government, and for the taxpayer, is little affected by the particulars of the present organizational arrangement. This is so because the Federal Reserve turns over virtually all of the income that it receives from interest on Government securities and all other sources, after operating expenses, to the Treasury. In 1970, for example, Federal Reserve Bank earnings totalled $3,877 million, of which $3,772 million was received as interest on Government securities held by the Banks as the major part of their assets. Current operating expenses of the Federal Reserve System were $321 million. Current net earnings after expenses amounted to $3,556 million and nonoperating earnings to $11 million, of which $41 million was paid in dividends (a 6 per cent statutory rate of return on investment), $33 million was transferred to the surplus accounts of the Federal Reserve Banks, and $3,494 million was paid to the Treasury and therefore included in Government revenues. Thus, Federal Reserve payments to the Treasury accounted for more than 92 per cent of the interest received in 1970 on Government securities.

I have gone into these figures in order to make a point that often seems to be overlooked concerning the financial operations of the Federal Reserve Banks. Virtually all of the net income earned by these Banks, as public instrumentalities, is returned each year to the Treasury. Thus there is no real effect on Treasury finances resulting from its payment of interest on the debt held by the Federal Reserve. If these payments were not made, Treasury receipts would be reduced commensurately, since the cost of operating the Federal Reserve System would still have to be met. These expenses are incurred in operating the country's monetary mechanism, in supervising and regulating member banks, in administering numerous laws enacted by the Congress, and in formulating monetary and credit policies. These activities are clearly essential to the public welfare. Perhaps the System could be more economically run, but my observation is that constant attention is devoted by the System to holding expenses down and operating as efficiently as possible.

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One further point requires clarification. Chairman Patman suggested that if the Federal debt held by the Federal Reserve Banks were to be retired, that amount of money—$63 billion currently—would be available to finance high-priority programs of the Government. This strikes me as dangerous economic reasoning. Additional Government expenditures, without commensurate increases in taxation, would put additional funds into the hands of the public. Not only would the new Government programs result in more spending, but the recipients of those expenditures would in turn increase their outlays. The economic effect would be exactly the same as with any other deficit spending, even though the total public debt is technically reduced. The end result would be a new and drastic inflationary upsurge.

The CHAIRMAN. Would you place in the record how the money is channeled to the Federal Reserve Board? Is it paid out, the $4 billion by the Federal Reserve Board on its direction? If so, how does it get the money? Does it come from the Federal Reserve Bank of New York or directly from the Open Market Committee? And how is the money now dated?

Dr. BURNS. I will be glad to explain that.

The CHAIRMAN. And go into detail on that, will you do that?

Dr. BURNS. I will do my best.

(The information requested follows:)

The principal source of income for the Federal Reserve is its portfolio of securities purchased for the System Open Market Account. Holdings of these securities are allocated among the Reserve Banks according to procedures determined by the Federal Open Market Committee. Present procedure calls for—

Redistributing holdings among all Reserve Banks on the last business day of each month to equalize in so far as possible the ratio of each Reserve Bank's gold certificate account to Federal Reserve note liability.

Allocating each day's transactions according to the percentages determined at the time of the distribution of the account on the last business day of the month.

Accrual of earnings and distribution of profit and losses on the basis of each Bank's current holdings at the opening of business each day.

The allocation of holdings in the account is designed to assure that each Reserve Bank has a sufficient amount in its gold certificate account to conduct interdistrict settlements. Such settlements are necessary in order that the public may collect on checks, fund transfers, and other interdistrict business flowing through the Federal Reserve Banks.

Earnings on securities held in the System Open Market Account are accrued daily based on holdings at the opening of business. For this purpose, each Reserve Bank has five accounts in its general ledger as follows:

Other Assets—
- Interest accrued
- Premium on securities

Other Liabilities—
- Discount on securities

Other Capital Accounts—
- Earnings on U.S. Government securities
- Profit and loss account

With exception of the profit and loss account, entries are made to the accounts daily based on a wire advice from the New York Reserve Bank, as agent for the account. The interest on coupon issues that accrues each day is added to the interest accrued account together with the daily amount of discount on securities acquired at less than face value. The total is credited to the earnings account after deducting one day's portion of the premium on issues purchased at more than face value. In the first part of each month, generally the 12th, the amount of net earnings from all sources after expenses, accrual of the statutory dividend and amounts to equate surplus with capital, is credited to the Treasurer's General Account as interest on Federal Reserve notes.

The amount in the interest accrued account is reduced by collections from the Treasury when the interest on the particular issue becomes due. The interest collection is handled by the New York Reserve Bank as agent for the account.

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Each Reserve Bank receives credit for its share of the interest collected. The offset is a reduction in the Treasurer's General Account on the books of the Reserve Banks as authorized by the Treasury. Interest is also collected from purchasers when the System sells securities, and the interest accrued account is correspondingly reduced.

The effect of such accruals, which are common to any major investment account, is that whoever holds the security on the date that interest is due from the Treasury will collect and own the interest, since all previous holders would have received their portion from subsequent purchasers.

The profit and loss account is increased whenever the proceeds from sale of securities on any one day exceed the value shown on the books of the Reserve Banks, and is decreased when the proceeds are under book value.

The disposition of income of the Reserve Banks, including the payment of earnings to the Treasury, is under the direct control of the Board of Governors of the Federal Reserve System. The budgetary process involves—

The submission by each Reserve Bank of a budget every six months, in sufficient detail for detailed analysis by Board staff.

The submission of quarterly data on all Reserve Bank expenditures for detailed analysis.

The submission of monthly reports on earnings, for analysis of the payments to the Treasury.

The semiannual budgets are analyzed by Board staff and presented to the Board of Governors for approval or exceptions. The actual performance budgets are followed through analysis of current expenditures at quarterly intervals, and the Banks are requested to explain and justify any significant movements in their cost trends.

Dr. Burns. Let me say just one word here, if I may. The earnings of the Federal Reserve System, practically all of it goes back to the Treasury. You know that.

The Chairman. Practically all the earnings are on the bonds you bought, 99 percent of it.

Dr. Burns. I know. But those earnings of the Federal Reserve System do not go to the commercial banks of this country.

The Chairman. I thought I made that plain.

Dr. Burns. They go right back to the Treasury.

The Chairman. They go to the Treasury all right. But the Board can expend any amount of money they want to out of that $4 billion.

Dr. Burns. That is correct. But the Congress set up the Federal Reserve System so it would be insulated from the political process.

The Chairman. I will go into that later.

Dr. Burns. If the Congress wants to change that, that is of course always the privilege of the Congress. But I hope you will think long and hard—in fact, I hope I am going to persuade you, Mr. Chairman, that this would be a bad thing to do.

The Chairman. It would be awfully hard. Here you are trading one form of Government obligations for another form. That is simple. In other words, a person who has an interest-bearing bond would rather have the money. He says, you give me the money and you give me the bond. That ought to cancel one of them. You do not have both of them outstanding. That is just simple arithmetic, I think, and square dealings. And I think people could be charged with doing some pretty bad things. They could insist on doing that. But of course you see it a different way, and you see it in a different area than I see it. And probably I am not capable of seeing it that way. But just as a matter of simple honesty, I will say, if you are representing somebody, and you are handling their money, you would do it on a loyal, faithful, honest

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basis, and you would not let them suffer what the Federal Government is suffering here, having to pay its bonds twice. And they can pay them 5 times or 6 times or 10 times, and here is the way it is done. When they get these bonds in their portfolios they might get up a scare, you know, that inflation has rounded us, and we have got to tighten up money, and we will just sell some of these bonds and get some of this money so as to tighten up. You do that all the time. But you buy these bonds back you give money for them again. That is more inflation. And then you keep them for a while and you have another scare and you sell some other bonds, and they are the same ones in the market again. And of course you pay them back and you have to pay for them again. So that method does not seem reasonable to me. I do not see how it can be justified.

But I will accept your argument, I mean accept your right to argue what you want to and make the remarks just as voluminous as you can. But I hope you have proved your point. I do not think that you will be able to do it with just a few remarks, although I personally have great confidence in you, Dr. Burns.

But one thing about the central bank—you know, I was in Mexico one time, and I noticed that the low-income groups there, they had all the housing in the world that they had needed, they had plenty of housing. And I made inquiry, and I did not get all the information I needed. But later on we secured the services of some people who were experts along that line, and we had an investigation made on central banks. I believe the major countries, 11 of them, all have central banks, including our own. Our own was not a central in 1935. Woodrow Wilson was against a central bank. It was set up as 12 Federal Reserve banks, each autonomous, and was not a central bank at all. It was only in the 1935 act did we go in that direction.

Well, this expenditure that you mentioned, that brings up a point—and I am glad that you mentioned it. I would rather the central bank would spend more if it would assume social responsibilities. I think every other bank——

Dr. BURNS. We do assume social responsibilities.

The CHAIRMAN. I think every other central bank in the world except our own assumes social responsibilities to the country.

Now, I have been trying to get you to take the initiative, not as just Dr. Burns, but as Chairman of the Federal Reserve Board, take the initiative and help us get some housing money. All other countries with central banks are helping their countries except ours.

Dr. BURNS. Why do you want to do it through the central banks? Congress can appropriate any amount of money that it chooses for housing.

The CHAIRMAN. I know, but the Federal Reserve claims to be independent. I do not go along with that independence. We are going to have to fight that out one of these days, Dr. Burns.

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Dr. BURNS. All I can say to you is that the powers that we have were given to us by Congress. Any law that the Congress passes this Federal Reserve Board will strictly observe. This is a promise from which there will be no exception or deviation. And I doubt if there have been any exceptions or deviations in the past.

The CHAIRMAN. But this ruinous inflation business—I just want to make a statement on that.

You know for 19 years William McChesney Martin, your predecessor, said that the way to stop inflation was to raise interest rates. Everyone knew that if you raised interest rates, you raised the cost of everything that is for sale, even the goods on the shelves, or the automobiles in the secondhand-car lot. You immediately raised the price of everything. That was proven out over a 19-year period that Mr. Martin was chairman. But if you keep on doing it, raising interest rates, you will have inflation. It is just like trying to put out a fire using gasoline instead of water. It doesn't work that way. And yet they kept on doing it and caused all this inflation. But it wouldn't cause any inflation at all to pay off their bonds, all it wants. If that causes inflation, we are already in a riotous inflation.

Referring back to the questions about these bonds, $63 million that you listed last week in the newspapers are bonds that are owned by the Federal Reserve. What did you pay for those bonds, Dr. Burns?

Dr. BURNS. The amount that you indicated.

The CHAIRMAN. Yes, sir. It was just a created money, wasn't it?

Dr. BURNS. The money was paid for by giving a credit.

The CHAIRMAN. That is right. They didn't want the currency.

Dr. BURNS. This is the way banking is done in our country.

The CHAIRMAN. That is right. I couldn't object to it.

Dr. BURNS. This is the way banking is done in every country in the world that has a modern financial system. And I know of no other way of doing it.

The CHAIRMAN. It is a good system, and I am all for it. But I don't think a debt should be paid twice.

Dr. BURNS. I don't think that they have been paid for twice. After all, when we buy bonds in the Federal Reserve, we pay for them.

The CHAIRMAN. Yes, with Government money.

Dr. BURNS. And we pay for them once.

The CHAIRMAN. With government money.

Dr. BURNS. Mr. Patman, bear this in mind. If you eliminated our portfolio, we could no longer conduct our market operations, and we could no longer manage the monetary credit system of this country.

The CHAIRMAN. I've answered that, Dr. Burns. The Federal Reserve testified that they could operate on $9 billion, and that is all they needed. And I am willing to let you have that, even more than that, twice that much.

Dr. BURNS. All right, suppose you do, and these bonds are retired. What are you going to put on the assets side? Are you going to declare us bankrupt? You don't want to do that.

The CHAIRMAN. The liabilities are behind the Federal Reserve notes, too, don't you know.

Dr. BURNS. These are difficult questions, Mr. Chairman.

The CHAIRMAN. I asked Mr. Martin one time, suppose you get a realtor to buy you a home here in Washington and the realtor buys

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the home that you want, but you find that it has a $40,000 mortgage against it, and you tell the realtor, here is my check, you go find the people who are holding that mortgage, and you pay them for the mortgage. And the realtor is your fiscal agent, he finds the person who owns the mortgage, and he pays the $40,000 to the fellow who holds it. And then the realtor, the fiscal agent, instead of giving you the paid-up mortgage, just holds the mortgage, and then when the mortgage comes to maturity, he wants it paid again. What do you think about that? That is the same thing that the Government is going through right now on these $63 billion in paid-up bonds. I don't mean to say that there is any corruption or anything like that, Dr. Burns; I don't want to imply that at all. But I do think that an agency like this should be audited by the General Accounting Office. I think that if we ever get that on the floor of the House where they can vote directly, you can rest assured that it will pass by an overwhelming vote.

If you will remember, there was an awful lot of opposition to the ban on Swiss bank accounts which we pushed through this committee. But when we got it down to just the vote on these secret accounts in Swiss banks, every Member in the House voted for it. In the same way in the Senate. And they will vote the same way on this, because the issue will be clear.

I am sorry I took so much time with you, Dr. Burns, but I wanted to get these things on the record, because we are going to fight them out in the future.

Mr. Rousselot.

Mr. ROUSSELOT. Dr. Burns, the suggestion has been made here today that no audit is made on the Federal Reserve Board. You do, of course, produce an annual report which has quite a bit of detailed statistics, but this is not considered a regular audit. Would there be any objection on the part of the Board to have the General Accounting Office from time to time to check or audit?

Dr. BURNS. There would certainly be no objection to an audit if you mean by an audit what a professional CPA does. If, on the other hand, you mean by an audit or critical review of Federal Reserve policies, there would be serious questions in my mind whether the General Accounting Office is best qualified to perform that function. I think that function is performed by the Congress every time I or another member of the Board testifies. I am quite ready to appear at any time and testify before this committee on any part of the Federal Reserve's operations.

There would be no objection to an audit of the CPA type. The other type of audit is being performed continuously by the Congress, and if Congress wants to proceed more intensively, you have my assurance that I will be here. If you want me here every day in the week, I will be here every day in the week. I am even capable now and then, if I have to, of being able to think like an economist in the long and silent hours of the night.

Mr. ROUSSELOT. Thank you.

The CHAIRMAN. Any other questions? [No response.]

We will take an intermission of 10 minutes and than decide how we will proceed.

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Mr. Mitchell, do you have your witnesses here? Do you want them to be heard now?

Mr. MITCHELL. Yes. Let us take 10 minutes.

The CHAIRMAN. Thank you very much, Dr. Burns.

Dr. BURNS. Thank you, Mr. Chairman.

(Brief recess taken.)

The CHAIRMAN. We will now hear testimony from Sampson Green, chairman of Activists, Inc., a civil rights organization in Baltimore. With him is Father John Martinez, cochairman of the Housing Committee of Activists, Inc. For 2 years, this organization has conducted an extensive study of real estate speculation and abuses in Baltimore, the inner city. Their report is based on extensive, and I dare say unique, computerized studies, and adds up to one of the most thoroughgoing examinations—and I congratulate you on it—in the nation of insiduous housing speculation. And it is linked with certain financial institutions. It is no exaggeration to say that what they have found in Baltimore is a description of problems which exist to a very large extent in other urban centers of the Nation.

And as I understand it, Mr. Green will deliver his statement, following which both Mr. Green and Father Martinez will be available for questioning by the members.

But before the witnesses begin, you have a very fine Congressman here in Mr. Mitchell, and I would like him to present you to the committee.

Mr. MITCHELL. Thank you, Mr. Chairman. It is a special pleasure for me to do this, because I have long been associated with these men—and the young men behind them—in their struggle against what we have in Baltimore City, which is known as the black tax. The black tax is extra profit that black people have to pay when they seek to rent or purchase homes. That black tax is sustained and supported primarily because of the system of interlocking directorates with which you have so much concern. So, it is with a great deal of pleasure that I welcome these gentlemen to the committee. I only regret that more of our colleagues are not here to hear the cogent and interesting testimony they will present.

The CHAIRMAN. The record will be made available to them.

And so you may brief your testimony and put it all in the record.

In addition, have you sent that to Mr. Romney?

Mr. GREEN. Mr. Romney's office has some parts of it, but not all of it.

The CHAIRMAN. I am going to send him the whole text, because I think he should have it.

Mr. GREEN. Thank you, Mr. Chairman.

The CHAIRMAN. We will send it to everybody that we think should have it, because it is a revelation.

I congratulate you on preparing such a fine report.

STATEMENT OF SAMPSON GREEN, CHAIRMAN, ACTIVISTS, INC.; ACCOMPANIED BY FATHER JOHN MARTINEZ, COCHAIRMAN, HOUSING COMMITTEE, ACTIVISTS, INC., BALTIMORE, MD.

Mr. GREEN. Mr. Chairman and members of the committee, I am Sampson Green, chairman of Activists, Inc., a civil rights organization in Baltimore, Md. This is Father John Martinez, cochairman of the

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Housing Committee of Activists, Inc. For 2 years our group has worked to stop the exploitation of families in the area of housing.

Our testimony in support of this bill is based on close contact with many of the exploited families and on our computer study of 60,000 sales of property in Baltimore City between January of 1960 and December of 1968.

Thousands of families are paying 30 to 40 percent more than the FHA fair market prices for their homes partly because of the conflict of interest which this bill strikes against.

An example from our data is Jefferson Federal Savings & Loan. Seventy percent of Jefferson's loans went to the customers of just the speculator, Morris Goldseker. Mr. Goldseker has an employee, Martin Weinberg, on the board of directors of Jefferson.

Jefferson's legal work is done by the firm of Jefferson's chairman of the board, William Siskind. Mr. Siskind also does the legal work for Uptown Federal Savings & Loan, another unconscionable savings and loan, which you know of from your investigation of speculation in Washington.

Jefferson consistently appraised houses at 40 percent above their value in order to circumvent the regulations of the Home Loan Bank Board. Their appraisals were done by Mr. Askin, at that time a member of Jefferson's board of directors.

The largest housing speculator in Baltimore, Morris Goldseker, bought 1,768 houses during the 1960's for $10,853,767, and sold 742 of them for $9,427,723. The 742 resold houses cost an average of $6,868 and were resold for an average of $12,706. This is a markup of 85 percent for houses in changing neighborhoods where the houses needed not rehabilitation but "cosmetic" treatment.

You can see why we so strongly support your bill. Anything which checks this exploitation of families and neighborhoods should be passed. We are concerned not only to check new slums but with the families who must support these exorbitant profits. For the excess costs—what we call the black tax—in human terms are spelled out in the stress and strain of working two jobs, wives working when needed at home to care for children, the inability to adequately take care of family and community responsibilities, children beginning work when education should be continued, funds being absorbed in house payments which should be available for college and other specialized training, a high level of economic stress causing disruptions in family relationships upon the inability of making housing payments and at the same time keep proper maintenance of the house, drastically cut chances of the family being able to enjoy better things of life like vacations, recreation, and entertainment. There is also the anxiety that the homes may be lost.

All of these things are not happening to all of the families who are caught up in the black tax. However, one or more of them are relevant to most of the families.

We are submitting three short studies which we hope will be printed along with our testimony because they prove what we have said and show the extent of the problems.

The first is the study of two blocks, chosen randomly. This study shows how few people among black working class families will ever own their own homes. We are turning the city from a community of

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freeholders to a community of landless and tenant people. And the root cause is economic—the lack of ordinary credit for working class families.

The second study is a complete presentation and analysis of all of Jefferson's business in Baltimore.

The third study proves the difference between fair price and what is paid to the speculators by the families. It analyzes and compares two census tracts, one white, one black. It compares prices between the two census tracts and within the black census tract.

The CHAIRMAN. Since you have another page there, after you read that page, if that is the completion of your testimony, then we will pass on, putting it all in the record.

Go ahead and finish it up.

Mr. GREEN. In conclusion, we definitely support this bank reform bill. It will help. But it will not, by itself, stop the economic devastation of the cities and of poorer people. We invite you to Baltimore. Find the answers to questions which we cannot understand. Why does the Home Loan Bank Board permit the circumvention of its own regulations? Why does one saving and loan lend to no one but families at fair price? Why does the saving and loan up the street never, never at all lend to a family? Find out how the unconscionable saving and loan's are controlled. Who controls them? What is the tie up between the commercial banks and exploiting saving and loans? Why is there a lack of credit for working class families? For without adequate credit in an essential area like shelter, families must deal with the exploiter. And it will be almost impossible for them to build equity into their property and to become more than what they are now—tenants with the responsibility for the upkeep of their property.

Thank you for this opportunity to support your bill. We hope that you will continue your essential and much needed work in our city.

(The three studies referred to by Mr. Green in his statement follow:)

TWO BLOCKS ON MT. HOLLY STREET

(Released Apr. 23, 1971)

There are 44 houses in the 800 block of Mt. Holly St.

There are 22 houses in the 900 block of Mt. Holly St.

Each of these 66 houses had a change of ownership at least once since January of 1960.

Here is a breakdown by year of when the houses were first sold.

Year	1960	1961	1962	1963	1964	1965	1966	1967
800 block houses	4	0	8	26	4	1	1	0
900 block houses	3	1	9	4	3	0	2	0
Total	7	1	17	30	7	1	3	0

We will study what happens to the houses when a block changes racially. How many of the houses are rentals? How many were sold? How many families obtained houses at fair prices?

Mt. Holly St. was chosen at random. The two blocks were chosen because there was a 100% change within the data available to us.

NOTE. The analysis of property in Baltimore is complicated by the existence of ground rent. A family can buy a house and not own the ground. They would pay a yearly rent to the owner of the ground.

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Suppose a house is bought for $12,000 with a 90 dollar a year ground rent. The $90 is considered as 6% of the value of the ground. So the ground is worth $1,500, and the property is valued at $13,500.

In this first study we will capitalize the ground rent when it occurs.

In the two studies which follow this one we will capitalize only the *increase* in ground rent.

Of the 66 houses, 24 were purchased for rentals, 32 were bought and resold, and 10 appear to have been bought directly by families.

THE RENTAL PROPERTIES WITH PRICES AND ADJUSTED PRICES

	Prices	Number of rental properties	Adjusted prices		Prices	Number of rental properties	Adjusted prices
800	$9,000	0	$9,000	834	$8,000	0	$8,000
801	9,500	0	9,500	838	8,300	0	8,300
802	9,000	0	9,000	839	7,000	90	8,500
808	6,500	108	8,300	841	9,000	0	9,000
815	9,000	0	9,000	900	9,000	0	9,000
816	8,500	0	8,500	904	8,000	0	8,000
818	8,500	0	8,500	908	7,000	90	8,500
823	9,500	96	11,100	910	6,000	90	7,500
825	9,000	0	9,000	912	7,000	90	8,500
827	8,500	0	8,500	914	9,000	0	9,000
831	9,000	0	9,000	918	8,500	0	8,500
832	8,000	0	8,000	919	9,500	0	9,500

The 24 rentals are valued (with the adjusted prices) at $209,700. The average value is $8,737.50.

The average investment (since 6 grounds were not purchased) is $8,346.

NOTE. The transactions for house numbered 823 are complicated and confusing It was included here among the rentals for lack of a better place to put it.

Here are the 10 properties which appear to have been bought directly by families. Underneath the sale price is the adjusted sale price with the ground capitalized at 6% and included in the adjusted price.

	Sale price	Adjusted price	No. of rentals	Loan	Bank	Date
810 E. Young	$8,000	$9,600	96	5,500	Prov S Bk	July 1963
812 Z. Newby	10,000		0	5,500	Prov S Bk	December 1963
820 G. Parker	10,000	11,500	90	9,800	Wv. Br	April 1963
820 R. Cherry	9,580	11,080	90			December 1966
821 J. Marchant	8,300	9,800	90	8,000	Edm. F.S.S.	August 1964
840 C. Johnson	9,000	10,500	90	8,550	S L Hamerman	October 1962
843 R. Jones	12,000		0	11,000	Prov S Bk	September 1962
901 R. Vaughn	10,000	11,600	96	10,000	Westview F S L	October 1962
902 O. Keyes	9,500		0	9,500	W Burton Guy	June 1964
905 C. Clicker	8,500		0			April 1966
907 A. Manning	7,000	8,500	90	5,400	Union F S L	January 1964

Counting only the first purchase of the house numbered 820, we have 10 properties valued at $101,500 with an average value of $10,150. (Adjusted values.)

Three of the above families had substantial down payments.

The first purchase of 820 was an FHA transfer. It is the only FHA or VA that we know of on the two blocks. But we do not have data on which were FHA or VA for before 1963.

There were 32 houses which were bought and resold. They cost (adjusted prices) $274,485, and they were sold (adjusted prices) for $425,228.

The average adjusted purchase price was $8,578, and the adjusted sale price was $13,228.

The investment (since 13 grounds were not purchased) was $258,080.

Summary of adjusted purchase prices:

Rentals, 24: cost, $209,700: average cost, $8,737.50.

For resale, 32; cost, $274,485; average cost, $8,578 (resale $13,288).

By families, 10; cost, $101,500; average cost, $10,150.

Total adjusted cost, $585,685.

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Average cost, $8,874.

The Companies:

Applefeld and/or Gerber were the most active business men in these two blocks.

Federal Co., P, T, S Leon Applefeld, V P Herman J Gerber. This company purchased 8 houses to rent and 5 others for resale.

Rs Agt Leon Applefeld, 359 Calvert Bldg.

Dunbar Rlty Co, P Herman J Gerber, V P Walter Kirson & Leon Applefeld, S Leon Applefeld, T Abraham Kirson. This company purchased 5 houses and resold 2 of them.

Rs Agt Herman J Gerber, 220 E Lexington.

Kent Realty purchased and resold one house, Kent was merged into Dunbar on May 31, 1962.

A & S Realty, P Arnold Applefeld, T & S Leon Applefeld. This company bought and resold 1 house.

Rs Agent, Arnold H Applefeld, 220 E Lexington.

So 20 of the 66 houses were handled by this group of men.

We have not checked their rents as yet. But since their markups on resold property is generous, we assume their rent levels are also healthy.

Goldseker bought 827 and has not resold it. He bought and resold the following 9 houses: 804, 813, 814, 817, 829, 906, 911, 913, 917

His adjusted purchase costs for those nine houses was $74,700. The adjusted resale figure is $127,540.

The adjusted averages for these nine houses are 8,300 and 14,171.

Since he did not buy 5 of the grounds, his investment was 67,000.

817 and 917 have since been forclosed on.

A Conspiracy to Defraud and Exploit Homebuyers: The Story of Jefferson Federal Savings and Loan

A. A Description of the Conspiracy

A gigantic conspiracy has operated in Baltimore, and probably in every other city, to rob black families of millions of dollars in the purchase of homes. During the sixties in Baltimore the major speculators bought over four thousand houses, and sold a little over half of them for what they all cost. The biggest operator was Morris Goldseker. He bought 1,768 houses for $10,853,767, and sold 742 of them for $9,427,723. The 742 resold houses cost an average of $6,868 and were resold for an average of $12,706. This is a mark-up of 85% for houses in changing neighborhoods where the houses needed not rehabilitation but "cosmetic" treatment.

The operation starts with big loans from the commercial banks. Goldseker borrowed a million dollars a year to buy up houses in changing neighborhoods. Using three different kinds of contracts, he then sold the houses to black families. He used the land installment contract, the lease and otpion contract, and the double mortgage contract.

The land installment contract is a recorded contract between the buyer and the seller which does not need a Saving and Loan Company. When a family buys a house under this type of contract, the price and interest rate and weekly payments are set down. However, the family does not receive title to the property until 40% of the purchase price has been paid.

Both speculators and legitimate sellers use the land installment contracts. Speculators, however, charge prices which are highly inflated. For example, a man paying for his home at $30.00 a week at a fair price on East 30th Street would finish paying for his house in about 12 years. He would pay about $13,000 in principal and interest. Paying for the same kind of house at the prices charged by Goldseker and other exploiters, a man paying $30.00 a week would pay for twenty-two years. He would pay a total of $23,000 in principal and interest.

So the problem with speculators does not lie in the use of land installment contracts, but in the high prices they charge.

The exploiter Saving and Loan Companies are not needed with this type of contract, but they are often brought in later in order to liquidate the investment of the speculator. For example, a family with a land installment

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contract for $13,000 from the early sixties would have it paid down to $10,000 by the late sixties. So the speculator takes the family to his Savings and Loan and arranges for the family to be lent $10,000. The speculator seller gets the $10,000, and the family continues to pay the Savings and Loan.

Now Jefferson, the main subject of our report, has not done much of this. Uptown Federal Saving and Loan would be a better example for this type of operation. For example, Uptown has put almost all of its home mortgage business in the city during the past few years into the hands of Morris H. Wolf. Wolf liquidated his land installment contracts from the early sixties. Uptown refinanced the customers of Wolf. Uptown also raised the interest rate of the original contracts from 6 to 6 and ¾%.

Now we admit that Wolf does not compare with Goldseker. (He bought only 416 houses, and his prices are not as high.) And we admit that 6-¾% compares favorably to what we shall see Jefferson doing. But we point out this minor half million dollar conspiracy in passing. It involves a Federal Saving and Loan which is liquidating a speculator so that he can take advantage of higher interest rates. The Savings and Loan not only cooperates with the exploitation of families, but gives it a boost with its own new higher interest rate.

Many speculators are using "Standard Lease and Option Contract." They tell the buyer that he is buying the home and have him make a down payment. These contracts, however, say that the person is paying rent (the contract says "tenants covenant to pay the rent when due . . .") The speculators say one thing; the contract says another.

Speculators use this kind of contract because the land installment has become regulated in recent years. The land installment contract must be recorded, and a court procedure is required in order to evict. The lease and option is really an unrecorded land installment with many advantages for the speculator seller. The buyer loses his down payment and his option to buy if he is ten days late with any weekly payment. And the claim by the seller that he will apply part of the weekly rent to the settlement when he puts the buyer into a Saving and Loan is verbal, not written. The Saving and Loan Companies are involved with this operation the same way they are involved with the land installment contract.

When a person signs either a lease and option contract or a land installment contract, he is usually told that he will get a mortgage from the building and loan within one or two years. The speculator does not tell the buyer that the building and loan will only give a mortgage to cover part of what he owes: he will still owe part of the money to the speculator. Typically, when a person buying a house for $11,950 gets into the building and loan, he will get a mortgage for about $9,000, and will still owe the speculator about $3,000. He pays both at once. To give a specific example, Goldseker bought a house in the 3000 block of the Alameda for $7,000 and no ground rent in February of 1966. In April of the same year he sold it to a family for $11,950 with a 96 dollar a year ground rent. He used a land installment contract at 6% with monthly payments of $130. In June of the next year he took the family to Jefferson Federal Saving and Loan. Jefferson lent the family $9,300 which covered very nicely Goldseker's $7,000 investment. Jefferson may also have bought the ground for $1,600. But the family still owes Goldseker $2558.04 at 6% a year in the form of a second mortgage.

B. WHO IS JEFFERSON FEDERAL SAVINGS AND LOAN

Valley Federal Saving and Loan changed its name to Jefferson Federal Saving and Loan in 1964. Then in 1965 Jefferson took over the assets of Oldetown Saving and Loan. The present board of directors of Jefferson is made up of directors from Valley and from Oldetown. Jefferson's present directors are:

Richard K. Adolph, treasurer, from Valley
Sidney Cohen, from Valley, went off the board in 1970
Henry J. Fensterwald
William L. Frick, secretary
Danield Friedman, local judge: from Oldetown: off board in 1970
Ernest Fox, from Oldetown
Gery Hucek, vice president, from Valley
M. Bud Kolker, from Valley
Clement R. Mercaldo
Walter H. Oberfeld, from Oldetown
Fred Pritt, executive vice president

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John H. Riehl, Ill., president, from Valley
William L. Siskind, chairman of the board, from Valley
Martin L. Weinberg, employee of Goldseker
Marvin Mandel, went off the board of Jefferson after being appointed Governor by the state legislature in 1968. Was pres. & director of Oldetown.

Valley had 2.7 million in deposits when it became Jefferson in 1964. With the deposits of Oldetown and with growth over the past seven years, Jefferson now has 6.3 million of depositors' money. How does Jefferson use its money?

C. THE ROLE OF JEFFERSON IN THE CONSPIRACY

Jefferson uses all its money to defraud and exploit homebuyers. Jefferson conspires with five agents. They are Morris Goldseker; the Becker brothers, Al and Walt; Anothony Piccinini; Walter Collins; and Stewart J. Greenebaum. Jefferson has also put some money ino a partnership, which is now partially bankrupt, made up of Robert Taylor, Sheldon Dobres, Richard Swirnow, and Robert Warfield. Some money also goes into the chairman's company, Calvert Realty Sales.

Jefferson gives most of its money to Goldseker. Of the $2,748,570 worth of mortgages which it wrote in Baltimore between 1964 and March of 1969, $1,933,570 went to Goldseker. When one man gets 70% of a bank's outlay over a five year period, then he must own that bank. This is confirmed by the presence of one of his employees, Martin Weinberg, on Jefferson's board of directors.

The role of Jefferson is to arrange the operation of exploitation so that exploited families owe money to the bank's depositors, and not to the exploiters.

The role of Jefferson is to finance the exploiters with the depositors' money. Sometimes the speculators' purchases are financed. But usually the customers of the speculators are financed. The prices are always highly inflated. November of 1967 is chosen as a typical month of Jefferson activity.

Company	Purchase price	Ground rent	Address	Sale price	Ground rent	Money lent by Jefferson
Goldseker	$6,519	$96	3217 Belmont	$12,000	$96	$8,500
Greenebaum	300	60	1834 Bethel Ct	2,750	60	2,800
Goldseker	6,000	96	1504 Carswell	12,000	96	8,500
Do	5,000	75	1756 Darley	11,500	75	8,000
Do	7,000	96	761 Edgewood	11,950	96	8,600
Do	(1)		1054 Ellicott Dr	11,000	96	6,300
Do	8,500	0	3935 Flowerton	15,000	0	10,950
Do	8,000	0	603 North Grantley	12,000	96	8,900
Do	4,000	96	750 North Grantley	12,000	96	9,000
Do	(2)	108	126 North Hilton	13,000	108	8,500
Marriot Realty	6,500	96	3111 Juneau	14,700	96	9,880
Goldseker	8,500	0	2606 Kirk Ave	13,000	96	8,700
Do	7,000	90	635 Linnard	12,500	90	9,000
Do	7,500	0	2511 Loyola Southway	13,550	0	10,500
Do	6,600	108	621 Radnor Ave	11,950	108	8,250
Do	6,232	96	2132 Sinclair Lane	10,950	96	8,400

[1] No stamps.
[2] Unknown.

Notice how amply the first mortgage to the family covers the initial investment of the speculator. The difference between the final sale price and the mortgage amount will give the second mortgage which is still being held by the speculator.

Besides the houses listed above there were ten other Goldseker houses which Jefferson refinanced in November of 1967. Let us consider one of these houses, say 2625 Hilton St. This house was bought by Herbert Kaufman, a well known Baltimore slumlord, in September of 1959 for $5,200 with a $108 a year ground rent. He sold it to Goldseker three months later for $7,000 with the same ground rent. (The rent will stay at $108 through the rest of this story.) Goldseker borrowed $7,000 from Equitable Trust in order to buy the house. After renting the property for two years Goldseker sold it to a black family for $12,000. He got them a $6,800 loan from Ridgely Building Association, and he took a second mortgage for $5,552. Both loans at 6%. Then, six years later, Goldseker

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used Jefferson to liquidate his second mortgage. Jefferson wrote a mortgage loan of $8,900 which paid off Ridgely and most of Goldseker's second mortgage.

Is the house worth $12,000 and ground rent? Is it worth $8,900 with ground rent? FHA was recently asked to appraise the house. After examining it they refused to set a price. They stated that the structural repairs needed were out of proportion to the existing mortgage.

Besides structural needs there are other needs. For example, in the yard there are some bed springs in place of a fence. Goldseker promised when the family moved in ten years ago that he would replace the springs with a fence.

Jefferson charged this family $220 as an origination fee for the refinancing which Goldseker, not the family, wanted done. Jefferson also charges $75 for an appraisal compared with $35 charged by FHA.

Jefferson did a lot of refinancing for Goldseker in 1967 and 1968. When Jefferson refinanced in 1968 the interest rate for the family was raised from 6% to 8%. One example among many is 3629 Edmondson Avenue. Goldseker bought it for $7,000 and 0 ground rent in July, 1962. He sold it in January, 1963 for $12,000 with a $96 ground rent. He arranged a loan of $7,200 for the family from Safety Perpetual Building and Loan. He created a second mortgage of $4,798. Both mortgages were for 6%. Then in June, 1967 Jefferson paid off both mortgages, and fixed up the family with an $8,900 mortgage at 8%.

D. THE EXTENT OF JEFFERSON'S INVOLVEMENT

Are the actions of Jefferson merely unconscionable and a detriment to the people of the city, or are they also illegal? They are illegal.

A Savings and Loan is licensed to "promote thrift and economical home ownership," and not to establish a slush fund for its directors and their friends. A Federal Savings and Loan is required by law not to put more than 10% of their eggs in any one basket. The 70% that went to Goldseker is more than 10%.

A Federal Savings and Loan is prohibited by law from making inflated mortgages. The Savings and Loan is expected not to endanger the depositors' money. Specifically, a Federal Savings and Loan may not lend more than 80% of the fair market value of a house if there is a second mortgage. Jefferson consistently violates this law.

The proof for this last statement can be offered from census tract 16–08 in the northern part of Edmondson Village in West Baltimore. This is a row house neighborhood which changed racially in the mid-sixties. There were 260 houses sold with FHA insurance. An FHA house must be sold at the appraised fair market value, and the house must be in good condition. The average sale price for these houses was $9,357. Other houses in this same census tract were handled by Goldseker. Of course, 35 were financed by Jefferson. Jefferson's *first* mortgage average is $9,300. Jefferson has consistently financed not 80% but 100% and more of the fair market value of the houses.

E. TECHNIQUES OF JEFFERSON FEDERAL S & L

Why does Jefferson make only inflated, dangerous mortgages? Because this is what Jefferson was set up to do. And because exploitation can be profitable and convenient.

The record of Valley and Oldetown and the subsequent record of Jefferson prove that Jefferson was set up to exploit. No family, no matter how good its credit, and no matter how big a downpayment it had, could have gone to Jefferson and gotten a loan. The Saving and Loan was in no way serving the public.

It was set up to enable the speculators to get in and to get out with the money. However, we do admit that there are a few mortgages where we cannot see what is wrong. Perhaps they were written for a director's brother or brother-in-law.

The extra profits would come first from higher points which the exploiter can pay the Saving and Loan. Then the fees charged the families are inflated, and one's own purchases can be financed.

The whole operation is also very convenient for the Saving and Loan. The families are brought in for the mortgages, and the speculator guarantees the first mortgage in writing. In other words, whenever a family collapses under the high double mortgage payments, the speculator bids at auction a price high enough to cover what is still owed on the first mortgage. The hypocritical Saving and Loan can actually claim that it has never foreclosed on a family. The second

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mortgagee always forecloses. The Saving and Loan gets back its money and its president never has to leave his office.

If the family is having trouble with the payments only, because, say, the husband has been layed off, then Goldseker will act as a collector. He will have the family make both payments to him, and he will send the Saving and Loan a check once a month. He charges the family $5.00 a month for this service.

It was said earlier that Jefferson gave Goldseker 70% of its money over a five year period. It would be more accurate to say that Jefferson lent Goldseker the money because he agrees in writing to return the money if any of the families collapse.

Who are the people Jefferson finances? They are in the business of providing shelter to black families, with high profits to themselves. Black families do not have access to the general housing and financial markets. They must buy in a restricted market. We are talking about the working class family.

The men who provide this shelter are, besides Goldseker, the Beckers. They bought 250 houses over the last ten years. They have a 70% mark-up on their sales. Jefferson has financed many of the Becker rental properties. Jefferson financed some of Walter Collins' houses, which he bought to rent. Collins is a Goldseker employee. Another Goldseker employee, Martin L. Weiberg, is on the board of directors of Jefferson.

Stewart J. Greenebaum was an employee of Jefferson in the mid-sixties. Jefferson has financed several of Greenebaum's operations. There was an interesting case in 1968. Congregation B'ai Reuben Athkanoth sold its synagogue at 3905 N. Cottage to Larry, Inc., Greenebaum's company, for $10,000. Greenebaum sold the building the same month to a black congregation for $30,000. Jefferson lent the minister $19,900 to buy the building. But the minister had to put up as security not just the building, but also his own home.

Jefferson has not made any loans in Baltimore since March of 1969. They are moving into the apartment house construction business. This is great new field with the Government paying part of the rents under section 236 of the 1968 Housing Act.

F. THE EFFECT OF THE CONSPIRACY

An Urban Crisis

By Walter Carter

The unceasing spread of the urban slum continues to be one of the most detrimental problems in Baltimore. Unabated real estate exploitation is the major cause of slum creation which extends to about two-thirds of the periphery around the inner city core, and between the suburban ring. As these previously white neighborhoods are characterized by deterioration caused by this exploitation, this fact, combined with panic sales, perpetuates a continued out-migration of white with a concomitant in-migration of congested blacks. Of course, the severe demand for housing of blacks contributes both to their moving in and their congesting. These real estate speculators take advantage of the situation by selling directly to blacks at deliberately inflated prices.

These speculators have calculatedly selected neighborhood after neighborhood with the sole motive being excessive profit far above the average realtor in his normal course of business. The usual freedom to buy property that is available to whites is denied to blacks initially because of rigid segregation, and now this is combined with economic inflation for restricting the majority of black dwellers. Since the speculator is the negative force behind change, a change that is detrimental, his operation undermines all that which has been envisioned by social and other professional planners. Because the black home buyers are economically insecure, having incomes much less than that of the average American, after they make excessive payments on their properties, they have an insufficient amount of money to maintain these properties. This, combined with the deterioration of city services and the psychology of hopelessness engendered by the accumulation of segregation and related aspects of frustration, results in the creation of a new slum area with multiple urban problems causing gross human suffering.

The Response: A Need for Organization

Since these newly exploited home buyers came into this common problem by individual efforts, they remain disorganized. They do not yet have an enabling social vehicle whereby they can address themselves to their common problem.

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This creates the biggest crisis in the Baltimore area where neighborhoods are being turned into economic, social and psychological shambles. This city cannot survive if it is to allow itself to continue to be a passive victim of the least responsible elements of the business community. Racial tensions in our city will reach and stay at or beyond crisis levels as this condition worsens. After neighborhoods and communities become organized and they develop into sufficient viability, they must be equipped to confront and handle the excesses of racially-charged economic transactions. Communities and present home owners will have to find new ways of coming to terms with the system of real estate speculation. Methods must be devised to arrest and reverse the evils of speculation and to place in operation a process of planned constructive change which will bring about stable, productive and healthy neighborhoods with the full range of institutional and city services.

Even though many public and a few private community activities are sponsored in the Baltimore area, none of these even in a haphazard or piece-meal manner deal with the problems caused by speculators, or with the speculators themselves. Speculation has continued during the past twenty to thirty years in fanning white out-migration, and fueling in-coming black satuation housing market. With routized business sophistication, they have prevented potential home buyers and the public from understanding their unethical and excessively profitable methods. Small community organizations acting alone with minimal resources are hardly effective against the lucrative combinations of speculators backed by some of the largest financial institutions and their smooth methods of transacting business. We must recruit potential leaders and lay organizers for intensive training so they can develop a network of countervailing forces at the community level to confront and neutralize the excessive practices of speculators. Based on our study "Edmondson Village Under Seige," we recognize that we must go on extensively using this method in order to define the problem with resident home buyers so that they can become organized around their most brutal and basic problem. Already the next level in this evaluation process has been instituted through the method of computer technology. Through this method we will be able to sort out individual home owners who have been victimized recently by the speculator and to warn others against this practice. Once this is known in detail, it can be combatted effectively.

The Black Tax Versus Black People

(A final statement by Sampson Green, Chairman of Activists, Inc.)

The speculating exploitive housing operator by imposition of the black tax, has left a blighted trail of miseries and frustrations among black people. Among the trail of the black tax ($3,000 to $7,000 above the market value for housing) lies deteriorating communities, stress and strain of working two jobs, wives working when needed at home to care for children, the inability to adequately take care of family and community responsibilities, the chance of wearing out body and mind at an early age, children beginning work when education should be continued, funds being absorbed in house payments which should be available for college and other specialized training, a high level of economic stress causing disruptions in family relationships upon the inability of making housing payments and at the same time keeping proper maintenance of the house, drastically cut chances of the family being able to enjoy better things of life like vacations, recreation and entertainment.

Further, the shady types of purchase contracts keep a high level of tension and anxiety that the homes may be lost.

All of these things are not happenings to all of the black families who are caught up in the black tax. However, one or more of them are relevent to most of the families.

These factors combined with the plain fact of being robbed, and the failure of city services within the exploited communities has instilled a level of frustration which is demanding correction. For at the end of the trail of the black tax lies devastated black families and greedy money-gorged exploitative housing speculators.

For many years the speculators have proceeded with their imposition of the black tax as if they had superior rights to exploit black people. However, the black people of Baltimore have now reached a point where the words of Henry Garnet are heard clearly:

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"Neither God nor angels nor just men command you to suffer for a single moment. Therefore, it is our solemn duty to use every means, both moral, intellectual and physical that promises success."

The activists and payers of the black tax are determined to pursue the eradication of the black tax.

They will take those means which promise success until the black tax is totally demolished.

APPENDIX I: VALLEY SAVING AND LOAN

Valley F S L changed its name to Jefferson Federal in 1964. At that time it had assets of $2,958,000, savings of $2,694,000, and mortgages of $2,400,000. The big man was and is William L. Siskind.

We have not done a complete study of Valley's activity in the city as we have for Jefferson and Oldetown. For Valley our data starts in 1960 and runs into 1964. We have acquired no data for before 1960. Our material covers only the 17 census tracts which were changing racially and not the whole inner city. And in those 17 census tracts we have no record of the refinancing but only of original mortgages.

We have a record of 74 mortgages worth $662,000. All of the money is going to investors and speculators. Goldseker arranged 41 mortgages. The Beckers had 8. And the remaining 25 were scattered.

The pattern is the same as Jefferson's pattern in the late sixties. Even the investors are the same with a similar proportion of Valley's funds going to the same men.

APPENDIX II: OLDETOWN SAVING AND LOAN

In 1960 and 1961 Oldetown floated inflated mortgages on apartment houses. In 1962, 1963 and 1964 they managed to stay on their feet while doing very little business. In 1965 they financed mostly Goldseker ($200,000) and the Beckers ($100,000).

The apartment house financing almost put them under. As an example, take 2028 Mount Royal Terrace, known as the Druid. In 1946, when it was a fine apartment of 19 units, it sold for $69,000. In 1957 it was sold again. But now the neighborhood was changing from white to black. Robert Feldman bought it for $90,000. Two years later he refinanced it through Oldetown. The Savings and Loan lent him $140,000.

The large loan is rationalized in terms of the profit stream from black families. In 1961 there were 29 units, most of which were put in before Feldman bought the property. No rehabilitation was done with the money in view of the basic repairs which the inspection bureau demanded during the following years. New apartments mean extra kitchens, not extra bathrooms. The inspection bureau forced them to change it back to 25 units, some of which are roomers. There is an illegal 26th. unit, without windows, in the basement.

This example is important because it shows a pattern. The Saving and Loan is milked for capital in the beginning. Then the rental income is used to amortize the mortgage instead of for maintenance. In this particular case the rental income is around $26,000 a year. Over $12,000 goes toward interest and principal on the mortgage. With taxes, insurance, and emergency repairs, there is little left for security, janitorial services or maintenance. Then we are expected to feel sorry for the struggling landlord, as was the city in the late 1960's when it reduced the taxes on this building.

Feldman also bought 3006 Hamilton Avenue in August, 1961 for $32,000 with an $8,000 loan from Oldetown. Nancy Realty (P. W. Collins) bought a structure at St. Paul and Monument for $48,200 with a $100,000 loan from Oldetown.

Robert Feldman had a housing empire in the black community, but he could not hold it up. In fact, he left town. This, and the Maryland Saving and Loan scandals of the early 1960's caused a crisis for Oldetown. But Mandel weathered the storm with Goldseker's help. Mandel took over a few apartments and kept the payments up. Goldseker, with the help of employees Collins and Stanley Wilen, took over other property. For example, Goldseker manages the Druid while Wilen is the owner of record. Goldseker holds many Feldman houses with Conveyor, Inc. Collins holds others with Pleasant Holding Co.

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In 1965 the process started up again. This time Goldseker bought the houses (he was buying all through the early sixties with the assistance of other banks and Saving and Loans). Mandel wrote inflated first mortgages for Goldseker's customers.

A financial institution will sometimes sell its mortgages or put them up as security to raise money for more loan business. In the very early sixties Oldetown raised $493,000 from Equitable Trust, $363,000 from Uptown, and $222,000 from Prudential Saving and Loan.

We have documented the massive exploitation of working class black families. We have explained in another report how to make a slum. All you have to do is take $300,000 a year out of a neighborhood for *excess* housing payments and rent while raising density 35% with multiple dwelling and new apartments. There has been surprising indifference.

Even the Home Loan Bank Board is indifferent. If they think about the little man at all, they think about the small depositor whom they have insured. But they appear to be completely indifferent to the customer. In fact they permit flagrant violations of the law by their Saving and Loan companies.

The politicans are also indifferent. They would have us believe is material is ancient history. But aside from houses sold in 1965, the over-financed apartments from the early sixties are still being paid for by the families.

APPENDIX III: WHO DID THE STUDY

Activists, Inc. is a Baltimore Civil Rights organization. It has been involved with many problems of injustice in the city and state. During the past two years its biggest struggle has been against housing exploitation. The organization began picketing the largest exploiter in the city in May of 1969. During the summer of 1969, the Activists reseached a section of the city called Edmondson Village. In the autumn of 1969, it published a study entitled *Edmondson Village Under Siege.* As a result of giving the study to the people, a large number of families who had been forced to buy at exorbitant prices came together and formed an organization called the Edmondson Village Community Association. The Edmondson Village people joined the Activists on the picket line and, with another organization, the Montebello Community Association, started a law suit in federal court against Morris Goldseker, the largest of the exploiters.

During the winter of 1969–70, the Activists and the community people decided to make the movement city wide. The first step was something that had never been done before in the country—a computer study of housing exploitation on a city-wide basis. Over two hundred people volunteered and put in over 4,000 hours to encode a source document of 60,000 house sales with all pertinent details, such as name of buyer, price, ground rent, first and second mortgages, interest rate, FHA notation, and mortgagee.

The key punching, programs and printing were generously done for the people by the Rouse Company, the builder of the new city of Columbia, Md.

The Activists then took the material during the summer of 1970, and began a series of publications.

In September of the 1970 the Activists published *Communities Under Siege.* This booklet is a comparison of a white and a black census tract. It documents the difference between the FHA prices in the black neighborhood, and the exorbitant prices charged by the speculators for comparable houses in the same neighborhood. Also, it compares real estate activity in the white and black census tracts. When a real estate company buys a house in a white neighborhood, it sells it at a fair price.

This present study is our second computer based publication. We have a print out of Jefferson's business. Jefferson is not the biggest exploiter bank; Uptown is bigger. But Jefferson is the worst. This study was delayed in publication because we had to go back to the city land records for the houses which were refinanced after their sale. This information was missing from our computer print-out.

During this past December, we made our raw material available to WJZ-TV, the Westinghouse station in Baltimore. Their investigative reporter, Christopher Gaul, made it the basis for his twenty part series on exploitation and the Saving and Loan companies. We have fourteen unconscionable Saving and Loan companies in the city. Most of them are state chartered. Mr. Gaul presented data about eight of them in his excellent report.

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The research on Oldetown was done by Nancy Lawler.

The computer studies have been coordinated by John J. Martinez, S.J. Father Martinez and Reuben Jones are co-chairmen of the Housing Committee of Activists, Inc.

JEFFERSON FEDERAL SAVINGS AND LOAN ASSOCIATION, AUGUST-DECEMBER 1965

Purchaser	Mortgage amount	Percent	Houses	Percent
Goldseker	$323,900	76	33	67
Piccinini	28,300	7	4	8
Becker	8,600	2	2	4
Other investors	24,400	5	4	8
Other (noninvestors)	41,200	10	6	12
Total	426,400	100	49	100

JEFFERSON FEDERAL SAVINGS AND LOAN ASSOCIATION, 1966

Purchaser	Mortgage amount	Percent	Houses	Percent
Goldseker	$176,000	56	21	52
Becker	30,900	10	4	10
Greenebaum	7,100	2	1	3
Other Investors	65,700	22	10	25
Others (Non-Investors)	31,600	10	4	10
Total	311,300	100	40	100

JEFFERSON FEDERAL SAVINGS AND LOAN ASSOCIATION, 1967

Purchaser	Mortgage amount	Percent	Houses	Percent
Goldseker	$528,800	63	62	52
Becker	52,700	6	5	4
Greenebaum	15,500	2	2	2
Other investors	90,900	11	11	9
Others (noninvestors)	32,225	4	5	4
Bought up mortgages from:				
Prudential Savings & Loan	[1] 112,240	13	[2] 33	27
Permanent Building Association of Baltimore city	2,080	0.2	1	0.8
Baltimore Colonial Savings & Loan	4,875	0.6	1	0.8
Total	839,320	100	120	100

[1] $14,300 now released.
[2] Five houses now released.

	Percent of capital	Percent of houses
Investor Oriented Activity	86	71
Bought Up Mortgage Activity	14	29
Total	100	100
Investor Oriented Activity:		
Goldeeker	73	73
Becker	7	6
Greenebaum	2	2
Other investors	13	13
Others (noninvestors)	4	4
Total	1C0	100
Bought Up Mortgage Activity:		
Prudential Savings & Loan	[1] 94	[2] 94
Permanent Building Association of Baltimore City	2	3
Baltimore Colonial Savings & Loan	4	3

[1] Thirteen percent now released.
[2] Fifteen percent now released.

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JEFFERSON FEDERAL SAVINGS AND LOAN ASSOCIATION, 1968

Purchaser	Mortgage amount	Percent	Houses	Percent
Goldseker	$766,050	74	83	75
Becker	24,900	2	3	3
Greenebaum	79,500	8	8	7
Piccinini	8,000	0.	1	0.9
Collins	25,000	2	4	4
Other investors	109,900	11	9	8
Others (Noninvestors)	15,700	2	2	2
Total	1,029,050	100	110	100

JEFFERSON FEDERAL SAVINGS AND LOAN ASSOCIATION, JANUARY-MARCH 1969

Purchaser	Mortgage amount	Percent	Houses	Percent
Goldseker	$138,600	97	15	94
Other investors	3,900	3	1	6
Total	145,200	100	16	100

JEFFERSON FEDERAL SAVINGS AND LOAN ASSOCIATION, AUGUST 1965—MARCH 1969

Purchaser	Mortgage amount	Percent	Houses	Percent
Goldseker	$1,933,350	70	214	64
Becker	117,100	4	14	4
Greensbaum	102,100	4	11	3
Collins	25,000	1	4	1
Piccinini	36,300	1	5	1
Other investors	294,800	11	35	10
Others (Noninvestors)	120,725	4	17	5
Bought up mortgages in 1967	119,195	4	35	10
Total	2,748,570	100	335	100

Communities Under Siege

INTRODUCTION

To promote a better understanding of the activities of real estate companies in the changing neighborhoods of Baltimore City, Activists, Inc. has prepared the following statistical report based on a computer analysis of real estate transactions in the city. The report will show, first of all, that the black homebuyer's housing dollar buys less than the white homebuyer's. Second, the report documents the wide discrepancy between the fair market value of houses and the prices charged by Morris Goldseker's companies. And finally, this report publishes information about the activities of companies in the Park Heights and the Liberty Heights corridors.

The first part of the report concerns the activities of real estate companies and compares a neighborhood that changed from white to black during the sixties (census tract[1] 16–08 in the northern half of Edmondson Village) with a neighborhood of similar housing that remained essentially stable during this period (census tract 26–03 along lower Bel Air Road).

The second part of the report looks at the activities of the FHA[2] in census tract 16–08 and compares the selling prices of houses with FHA insured mortgages with the selling prices of houses sold by the Goldseker companies.

Although these two parts of the report focus on a part of Edmondson Village, the information about the Liberty Heights and Park Heights corridors indicates that similar things can be said about these areas, indeed about every area in the city where the population has changed from white to black.

[1] The census tracts referred to in this report were assigned in 1960. There were 173 such tracts in the city in 1960.

[2] The Federal Housing Administration encourages home ownership by insuring mortgages for homebuyers. In each case it must approve the purchase price. Insuring by the Veterans' Administration is also included in this total.

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SEPTEMBER 1970.

Comparison of 16–08 and 26–03

Tract 16–08 is the northern half of Edmondson Village. It is above Edmondson Avenue to the west of the Hilton Street bridge. It changed from white to black between 1960 and 1968.

Tract 26–03 is located in the northeastern section of Baltimore. Like 16–08 it is a predominantly residential area, with housing not quite as old as that in 16–08. 26–03 has remained white.

Table 1 presents the racial characteristics of each census tract.

TABLE 1.—RACIAL CHARACTERISTICS OF TRACTS 16-08 AND 26-03, BALTIMORE CITY, 1960 AND 1968

	16-08				26-03			
	1960		1968		1960		1968	
	N	Percent	N	Percent	N	Percent	N	Percent
Total population	8,817	100.0	12,000	100.0	17,511	100.0	15,600	100.0
White	8,708	98.7	500	4.1	17,490	99.8	15,500	99.3
Black	96	1.0	11,500	95.8	2	.0	100	.6
Other	13	.1			19	.1		

Sources: U.S. Census, 1960. Baltimore City Department of Planning, 1968 Population Estimates, White and Nonwhite by Census Tract, February 1970.

Table 2 presents various comparative measures of housing in the two census tracts.

Housing in 16–08 is somewhat older than 26–03, although the 1960 value of both is approximately the same.

The average selling price of houses with FHA mortgages in the 1960's indicates the fair market value in each tract; and shows further that the value is similar in each tract.

The assessed values (for tax purposes) are another indication of the value of houses in the two tracts.

TABLE 2.—YEAR BUILT, CONDITION, AND VALUE MEASURES, CENSUS TRACTS 16-08 AND 26-03, BALTIMORE CITY

	Tract 16-08		Tract 26-03	
	Number	Percent	Number	Percent
Total housing units	2,883	100.0	5,443	100.0
Year built:				
1950 through 1960	546	18.9	2,493	45.8
1940 through 1949	907	31.4	1,573	28.8
1939 or earlier	1,430	49.6	1,377	25.2
Condition:				
Sound	2,708	93.9	5,380	98.8
Deteriorating	174	6.0	60	1.1
Dilapidated	1		3	
Census 1960: Median value	$8,700		$8,900	
Average FHA sale price	9,357		9,424	
Adjusted average assessed value [1]	9,582		10,147	

Source: U.S. census, 1960; Lusk Reports, 1960–68; Baltimore City real estate tax assessments, 1969.

[1] This is a 5-percent sample. I tincludes land and house. It is ⅔ the adjusted average.

Corporations buying and selling in 16–08 and 26–03

Although the value of houses in 16–08 and 26–03 is approximately the same, the history of investor housing sales in the two tracts is very dissimilar.

In tract 16–08 there was large traffic in housing by real estate companies controlled by a small band of individuals. The average cost of these houses to the investors was below all the norms presented for fair value. And these houses were then sold well above the norms for fair market value.

Table 3 presents the data on houses bought and sold by Maryland Corporations. Some of these purchases were by financial institutions. These purchases were foreclosures which were then sold at approximately fair market value. Other purchases were by real estate companies.

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TABLE 3.—HOUSING TRANSFERS INVOLVING CORPORATIONS [1]—TRACT 16-08, 1960-68, TRACT 26-03, 1965-68

	16-08	26-03
Total transactions [2]	391	22
Total cost to companies	$2,901,179.00	$162,200.00
Average cost to companies	$7,419.90	$7,373.00
Total sale price by companies [3]	$4,464,761.00	$204,250.00
Average sale price by companies [3]	$11,418.83	$9,284.00
Average markup	[4] $3,979.11	[5] $1,911.00
Average length held	[6] 5.8	[6] 5
Average sale price of FHA insured houses	$9,357.00	$9,424.00

[1] Includes only houses bought by Maryland corporations and sold to private individuals within 18 months.
[2] For 16-08 between January of 1960 and December of 1968.
For 26-03 between January of 1965 and December of 1968.
[3] Excludes increased or newly created ground rents.
[4] 53.6 percent.
[5] 25.9 percent.
[6] Months.

Real Estate Companies Buying and Selling in 16-08 and 26-03

In 26-03, 15 of the 22 bought/sold records involve real estate companies. But 26-03 was a white neighborhood and the whites bought these 15 houses at fair market price from the real estate companies. This shows dramatically that the dollar in the hands of the white man buys more than the dollar in the hands of the black man.

Table 4 will compare the largest speculator in 16—08 with the real estate companies in 26-03. M. Goldseker had 144 transactions (out of the 391) in 16-08.

TABLE 4.—Housing Transfers Involving Goldseker Companies in 16-08 and all Real Estate Companies in 26-03

	16-08	26-03
Total transactions	144	15
Total cost to companies	$1,054,024	$104,100
Average cost to companies	$7,320	$6,940
Total sale price by companies	$1,783,719	$139,875
Average sale price by companies	$12,387	$9,325
Average markup	[1] $5,067	[2] $2,385
Ground rent creations or increases [3]	86	3
Capital value of new ground rents	$118,000	$3,533
Average capital sale price by companies	$13,206	$9,561
Average total capital markup	[4] $5,886	[5] $2,621
Average sale price of FHA insured homes	$9,357	$9,424

[1] 69 percent.
[2] 34 percent.
[3] In 26-03, one rent went up $26 and one rent went down $6. Two rents were created.
[4] 80 percent.
[5] 38 percent.

A closer analysis of FHA houses and Goldseker houses in 16-08

In 16-08 there were 260 houses sold with FHA mortgages. None of these were bought or sold by Goldseker companies. 144 other houses were bought and sold by Goldseker within the 18 month control period. Table 5 will present the yearly FHA average together with the average yearly purchase and sale prices of Goldseker company houses.

There is little variation from year to year in the averages. If Goldseker buys 2 houses in 1960, then the sale price has been put with them in the table in the 1960 column, even if one of them is sold in 1961. The *increase* in ground rents has been averaged in. Variations in price due to the *presence* or *absence* of ground rents in FHA or in Goldseker purchases is not averaged in. For the record, 70 of 260 FHA in fee; 78 of 144 in fee.

Note on FHA data

The Lusk Report is a service which provides data on house transfers. We have used the Lusk Reports. But a difficulty is that FHA was not noted in the report for 1960, 1961, and 1962. The local FHA office has no data for these years. But we believe there was little financing for black families before 1963.

Here are some indications of that fact. Some banks cooperate with the speculators. Some do not. Some banks which are not involved with the speculators and which dealt with FHA at fair market price in 1963 are Vermont, Rouse, Weaver,

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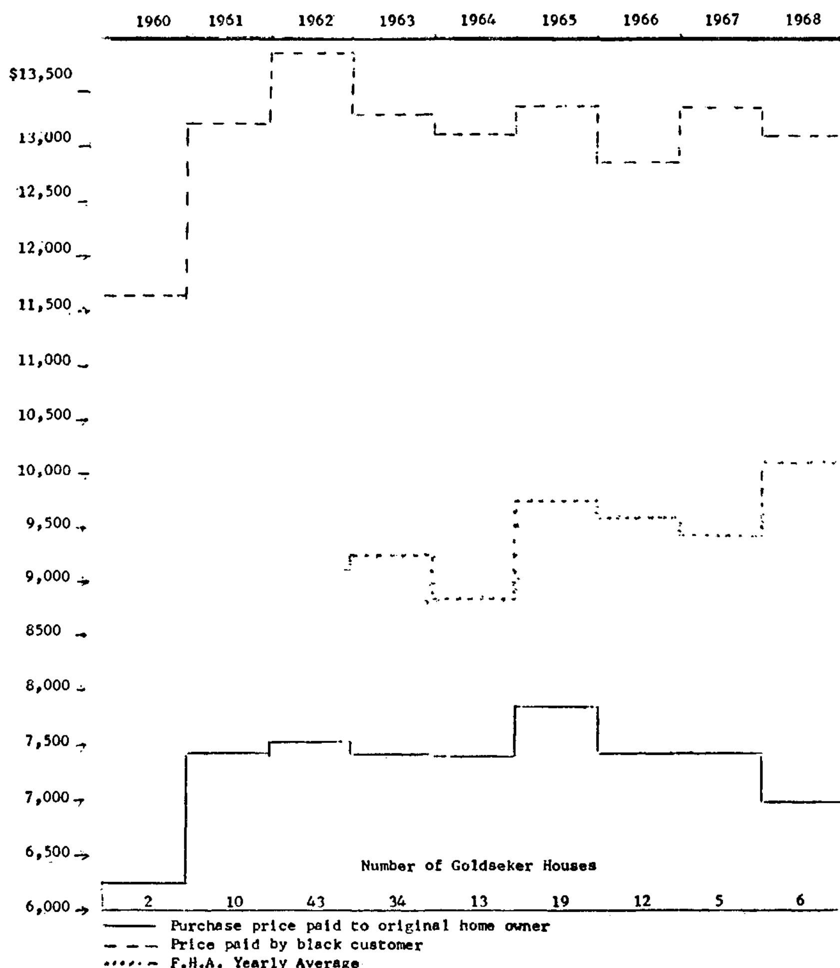
and Provident. But they had much less business in 1962 in tract 16–08 even though 423 houses changed hands in 1962 while 591 changed hands in 1963. So we would expect them to have almost as much in 1962, if FHA had been insuring.

For example, Rouse had 7 FHA houses in 1963 in 16–08 but only 2 houses (FHA not noted in Lusk) in 1962. In 1963 Weaver had 8 houses (6 through FHA) while in 1962 it financed only 3 houses. Vermont had 5 FHA in 1963, and financed 4 houses in 1962. Provident had 14 houses (6 by FHA) in 1963, but handled only 8 in 1962. There are four houses that Lusk happened to mark as FHA in 1962 which are used in the next two tables. This note is an indication that Table 6 is substantially accurate in the early sixties.

Table 6 will bring out an important relation between FHA and Goldseker. FHA stopped discriminating against black people in 1962 as a result of Executive Order No. 11062. The table is self-explanatory. The presence of FHA financing cut into Goldseker's market and saved many families from exploitation. The

TABLE 5: Yearly Record of F.H.A. Transactions in 1608
Yearly Average Buying and Selling Prices by Goldseker Related Companies in 1608 during the Period of 1960 1968*



* The increase in ground rent is included in the mark up. The Goldseker houses which are being studied are the 144 each of which was bought and sold within an 18 month period.

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graph represents all Goldseker purchases in 16–08; namely, 351 houses. The graph of the 144 would have the same shape (see bottom of Table 5).

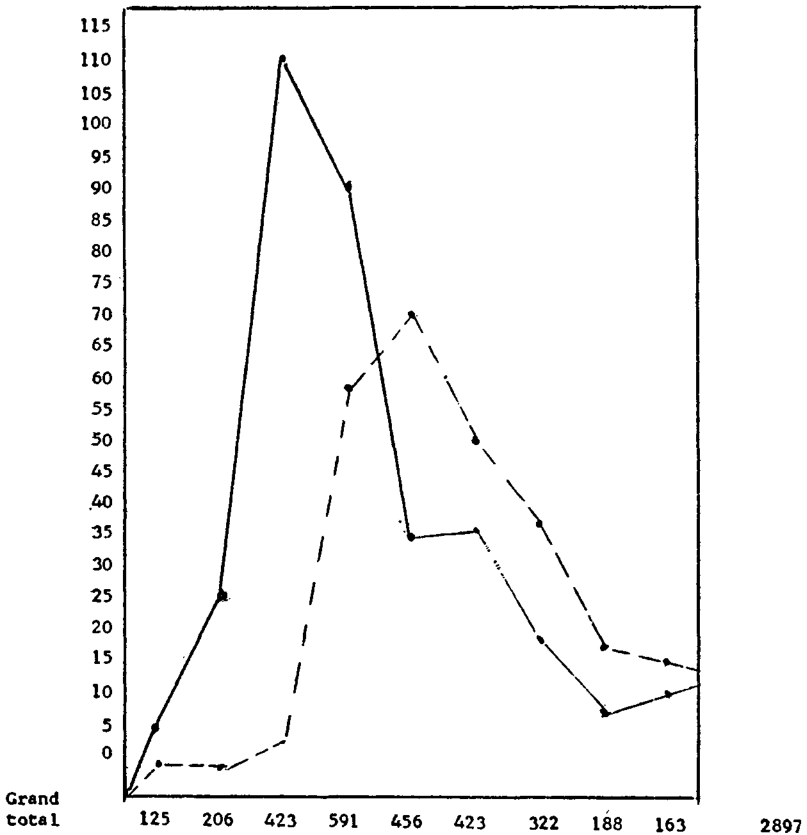
The graphs show that all Goldseker customers are treated the same. Table 6 proves that all Goldseker customers, in 1962, had to buy high. At least some must have had the credit rating of FHA customers in 1964. The way his business collapsed in 1964 indicates he is serving ordinary FHA customers.

There are three houses among the 144 Goldseker houses which were bought and sold twice. So we are speaking of 141 houses. Among the 144 families there had been seven foreclosures by December 31, 1968. Among the 260 FHA in 16–08 there were six foreclosures.

TABLE 6

YEARLY PURCHASE RECORD OF GOLDSEKER RELATED COMPANIES COMPARED WITH YEARLY PURCHASE RECORD OF HOUSES RECEIVING FHA LOANS*

Number of Purchases 1960 1961 1962 1963 1964 1965 1966 1967 1968



Code: —— Goldseker related companies purchases
– – – FHA finance homes

*Executive Order 11062 in 1962 instructed FHA to require non-discrimination pledges from loan applicants. As FHA loans became available to Negroes, Goldseker purchases decreased. (Grand total refers to total yearly house purchases in the area: FHA financed plus Goldseker related companies plus all others.)

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GOLDSEKER—CENSUS TRACT 16-08

Address	Date Bought	Date Sold	Company	Ground rent	Purchase price	Sale price
Augusta Ave., N.:						
616	June 1966	June 1966	Lee Realty	96	$8,050	$12,950
618	October 1965	February 1966	do	96	8,050	12,950
621	September 1966	September 1966	do	96	8,800	12,950
639	June 1964	June 1965	do	(90)90	7,200	12,950
641	November 1964	August 1965	Eagle Corp	96	8,700	12,950
643	October 1964	May 1965	do	(96)96	9,490	12,950
643	August 1966	August 1966	Lee Realty	(96)96	9,490	12,950
720	September 1965	January 1966	Eagle Corp	96	8,800	12,950
805	June 1964	December 1965	do	96	8,100	12,950
815	August 1963	November 1964	Best Realty	90	7,000	13,000
821	March 1968	June 1968	Lee Realty	(90)90	8,500	13,950
837	March 1963	September 1963	Eagle Corp	96	8,500	13,000
1007	July 1966	September 1966	Lee Realty	(90)90	6,800	11,950
1012	August 1964	April 1965	Eagle Corp	96	7,750	11,950
1114	October 1962	December 1962	Woodhaven Investment Co	(90)90	7,000	12,500
1212	August 1963	January 1965	D & E Realty	90	6,000	12,950
Allendale St., N.:						
607	February 1963	June 1964	Eagle Corp	96	7,500	12,000
704	June 1962	October 1962	do	96	8,500	12,000
714	November 1964	August 1965	Lee Realty, Inc	(85)96	6,250	11,950
804	December 1965	July 1966	Eagle Corp	96	8,700	12,000
810	June 1965	September 1965	do		8,650	11,950
824	February 1963	December 1963	do	96	8,500	13,000
836	May 1965	October 1965	do	96	8,500	13,000
842	January 1963	August 1963	Safety Realty Corp	(90)90	7,500	13,000
842	December 1965	May 1966	do	(90)90	9,588	12,950
903	October 1962	July 1963	D & E, Inc	(90)90	7,000	13,000
911	November 1963	October 1964	Woodhaven Investment Co	(90)90	6,000	11,950
919	July 1962	December 1962	Dean, Inc	(90)90	7,000	13,000
Colborne Rd., W.:						
3703	September 1968	September 1968	U & I, Inc	(75)96	5,000	12,300
3709	February 1963	January 1964	Eagle Corp	96	8,000	12,000
3802	August 1966	August 1966	Lee Realty, Inc	(84)96	6,800	11,950
3817	June 1968	June 1968	Mosher Investment Co	(96)96	7,280	11,950
4000	October 1962	October 1963	Eagle Corp	96	7,500	12,000
Cranston Ave.:						
3703	October 1965	March 1967	do	96	8,000	11,950
3712	August 1965	November 1966	do	96	8,000	12,000
3806	November 1962	August 1963	do	96	7,000	12,000
3812	do	May 1963	do	96	7,500	12,000
3907	July 1962	August 1963	do	96	7,500	13,000
4002	May 1963	September 1963	do	96	7,500	11,500
4003	October 1965	December 1965	do	96	7,900	11,950
4018	August 1962	February 1963	do	96	8,000	12,000
4021	October 1962	September 1963	Birch Realty	(84)96	7,000	12,500
4024	March 1966	April 1966	Eagle Corp	96	7,800	11,950
Denison St.:						
607	May 1962	November 1962	Caton, Inc	(66)96	5,500	12,000
629	April 1960	January 1961	Luke, Inc	(75)96	6,000	11,000
740	November 1962	March 1963	Mel, Inc	(96)96	3,200	11,000
Edgewood St.:						
608	May 1962	February 1963	Lee Realty, Inc	(90)90	5,100	12,000
625	March 1962	April 1963	Eagle Corp	96	7,000	12,000
701	September 1961	March 1962	Woodhaven Investment Co	(90)90	5,500	12,000
703	October 1961	January 1962	Eagle Corp	96	7,500	12,000
719	November 1961	May 1962	Arbor, Inc	(80)80	11,000	12,000
728	November 1962	December 1963	L & A Corp	(80)96	6,000	12,000
765	May 1962	October 1963	Eagle Corp	96	7,500	12,000
765	June 1968	June 1968	U & I, Inc	(96)96	6,850	11,950
769	June 1965	April 1966	Eagle Corp	96	7,750	11,950
Edmondson Ave.:						
3422	September 1961	September 1961	do	96	7,000	12,000
3428	September 1962	January 1963	do	96	7,000	12,500
Flowerton Rd.:						
3806	July 1963	May 1964	do	96	7,500	12,000
3809	November 1965	February 1966	Lee Realty, Inc	96	7,800	11,950
3902	May 1963	November 1963	Try, Inc	(90)90	7,000	13,000
3904	April 1967	April 1967	Kenneth Co., Inc	(90)90	5,000	12,950
Gelston Dr.:						
3513	July 1962	April 1963	Poplar Grove R.E	(75)96	7,000	12,000
3601	do	January 1963	N & O, Inc	(90)90	6,500	12,000
3643	October 1961	February 1962	Arbor, Inc	(85)85	7,000	13,000
3655	do	January 1963	do	(90)90	6,500	13,000
3710	May 1963	May 1964	Eagle Corp	96	7,500	12,000
3922	October 1963	December 1964	The Lynn Corp	(75)96	5,500	11,950
3924	September 1962	November 1963	Luke, Inc	(75)96	6,000	12,000
4028	December 1963	May 1964	Eagle Corp	96	7,000	11,950

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GOLDSEKER—CENSUS TRACT 16-08—Continued

Address	Date		Company	Ground rent	Purchase price	Sale price
	Bought	Sold				
Grantly St.:						
604	August 1961	March 1962	Caton, Inc	(90)90	$7,000	$13,000
607	February 1962	December 1962	Eagle Corp	96	7,500	12,000
615	November 1961	September 1962	do	96	8,000	12,000
704	June 1962	March 1963	do	96	7,500	12,000
721	April 1962	July 1962	Poplar Grove R.E.	(90)90	5,500	13,000
742	July 1962	April 1963	Knickerbocker Inv	(85)96	6,000	12,000
754	do	August 1963	Eagle Corp	96	8,500	12,000
755	September 1962	March 1963	do	96	7,000	12,000
789	December 1964	December 1964	Lee Realty, Inc	(96)96	4,700	12,000
Linnard St.:						
606	August 1962	November 1963	Eagle Corp	96	7,000	12,000
608	do	do	do	96	7,000	12,000
629	June 1962	November 1962	D & E, Inc	(90)90	5,500	12,000
705	October 1961	October 1962	Fairfax Inv. Corp	(90)90	7,000	13,000
714	August 1962	November 1962	Eagle Corp	96	8,000	12,000
760	October 1962	November 1963	do	96	6,500	12,000
766	August 1962	December 1962	do	96	7,000	12,000
770	July 1962	March 1963	do	96	7,500	12,000
776	September 1961	November 1961	do	96	7,500	12,000
779	August 1962	November 1963	U & I, Inc	(75)96	6,500	12,000
785	April 1964	May 1965	Normal Realty Corp	(96)96	5,200	11,950
796	October 1963	August 1964	Eagle Corp	96	7,000	12,000
Lyndhurst St.:						
723	April 1964	May 1965	do	96	8,000	12,950
725	July 1964	June 1965	do	96	8,500	12,950
805	August 1965	August 1965	Lee Realty, Inc	(90)90	7,100	13,000
809	July 1963	April 1964	Eagle Corp	96	8,000	12,000
819	September 1965	October 1965	do	96	8,700	12,950
830	March 1963	June 1964	do	96	8,500	12,490
831	November 1962	July 1963	Best Realty, Inc	(90)90	7,000	13,000
840	July 1963	May 1964	Deen, Inc	(90)90	7,500	13,000
905	July 1964	April 1965	Lee Realty, Inc	(90)90	6,500	11,950
906	February 1967	February 1967	U & I, Inc	(96)96	4,500	10,200
1017	July 1964	May 1965	Eagle Corp	96	8,400	11,900
1111	May 1966	July 1966	Lee Realty, Inc	(96)96	6,470	11,950
Mt. Holly St.:						
625	November 1962	August 1963	Eagle Corp	96	7,500	12,000
701	September 1962	July 1963	do	96	8,000	13,000
715	July 1964	April 1965	Lee Realty, Inc	(90)90	6,650	12,950
813	July 1963	November 1964	Luke, Inc	(96)96	6,500	13,000
814	January 1963	December 1963	Best Realty, Inc	(90)90	7,000	13,000
817	March 1963	September 1963	Eagle Corp	96	9,500	13,500
911	May 1962	January 1963	do	96	8,000	13,000
913	October 1963	November 1963	do	96	8,000	10,000
1006	June 1968	July 1968	Ovid Realty, Inc	96	5,000	11,950
1007	March 1963	August 1964	Eagle Corp	96	9,000	12,500
1017	September 1963	January 1965	do	96	8,500	12,950
Mountwood Rd.: 4112	March 1966	June 1966	Lee Realty, Inc	(96)96	6,600	11,950
Rokeby Rd.:						
3810	October 1965	October 1965	do	(90)90	6,800	11,950
3811	November 1965	April 1966	do	(90)90	6,500	11,950
4107	August 1966	September 1967	do	(90)90	5,700	11,950
Wicklow Rd.:						
620	June 1966	September 1966	do	(96)96	8,430	12,950
624	July 1967	June 1968	do		9,500	14,550
626	September 1967	do	do		9,000	14,550
Wildwood Pkwy.:						
622	October 1962	December 1963	Eagle Corp	96	9,000	13,000
636	September 1967	June 1968	Lee Realty, Inc		9,000	14,550
701	April 1963	December 1963	Eagle Corp	96	8,500	13,000
821	January 1963	May 1964	Mel, Inc	(96)96	7,500	13,000
903	January 1966	June 1966	Lee Realty, Inc	(96)96	7,000	12,979
909	September 1965	September 1965	Eagle Corp	96	8,500	12,950
914	June 1965	do	Lee Realty, Inc	(96)96	6,730	12,950
921	March 1963	October 1963	Normal Realty Corp	(96)96	7,500	13,000
1005	October 1962	August 1963	Eagle Corp	96	8,500	13,000
1007	September 1962	May 1963	Birch Realty	(96)96	8,000	13,000
1009	February 1966	June 1966	Lee Realty, Inc	(96)96	7,000	12,950
1019	March 1963	October 1963	Normal Realty Corp	(96)96	7,500	13,000
1204	September 1965	January 1966	Lee Realty, Inc	(96)96	7,346	12,950
Woodington Rd., N.:						
802	March 1968	March 1968	do		9,300	14,550
Woodridge Ave.:						
3700	October 1962	December 1963	Eagle Corp	96	8,000	12,000
3807	January 1963	April 1963	Safety Realty Corp	(75)96	6,500	10,000
3813	February 1963	January 1964	Eagle Corp	96	7,500	12,000
3818	January 1963	August 1963	do	96	8,000	12,000
3911	April 1965	April 1966	Lee Realty, Inc	(90)90	6,000	11,950
3925	June 1963	December 1964	Eagle Realty Corp	(75)96	6,500	12,000
4101	March 1963	November 1963	Arbor, Inc		5,500	11,000

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ALL COMPANY SALES WITHIN 18 MONTHS OF PURCHASE, LIBERTY CORRIDOR, 1960-68

	Census tracts				
	15-08—Below Liberty Heights Ave. to Clifton Ave. between Denison and Chelsea	15-09—Beyond Chelsea and south of Forest Park Ave.	15-10—Mostly north of Liberty Heights above 15-08 and beyond Ayrdale Ave.	15-11—North of Liberty Heights Ave. just east of 15-10 and west of railroad tracts	28-01—North of Liberty Heights Ave and out to the country beyond 15-0
Total transactions within 18 months	51	92	116	89	71
Total purchase price for companies	$427,700	$656,847	$862,725	$820,290	$522,915
Average purchase price for companies	$8,386	$7,140	$7,437	$9,216	$7,365
Average length held (months)	2.8	5.3	5.2	4.5	4.13
Total selling price to individual	$619,915	$1,026,170	$1,335,140	$1,082,040	$789,950
Average selling price to individual	$12,147	$11,154	$11,510	$12,158	$11,126
Difference between average purchase and selling price	$3,761	$4,014	$4,073	$2,942	$3,761
Percent markup	45	56	55	32	51

Note: These data on the Liberty Heights section of west Baltimore do not take into account the separation of ground from house. The creation or raising of ground rent is very common. For example, Goldseker creates a ground rent with about half his sales. Other times he raises it. This would increase the exploitative markup.

CENSUS TRACT 15-13[1] IN PARK HEIGHTS

	All companies	Goldseker
Total transactions within 18 months	72	21
Total purchase price for companies	$459,100.00	$133,200.00
Average purchase price for companies	$6,376.39	$6,345.00
Average length held (months)	6.24	6.84
Total selling price to individual	$716,710.00	$243,030.00
Average selling price to individual	$9,954.31	$11,572.00
Difference between average purchase and selling price	$3,577.92	$5,227.00
FHA average (number of transactions, 64)	$8,564.21	$8,564.21
Percent markup [2]	56.11	82

[1] 15-13 boundaries:
Shirley=S.
Cold Spring=N.
Greenspring=E.
Railroad=W.

[2] Does not include profits made by the separation of ground.

CENSUS TRACE 15-12 [1] IN PARK HEIGHTS

	All companies	Goldseker
Total transactions within 18 months	94	38
Total purchase price for companies	$595,380.00	$254,230.00
Average purchase price for companies	$6,333.82	$6,690.53
Average length held (months)	6.82	7.82
Total selling price to individual	$999,595.00	$455,305.00
Average selling price to individual	$10,633.56	$11,981.71
Difference between average purchase and selling price	$4,300.00	$5,291.18
FHA average (number of transactions, 77)	$8,400.71	$8,400.71
Percent markup [2]	67.89	75.69

[1] 15-12 boundaries:
Park Circle=S.
Shirley=N.
Greenspring=E.
Sequoia and railroad=W.

[2] Does not include profits made by the separation of ground.

CONCLUSION

The housing statistics in this report have been subject to many restrictions: the numerous speculators buying and selling in their own names are not included among the speculating companies; only those houses bought and sold within eighteen months are considered; thirteen more census tracts with a greater

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than 30% increase in percentage of non-white population between 1960 and 1967 are also not included. When high rents, subdividing of dwellings and the building of more apartments in already crowded neigborhoods are also considered, this report indicates only the tip of a great iceberg of problems paralyzing the black family's fight for decent housing in this city.

No statistics, however, can ever document the strains which the real estate and financial industries of the city created in the neighborhoods mentioned in this report. Hidden behind these statistics are parents who have to work two and three jobs together to pay the housing bills, children who must suffer from the absence of their parents and in overcrowded schools, deteriorating properties which cannot be improved because the necessary money is already sunk into the over-priced market.

Nor will any statistics solve the problem. Only the people themselves are capable of wresting from the real estate industry the control over their own neighborhoods. It is to this end that this report is published.

(Printed below is a reply to certain aspects of the Activists, Inc. study submitted for the record by Thomas J. Kenney of Baltimore, Md.)

BURKE, GERBER & WILEN,
Baltimore, Md., April 27, 1971.

Hon. WRIGHT PATMAN,
Chairman, House Banking and Currency Committee,
House of Representatives,
Washington, D.C.

DEAR CHAIRMAN PATMAN: We represent M. Goldseker Real Estate Company, an organization which has been in the real estate business in Baltimore, Maryland, for over forty years.

The Baltimore "Morning Sun" this morning contained a report of a hearing of the House Banking and Currency Committee at which charges were made by a group know as Activists, Inc., against Jefferson Federal Savings & Loan Association, and our client.

We have only the newspaper report of the hearing and are not aware of the full content of the hearing of the House Banking and Currency Committee. We do not have the full details of the charges made at the hearing by Activists, Inc. However, for more than two years, Activists, Inc. has been involved in a massive unjust and unfounded campaign against our client. Activists, Inc. has complained about our client to many different Federal and State agencies and has submitted several reports to the news media.

We would greatly appreciate immediately receiving a full transcript of the hearing, if one is available or if one can be made available. If there is any charge for such a transcript, we will be happy to remit such charge.

We believe that the Committee has been presented with only a part of the relevant facts and that, as a result, your Committee has been given a distorted picture. Therefore, on behalf of our client, we request an opportunity to appear before your Committee to present the full story, to submit documentary evidence and to answer any questions.

According to the newspaper article, Activists, Inc. has made the same allegation before your Committee that it has made many times in the past before other groups. The basic allegation which Activists, Inc. has leveled at our client and those savings and loan associations which grant mortgages to customers who purchase houses from our client, is that our client charges "inflated prices" and, therefore, makes "exorbitant profits". Activists, Inc. then immediately jumps to the conclusion that any savings and loan association which grants mortgages to customers who purchase from our client, is "conspiring" with our client. While the Activists, Inc. "computer study" has not been made available to us, we understand from newspaper accounts that the "study" contains the allegation that our client purchases houses at approximate average cost of $7,000.00 and then sells the houses for an approximate average price of $13,000.00. Activists, Inc. then contends that the difference represents a profit of 85% which is exorbitant and exploitative. The study apparently attempts to create the impression that our clien receives cash in full immediately upon sale which, in fact, is not the case. The study completely omits any reference to any of the other costs of our client except the base price paid for a house by our client. Because legitimate costs,

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including direct and overhead expenses, are omitted from the study, the profit figure claimed is grossly inaccurate. Further, since our client waits an average of twelve years to obtain the return of his investment and realize any profit in a transaction, our client assumes a very substantial risk and also incurs very great costs of collection and recording and accounting for periodic payments.

The costs incurred by our client that Activists, Inc.'s report deliberately omits include the following (*all certified figures*):

1. The most significant cost to our client, and the one which is of the greatest benefit to purchasers of homes from our client is the average amount of $1,500.00 which our client spends in improving each home it sells. Even the news media seems to recognize that the homes sold by our client are in excellent condition at the time of sale. Our client does all its own remodeling, improvements and decorating and is able to effect savings by quantity purchases of the material and equipment used in improving the houses. Our client includes no profit in determining the average amount spent to improve each home sold. Since the improvements are made by our client at cost, it would probably cost a homeowner double if the homeowner hired someone to do the same work.

2. Settlement expenses and costs of purchasing which vary from house to house but are generally in excess of $300.00.

3. Costs of sale including advertising and saleman's commissions.

4. Costs of vacancy until remodeled and sold which includes insurance, taxes, interest and ground rent.

5. Costs of comebacks when homes have to again be remodeled or refurbished.

6. *Costs of a full year's guarantee which Goldseker provides on the repairs to all homes.*

7. Costs of waiting an average of twelve years for the return of investment or realization of profit. These costs include overhead costs—to name only a few—cashiers, clerk typists, switchboard operators, supervisory personnel, computers, bookkeeping machines, typewriters, postage, stationery, telephone bills, lighting bills and office rent.

The above costs must be considered before making any determination as to whether or not the prices charged by our client are "inflated" or whether the profits our client realizes are "exorbitant." The computer deliberately was not fed all of the relevant facts. Therefore, all the computer punched out was a gross profit picture which has not real relevance. The computer could not, and did not, punch out the really relevant figure of adjusted net profit since the hand, or hands, operating the computer refused to feed the computer all the data it needed.

In order to show the importance of considering all the costs before determining whether "exorbitant" profits are made, we enclose a copy of a letter written on November 18, 1969, by Professor William Grigsby of the Institute for Environmental Studies of the University of Pennsylvania to Mr. Neil Curran of the Department of Planning City of Baltimore. Professor Grigsby is a recognized expert on the inner city housing problem and has been doing work for the Office of Economic Opportunity. Our client did not know of Professor Grigsby in 1969 and Professor Grigsby has had no relationship with our client. We understand that Mr. Curran had submitted to Professor Grigsby an Activists, Inc. study. Professor Grigsby's letter came to our attention only within the past few months when it was publicly distributed in connection with a meeting of a subcommittee of the Citizens' Planning and Housing Association of Baltimore. We will not comment on the letter. It speaks for itself.

In addition, J. K. Lasser & Company, an international firm of certified public accountants, reviewed all of the figures with regard to sixty-eight properties involved in litigation filed against our client by two groups closely allied with Activists, Inc. and by sixty-eight individual plaintiffs. These sixty-eight sales were chosen by the antogonists of our client and not by our client. J. K. Lasser & Company reviewed and considered all of the costs set out above, but ignored by Activists, Inc. in their study, and determined that the average Gross Future Possible Profit of our client on the sixty-eight houses (without considering costs of servicing for 12 years) would be 24.95%. The accountants further found that the average Net Future Possible Profit, after deducting costs of servicing and after adding estimated net interest income, would be 18.17%. We enclose the cover sheet prepared by J. K. Lasser submitting its reports on the sixty-eight properties. We would be happy to submit to you, if you desire, the accountants' figures on each of the sixty-eight properties.

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We believe that when all the facts are considered and not just the limited facts included in the Activists, Inc. study, it is demonstrated that the prices charged by our client are not "inflated" and our client does not realize "exorbitant" profits. Of course, all of the savings and loan associations who have granted mortgages to customers of our client are aware of all the costs in each transaction and are aware of the actual condition of each individual house sold by our client on which the association grants a mortgage. Independent appraisers appointed by each savings and loan association examine each house after the improvements are made and they arrive at the appraised value. In the case of any federal savings and loan association, any appraiser was selected and made appraisals under the laws and regulations of the Federal Home Loan Bank Board.

According to past reports in the news media, Activists, Inc. claim that savings and loan associations, who grant mortgages to customers of our client, are taking undue risk with money placed in the savings and loan association by depositors. Our client has been in business in Baltimore for 40 years and in that period of time not one of the approximately 100 building and loan associations and one dozen banks, who have done business with our client, has suffered a loss when it granted a mortgage to any customer of our client. Each savings and loan association in Baltimore is aware of this unblemished record of our client. We feel certain that the entire financial community in Baltimore recognizes that our client is one of the best credit risks in the City of Baltimore, and this fact accounts for the large number of lending institutions who have done business with our client and customers of our client. We believe that those lending institutions who have granted mortgages to our client's customers have been true to the tradition of encouraging thrift and home ownership by a group that desperately needed to have homes and credit made available to them. Most members of the group had no downpayment or money available for settlement expenses and were, therefore, unable to obtain conventional or FHA financing. Further, for a long period of time, the FHA would not insure mortgages in changing neighborhoods.

It is tragically true, as set out in the letter of Professor Grisby enclosed, that sufficient homes and sufficient credit are not being made available to the increasing number of black persons in inner city areas all over our country who desire to purchase homes. The public sector of our economy must do more to make homes and credit available to poor families whether they be black or white.

Until such time as the public sector of the economy can solve the entire problem of housing for the poor through subsidation and other vigorous programs, the private sector of our economy must do what it can to meet the needs. This is exactly what our client has done. This is exactly what has been done by those savings and loan associations who have granted mortgages to customers of our client.

Further, we would like to point out that our client is an investor and not a speculator. Our client invests its money in selling houses in the inner city to persons who are unable to obtain credit elsewhere. Our client waits many years to retrieve its investment and to realize reasonable profits. The fact that our client has been able to make a profit in this difficult business is due in large part to the integrity, efficiency and dedication which is an intergal part of the operation of our client's business.

We note in the newspaper report of the hearing that Mr. Sampson Green testified that Martin Weinberg, an employee of M. Goldseker Real Estate Company, is a member of the Board of Directors of Jefferson Federal Savings & Loan Association. Complete disclosure was made to the Federal Home Loan Bank Board by Jefferson Federal Savings & Loan Association at the time they considered adding Mr. Weinberg to their Board of Directors in November of 1967. The Federal Home Loan Bank Board, after receiving the disclosure, made no objection to Mr. Weinberg's serving on the Board of Directors of Jefferson Federal Savings & Loan Association. We attach hereto a copy of a letter dated November 10, 1967, from Thomas F. Carney, Executive Vice President of Jefferson Federal Savings & Loan Association to Mr. Robert T. Waugh, Supervisory Agent, Federal Home Loan Bank of Greensboro. We also enclose a copy of a letter dated November 20, 1967, from Robert T. Waugh to Thomas F. Carney. Mr. Weinberg is only an employee of M. Goldseker Real Estate Company and is not a director or stockholder in any of the Goldseker corporations and has no

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financial interest in the Goldseker business. Mr. Weinberg has no participated in any deliberation of the Board of Jefferson Federal Savings & Loan Association with regard to loans made to Goldseker or any customer of Goldseker.

We reiterate our request that we be allowed to appear before your Committee to present the full story, to submit documentary evidence and to answer any questions. We are prepared to come to Washington to appear at your convenience.

Respectfully yours,

THOMAS J. KENNEY.

UNIVERSITY OF PENNSYLVANIA,
Philadelphia, Pa., November 18, 1969.

Re the Edmondson Village study, the gross mark-up figures strike me as quite misleading. They are evidently intended to suggest that the dealer's costs are insignificant, which is not the case.

Mr. NEIL CURRAN,
Department of Planning, City of Baltimore,
American Building, Baltimore, Md.

DEAR NEIL: Assume a $6,000—house that is held for four months and then transferred to the ultimate owner, using either a 100% mortgage or a first and second mortgage totalling 100% (but not a land installment contract. Let me introduce this complication later.) What costs and mark-ups are involved. The following seem minimal.

Acquisition price	$6,000
Closing costs at time of purchase (guest based on Pennsylvania laws)	300
Prepare house for sale (absolute minimum if house is in good condition)	600
Time and overhead of person who buys, repairs, resales (Brokers who only sell claim they need at least $500-a house)	
Taxes for 4 months	60
Insurance for 4 months	20
Bank loan, 4 months, 7.5 percent, for acquisition price plus upgrading	170
Closing costs (here the seller would pay all; buyer has no cash)	600
Subtotal	8,450
Cost of 100 percent financing, at least 15 percent to cover extra risk	1,265
Total	9,615
Mark-up 5 percent (covers normal risks of vandalism, drop in the market, etc.)	425
Total	10,040

These figures indicate a *minimum* gross mark-up of about two-thirds is not unreasonable. However, when I asked an inner-city investor in Philadelphia if he would be interested in such a proposition, he answered strongly in the negative. First of all, the returns don't cover his perceived risks. Second, unless he could get 100% bank financing, he would tie up his money both during and between deals at lower rates than he can earn elsewhere (incidentally, bank rates today are considerably above the 7.5% figure used in the example). Assuming, therefore, that there is some upper limit in the price which consumers will pay, and that in our case the limit is around $10,000, then the only attraction to the Philadelphia investor would be a bargain acquisition price, say $5,500. This would raise the mark-up to about 80%, which is close to the median for the transactions listed in the study. I would guess this is what happened in Edmondson Village, that is that the investors picked up properties from distressed sellers. The profit is in buying low not selling high. It would be interesting to know what percentage of transactions involved investors and whether they did indeed make bargain purchases relative to prices paid for comparable properties by ordinary home-buyers from 1955 to 1968.

The example, it will be recalled, did not involve a land installment contract. Would use of such an instrument change our figures materially? I think not. Some risks to the investor are reduced since he can "foreclose" more easily, but he is dealing with a riskier buyer than the one who could get a 100% mortgage.

The figures suggest three things to me. First, the ordinary home transaction contains apparent economics by reason of the ability of the seller to live in the

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structure while he is selling it, his willingness to absorb some of the risks of sale, the willingness of the buyer to spend money on the structure after purchase, and the single transfer of ownership. Second, the risk and liquidity position of the low-income purchaser is a major deterrent to acquitting at a reasonable price. The public sector, including the City of Baltimore, is terribly remiss in not pursuing programs which would either socialize the risk or reduce it. Third, the study may well contain other misleading information.

The blacks are indeed being screwed, but they should be pointing their figures at us, not the Goldseekers, since the speculative portion of the black tax is a low percentage of the total mark-up and a small part of the overall problem.

Cordially,

WILLIAM C. GRIGSBY.

J. K. LASSER & Co.,
Lutherville, Md., November 6, 1970.

MR. M. GOLDSEKER,
Baltimore, Md.

We have examined the statements presented to us on the 68 properties as shown on the attached list. The actual costs as shown were verified by us and the pro-rate figures were prepared by us at your request. These pro-rate figures were based on your 1968 expenses and income.

In analysing these statements, the average of your Gross Future Possible Profit (without considering cost of servicing accounts for 12 years) is 24.95%. The average of the Net Future Possible Profits after servicing and estimated interest income is 18.17%.

As you will note in the statements all ground rents are capitalized at 6%. Due to business conditions, the ground rents you have retained have a market value less than the 6% capitalized value. However no adjustment has been made for these possible losses.

Very truly yours,

J. K. LASSER & CO.
H. G. FREIMAN, C.P.A.

JEFFERSON FEDERAL SAVINGS AND LOAN ASSOCIATION,
Baltimore, Md., November 10, 1967.

MR. ROBERT T. WAUGH,
Supervisory Agent, Federal Home Loan Bank of Greensboro, Federal Home Loan Bank Building, Greensboro, N.C.

DEAR BOB: We are considering a man for our Board of Directors who is employed by a real estate dealer whose buyers are granted mortgage loans by the Association. This man has no financial interest in this brokerage business, but is simply a salaried employee.

As a board member, he will not belong to our Executive Loan Committee that reviews loan submissions and would have no vote on loans coming from this brokerage house.

Would you please advise me of our position regulation-wise. Your views on this matter would be a considerable aid in making a decision.

Respectfully,

THOS. F. CARNEY,
Executive Vice President.

FEDERAL HOME LOAN BANK BOARD,
Greensboro, N.C., November 20, 1967.

MR. THOMAS F. CARNEY,
Executive Vice President, Jefferson Federal Savings and Loan Association, Baltimore, Md.

DEAR MR. CARNEY: Thank you for your letter of November 10, 1967.

It is our understanding that your association is considering the addition of a member to the association's board of directors who is an employee of a real estate dealer, but does not have an ownership interest in the business. We further understand that the proposed member would not vote on loans where the company at which he is employed has an interest. The regulations do not prohibit transactions by the association and a director's company in circumstances such as those set out. There would be no supervisory objection to this gentleman serving on the board of directors so long as he makes known to the

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directors his company's interest in properties proposed as security for association loans and refrains from voting on these transactions. We are sure that you understand that an undue concentration of lending activities involving this company or the granting of special considerations on loans involving this company would subject the association to supervisory criticism.

Sincerely yours,

ROBERT T. WAUGH,
Supervisory Agent.

The CHAIRMAN. Thank you very much for your testimony. Do you want to make a statement, Mr. Mitchell?

Mr. MITCHELL. Yes.

The CHAIRMAN. And then I will call on Mr. Levine.

Mr. MITCHELL. I would like very much to comment briefly on this.

The CHAIRMAN. If you are just going to comment, I think we ought to hear from Mr. Levine.

Mr. MITCHELL. It will just take 2 minutes.

The CHAIRMAN. I will call on Mr. Levine. It won't take too long.

Your statement will be put in the record, Mr. Levine, and you may summarize it. Without objection, the statement will be put in the record in full.

Our last witness is Mr. Milton E. Levine, chairman of the board of Meyers Pollock Robbins, Inc., New York, which are brokers for the deposits of pension trusts and welfare organizations.

Mr. Levine has described his firm as the oldest one of its kind in the Nation dealing exclusively in this particular brokerage deposit area.

We are happy to have you with us, Mr. Levine. You may proceed by giving your statement and after you finish it, the committee members will question you on the provisions of H.R. 5700.

You may proceed.

Mr. ROUSSELOT. Mr. Chairman, would you yield for just a moment? Many of the people that this gentleman has charged with what he feels are incorrect actions—as I understand it, Jefferson Savings has been merged, hasn't it?

Mr. GREEN. No.

Mr. ROUSSELOT. Will they have a chance to respond to this?

The CHAIRMAN. Yes, if they want to be witnesses. Or if they are here now, they may respond.

Mr. ROUSSELOT. At least in writing?

The CHAIRMAN. Yes. You can get up a statement for them.

Mr. ROUSSELOT. I don't want to do that. I don't even know them.

The CHAIRMAN. We want to hear both sides.

Mr. ROUSSELOT. I don't know them.

The CHAIRMAN. I want to give them a fair deal. They may answer. Mr. Levine is recognized.

STATEMENT OF MILTON E. LEVINE, CHAIRMAN OF THE BOARD, MEYERS POLLOCK ROBBINS, INC. NEW YORK, N.Y.

Mr. LEVINE. Mr. Chairman and members of the committee, I want to first thank you for affording me this opportunity to appear here to supplement the letter which I wrote on March 15.

Unfortunately, I did not learn until Thursday night that I was to appear here and at that time I was told I would appear at 2 today. In

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preparing this statement which you have before you, I did the best I could on short notice, and flew down here and delivered the copies this morning at about a quarter to 10. So I understand that probably some members of the committee either have just received my statement or have had little if any opportunity to examine it and comment upon it.

The CHAIRMAN. We are starting out today on 6 days of hearings, including Saturday. So we have plenty to do today. We are glad to hear you. You are more fortunate than some of us in some respects. So it is not a question of whether you are inconvenienced or not, it is a question of getting your side over. You have an opportunity now. It will be printed in the record, and it will be distributed all over the United States, to all the different groups who are interested. And you have a quorum now that will lend itself to something that I know will be helpful to you in your advocacy.

Mr. LEVINE. All right, sir.

At first, I shall limit my remarks to objections to sections 19, 20, and 21 of H.R. 5700, since those are the provisions which deal with brokerage, and industry which my firm and its predecessors have served for almost 34 years.

At the outset, sitting here last week, and listening to the comments of both the witnesses and members of the committee, it seems to me that there is some need for a clarification of the various types of brokerage in the financial community. And to this extent, I think this may be helpful in solving what appears to me to be a dilemma, and which might avoid the possibility of the destruction of an entire industry, as this proposed bill contemplates.

Brokerage for savings and loan associations, under the aegis of the SLIC, has been a time-honored and recognized method of obtaining funds for Federal savings and loan associations, and is distinctly recognized and permitted by the rules and regulations for insurance of accounts, sections 563–25, and what follows. Further, brokers are required to be registered with the Securities and Exchange Commission, and in New York State with the New York Bureau of Securities. Futhermore, as you can see, they are rather closely supervised.

Savings and loan brokerage—and this, I think, is the essential difference between savings and loan brokerage and brokerage for commercial banks—savings and loan brokerage is a method whereby accounts are sent directly to associations in the depositor's name, a savings account is opened in the depositor's name, the passbook and signature card is sent directly to the depositor and the broker is never in the picture except for initiating and transmitting the funds. No charge is made to the depositor. The broker—and this is most important—the broker receives a one-time fee for servicing that account from the association at the legal rate, which is usually 1 percent, permitted by the regulations. That is all the association pays, no matter how many years the account stays with the association.

Incidentally, in order to do business with the savings and loan association under the rules and regulations, you are required as a broker to have a contract. This contract must be on file with the savings and loan association. It is examined by the regulatory agency. There is a continuing relationship between the broker and the association. For instance, as I point out here, as a result of our firm's activities over

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the many years, unions, pensions, trusts, corporations, individuals have placed over the years $2 billion in savings and loan associations, and I would say that possibly the figure for the entire industry might be as much as $5 billion in placements.

To give this committee some idea of the help brokers give to all kinds of insured associations, our firm has forwarded funds to approximately 1,000 institutions in 44 States as well as Puerto Rico. We place funds in tiny, young associations serving minority groups which cannot get enough money to cover the demand for housing loans in their communities, and the money they received was long-term money, which they needed desperately. We have also sent funds to medium and large-sized institutions when they required and requested it. And the only reason they took the funds was that our funds were the longest lasting and the cheapest to acquire.

That savings and loan brokers perform a most useful function is attested to by the phenomenal growth of the industry. Many years ago unions, pensions, trusts, and incorporations were negligible depositors in the savings and loans. Largely through the educational efforts of reputable brokers, the image of savings and loans, once a most confusing one, was clarified and explained to stop unfounded rumors concerning their safety.

Going off the record for a moment, I think—I am sure that the Chairman knows and other members of the committee know, that years ago there were unfounded statements as to the insurance of accounts, the value of the insurance of the FSLIC. This was booted about as a rumor. Reputable brokers, people like ourselves, went to unions, pensions, trusts, and addressed clubs, addressed conferences, and made the people understand that savings and loans accounts in those years insured for $5,000 and then for $10,000 were a marvelous place to deposit their funds.

There was another point that should be borne in mind. Unions and pensions and trusts by their bylaws are, for the most part, limited in the type of investment they may make. They may be required under the bylaws to place their funds in legal investments, and I respectfully submit to the members of this committee if you take unions with thousands of members, and you hold them to a local community, very shortly they exhaust the few institutions that are there, and they must of necessity be able to spread out to invest up to $20,000 per crack, if they wish. They must be able to spread out all over America. And the money that they place is the finest and longest lasting money that any institution can get.

I think that is proven by the statement that I make in here, that we are doing business today with the same associations we did business with 10, 15 and 20 years ago.

Bear in mind one other point. Associations and savings and loans only accept money when they need it. The fee they pay is set by the regulations. And it can vary from 1 to 2 percent, but 1 percent is the usual amount. In a study made in 1959—and I think the Chairman is cognizant of it, I wrote him about it—I was one of the people who suggested codes of ethics at that time in hearings before the insuring agency for savings and loans, and it showed in testimony before that committee that over a period of 10 years involving 42 reporting

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associations at that time, involving amounts of more than $100 million, the moneys which came from reputable brokers were longer lasting and cheaper to acquire for the association than any other money they had, including the local money. There is a very simple reason for it. When our association takes money from a savings and loan broker, it pays him. He warrants that money to the association, he warrants it for a year. And if it doesn't stay, he will refund his fee to the association. If he gives the association hot money, or short-term money, he loses his fee because he has got to refund it.

I admit there have been some small abuses, as there are in any industry. We have had some time one or two brokers—and I am talking now only about savings and loans, I will come to the bank CD's later. I think since the regulations in 1964 and 1965, there has been, to my knowledge, almost absolute peace. There has been no problem at all so far as I know in savings and loan associations with any form of bankruptcy concerning with broker money. And the situation is just as simple.

If a broker tried to send an association short-term money, he could have 1 year. The second year he would be stricken off the list, because the contract that you have with the associations states that they may cancel with you on 30 days notice, at least ours does. At any time on 30 days notice they may cancel the contract.

And in that connection, I state that the broker performs this very useful function of getting long-term money from excellent contacts which are a basis for an association being able to make intelligent long-term loans, and the fact that there may here and there be an isolated abuse is certainly not a reason for cutting out a business, and I mean cutting out, because of the way this bill is written. If this bill were to be passed, we could close our doors tomorrow after 34 years, in fact, we would be branded criminals for doing the things that we have done for 34 years.

I should like to move to what happened here last week. Mr. Preston Martin, Chairman of the Federal Home Loan Bank Board in his testimony stated there that he did not feel that savings and loans brokerages should be prohibited, that the FSLIC had ample supervisory and regulatory authority in connection with brokerage, and that brokerage performed a useful function. He said he would be in favor of a regulation prohibiting a tie-in or below-surface arrangement. And we would concur in this, except that we don't know how you would have a tie-in or below-surface arrangement with savings and loans. This could happen possibly in a commercial bank CD, because there is an enormous difference. And we would go along with that and say that you have ample regulations on the books, that savings and loans have prospered with the aid of brokers, and that they should be left as they are.

I would now like to address myself to the brokerage CD's which are under FDIC, and have to do with commercial banks.

Mr. Camp, who testified last week, Comptroller of the Currency, and Mr. Frank Wille, Chairman of the Federal Deposit Insurance Corp., stated in their testimony that the number of banks having problems were minute in the overall picture. And possibly you will recall that Mr. Camp's figure was .000 something, in regard to the number of banks involved compared to the overall number of banks,

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and in regard to the amount of money in the overall picture, it was also .00041 for banks insured by FDIC. So that this is miniscule as compared to the effect of cutting off or shutting off the ability of disadvantaged banks to bring money into their areas in time of need. I think that nowhere has there been a better example of this than what has happened in the last 3 years. Three years ago or 2 years ago, savings and loan associations found it almost impossible to get money, the reason being that Government obligations or almost anything you bought, paid far more interest than savings and loans did. Nevertheless, we would like this committee to know that unions, pensions, and trusts which accepted this as a program and as an intelligent, sensible way of helping the economy generate, still continued to put millions and millions of dollars in the savings and loans. Now, when the pendulum has swung somewhat, and yields on all other types of investments are low, and savings and loans today offer a good rate of return, you will find a very simple thing. Not all savings and loans will accept money from brokers. Our lists have been cut actively, and we no longer have open allocations. We are probably operating under a 100 a day, whereas normally we would have anywhere from 300 to 400 associations on the active list, with another 500 standing by for limited sums of money.

I have a note here that I must conclude.

The CHAIRMAN. This will all be put in the record. I assure you, you will get real attention on this. These records are looked over by the staff, and each member's administrative assistant will call the member's attention to things he knows he is interested in. Furthermore, the different agencies of the Government will look them over and make reports on them. This will go all over the Nation and into the libraries, so you will get real coverage and real attention.

You see, we have only a certain amount of time. Each Member of Congress has constituents they have to give time to. We have been here since 10 o'clock, and, of course, we expect to do that. We have sessions all this week until Saturday afternoon, so, this is a situation where we just can't give everybody all the time that they want under the circumstances.

Mr. LEVINE. May I have 30 seconds to 1 minute to complete?

The CHAIRMAN. Go ahead.

Mr. LEVINE. I just want to say this. We believe that any difficulties which have occurred from the use of broker CD's have resulted not from the source of the funds, but from the lack of proper credit investigation and control on the part of the loan officer and credit committee of the bank, which was responsible for approving the loan. A bad loan is a bad loan and it doesn't matter where the money for it came from.

Mr. Chairman, in closing I would like to read into the record a letter from Mr. John H. Armbruster, the executive vice president of Community Federal Savings & Loan Association, St. Louis, Mo., to Mr. Daniel Pollock in 1952. The Community Federal Savings & Loan Association has done business with our organization. The letter states:

> While we are not at present seeking funds through you as a broker, we have at various times during the past sixteen years been in position where the demand for loans exceeded our regular flow of funds and in such cases have had a very satisfactory experience with your apparently always available supply.

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When we first accepted funds through you we were concerned about rumors that these funds would not be long term funds, but would be withdrawn as soon as one year had elapsed and the accounts switched to others in order to earn an additional one percent brokerage. But experience has shown that this is not true and many of the accounts secured through you many years ago have remained with us year after year.

When we spread the one percent cost of acquisition of such accounts over the number of years they have remained with us, the ultimate cost has dwindled to a negligible amount per year we have had the use of them.

We believe that it is the most productive use of advertising funds because we only pay when results are obtained whereas in general advertising there is no guarantee of productiveness. Some of our advertising campaigns have cost a great deal with unsatisfactory results and showing the cost of acquisition of accounts much greater than the one percent paid for definite results through the broker's accounts.

Thank you, Mr. Chairman.

(The prepared statement of Mr. Levine follows:)

PREPARED STATEMENT OF MILTON E. LEVINE, CHAIRMAN OF THE BOARD OF MEYERS POLLOCK ROBBINS, INC., NEW YORK, N.Y.

I wish to thank the Committee for affording me the privilege of appearing before it and allowing me to supplement my letter of March 15, 1971 by testimony.

I shall limit my remarks to objections to Sections 19, 20 and 21 of H.R. 5700, since those are the provisions which deal with brokerage, an industry which my firm and its predecessors have served for almost 34 years.

At the outset, I wish to state that there is a difference in the various types of brokerage in the financial field, and perhaps a few words should be said to clarify the differences.

Brokerage for Savings and Loan Associations, under the aegis of the F.S.L.I.C. has been a time honored and recognized method of obtaining funds for Savings and Loan Associations and is distinctly recognized and permitted by the Rules and Regulations for insurance of accounts (Secs. 563.25 etc.) Further, brokers are required to be registered with the Securities and Exchange Commission and in New York State with the N.Y. Bureau of Securities.

Savings and Loan brokerage is the method whereby accounts are sent directly to associations in the depositor's name, a savings account is opened in the depositor's name, the passbook and signature card is sent directly to the depositor and the broker is never in the picture except for initiating and transmitting the funds. No charge is made to the depositor.

The broker receives a one time fee directly from the Association at the legal rate (usually 1%) permitted by the Regulations, and this is all the Association pays no matter how long the funds stay at the institution. The Association and the broker are required by Regulations to operate under a contract which the Association must keep on file. This is a continuing relationship between Association and broker until such time as either party gives notice of termination. Associations may accept accounts up to 5% of their savings accounts.

As a result of our firm's activities over the many years, Unions, Pensions, Trusts, Corporations and individuals have placed about two billion dollars in savings and loans and I would think that the figure for the industry might well be 5 billion dollars.

To give the Committee some idea of the help brokers give to all kinds of insured Associations, our firm has forwarded funds to approximately 1,000 Associations in 44 States as well as Puerto Rico. We have placed funds in tiny young Associations, serving minority groups who could not get enough money to cover the need for housing loans in their communities, and the money they received was long term money which they needed desperately. We have also sent funds to medium and large institutions when they required and requested it and the reason they took the funds was that our funds were the longest lasting and cheapest to acquire.

That Savings and Loan brokers perform a most useful function is attested to by the phenominal growth of the industry. Many years ago, Unions, Pensions, Trusts and Corporations were negligable depositors in Savings and Loans. Largely through the educational efforts of reputable brokers, the image of Savings and Loans, once a most confusing one, was clarified and explained to stop

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unfounded rumors concerning their safety. As a result of our efforts, huge sums were made available to the housing market.

We are proud to say that it is commonly acknowledged throughout the industry that our firm supplies the longest lasting accounts at the lowest fees and the fact that we still do business with the same Associations we dealt with 10, 15 and 20 years ago must attest to how satisfied they are with the longevity of the accounts we send. Some of our accounts have been with Associations for 10 or more years and are still there.

In his testimony before this Committee on April 20, (pages 39, 40, 67, 68, 70 of the hearing transcript) Mr. Preston Martin, Chairman of F.S.L.I.C., stated that he did not feel that savings and loan brokerage should be prohibited; that the F.S.L.I.C. had ample supervisory and regulatory authority in connection with brokerage and that brokerage performed a useful function. He said he would be in favor of a regulation prohibiting a tie-in or below surface arrangement.

Any discussion of "Brokered C.D.'s" in commercial banks must correctly define the normal, proper and typical transaction such as those handled by our firm. In these funding operations, the broker has no connection whatsoever with the loan transaction. The funds are supplied in a certain set amount for a definite period of time and the bank does not pay the broker in a proper transaction. The broker supplies funds only after the borrower is in a position to advise that the loan has been approved on its own merits. An improper credit determination would result in a bad loan at this point whether the money was funded by a broker, or obtained from the bank's local money sources. To say that a credit officer makes only good loans with regular funds but is tempted to make bad loans with broker funds is a reflection on the ability and integrity of the credit officer and not on the source of the funds.

In connection with the provisions banning the use of brokered certificates of deposit in commercial banks, it is well known that the use of outside funds by banks is a standard recognized money market procedure that has been in existance for many years. The recent two to three year period of tight money conditions maximized the use of this method of financing since many banks found themselves in a position in which they had insufficient lendable funds from their normal sources to service the proper and credit worthy needs of their regular customers.

We believe that any difficulties which have occurred from the use of brokered C.D.'s have resulted not from the source of the funds, but from the lack of proper credit investigation and control on the part of the loan officer or credit committee at the bank who was responsible for approving the loan. A bad loan is a bad loan and it is essential that each and every loan extended by any bank must stand on its own merits without consideration of any sort for the funding of deposits by the borrower. But, in the normal course of business, when an application for a loan from a bank meets with all of the required credit criteria, yet cannot be funded simply because the bank's funds are insufficient due to its being in a capital shortage area, or because the bank is at a competitive disadvantage in competing with the larger banks in its area in the attraction of money from the public, the use of brokers provides not only a valuable source of funds, but fulfills one of the basic needs of a free economy, allowing disadvantaged banks to effectively service their customers and compete in the free money market.

By cutting off from banks and their customers the services of legitimate brokers who help banks and borrowers compete in the open money markets for funds, this Bill, as written, will, in effect, force some credit worthy borrowers to utilize secondary money sources such as second or even third mortgage lenders, unregulated lending sources, and other prohibitively high rate money sources; thereby often endangering the financial health of a business or project for which the funds are required.

Both Mr. Camp, Controller of Currency and Mr. Frank Wille, Chairman of the F.D.I.C., stated in their testimony that the number of banks having problems, were minute in the overall picture. Mr. Camp very positively stated that brokerage, properly used, served a valuable function and that he was against eliminating brokerage.

We respectfully submit that to eliminate an entire industry as H.R. 5700 proposes, because of the actions of a few in it, is so drastic a step as to defy comprehension, and that further *Regulation* of brokerage, not elimination, is the proper procedure to follow.

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We trust that in the light of the foregoing, sections 19, 20 and 21 of H.R. 5700 will be deleted and that brokers will be permitted to perform the useful services they have rendered to the financial community for so many years.

(The following letters with attached material were received by the committee in regard to H.R. 5700 and related issues mentioned above for inclusion in the record:)

HEROLD, KASTOR & GERALD, INC.,
New York, N.Y., April 28, 1971.

Hon. WRIGHT PATMAN,
Chairman, House Banking and Currency Committee,
House Office Building,
Washington, D.C.

DEAR CONGRESSMAN PATMAN: I am submitting this brief to you and the Banking & Currency Committee on a matter of principal, concerned with the Banking Reform Act of 1971—HR 5700, particularly with respect to that portion of the proposed bill dealing with the prohibition of brokered deposits in Insured Savings and Loan Associations, Section 20 and 21.

Briefly, the principle involved is our right as an Investment firm and the right of other such firms to continue to carry on a legitimate investment service both to the public and the Savings and Loan Industry. We qualify this to the extent we are not objecting to regulation of the brokerage business, which is something we live with daily.

Granted, we are the little fellows in this picture. We have behaved ourselves and have never foxed up schemes to evade or circumvent the area of the Association's responsibilities under the regulations, nor our own.

I was impressed at the hearings by the thoroughness of the approach by the members of the Committee to all the problems of the proposed legislation and came away with lessened apprehension that under our system the path of solving any problem that might exist in our area would be the sentence of death, by prohibition. I am sure that the American way would be regulation designed to eliminate the possibility of abuse and the continuance in business of such little fellows whose part in the overall picture may be small, but who nevertheless have served a useful and important function to approximately 20% to 25% of the Savings and Loan Industry.

I urge you to render the support of your high office to the modification of the proposal regarding prohibition of brokerage of Savings and Loan accounts.

Respectfully,

JOHN F. HAMEL.

COMMENTARY OF SECTIONS 20 AND 21 (BROKER DEPOSITS PROHIBITION) BANKING REFORM ACT OF 1971, H.R. 5700 BY JOHN F. HAMEL

SUMMARY AND COMMENT

After study of the Proposed Bill, personal attendance at the Committee Hearings, and review of the testimony, it is our judgment on Sections 20 and 21 of the Banking Reform Act of 1971 that additional regulation is desirable to prevent loans which are directly or indirectly tied in with brokered deposits in Savings and Loan Associations. However, it is not necessary to legislate a prohibition of broker deposits to prevent such loans.

While we have never brokered certificates of deposit with commercial banks, since 1939 my associates and I have offered a service in connection with the placement of funds with Insured Savings and Loan associations. Our business has always been carried on within the Regulations for Insurance of Accounts, and it has been our policy from the very beginning not to place funds with an association under any third party or tie-in arrangement. We deal only directly with the Savings and Loan Association under signed agreements with them for placement of our clients' funds directly with that Savings and Loan Association, for a commission paid direct to us by that Savings and Loan Association.

We have lived all these years with regulation, and would welcome additional regulation to finally close the book on an abuse which in this day and age is indulged in by few, if any, Savings and Loan Associations or brokers of Savings and Loan accounts. We would then be in a position to carry on what has been a reputable investment business for the only parties involved in our transactions, namely: ourselves as broker, the investor, and the Savings and Loan Association.

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It is our opinion that the proposed prohibitions and penalties relating to acceptance of commission funds by Savings and Loan Management, and solicitation of such funds by investment firm, if enacted, might constitute:

A. a transgression of Savings and Loan Management prerogative,

B. an impediment to free market access both for the Savings and Loan and the investor who desires to use a broker service, and

C. relegates a legitimate activity of responsible investment firms to a criminal act; will adversely reflect upon the good reputation of individual investment men built up over a lifetime of service; and could deprive such individuals of a livelihood.

A brief background on each of the parties to our transactions in Savings and Loan brokerage is given below in the hope that the attention of the Committee may be clearly focused on what has made the brokerage of savings and loan deposits a valuable service to the Savings and Loan Association and the investing public, and a desirable adjunct to our general securities business.

OURSELVES AS BROKER

Speaking for my associates, please consider our record of accomplishment in this endeavor:

1. Up to forty years of experience in the general Investment business.
2. More than thirty years of service in directing over six hundred million dollars to Savings and Loan Associations in all states and Puerto Rico from thousands of investors throughout the Country.
3. Performed educational and advisory services to investors in connection with savings and loan deposits. Our client knows what he is getting into and has proven to be a stable and economic account holder for the S & L.
4. All of the above activities having been carried on, in addition to a general securities business, as registered dealers with the Securities and Exchange Commission, New York Stock Exchange and National Association of Securities Dealers.

THE SAVINGS AND LOAN ASSOCIATION

(There is attached hereto an excerpt of the Regulation for Insurance of Accounts pertaining to broker funds.)

1. In accordance with Federal Home Loan Bank regulation, we have signed agreements on file with the Associations with which we deal. Under the regulations, the Association is limited to accepting no more than 5% of its total savings in broker funds.
2. The commission paid to us by the Savings and Loan Associations average 1% although regulations permit the association to pay up to 2%, and we are currently placing funds for as little as ½ of 1% commission.
3. An association in a capital-short area may use our service to develop sound savings accounts when funds are needed. At a given time, we have furnished as little as two or three insured accounts in the case of small associations, to as much as one million dollars to large associations in the form of many insured accounts ranging from $5,000 to $20,000.
4. We have developed our contacts with the savings and loan associations over many years of satisfactory service.

Since we placed our first account with a small federally-chartered association in northern Pennsylvania, we have had arguments off and on with approximately 1,000 associations. The number of associations we have had agreements with at a given time has ranged from approximately 20 up to 100.

5. Capital short areas which we served at various times included Florida, Georgia, Alabama, Louisiana, Texas, Kansas, Missouri, Illinois, Pennsylvania, California, New Mexico, Colorado, Alaska, and Puerto Rico.
6. Over the years, associations have told us that our clients' accounts stayed with them longer than local funds and that the cost was more economical than advertising.

THE INVESTOR

1. We make available to our clients a list of Insured Associations with which we have agreements under the regulations. The client makes his checks payable to the associations he selects from our list and forwards the checks to us. We transmit the checks to the associations with registration and any other instructions, such as type or term of the account and whether earnings are to be paid by check or credited to the account. The evidence of the account such as certifi-

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cate or passbook is sent directly to the client. Our commission is paid to us by the association under our existing agreement—there is no charge to the client in connection with his investment.

2. Our clients are individual investors, credit unions, pension funds, etc. seeking a good yield, insured safety, and freedom from market fluctuation for a part of their investable or surplus funds.

3. We have developed our cliens through personal contact and referral, and our success in this respect is due entirely to our serving their needs over the years with their best interests being paramount.

Respectfully submitted.

JOHN F. HAMEL.

FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION, WASHINGTON, D.C.,

EXCERPTS FROM THE NATIONAL HOUSING ACT

RULES AND REGULATIONS FOR INSURANCE OF ACCOUNTS, CHAPTER V(D), TITLE 12, BANKS AND BANKING CODE OF FEDERAL REGULATIONS, APRIL 25, 1970

INSURANCE REGULATIONS

§ 563.25 Sales commissions.

(a) *General provisions.* Except as provided in paragraphs (b), (c), (d), and (e) of this section, no insured institution shall, directly or indirectly—

(1) Pay any sales commission except to an employee of such institution;

(2) Pay to any employee of such institution any sales commission the payment or the amount of which is based in whole or in part upon the opening or increasing of any account or accounts in such institution, except a prize in cash or otherwise for participating in a new account drive or contest conducted by such institution; or

(3) Allow to any person any discount or rebate on or with respect to any account in such institution if the allowance or the amount of such discount or rebate is dependent in whole or in part upon another person's having solicited or obtained the opening or increasing of any account or accounts in such institution, or enter into any contract or agreement under which any person other than such institution is allowed to collect or receive from any other person (except such institution) and compensation for or in connection with the opening or increasing of any account or accounts in such institution; or

(4) Enter into, extend, or renew any contract, agreement, understanding, or arrangement, which authorizes or permits any person other than such insured institution itself to pay, or utilize any device whatsoever pursuant to which any person other than such insured institution pays, any compensation to any person for or in connection with the solicitation, the opening, or any increase of any account in such institution or for any advertising in connection with any such solicitation, opening, or increase, or accept the opening of or any increase in any account in connection with which any person other than such insured institution pays any compensation to any person for or in connection with solicitation, the opening, or any increase of any account in such institution or for any advertising in connection with any such solicitation, opening, or increase.

(b) *Exceptions.* The provisions of this section shall not prohibit any action which (1) is permitted by paragraph (c), paragraph (d), or paragraph (e) of this section or (2) constitutes the giving of a give-away within the meaning of § 563.24 but is not prohibited by § 563.24 for the reason that such give-away does not exceed the monetary value (as defined in said § 563.24) which is permitted by said section.

(c) *Use of brokers—(1) General provisions.* The provisions of *this section shall not prohibit* the payment by any insured institution, within the limitations of this paragraph (c), or *sales commissions to brokers,* but *no insured institution shall accept the opening or any increase of any account* as a result of services of any broker or brokers *or pay any sales commission* pursuant to the permission granted by this paragraph (c) at any time *when the outstanding balances of all accounts* in such institution which were *opened or increased as a result of services of any broker or brokers* aggregate a *total in excess of five percent of the total of all accounts* in such institution at the close of the next preceding December 31 or the next preceding June 30, whichever is later.

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(2) *Limitations.* Sales commissions permitted by this paragraph (c) shall be only such as are payable to a broker with respect to an account or accounts opened or increased as a result of services of such broker. *No such commissions shall exceed, in amount or value, two percent of the amounts paid in for the opening of the accounts involved,* in the case of accounts opened, or two percent of the amounts paid in for the increases involved, in the case of accounts increased. As used in this paragraph (c), *the term "broker"* means a person employed, engaged, or retained by an institution for *services consisting in whole or in part of soliciting or obtaining the opening or increasing of accounts in such institution,* except (i) an individual who is an officer, a director, or an employee of such institution, or (ii) an agent (as defined in paragraph (d) of this section) or a salesman (as defined in paragraph (e) of this section) utilized by such institution under circumstances permitting the payment of sales commissions to such agent or salesman under said paragraph (d) or said paragraph (e).

(3) *Maintenance of records; requirement of written agreements.* Each insured institution that accepts any account or any increase in any account as a result of the services of any broker or brokers or that pays any sales commission to any broker or brokers *shall, in addition to maintaining such other records* as will establish compliance with the provisions of this section, (i) before it accepts any such account or increase, and before it pays any such commission, *identify each outstanding account* that was opened or increased as a result of services of any broker or brokers, (ii) *similarly identify each account that is opened or increased subsequent to the effective date of this section* as a result of services of any broker or brokers, (iii) establish and maintain by a separate ledger control or otherwise a record which *shows at all times the aggregate of the outstanding balances of all accounts that were opened or increased as a result of services of any broker or brokers,* and (iv) make and retain an itemized *record of each payment of sales commission to any broker,* identifying each account and stating the amount thereof in respect to which such sales commission is paid. *No insured institution shall accept* any account or any increase in any account as a result of services of any broker or pay any sales commission to any broker *unless such broker is employed, engaged, or retained* by such institution *by agreement in writing,* stating the service or services to be performed by the broker or brokers and the sales commissions to be paid, and the original or a signed duplicate of each agreement by which an insured institution employs, engages, or retains any broker shall be retained by such institution.

(d) *Saving clause; use of agents*—(1) *General provisions.* The provisions of this section shall not prohibit the payment of sales commissions, within the limitations of this paragraph (d), by any insured institution which on October 17, 1958, whether or not it was then an insured institution, was utilizing one or more agents having on said date one or more offices located within such institution's regular lending area and no agent who then had any office located outside such area or was being utilized as an agent by any other building and loan, savings and loan, or homestead association or cooperative bank.

(2) *Limitations.* Sales commissions permitted by this paragraph (d) shall be only such as are payable to an agent or agents having one or more offices located within such institution's regular lending area and having no office located outside such area. No such commissions, except to the extent that the same are separately ascertainable compensation for services other than soliciting or obtaining the opening or increasing of an account or accounts in such institution, shall exceed, in amount or value, two percent of the amounts of funds transmitted through such office or offices to the insured institution for the opening or increasing of accounts in such institution. As used in this paragraph (d), the following terms have the following meanings:

(i) The term "agent" means a person employed, engaged, or retained by an institution for services consisting in whole or in part of soliciting or obtaining the opening or increasing of accounts in such institution, and except as used in subparagraph (1) of this paragraph (d) means such a person other than an individual who is an officer or a director of such institution; and

(ii) The term "office" means a place of business which an agent of an institution maintains for soliciting or obtaining the opening or increasing of accounts in such institution.

(e) *Saving clause; use of salesmen*—(1) *General provisions.* The provisions of this section shall not prohibit the payment of sales commissions, within the limitations of this paragraph (e), by an insured institution which on October 17,

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1958, whether or not it was then an insured institution, was utilizing one or more salesmen.

(2) *Limitations.* Sales commissions permitted by this paragraph (e) shall be only such as are payable to a salesman or salesmen having no office as defined in the last sentence of this subparagraph.

S. L. MILLER & CO., INC.,
Port Chester, N.Y., April 23, 1971.

Hon. WRIGHT PATMAN,
Chairman, Committee on Banking and Currency, U.S. House of Representatives, Washington, D.C.

DEAR MR. PATMAN: Enclosed please find my analysis and commentary of Sec. 19 and Sec. 21(a) of your proposed bill docketed as H.R. 5700, 92nd Congress First Session.

As a broker in certificates of deposit principally in banks with deposits of $500 million or more, I am not without self-interest in my point of view. Yet I hope that my analysis has been as unbiased as my interest in remaining in business would permit. I trust that I am not too immodest to hope too that it will provide some new information and insights which might cause you to modify your own views to some extent.

Thank you for the time you allow to read the paper. I would appreciate your comments.

Cordially yours,

STANLEY L. MILLER.

ANALYSIS OF PROPOSAL TO PROHIBIT BROKERED DEPOSITS*

1. SUMMARY AND CONCLUSIONS

Section 19 of H.R. 5700, 92nd Congress, 1st Session is designed to eliminate the abuses surrounding certain banking transactions involving brokered deposits which have been an important causal factor in the failure of several small commercial banks in recent years.

It is the contention of this analysis developed in the body of this commentary that the effect of the proposed bill as it is written will go far beyond the intent of the proposers and as such will cut off a very substantial number and considerable volume of sound, legitimate banking transactions involving brokers and others deemed to be brokers under the bill. It will cut off brokered deposits whether they are tied to a loan or not. Further it will tend to widen the advantages that large banks already have over the medium sized and smaller banks and that larger business borrowers have over smaller ones. In certain types of transactions, moreover, it will tend to raise the cost of bank credit to smaller businesses while leaving the larger ones unaffected. Finally, it will penalize the sound and reputable elements among the money brokers just to eliminate that small segment of irresponsible ones who have been connected with bank failures attributable to unsound loans made possible by the ready availability of brokered deposits.

I am sure there can be no more agonizing decision confronting the legislator or other government official than to deprive citizens of integrity and diligence of their livelihood in order to correct the abuses of a few. Very often such a decision need not and certainly ought not be made if those aberrations can be eliminated without affecting the functioning of those pursuing sound and ethical practices. The way out in connection with the proposed prohibition of brokered deposits is not to prohibit them, but to limit them to, say, 5% of total commercial bank deposits. The limitation would drastically reduce if not cut off these abuses altogether by eliminating the incentive to make loans supported by brokered deposits on the part of the smaller banks where these abuses appear to have been concentrated. Such loans (and related deposits) would be too small to tempt the small banker, and equally important, to make it worthwhile for an unprincipled borrower or broker. Yet, there would be sufficient leeway for

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*H.R. 5700 (Sec. 19). Statement presented to House Committee on Banking and Currency, Hon. Wright Patman, Chairman, April 23, 1971.

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the medium sized and larger banks to effect the large body of sound, legitimate lending and other transactions which might not otherwise be placed but for brokered deposits.

2. TWO MAJOR TYPES OF BROKERED DEPOSITS

Type I—To Fund a Loan

From press accounts, my reading of H.R. 5700, and my experience in the business, it appears that the House Committee on Banking and Currency is chiefly interested in eliminating banking transactions in which brokered deposits are supplied in order to *fund* a loan. In such a transaction the amount of brokered deposits is usually equal to the amount of the loan enabling a bank short of loanable funds to extend the credit. Generally speaking, these deposits have been placed in smaller banks in maximum amounts of $20,000 each so that they may be fully insured, and in an aggregate amount equal to the loan amount. For example, a $100,000 loan would be funded with five deposits of $20,000 each. As evidence of the deposit, the bank would issue its certificate of deposit (C.D.) with a maturity date coinciding with that of the loan, and the bank would pay the going rate on the certificate. The borrower seeking the loan would pay an additional fee to the broker which fee the broker shared with the depositor. The C.D. is usually issued in nonnegotiable form in the name of the depositor and is not collateral for the loan.

In the case of such transactions among large banks whose C.D.'s are readily acceptable in the money market, just one large deposit is made and one C.D. issued. The latter, usually in bearer form, is generally delivered to the broker's bank against payment and the broker then sells it in the open market at a discount.

The abuses arose when sizable unsound or fraudulent loans were presented to a bank and the banker was dazzled by the prospect of large deposits which would provide the banker with the wherewithal to make the loan. This could be done only with small banks because in the medium sized or large banks of several hundred million to several billion dollars, the loans and the deposits could not be large enough to dazzle. Thus, the prospect of substantially increasing the size and income of a small bank was often too tempting for the small banker to resist, and when at maturity date the loans could not be repaid and the deposits would therefore not be renewed (since the borrower was no longer willing or able to pay the brokerage fee), there was nothing to do but for the bank to close. Chairman Wille of the FDIC has testified before your committee that in eight of the 19 banks failing from January 1, 1969 to March 1, 1971, "misuse of brokered funds was a major contributing factor to the bank's closing." All but two of the 19 banks were very small, and the two largest ones with deposits ranging from 55–70 million may be classed as small.

In seeking to correct this situation, the Committee should give consideration to the fact that there is a much larger dollar volume if not a much larger number of these "funded" loans among the medium-sized and larger banks than among the smaller banks. Over all, these loans have been sound loans, and the brokered funds have enabled the granting of credit that might not otherwise have been effected (1) in areas of the country experiencing well above average growth rates (Houston, Dallas, Nassau County, the West Coast, Atlanta, etc.) and where credit facilities needed expansion, and (2) by banks which for one reason or another more actively seek to grow. Brokered deposits among such banks have generally been used properly because bank management has considered first and foremost the prospects of the loan being repaid at maturity. At such banks, furthermore, the performance of the lending officers is judged not so much by the number and amount of profitable loans they have made but by the few mistakes and losses they have incurred. Proposed loans are also generally subject to the approval of a loan committee before they are granted.

Thus, H.R. 5700 will indiscriminately cut off these sound "funded" loans as well as the unsound ones. Furthermore, H.R. 5700 will place the medium sized banks at a further disadvantage to the large banks which can raise all the funds they want since they have access to the commercial paper market through their holding companies, often through brokers, and to the Euro-dollar market through their London or Nassau Branches (though this last has generally been more costly). As a corollary, the medium sized banks have a larger proportion of small business loans than do the larger banking institutions.

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Type II—To serve as compensating balance

A second type of brokered deposit transaction is that in which the broker is requested to supply deposits to serve in lieu of compensating balances. It is well known that banks generally require their borrowing customers to keep immobilized in their checking accounts an amount of funds ranging from 10–20% of their lines of credit, otherwise known as compensating balances. With the consent of their banks, borrowers often arrange for brokers to place funds on deposit in amounts equal to their compensating balances against the issuance of noninterest-bearing C. D.'s. Borrowers are then permitted to withdraw their own compensating balances out of their checking accounts for use in their businesses (thus increasing their working capital at low cost). They pay the brokers an agreed-upon interest rate, the bulk of which the broker passes on to his clients, the depositors. The latters' funds substitute for the borrowers' balances.

The brokered deposit transaction that serves in lieu of a compensating balance can hardly lead to any abuse. No banker is likely to be swayed to make a loan on the strength of an outside (brokered) deposit for only 20% of the loan. Doing away with this type of transaction, furthermore, means doing away with the opportunity of the borrower to reduce the cost of his loan, as shown in Illustrations I and II enclosed. For a compensating balance requirement of 20% raises the effective interest rate on a bank loan by 25%. If a broker brings in his client's deposit, the borrower then receives 100% of the proceeds of his loan, and this plus the fact that the rate on the brokered deposits is lower than the rate charged the borrower by the bank can bring the cost of the loan down by as much as ½ of 1% per annum. (The actual reduction is based on the relationship of the bank loan rate and the deposit rate.)

The compensating balance type of brokered funds provides a useful tool for commercial banks enabling them to obtain the rate they need to make a loan profitable and at the same time to keep the cost of the loan to the borrower to a minimum. Such transactions are more prevalent among the medium sized banks and the larger more aggressive institutions mentioned above. Their willingness to employ these transactions has given them a useful device to undercut their larger more staid bank competitors. As for small business, the elimination of these transactions removes their only opportunity, through the purchase of low cost brokered deposits, to offset the advantage of large business' access to the commercial paper market. (Illustration III shows this advantage.)

ILLUSTRATION I.—*Cost of One Year Bank Loan to Borrower Maintaining 20% Compensating Balance out of His Own Cash*

Amount of loan	$100,000
Compensating Balance	$20,000
Loan funds available to borrower	$80,000
Interest on loan at 6% per annum	$6,000
Effective rate per annum on available loan funds ($6,000÷$80,000) (percent)	7.5

ILLUSTRATION II.—*Cost of One Year Bank Loan to Borrower Maintaining 20% Compensating Balance through My Client's Time Deposit*

Amount of loan	$100,000
Compensating balance maintained by borrower	0
Compensating balance maintained as time deposit by my client	$20,000
Loan funds available to borrower	100,000
Interest on loan at 6% per annum	$6,000
Interest on time deposit at 5% per annum	$1,000
Total interest cost to borrower	$7,000
Effective rate per annum on available loan funds ($7,000÷100,000) (percent)	7.0

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ILLUSTRATION III.—*Cost of One Year Bank Loan to Large Business Borrower Maintaining 20% Compensating Balance out of his Own Cash and Borrowing an Equivalent Amount in the Commercial Paper Market*

Amount of bank loan	$100, 000
Compensating balance	$20, 000
Net proceeds of bank loan	$80, 000
Sale of borrower's commercial paper	$20, 000
Total borrowed funds	$120, 000
Total loan funds available to borrower	$100, 000
Interest on bank loan at 6% per annum	$6, 000
Interest on commercial paper at 5% per annum	$1, 000
Total interest cost to borrower	$7, 000
Effective rate per annum on available loan funds ($7,000÷100,000) (percent)	7. 0

In addition to brokers, two classes of institutions have been important factors in supplying compensating balances for borrowers. It has been a custom or practice dating back to the twenties for title companies to place funds on deposit to serve in lieu of compensating balances for mortgage bankers and brokers and builders and others in the real estate field in return for the title business of those for whom they place the deposits. Such title company funds are placed in their customers' banks in the form of demand deposits in the title company's name. Usually no interest is charged.

It has likewise been a long-time custom for credit life insurance companies similarly to provide for the compensating balance requirements of their customers, chiefly and medium-sized installment loan and finance companies. As a quid pro quo, the latter insured their installment borrowers' lives through policies issued by the credit life companies supplying their compensating balances. The insurance companies place their funds on deposit with the banks against negotiable certificates of deposit issued in their names and usually charge their customers the current prime commercial loan rate.

It should be noted that the banking authorities have raised two objections to the compensating balance type of brokered transaction, both of which are open to question. First, they have contended that the borrower ought to use his own funds for compensating balances. The answer to this is that in any case the borrower uses part of the proceeds of the loan and sets it aside to meet the bank's compensating balance requirement. In other words, borrowers always use the banks' funds, never their own.

The second objection raised is that the bank loses the right of offset (the right to deduct from the borrower's credit balances whatever is owed the bank should the loan default). But this is largely an imaginary right. If a bank grants a loan of $100,000 and requires a $20,000 compensating balance, then it is really extending an $80,000 loan and charging for a $100,000 one. If the bank agrees to accept a brokered deposit as a substitute for the compensating balance, then certainly the bank ought to be permitted to exercise its own judgment concerning the credit-worthiness of the borrower, that the risk is just as good at $100,000 as at $80,000. To illustrate this most conclusively, banks often lend their customers their compensating balances (setting them aside in a time open account) but generally at the same rate as the entire loan. Thus, the bank increases its risk to $100,000. The difference between such a loan of compensating balances and brokered deposits is that the latter are much cheaper.

3. PROVISIONS OF H.R. 5700 SEC. 19

The language of H.R. 5700, Sec. 19 is truly all-inclusive. Neither an insured bank nor any person connected with it, "officer, director, agent, or substantial stockholder" may pay a broker, finder or any other person for obtaining deposits for such bank. Any payment made by any other person (presumably including borrowers) for obtaining deposits in a bank "shall be deemed to be a payment of compensation by the bank if the bank had" any knowledge thereof. The term payment of interest furthermore is broadened to include any compensation by a bank, officer, etc. (as defined above) to a broker, finder and to a depositor for placing or inducing the placement of deposits in a bank. Anyone who makes such payment shall be subject to a $10,000 fine and/or imprisonment for one year. A bank in violation of these prohibitions shall be subject to a penalty of not

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more than 10% of the deposits illegally obtained. Further, anyone who receives a fee for "obtaining funds of another for deposit or investment" in a bank is subject to the same penalties ($10,000 fine and one year's imprisonment). Thus, under the bill the term "brokered deposits" comes to mean all deposits on which compensation has been paid to induce their placement in a bank, whether a broker is involved or not, and a blanket prohibition is placed on all such deposits.

H.R. 5700, Sec. 19 is so broad and far-reaching as to preclude a great many sound deposit transactions. It fails to discriminate as between brokered and nonbrokered deposits, between deposits tied to a loan and those not tied to a loan and as between brokered deposits properly used and those misused. For example, a bank offering its C.D.'s in the open market at a higher yield than generally available in order to obtain funds against an anticipated increase in demand for its loans may be engaging in an illegal transaction. Conceivably, many negotiated sales of original issue C.D.'s could be eliminated for fear that a higher rate of interest paid to one hard bargainer will be deemed to be compensation for making the deposit. At least, any differential rate paid by a bank directly to a depositor becomes suspect.

4. SOUND USES OF BROKERED DEPOSITS

Clarification of the bill appears necessary to determine whether such transactions are exempt or included, and in fact the bill may well be rewritten in part to discriminate between those deposit transactions, whether brokered or not and whether tied to a loan or not, which represent sound uses of funds and those which are subject to abuse. This may well be a tall order, but I would like to offer as a guide the following list of a number of transactions involving sound and proper use of brokered deposits or deposits for which compensation has been paid:

1. Brokered deposits may be accepted by banks from customers in lieu of service charges. Here the deposit is not connected to any loan at all but may be availed of by a bank during periods of tight money when the additional funds may allow further expansion of the bank. Funds at such times can be advantageously used to ween away especially credit-worthy customers the bank had previously been unable to attract.

2. Large banks may at times seek commitments from Government security dealers or brokers to purchase large blocks of long-term C. D.'s at a higher than market rate commensurate with the risk and including a larger brokerage fee than usual, so that the banks may fix their money costs on term loans, thus avoiding a squeeze that could come from lending long and borrowing short.

3. A variation of this kind of transaction may be seen during periods of declining interest rates when banks overinvest in short and medium-term Government and other securities and finance these holdings daily by purchases of Federal funds or by making "repos" (sales of such securities with agreements to repurchase them the next day). Thus the banks are in the position of investing long and borrowing short. When interest rates begin to rise again, the banks may often sell through brokers substantial amounts of their C. D.'s with maturities coinciding wtih the average maturity of their investment portfolios, i.e. the banks use the C. D.'s to fund short-term and medium-term investments purchased by the banks for their portfolio.

4. Brokered funds may also be used in transactions in which a prime customer of a bank, such as an electric utility or an air line, wishes to defer temporarily delivery of heavy equipment it has contracted to purchase but does not wish to show additional borrowing on its books. Instead of borrowing from a bank the utility purchases a noninterest-bearing C. D. which it sells immediately in the open market to replenish its cash. Then the utility arranges for the bank to make payment for the equipment which can be set aside at the supplier's plant or placed in storage.

5. Banks have in many instances accepted deposits from brokers and from title companies and credit life insurance companies as a substitute for compensating balances. As indicated in Section 2–II, this type of transaction is not open to abuse and has some positive advantages for the smaller borrowers.

6. Finally, as analyzed in section 2–I, the medium-sized and larger banks have accepted brokered deposits to fund loans, with advantage to all concerned. Such brokered deposits have enabled the financing of business activities that might not otherwise have been effected, and have promoted a more efficient use of savings. Brokered deposits among such banks have been used properly and

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sparingly, and the loans funded by such deposits have received as careful investigation as or perhaps even more care has been given them than other loans. A particularly helpful use of brokered deposits to fund a loan is that related in paragraph 2 above.

5. CONCLUSIONS AND RECOMMENDATIONS

The broad language of H.R. 5700 (Sec. 19 and 21(a)) appears to make its provisions and prohibitions apply to many hitherto routine C. D. transactions, many of which involve Government security dealers which make a market in bearer C. D.'s of larger banks. The bill imposes an immovable rigidity on a part of the banking process where flexibility and sensitivity ought to prevail.

The foregoing suggests that more consideration be given to defining the prohibited transactions, a task which should not be delegated to the Federal Deposit Insurance Corporation through its regulatory powers. The Corporation itself needs more guidance and if none is forthcoming through revision of the bill, the ultimate decisions are likely to be made years hence in the courts.

But no matter how narrowly brokered deposits may be defined, the legislation is likely to result in more harm than good. For the question comes down to the proper use and the misuse of brokered deposits and these cannot be legislated or distinguished in any bill so as to ban one and leave the other intact. The only way to get at this problem is to place a limit on brokered transactions beyond which they are absolutely prohibited. Some figure such as 5% of the total deposits seems a good one for it leaves plenty of room for the medium-sized and larger banks which generally utilize the brokered deposit technique soundly; and it is small enough to reduce the incentive for its employment among the smaller banks where it has been shown to have been misused most. The volume of loans conditioned upon the placement of brokered deposits will no longer be large enough to tempt management of small banks to consider such loans only in terms of the deposits they will bring in. They will be more apt to judge them by their merits.

If 5% may be too large a limit for the smaller banks, then a graduated limit might be adopted running from 2% for banks with deposits under $100 million to 3% for banks with $100 to under $300 million and 5% for all banks with deposits of $300 million or more.

STATEMENT OF HON. ELFORD A. CEDERBERG, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN, ON H.R. 3242 AND H.R. 5700

I appreciate the opportunity to present to the Committee on Banking and Currency my views on the bill H.R. 3242 which I have introduced and the corresponding sections of H.R. 5700, introduced by the distinguished chairman and several members of this Committee.

Over a year ago, following the failure of the Peoples State Savings Bank of Auburn, Michigan, I called upon this Committee to launch a full-scale investigation of the use of brokered funds in the light of the fact that this practice had contributed substantially to the failure of several banks during the previous year. Since that time several other banks have failed under similar circumstances.

Mr. Chairman, I do not believe that we in the Congress can sit by and watch the banking institutions of our small, largely rural, communities systematically victimized by the get-rich-quick schemes promoted by brokered-funds/linked-financing arrangements. In testimony before your Committee on March 8 the Chairman of the Federal Deposit Insurance Corporation noted that, in nearly half of the bank failures occurring between January, 1969, and the present, the "misuse of brokered funds was a major contributing factor to the bank's closing." I submit that any arrangement which is found to be the source of such widespread misuse must be controlled.

The bill which I have introduced, H.R. 3242, deals directly with this problem by prohibiting the use of brokered funds and by placing the responsibility for such schemes where it belongs, with the bankers. It has been said that brokered funds have a legitimate place in the banking community since they can serve to provide needed funds in situations where additional deposits would serve the best interests of an individual bank.

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It was noted on the first day of these hearings, however, that the banks which failed during the past eighteen months were not in such a situation. The brokering of funds in these cases was directly connected with loan arrangements which required substantial commitments from a given bank without corresponding long-term collateral. I believe that these arrangements must be controlled and that legislation prohibiting such situations is desirable. An article in the Wall Street Journal describing the normal course of such arrangements would, I believe, be informative and I would, therefore, like to place it in the record of the Committee at this point:

[From the Wall Street Journal]

Small Banks Go Under, and Authorities Assail Role of Money Brokers

GO-BETWEENS IN BIG LOANS ASSIST IN DUBIOUS DEALINGS; "SCAPEGOATS," THEY SAY

(By Frederick C. Klein)

A small bank fails in Prairie City, Iowa. Another goes under the Auburn, Mich. Still another in Coalville, Utah. And Petersburg, Ky., Covington, Ga., and Aransas Pass, Texas.

All these banks have failed in the past 18 months, and Federal regulators indicate all have failed for much the same reasons. In each case big borrowers defaulted on loans or appeared likely to do so. In each case the loans were in excess of what the little banks should prudently have made and in most cases were made to persons from outside the bank's normal business area. And in each case some of the loans had been backed by deposits generated by so-called money brokers.

Money brokers are an oft-criticized breed who act as middlemen in loans that banks made to persons or corporations. Say Mr. A. wants to borrow $100,000 from the Jones National Bank. The bank won't make the loan because it doesn't have the funds, or if it does have the money it has more credit-worthy customers to lend to. But the bank will agree to lend the money if Mr. A. can bring to the bank depositors willing to deposit $100,000. Mr. A. doesn't know anybody with that kind of money, so he goes to a money broker. The broker finds the people, and the deal is arranged.

THEORY—AND PRACTICE

In theory, everyone is happy. The broker is happy because the borrower pays him 3% to 5% of the loan as his fee. The depositors are happy, because they are getting 5½%, say, on their certificates of deposit (which are insured by the Government) and another 2% or so that the broker pays them out of his fee to entice them. The bank is happy, because it has new deposits and a new loan. And the borrower is happy, because he has his loan.

That's not only the way it works in theory, but also the way it works in practice a lot of the time. It isn't known how much money is channeled through brokers in the course of a year, but the total is probably somewhere around $750 million. Seaboard Corp., a Los Angeles company that is the largest money broker in the U.S., says it will place deposits of $130 million to $150 million this year, up from $50 million in 1968. These deposits probably will offset a like amount of loans, though the deposits offsetting any one loan can range from 20% to 200% of the face value to that loan. In most cases the loan is repaid to the bank, the certificates come due and the deposits are returned to the depositors and all goes well.

But sometimes—increasingly, Federal regulators say—all doesn't go well. The borrower defaults, and the bank is left with insufficient capital to carry on. Sometimes the borrower defaults because he was borrowing to finance a hare-brained scheme that failed. Sometimes he defaults because he was just a bad businessman. And sometimes, according to several court suits, he defaults as part of a conspiracy to defraud the bank.

"A SINISTER RING"

The nation's money brokers say it's too bad when one of these defaulted loans leads to a bank failure, but they fume at frequent suggestions that they are the true culprits. The money brokers say they are strictly middlemen. They don't

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lend money or assess the credit-worthiness of prospective borrowers, they assert, and they say the blame for any bad loans must be placed squarely on the bankers.

"When a bank goes under, the Government and the banking fraternity look around for a scapegoat," says one money broker. "The word 'broker' has a sinister ring, so if we're handy to take the blame, we get it."

The brokers are correct, of course. They neither lend money nor assess credit-worthiness. But the brokers aren't beyond reproach, many critics contend. These critics assert that some money brokers know that some of the borrowers they deal with are less than upstanding and that the brokered deposits sometimes tempt bankers into questionable deals. The critics also say that the 3% to 5% fee that the brokers charge the borrower is sometimes enough to push him under. And the critics say that some brokers know about, and participate in, schemes to defraud banks.

"KEEPING OUR FINGERS CROSSED"

Whether the culprit is bank, borrower or broker, it's clear that when the three get together a little bank can quickly get in trouble. In addition to the eight banks that have failed, many others may be in trouble, a Government regulator says. "We're keeping an eye on about 10 small banks that we know to have considerable amounts of brokered deposits," he says. "We are sure that there are others. We're keeping our fingers crossed."

Last February the Federal Deposit Insurance Corp., the Federal Savings & Loan Insurance Corp., the Federal Reserve System and the Comptroller of the Currency all sent letters to member institutions advising them "to be alert to schemes which would expose depositors' and shareholders' funds to the risks involved in loans based on brokered 'deposits.' "

Often banks can survive defaulted loans. The bigger the bank and the smaller the loan, the more chance there is for survival. But once burned, a bank isn't likely to take any more brokered loans.

The Citizens State Bank of Earth, Texas, for instance, no longer deals with money brokers. In 1968 the bank, which had assets of $3.4 million, made a three-month $100,000 loan to a New Yorker named Emanuel Lester after securing $200,000 in deposits produced on behalf of Lester by Sumner Financial Corp., a Jacksonville, Fla., money broker. It turned out that Lester had a police record that dated to the 1940s and included convictions for transporting stolen property and violating Federal gold laws. When his loan came due, "Lester was gone, and the stock he pledged as collateral turned out to be bogus," says a lawyer for the bank's present management. The bank still had to make good its obligations to the depositors, of course.

Lester, who authorities say has also used the name Emanuel Lieberman, currently is facing trial in Toronto on charges of possession of stolen securities and in Baltimore on charges of mail fraud. Hohn C. Sumner, president of Sumner Financial, says he knew Lester "only as a businessman." He says he put up deposits for bank loans to Lester on "two or three, maybe four" occasions. He says he hasn't heard from Lester in "over a year" and didn't know until now that he had defaulted on the Earth loan.

When the bank involved is smaller and the doubtful loans larger, the bank is a good bet to fail. That's what happened earlier this year when Iowa banking officials closed the State Bank of Prairie City, after classifying as unsound loans that "exceeded the bank's capital many times," according to Collin Fritz, the State banking superintendent.

Mr. Fritz says the largest group of loans in the "doubtful" category were to a group of some 30 companies and individuals, most of them from nearby Des Moines, who secured $850,000 in deposits through Seaboard Corp. to back up their applications for loans amounting to that sum. Some loans already are due and "not a dollar" has been repaid yet, says Mr. Fritz. "The bank was worth $2.5 million a year ago, and here it tried to swing one set of loans for $850,000. Without brokered funds, it couldn't have considered such a move."

As a result, Mr. Fritz has ordered that his office be contacted by any other Iowa bank that is approached to accept brokered deposits.

Bank failures linked to brokered deposits often are complex and tangled affairs. Federal and Michigan banking authorities still are trying to unravel the arrangement that led to last April's closing of the People's State Savings Bank of Auburn, Mich., a town of 1,500 residents.

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THE AUBURN CLOSING

Officials say the dealings began when Graham B. Alvey, a 56-year-old Detroit schoolteacher, got the idea to develop a resort at Sanford Lake, near Auburn. His search for funds took him to a number of financial sources, in the process of which he came into contact with Robert K. Drake, a Brodentown, N.J., auto dealer, and Frank Harris, head of a Birmingham, Ala., auto-leasing firm, who also were in search of loan funds. Mr. Harris called in Sumner Financial, the money-broker, and the four worked out a deal to get $3 million from People's State Savings Bank of Auburn. Mr. Alvey was to get $1.5 million before fees, and Messrs. Drake and Harris $750,000 each.

The Sumner firm was to secure matching deposits of $3 million. As is often the case when large sums are involved. Sumner farmed out part of the job to other brokers. In this manner both Seaboard and C. H. Wagner & Co. of Boston were brought into the deal.

During February, March and April, $2.7 million in deposits poured into the little bank. But instead of going into certificates of deposit in the names of individual depositors, the money was put into a checking account for Mr. Sumner's firm, and he began drawing it out. By the time state banking officials closed the bank, he had withdrawn about $2.3 million. Instead of CDs, the individuals who sent their money to the brokers received "irrevocable letters of credit," signed by bank president Donald Pickelman and cashier Gerald Nellett, for the amounts they put up.

Mr. Sumner says that of the $2.3 million he withdrew from the Auburn bank, he sent $733,950 to Mr. Alvey, $419,400 to Mr. Harris, $384,450 to Mr. Drake and $116,500 as fees to "others who helped arrange the loan." The rest—about $675,000—he says he kept for his own fee or put into an escrow account to pay the interest to depositors. He says that his role as "disbursing agent" for the funds was taken "to protect fees due to me." He adds: "It was part of the loan agreement."

"THE CRAZIEST THING"

Others aren't quite so clear on what happened. "The fact is that there's not a scrap of paper around to indicate that a loan was actually made or that any collateral was put up. It's the craziest thing there ever was", says Lloyd W. Bartlett, a Bay City, Mich., lawyer representing the Federal Deposit Insurance Corporation. The FDIC, which was named receiver of the bank, has sued Messrs. Sumner, Alvey and Drake for return of the money they received.

A suit also has been brought by several directors and stockholders of the bank who contend that Messrs· Pickelman and Nellett issued the "letters of credit" without proper authority and the instruments thus are not obligations of the bank. If they win, the FDIC might not have to pay off the brokers' depositors.

Mr. Alvey won't comment on the matter. His wife, Helene, also a defendant in an FDIC suit, directs questioners to lawyers Bartlett. He says the Alveys used the $733,950 "to pay debts." He says the couple has pledged their remaining property to make the Auburn debt good, and while it won't be enough he thinks the suit against them will be dropped. "What good is a judgment I can't collect?" he says.

Mr. Harris can't be reached for comment. Mr. Drake says he, too, is confused—"I thought I was borrowing from Summer"—but says he intends to pay the money back. He has sued the FDIC, contending that its charges hurt his business.

Mr. Summer says he has done "nothing wrong." He says he has been a money broker "on and off for seven years, steady for the last four," and has "never lost a nickel for an investor." He says he is being "smeared" by the Federal Government. "Nixon is trying to put the brakes on the economy, while I'm putting up money to keep it going. They don't like us," he says.

Another suit, in Kentucky, names the Seaboard brokerage firm as a defendant. In May the new management of two small Kentucky banks, the Corbin Deposit Bank & Trust Co. and the Bank of Williamsburg, sued in Federal court in London, Ky., charging that a group of borrowers, Seaboard and numerous holders of certificates of deposits got together with the former president of the Williamsburg bank and executive vice president of the Corbin bank to make loans totaling $2.25 million, which were "illegal," "fraudulent" and "worthless." Of that sum, about $1.4 million was actually paid out, backed by a similar amount of brokered funds supplied by Seaboard.

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Leading the group of six individuals and six corporations named as borrowers in the action is Samuel R. Calabrese of Los Angeles, who heads several companies, including Standard Computer & Pictures Corp. of North Miami, Fla. As collateral for the Kentucky loans, the group put up 200,000 shares of Standard Computer and 300,000 shares of Photo Mark Computer Corp. In separate actions last year, the Securities and Exchange Commission halted trading for a time in both those stocks. Eventually, the SEC obtained court rulings enjoining various officers and shareholders of the concerns against further violations of antifraud provisions of U.S. securities laws. Mr. Calabrese consented to the order but admitted no wrongdoing.

Mr. Calabrese was one of those named in the Standard Computer injunction. Among those named in the Photo Mark case was Emanuel Lester, who authorities say used unregistered shares in the concern to negotiate various purchases for Wiltron Associates, a New York firm he headed. Injunctions in the Photo Mark case also were entered against World Land & Realty Corp. one of the borrower-defendants in the Kentucky bank suits, and Anothony J. Romano, listed as the operator of T. J. Investment Co. of Ormond Beach, Fla.

According to Mr. Calabrese, he and Photo Mark came together when Photo Mark sought to acquire Colorvision Studios Inc., a California firm he heads. He says the deal didn't materialize, but through it he met Mr. Romano, who later arranged the Kentucky loans. For this, Mr. Romano and two Kentucky lawyers shared a $100,000 "finders" fee, Mr. Calabrese says.

According to Federal officials. Mr. Romano was convicted in 1967 of the use of interstate wires to commit fraud in connection with a scheme to sell a phony "battery" that never wore out. Currently, he is one of three men awaiting trial in Buffalo on charges of conspiring to transport stolen jewelry across state lines. One of his co-defendants in the matter is Salvatore Pieri, who was identified in the McClellan committee's 1963 Senate probe into organized crime as an "underboss" in a Buffalo-based branch of the Mafia.

Mr. Calabrese says the allegations of fraud in the Kentucky bank suit are "far from true." He says the bank officers bringing the suit "reneged" on the original agreement for five-year loans totaling $2.25 million. He says he put up additional collateral at the request of the new management, including first and second mortgages on real estate and $200,000 in cash, but it was later returned, immediate repayment of the $1.4 million was demanded and the suit was filed. He says he fully intends to repay the loans, "but I'll need one year more. The money is invested and I just can't shake it loose."

Seaboard Corp. says the charges against it made by the Kentucky bankers are "absurd . . . not true." Seaboard says it has sued the banks to force them to make good on the certificates of deposit it issued to investors that Seaboard provided.

A Seaboard attorney says his company has been involved before in loan transactions of Mr. Calabrese and "never had any trouble." In the present matter, however, the company is taking no chances. It has filed suit against Mr. Calabrese in a California state court, charging that he didn't pay his brokerage fee.

Today, over one full year after the failure of the Auburn Bank, litigation continues on the legitimacy of the obligations created by a few of the officers of that bank. Such uncertainty cannot be be allowed to jeopardize the investments of individuals who have placed their trust in any financial institution. My legislation, therefore, recognizes this fact and places the burden of regulation on the banker. To expect that individuals, often older, and more encouraged by the safety of banks than the uncertainty of market transactions, would be obligated by, or even be aware, of some of the schemes which prey upon small banks is unrealistic. The testimony of Chairman Wille of the FDIC indicates that the Corporation shares such a view. In his statement on April 20, the Chairman indicated that "the Corporation is not convinced that any essential banking service is performed through "money brokering" activities that could not be performed in some other way. The difficulties that a bank may experience through the misuse of brokered deposits by a bank management which makes poor loans with those deposits or is insensitive to the need for matching deposit and loan maturities far outweigh any benefits which might flow from the use of brokered deposits.

Certainly a practice which has caused uncertainty and financial loss for so many people during the past two years must be regulated. Upwards of 25,000 people have been victimized by the brokered money scheme and this is a real blot on the quality of existing bank regulations. It is painfully obvious that

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the Congress must act, and act immediately. I urge the members of this Committee to take whatever reasonable steps are indicated to rid our banking community of the potential for the type of disaster which occurred at Auburn last year and at nearly a dozen banks in the past two years.

Mr. Chairman, I would like to request at this time that the entire story of the Auburn bank, as recounted by two fine journalists in my District, be made a part of this record. I believe that this story, in its entirety, makes a more than sufficient case for the passes of this legislation.

[From the Bay City Times, June 28, 1970]

Times Reporters Unearth the Story Behind the Story

(By Ray J. Kuhn)

When Federal Deposit Insurance Corporation tacked a "closed" sign on the doors of Peoples State Savings Bank of Auburn last April 16 it appeared to be just another town bank failure. There had been infrequent but recent closings of similarly structured banks. Federal and state officials involved, although apprehensive of the consequences, did not appear disturbed.

And, with the exception of litigation which normally follows bank failures, the closing seemed to be just another one of those unfortunate events, precipitated by mismanagement.

But the story of the closing brought to light a new type of a loaning device involving "letters of credit."

How could letters of credit break a bank, are they a new banking device? editors as well as readers of The Times asked.

In ferreting out the answer, reporters of The Times have uncovered a bank manipulation which had sent at least 15 banks down the drain in six years and if permitted to continue could well shake the hallowed banking structure to its foundations.

Here on this page is the story behind the story of the closing of the Auburn bank.

It was unearthed in weeks of intensive investigation by two Times staffers, Michael F. Wendland, reporter, and Alfred L. Peloquin, city editor.

It elicited an observation from a top official of FDIC to the effect that it was only through persistence of Times reporters that the story of current bank failures which should have been told a long time ago is finally being brought into public focus.

The Times today is introducing its readers to the "Shadow Syndicate."

There will be much more to read on the same subject as the weeks go by. Ramifications surrounding the closing of the little bank in Auburn stagger the imagination.

Shadow Syndicate Seen Lurking in Background of Bank Failures

(By Michael F. Wendland)

Washington, D.C.—A shadowy syndicate, operating on the law's razor edge, has infiltrated the hallowed world of American banking.

It has played the principal role in the closings of a series of small town banks, including Peoples State Savings Bank of Auburn, Mich., last April 16.

And, in at least one of the failures, the Mafia, keystone of the Nation's organized crime, has figured in a large way.

The instrument by which the syndicate gets its foot in the bank door are called "letters of credit" or "certificates of deposit" and invariably are tied in with high risk loans.

And, the victims of the complicated finance scheming are for the most part small American banks whose officers are duped into opening up their vaults to some of the sharpest confidence men in the world.

Those are the frightening conclusions heard here from top federal investigators after a sudden series of similar bank closings around the country which sent a half-score of government agencies scrambling to come up with answers to questions many say should have been asked long before.

Much of their fear stems from a growing list of names being complied by several federal agencies, including the Federal Bureau of Investigation, the Federal

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Deposit Insurance Corp., the U.S. Treasury Dept., the U.S. Post Office Dept. and the Securities and Exchange commission.

That list—said to be made up of 100 or more individuals and probably the same number of companies—forms what some key government investigators are convinced is a massive network of white collar criminals who have now turned part of their attention to the legitimate field of high finance.

Many names had been known for years for their colorful freewheeling in financial circles, always close to the most exploitable situations around but just far enough away from the arm of the law to remain respectable.

Others are new and hidden behind a mysterious web of interwoven companies linked, to questionable transactions in the ripe financial markets of the world.

To the amazement of federal investigators here, it was not until the Auburn bank suddenly collapsed some two months ago that anyone outside of a handful of second-echelon officials realized something strange was going on.

Auburn was the fourth small town bank in just 15 months to close its doors after a whirlwind romance with a "money broker" from out of the area who had a plan called "link financing" to provide fresh capital for loans.

And then, just last Thursday, in a tiny farming community of 390 on the northern border of Kentucky, another bank suddenly went belly-up. It too had been having an affair with the same method of financing.

Although the practice is frowned upon by the big federal regulatory agencies, the plan is a tempting proposition for small town bankers in search of new assets.

The "broker," in a typical link financing package, promises to place large deposits in the bank on the condition that a loan is made to a third party.

Handled well, the plan can work: the bank gets large amounts of new cash, the broker collects a fee, the investors get interest on their "certificate of deposit" or "letter of credit" and the third party—who often is the one who puts the money broker in touch with the bank—gets the loan.

But if the banker is naive, the broker an unethical salesman or the third party a poor credit risk, the plan can be disastrous.

What is shaking up the officials here is that there has been a series of bank disasters lately.

And, except for the banks and most of the innocent investors who purchased the certificates of credit, the names of the brokers and others involved in the closing have often been the same.

In Auburn's case, some $2.7 million in brokered funds were deposited in the bank—all in an eight week period this spring—by 545 investors around the country who were talked into buying a $5,000 letter of credit which, at the end of two years, would return them $5,700.

Although there is nothing illegal about brokered funds and tied-in loans the practice has been involved, in varying degrees, in the closing of at least 15 of some 30 banks that have shut down since 1963.

Link financing had been under suspicion for some time. But when the practice broke the Auburn bank in April, officials here found their suspicion turning to fear.

And now, they realize, the last five bank closings—Farmers Bank of Petersburg, Ky., Auburn, the Prairie City State Bank in Iowa, the First National Bank of Coalville, Utah, and the Morrice State Bank of Morrice, Mich.—indicate a dangerous pattern.

In those five closings, and in a half-dozen other banks that have failed after becoming involved with link financing, many of the same names keep cropping up.

While the exact association between the names, if they are connected at all, is still too tenuous to chart, there is a growing concern about the vulnerability of small American banks.

"There's nothing wrong with brokering money into a bank," says John J. Slocum, chief of the FDICs liquidation division. "Just brokering money per se into a bank creates an asset. Its the resultant poor loans these banks made that caused them to fail."

Slocum, who has handled 20 bank liquidations in nine states, admits, however, to having "strong suspicions" about who is behind the recent failures.

"I suspect," he said, "that some of the same guys that I ran across in the other deals are still operating. Although their names are not showing up, I can see their hands in all this."

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Federal officials here say the last four closings, and many of the other banks that have failed in the past six years, indicate that small banks in particular appear to be the most vulnerable.

Besides all being located in small farming communities under 1,500, the banks were said to be "highly extended" and looking almost frantically for fresh cash.

In Auburn, the Times has learned, more than $200,000 in "bad" loans were on the books at closing time, not counting some $80,000 to a Sanford, Mich. resort operator.

"We find most of these banks were operating on a shoestring," one FDIC high-ranking examiner said. "They'd make loans to farmers on a handshake and not expect any payment until the crops came in, things like this. Besides, in a small town, the banker usually knows everybody and is much more inclined towards making these kind of loans."

Bad loans by small banks can make big problems and Auburn, the largest of the banks to go under because of link financing, was riding an uncomfortable position dangerously close to the minus side of the ledger sheet, the FDIC source told the Times, even though it had passed a routine bank examination in January of this year.

"We find very often that if any wheeling and dealing is going to happen, it usually occurs either immediately after an examination when there is enough time for these guys to come in and fleece the bank and leisurely moves on, or when the bank's day of reckoning with those uncollectable loans is coming near," he said.

For Auburn, both those times had apparently passed when, in mid-February, a novel plan involving the sale of letters of credit was drawn up and initiated.

In the Auburn case, letters of credit purchases brought $2,725,000 into the bank in less than two months. Of his amout, only $410,000, deposited in the account of the Florida broker who apparently devised the plan, was still in the bank. Some $30,000 remains unaccounted.

The FDIC claims the rest of the money, more than $2,300,000 had been disbursed: some 30 per cent as a loan to Graham B. Alvey and his wife, of Sanford, Mich., a business associate and two corporations; 16 per cent to Frank Harris and Robert K. Drake, of Alabama and New Jersey, who have indicated to federal officials they thought the money was a loan; a little under 2 per cent each to James McConnell of Florida and James Dondick, of Nevada, for their apparent services as "brokers" and some 34 per cent to Sumner Financial Corp. of Jacksonville, Fla., the original money broker who says almost half of its share went into a prepaid interest account.

The bank, which took on the liability of the $2.7 million in letters of credit, was left holding the bag. Not a cent of the money funneled out was secured by collateral.

"This letter of credit thing was unbelievable to us," a federal investigator said. "In the other closings, at least they had loan agreements made out for the brokered funds. In this case, it looks like it was a free giveaway."

The bank was closed by the Michigan State Financial Institutions Bureau on April 16, about a week after banking Commissioner Robert P. Briggs says an out-of-state woman presented a letter of credit to a teller at the Auburn bank who then called authorities.

But what led federal authorities to the Auburn bank in the first place began several weeks before, the Times has learned, when FBI agents, investigating the closing of the Prairie City Bank, found $3 million in unissued letters of credit.

The money broker who was to apparently steer the investors into Prairie City was the same Florida broker who handled the Auburn transactions.

Tracing the letters of credit found in Prairie City to a Denver, Col. printing firm, the FBI agents learned that a similar batch had been printed up for Auburn.

The Prairie City bank, the first bank shut down this year, was apparently negotiating with the Sumner Corporation at the time it was ordered closed Feb. 23 by state banking authorities for making faulty loans with some $850,000 in brokered deposits.

Although the president of the bank claims to have abandoned the letter of credit idea shortly before officials ordered the bank closed, a confidential treasury department directive sent to government bank examiners blames the Sumner firm for causing the Auburn and Prairie City failures and warns examiners to be on the lookout for dealings of a "questionable nature" between the company and still-operating banks, the Times has learned.

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An investigator for a legislative investigating committee has also told the Times that the Florida broker has been involved in "highly suspicious" financial dealings with banks in Texas, California and Ohio.

The investigator, who asked not be named, said the firm brokered funds into two banks in the two Western states in 1969 that were linked to $100,000 loans made to an ex-convict reputedly involved in organized crime.

But there are other brokerage companies also making the list that is now being drawn up by federal agencies here.

Seaboard Planning Corp., a Boston, Mass. firm, and two of its subsidiary companies, The Times has discovered, is known to have brokered deposits into at least six closed banks, including the three most recent.

That firm is now being sued by two Kentucky banks that charge fraud in a linked financing "scheme" that allegedly saw the banks collectively lose $1,430,000.

McConnell and Dondick who the FDIC say received some $38,000 each for their brokering services in the Auburn bank letter of credit transactions, have also had colorful financial careers.

Both men, in 1969, were charged by the Securities and Exchange Commission in the U.S. District Court in Maryland with violations of antifraud provisions of federal securities laws in connection with the sale of unregistered stock they allegedly had created a fictitious market for.

The two consented to the issuance of a permanent injunction forbidding them to sell the stock without admitting or denying the charges.

They are also, according to a federal investigator here, allegedly involved in a link financing transaction with an Ohio bank that lost more than $1 million in bad loans made on brokered funds.

Government officials here admit that much more of their suspicions lie in the names that remain behind the scenes in transactions that have led to a bank's financial woes.

The Times has learned, for example, that a Florida minister, the Rev. Yancey L. Anthony, well known to investigators here for his past dealings with troubled banks, has been linked to the Auburn closing.

Dr. Anthony was identified by Harris in the Auburn closing as the "titular" head of Church Mission Fund Baptist Foundation.

The foundation was to issue a $1.5 million long term mortgage that would partially secure the loan taken out by the Sanford real estate speculator, a former official of the closed bank has told the Times.

But when the bank were closed and the FDIC began searching the records, no trace of the mortgage was found.

"We thought the deal (mortgage) was on," the former bank official said. "If it wasn't, we wouldn't have gone ahead with the thing (letter of credit transactions) without collateral."

Rev. Anthony, who says he serves as a "consultant" not an officer for the foundation, has been involved in at least one other bank closing.

A $10,998 judgment was issued against him in U.S. District Court for the Northern District of Florida in 1967 in connection with an outstanding loan he, as "treasurer" of a small Florida company that officials say was nothing more than a "shell," had taken out in 1964 from the Crown Savings Bank of Newport News, Va.

That bank was closed in September the same year because of pyramiding loans made from brokered funds. A congressional subcommittee, which conducted 12 days of hearings on the failure, charged that the bank had been "virtually taken over by loan sharks, racketeers and persons with criminal records."

Rev. Anthony is also known to investigators of the Securities and Exchange Commission.

In May 1966, he and several other men were enjoined by a federal judge from selling some $14 million in unregistered bonds from a small Florida church where he was identified as the pastor.

The bonds, the SEC charged, were sold by fraud and misrepresentation by inflating the assets of the church using a variety of corporations and two "sham" banks that existed only on paper.

Then, there are still details about the Auburn closing that are puzzling federal investigators—like a series of trips made to Las Vegas, Nev., by Nellett.

Although Nellett, contacted by the Times, admits the trips, he says they had no connection with bank business.

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It is known, however, that investigators are looking into a November 1969 trip the banker made to Vegas with five other couples.

A woman, who claims to have been invited to go along but refused, has told this newspaper that she understood the four-day excursion was free, to be paid by a man whose last name is Harris, same as one of the principals involved in the letter of credits transactions.

The banker, and others on the trip including Bay County (Circuit) Judge Leon R. Dardas, have said they all paid their own way. The judge, who is a social friend of the banker, has told the Times he would disqualify himself from any court action involving the banker.

During the last visit Nellett made to Nevada in March, he told the Times, he met Harris who was on his way to Disneyland with his family.

"We met and had dinner and that was it," the banker said.

But the last trip, the banker says, was free, paid for by the hotel he was staying at.

"There's nothing unusual about that," he said, "they do that all the time if they think you're a high roller. They figure they'll make it all back at the tables. This FBI guy that talked to me kept asking all these questions about it like he never heard of it before."

All three federal regulatory agencies charged with overseeing the nation's banks have admitted concern over the increased use of link financing.

William B. Camp, comptroller of the currency and the man whose job it is to supervise America's 4,716 national banks, says it is "unsafe and unsound" for banks to use many brokers as a means of obtaining deposits.

Frank Wille, chairman of the FDIC, and Arthur Burns, chairman of the Federal Reserve Board, have both expressed similar displeasure about the increased use of brokered funds and have urged their examiners to be on the alert for "schemes" that could endanger banking deposits.

But the warning signs continue to pop up, the latest in the form of a shadowy overseas "bank" which has been making overtures to American banks.

The Bank of Sark, Ltd., St. Peter Port, Guernsey, Channel Islands, U.K., has approached several banks in this country with proposals to engage in certificates of deposit or letters of credit brokering.

"Extreme caution is urged in any dealing with the Bank of Sark," an FDIC memo dated May 22 said, warning all state insured banks under its jurisdiction that such operations may involve a "high degree of risk."

The English bank, located on an island, is quietly being investigated by the SEC and other agencies for its possible ties to fraudulent dealings in the insurance industry here and in Europe, the Times has learned.

Through a West Coast "foundation," the foreign bank is also believed to be connected with some of the companies involved in the link financing that closed several of the American banks, a legislative investigator says.

Just who is behind the sudden bank problems in the U.S. and why have they been allowed to operate?

"What you've got here is a syndicate, operating all over the country—internationally, in fact—that can work their way into any small bank and legally rob them blind in 30 days," says one FDIC legal aide here.

"There is no doubt in my mind that all these closings are connected," says a legislative investigator. "These people all know each other, their companies are interwoven behind an umbrella and they're out to take advantage of any situation they can."

"The Mafia is directly in it," says another official.

But action is still a long way off.

Officially, banking authorities say they are awaiting the results of a court suit in Michigan that will test the validity of the letters of credit before they begin full-scale investigations.

Unofficially, the second echelon authorities say their bosses are afraid of shaking the public confidence in American banking and jeopardizing an almost God-like respect for banks that has been carefully built up over the years since the Depression.

"With the economy going the way it is these days, banking problems are a touchy subject," admits one staff man for a high level regulatory official.

"Sure, organized crime is going after the banks. But that's not all they're going after. I think its important to keep that perspective. Banks are just a fraction of the problem."

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Rep. Wright Patman, D-Texas, chairman of the House Banking and Currency Committee, told The Times his committee is interested "in reviewing any information brought before (us) concerning bank closings."

Patman, however, says the regulatory agencies are primarily responsible for uncovering any "questionable practices" in banks.

"Most of these bank problems can be traced back to lax or non-existent bank supervision," he said.

The General Accounting Office here, in reporting that bank closings during 1969 brought a $2.7 million loss to the FDIC on $11.5 million insured deposits paid, said it is unable to determine whether FDIC examinations are of sufficient scope to be relied upon to identify serious problems at insured banks.

The congressional watchdog agency said FDIC auditors refused to give them unrestricted access to files and, because they couldn't among other things, dip deep enough, they were unable to discover the scope of potential problems in open banks.

But calls for congressional action are already underway. Rep. Elford A. Cederberg, R-Bay City, Mich., says, besides asking for a full scale probe of the bank closings, he is drafting legislation that would put tighter restrictions on banks involved with brokered deposits.

In Iowa, the state banking commissioner has ordered all banks under his jurisdiction to first apply to his office and get approval before accepting brokered money.

Nationally, Wille of the FDIC and Comptroller of the Currency William B. Camp have indicated they would be in favor of tighter restrictions.

"Just talking about it isn't any good," says Rep Garry Brown, R-Schoolcroft, Michigan's only member on Patman's powerful banking and currency committee.

"We've got to take steps to stop these small town banks from being fleeced. We don't want to regulate them to death, but we certainly should have better control."

Brown, who supports Cederberg's call for congressional action, says the method of operation in the bank closings is "very similar to the way organized crime works."

Meanwhile, the problem of link financing continues to grow.

In Nevada, Virgina and a half-dozen other states, federal officials are watching closely over banks, all reportedly deeply involved in brokered funds and high risk tied-in loans.

The only question is where will the next bank be that closes?

If federal watchdog agency officials here are right, it will be in a small town, have a large share of poor loans on the books and have been recently involved with some strangers called "money brokers."

STATEMENT OF MICHAEL J. KLEIN, VICE-PRESIDENT, J. P. CABOT, INC., NEW YORK, N.Y.

My firm and I are grateful for this opportunity to testify in relation to H.R. 5700. My firm is J. P. Cabot, Inc., which has been in business since 1963, serving investors by placing insured deposits in Banks and Savings and Loan Associations. No client of our firm has ever lost a cent of insured principal or interest through dealing with us, and we have provided a sound and valuable resource to small and medium sized financial institutions all over the country.

Our opposition to the provisions of this bill, which would illegalize our activities, is based on more than our obvious self-interest. Many facts have been overlooked or omitted in prior testimony, resulting in a misleading conclusion that recent banking problems result from the activities of money brokers. We hope our attempt at clarification of the situation will help the committee to draft legislation that will deal with the real problems, instead of unfairly banning the legitimate activities of money brokers. An incorrect approach will not solve the problems; will destroy an honest business; will unfairly, and perhaps unconstitutionally discriminate against smaller banks; and will still leave the door open to the same abuses.

THE NATURE AND SCOPE OF PRESENT MONEY BROKERAGE PRACTICES

The money brokerage issue is far greater in scope than the 264 banks identified by the F.D.I.C. as users of money brokers to the extent of $260 million. In fact,

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almost every bank in the United States is involved in some sense since almost all require compensating balances, ranging from 10% to 200% of the amount of any particular loan. Here is one example of the reason for the widespread use of compensating balances: A borrower may borrow $100,000 from a bank, but be required to leave $20,000 (20%) in a non-interest-bearing checking account. Thus, if he pays 6% interest ($6,000) on his $100,000 loan, but only has the use of $80,000, he is paying more like 7.5% for his loan, instead of the quoted 6%. Thus, the true purpose of compensating balances is to increase the return to the bank above the quoted rate. The compensating balance requirement would *not* be necesary if its true purpose were to be the provision of additional security to the bank. For clearly, if the borrower is only good for $80,000, but not for $100,000, the bank should lend him only $80,000, charge him 7.5%, and end up with the same degree of risk and the same return. But if the borrower *is* good for $100,000, the bank may permit him to get a third party to provide the $20,000 deposit that the borrower otherwise would have to maintain under the compensating balance arrangement. The third party may be a friend or business connection. If such sources are unavailable to the borrower, he may go to a money broker and pay him a fee to provide the deposits. Suppose he pays the broker 6½% to find the deposit. That would be $1,300 for a $20,000 deposit. His total money cost, thus, would be the $6,000 he pays the bank, plus the $1,300 he pays the broker, or $7,300 for the use of $100,000. He then has the use of his total loan, at about the same interest rate. Sometimes he even saves money.

This practice involves billions of dollars, and has always been a fact of banking practice. Please note, as will be emphasized later once again, that it is not the practice, in almost all cases, for brokers to introduce an unknown borrower to the bank, and offer deposits if the loan is made. It is the reverse: a bank offers to make a loan on its own merits, and REQUIRES compensating balances, which the borrower then seeks from an outside source. In tight money periods, banks may require 100% or more in compensating balances.

HOW THIS BILL WOULD PENALIZE SMALLER BANKS

Some of the largest banks in the country have used brokered deposits, although their large size permits them to do it in a way that doesn't give the appearance of doing so. For example, a large borrower may be required to keep a compensating balance of $1,000,000 in connection with a loan. The bank may permit the borrower to keep the balance in the form of a negotiable, even "Bearer" certificate of deposit. The borrower can then sell the certificate of deposit in the New York money market, through a broker, at a discount, sometimes on the same day. Thus a third party deposit is substituted for the borrower's deposit, through a broker. There is nothing wrong with this, but small banks (under about $400 million) cannot do this, since their certificates are not saleable in the money market. If H.R. 5700 were to pass, it would unconstitutionally penalize smaller banks. If there is something wrong with the practice, then compensating balances and negotiable C.D.'s should be banned to all banks, so that the large banks do not retain an unfair advantage. At present, there must be several billion dollars of C.D.'s of large banks traded in the secondary market which originated in the way I have described. During the tight money peak last year, many traded at yields in excess of 8% (which was above the regulation Q maximum).

We merely do for smaller banks, by a different mechanism, what big banks do through the market mechanism. If the principle is sound, all should be permitted to use it. If not, all should be barred.

THE POSITIVE VALUE OF MONEY BROKERAGE

Money brokers provide a vital function, and a large one, once one accepts the fact that many banking practices are money brokerage under a different name.

(a) We help shift capital from surplus to deficit areas, thus improving the efficiency of the money market mechanism, and furthering competition. A credit-worthy borrower, who may be intimately known to his local bank, may not be able to get an adequate loan only because of a regional capital shortage in some dynamic growth area of the country, such as the south or southwest. Money brokers help induce the necessary shift of capital.

(b) The hard-pressed local small home builder in many areas could not get construction loans from smaller local banks without services such as ours.

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(c) We help the small investor, who, by placing insured deposits through our firm, obtains one of the few fully safe outlets for his money. Our clients' principal and insured interest have always been 100% safe.

(d) We help the small banks, who have few other ways of obtaining funds to serve their LOCAL markets. To foreclose this method would put them at a greater competitive disadvantage viz-a-viz the big banks who have many other tools, such as:

(1) Advertisement for deposits in major money centers.
(2) Sale of commercial paper through bank holding companies.
(3) Eurodollar market operations.
(4) Sale of Negotiable C.D.'s in the money markets.
(5) Borrowing from foreign branches or banks.
(6) Sale of capital notes in the securities markets.
(7) Loans from the Federal Reserve System (not available to non-member banks).

ABUSES AND THEIR CAUSES

It is true that abuses exist. There are undoubtedly dishonest brokers involved in fraudulent schemes, as is the case in every line of endeavor. The malefactors should be exposed and subjected to the appropriate legal penalties, which exist. There are undoubtedly badly managed banks, which need better supervision. However, it is unreasonable to confuse the issue by blaming ONE source of money for the misuse of that money. If money brokers are to be banned, one might as well ban dealers in commercial paper, if some of the money raised in that way was misused by some corporate issuer.

In *all* cases that we have been involved in, and to our knowledge this is true of almost all other recognized brokers, our firm:

(a) Does not introduce borrowers to banks.
(b) Does not originate loans or cooperate in such origination.
(c) Does not create deals.
(d) Usually does not know the purpose of the loans.
(e) Does not pass on the credit of the borrower.
(f) Does not seduce inexperienced bankers into bad deals.

As mentioned above, we do not offer deposits to a bank on the condition that they make a loan. On the contrary, the bank makes the loan on its own merits, usually to a known local borrower (frequently a builder for construction purposes), and requires deposits as a condition of the loan. We enter the situation only at that point.

What then are the real abuses that need to be controlled? Fundamentally, they are poor bank management or fraud, affecting banks both large and small. Since the F.D.I.C. has to rescue mostly small banks, while the large ones absorb the losses, a false impression is created that the problems are only in areas where the F.D.I.C. is involved. Actually, the problems are widespread, and include:

(a) Self-dealing and self-serving loans. The F.D.I.C. has indicated that this is the problem in most problem banks, not just those which fail.

(b) Fraud, either in the bank, or outside it.

(c) Poor supervision.

(d) The liquidity squeeze of 1969–1970.

(e) Bad bank management of liquidity (which is unrelated to money brokerage). If some bank, in order to show higher earnings, invests short-term deposit money into long-term liquid tax-exempt bonds, problems can develop in declining bond markets.

(f) Loans to takeover companies, or other banks, securitd by the stock of the target company. If any difficulties develop, the collateral may be almost unsaleable, except at severe losses.

(g) Equity kicker inducements which distort credit evaluation.

(h) Out of area loans.

These matters are not the exclusive province of smaller banks or of banks which obtained brokered deposits. Some of our largest banks found themselves involved in large loan losses through bad judgment or fraud.

We are confident that appropriate legislation and regulations can be devised to counteract these abuses without annihilating our useful and honest function as a money broker—a function that has no direct connection with the abuses in certain banking practices. We support the sections of this bill relating to conflicts of interest, interlocking relationships and equity kickers. As an example of regulatory proposals which we support, the Federal Home Loan Bank Board,

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last week, proposed to prohibit certain types of self-dealing transactions by insured savings and loan associations; and also proposed to prevent savings and loan associations from providing compensating balances in banks where the balances are related to loans to any person affiliated with the savings and loan association. This type of regulation strikes at the source of problem-creating situations. It seems obvious to us that the type of abuses that the Federal Home Loan Bank Board wants to control would otherwise continue whether we exist as a money broker or not.

We are not adverse to regulations relating to our own activities which would permit us to continue our useful function while protecting the public and financial institutions fully. We offer our cooperation in a consultant capacity in the drafting of such regulations.

Thank you for your attention.

The CHAIRMAN. Without objection, Mr. Mitchell will be allowed to extend his remarks in the record.

Thank you very much for your testimony, Mr. Levine.

Mr. ROUSSELOT. May we be permitted now to ask questions?

The CHAIRMAN. Yes. Of course, these are unusual circumstances because we are staying so late to take these witnesses.

Mr. ROUSSELOT. That is right. Since the witness can discuss one major position of the bill—that is brokered accounts—I would like to ask some questions.

You mentioned that the broker's CD account, or certificate of deposit account, offers no fee to the broker. How does the broker make it worth his while to participate with this? I understand broker accounts in savings and loans, at least I think I do. They are paid 1 or 2 percent by the association.

Mr. LEVINE. By the association.

Mr. ROUSSELOT. But where does the broker get paid for his time if he is not paid a fee?

Mr. LEVINE. The broker is paid a fee, but not by the bank, in fact, it is illegal for the bank to pay them more than the usual amount permitted on a CD.

Mr. ROUSSELOT. So it is paid by the borrower?

Mr. LEVINE. It is paid by the borrower or a mortgage broker on the open market. We get calls from all over the country. In some cases it might be a borrower. But we have nothing to do with the banks, their loan policy or commitments or whatever they do with the money. We simply state when we request a certificate of deposit from an insured bank, gentlemen, issue this certificate of deposit in the name of so and so for a specific period of time, and please issue your normal negotiable certificate of deposit with your normal rate of interest. That is the sole instruction we give them.

Mr. ROUSSELOT. How does your association of brokers or—do you have an association of brokers?

Mr. LEVINE. No; we don't, unfortunately, we are scattered—there are many of us.

Mr. ROUSSELOT. About how many would you estimate?

Mr. LEVINE. I would probably estimate in the neighborhood of—it depends on what you call a broker—several hundred who engage in the brokerage business.

Mr. ROUSSELOT. The main concern of this committee and the purpose of this legislation is to prevent abuse where the broker and/or someone is representing the person that is not connected with that, some kind of a condition on a loan. How can that be prevented and, especially, on unwarranted loan?

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Mr. LEVINE. I think you come back again, sir, to this. If an officer in a bank, or a member of a loan committee is going to do something that is illegal and unethical and they make a poor loan, and if he somehow gets by the general loan committee in that bank, I don't really think there is any way that you can control this kind of dishonesty. But I think it is fair to say that when a bank needs money—I think someone on the committee talked last week about a big plant being built in Mississippi and there were just a few associations, and they certainly needed money. These people may need money desperately and go out in the brokerage market and borrow money. But it doesn't mean that they will put that money into bad loans. The loans made probably are excellent loans. But that is not a function of the broker. That is a function of the bank or the bank committee or the loaning officer.

Mr. ROUSSELOT. What is the average fee that you would receive on a percentage basis on a broker CD?

Mr. LEVINE. On a broker CD it will vary, it could vary right now from as little as three-quarters of a percent conceivably to as high as 2 percent.

Mr. ROUSSELOT. So it is not much different from the savings accounts that are acquired in the savings and loan business?

Mr. LEVINE. It is, because in one case you have a direct continuing relationship with the institution and in the other case—I might get a call from an interested party for $500,000 for a 6-month certificate of deposit for a commercial bank and never hear from them again the rest of my life. That is the difference between a certificate of deposit transaction and an association relationship for years with people who know you and know that your money is good, long term money. If you are in a bank you get a one-shot deal and you may never hear from them again. But on the other hand, a year later they might ask you for a million dollars.

Mr. ROUSSELOT. How can we be assured that the brokers are not engaging in the kind of abuse that we have been informed does occur and, that is, they are brokering CD's on the basis of some kind of a condition of a loan?

Mr. LEVINE. I can only tell you that I have talked with some of the outstanding brokers in the brokerage field in my area and we do not know—at least, we do not engage in such practices, and certainly my firm does not. The others have told me that they do not engage in them. We don't know how this happens. We can understand that conceivably this happens once in a blue moon. You may have something happen once out of thousands of loans and out of millions or possibly billions of dollars of funds. And, yet, again I come back to the point that you can't stop it. It is very difficult for me to believe that a broker can talk to a loan committee and say, you make out a loan or we won't give you the money. It is hard to conceive.

Mr. ROUSSELOT. Then you object to this kind of information in the law which would prevent any connection between the brokerage and the time loan?

Mr. LEVINE. In the case of broker CD's, I am strongly for it; I agree that this is an area where it can be done simply by regulation and not wiping out an entire useful industry.

Mr. ROUSSELOT. I understand my time has expired.

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The CHAIRMAN. Yes, sir; Mrs. Sullivan has agreed to act as chairman. Thank you very much.

Mrs. SULLIVAN (presiding). Mr. Levine, the question I wanted to ask you is, you mention on page 2 that the brokers receive a one-time fee directly from the asociation at the legal rate. Is the association the savings and loan to whom you——

Mr. LEVINE. Direct the loans.

Mrs. SULLIVAN. Mr. Wille of the FDIC was the one who said last week—and you were in the audience— he said this in testifying on another issue—that there were violations in the handling of brokers' fees by the banks and the associations. And while it is true that many of them would be honest suppliers of money, there have been and can be some who come in as brokers, and say, I have this amount of money, and these are the people I want the money to go to, and there is an understanding. I don't know if that is illegal or what.

Mr. LEVINE. It is not a matter of being illegal, Mrs. Sullivan, it is a matter of being practical, because no one can walk into a savings and loan association and say, "I want to be your broker today." They deal with people who are recognized, reputable sources of funds.

Mrs. SULLIVAN. You deal only with savings and loans?

Mr. LEVINE. Basically, yes. We do some certificate-of-deposit business. We have helped minority banks, Puerto Rican banks, and we have been instrumental in educating unions and getting their pensions and trusts going. We have helped minority banks that needed help desperately. Some of them started with $300,000 capital under the law. And I tell you that I have personally put into minority banks twice as much money as the capital that they had in order to help them get a start. You may say that they don't need you, that they can go out and borrow from the Federal Home Loan Bank. But experience has shown that the money they get from us is much cheaper than they get from the Federal Home Loan Bank Board.

Mrs. SULLIVAN. Especially in times of tight money where you are the supplier of funds that you can bring to an association for use as loans, or whatever they decide to use them for?

Mr. LEVINE. We assume that savings and loans have made more housing loans than all of the other sources combined, including commercial banks and everyone else, insurance companies. Saving and loans are the largest source for housing loans. We assume that the normal continuing supply of money coming from all over the country and even from their own deposits is used normally in the course of their business for making loans, and that they are solid, intelligent loans. And if in the course of thousands of transactions, one of the officers sometimes makes a mistake, or even does a fraudulent thing, my point is, this is not an excuse for eliminating an industry. You regulate it, you don't destroy it.

Mrs. SULLIVAN. Thank you. I want to question Mr. Green and Father Martinez.

Gentlemen, what you have given us in this testimony is something we uncovered here in Washington, D.C., in an ad hoc committee which I chaired 2 years ago, where the speculators, the real estate speculators, went out and bought property and they would hold this property and come to a savings and loan in Washington, D.C., to get maybe $100,000 to $3 or $400,000, under their name from a savings and loans

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institution as the mortgagor. Then this speculator would go to individuals and sell to them at inflated prices and become the mortgagee. This would mean that the individuals who had purchased the individual property, make the mortgage payments to the speculator—who in turn was responsible for the payment of the original mortgage held by the savings and loan. We uncovered much of the wrongdoing on these things where a piece of property would change hands four times within a day or two, the same piece of property, and no monetary consideration changed hands in these so-called sales. This is accomplished by the use of strong parties, each transfer jumping the cost of that property, so that by the time the mortgagor went to the savings and loan, the price had been greatly inflated. And we found out that none of these loans went through FHA. Many of them were conventional loans, not just by the savings and loans, but also by some "nice fellow" down the street.

But the one thing—and this is what I was thinking of with you, sir—was that sometimes brokers as well as speculators become involved in this type of a transaction. What we are trying to correct by changes in the regulations of savings and loans is to prohibit the practice so that no person can get a loan for any high amount, then break it down into small loans, with the original speculator responsible for paying back this principal amount to the savings and loan. The savings and loan are paid back. But, in the meantime, the speculator is gouging the uninformed person to whom he sells a portion of the original property which is security for the original debt to the saving and loan. This very often is property beyond the means of the purchaser from the speculator, and when defaults occur the speculator then takes it back and resells it to another unsuspecting victim. This is what we have uncovered. In reading part of your testimony, I think you have probably had some of the same problems.

Father MARTINEZ. Yes, we have.

Mr. GREEN. I think ours is a little different in Baltimore in the sense that the speculator will guarantee to the savings and loan the mortgages which they will issue on this particular speculator's customers. Our information seems to lead us to believe—of course, we have no way of going into it—that some of the savings and loans were set up by the speculators to help them to exploit the black families in this city. Jefferson Savings & Loan are just an example of what is going on. Our information leads us to believe that there are many in this city which are doing the same thing.

Mrs. SULLIVAN. I want to read this testimony a little more carefully, so I can understand more clearly what you are telling us. Because I think that we have seen people exploited, not only black people, but white people and uniformed people, when they were buying pieces of property, thinking that they were going to a reputable financing agency for the mortgage.

Father MARTINEZ. Mrs. Sullivan, we sent our studies to the Home Loan Bank Board, and we have a letter from them which I have here, in which they implicitly admit the truth of everything we say. And then they tell us that nothing can be done about it. They say that their responsibility is to the depositors. And they seem——

Mrs. SULLIVAN. Is to whom?

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Father MARTINEZ. To the depositors, and the people they have insured. And they say that there is nothing that they can do about the kind of loans that are made. And yet they are supposed to be regulating their savings and loans which are violating the regulations of the Home Loan Bank Board itself.

Mrs. SULLIVAN. It seems to me that there is a responsibility that they have as to how that savings and loan is operating, whether it is operating in a legitimate way or not. And it is true that they are responsible, but in the end the Home Loan Bank Board is not responsible for the insurance. That is the Federal Deposit Insurance Corporation, but the Federal Home Loan Bank Board is responsible for how the savings and loans, which are Federally insured—not only Federally insured but Federally chartered—they are responsible for how they conduct their business.

And if you would give us a copy of that letter, we will see that it is placed in the record and follow it through.

Mr. ROUSSELOT. I was going to ask that the letter be placed in the record.

(The letter referred to follows:)

FEDERAL HOME LOAN BANK BOARD,
Washington, D.C. February 18, 1971.

Mr. SAMPSON GREEN,
Chairman, Activists, Inc.,
Baltimore, Md.

DEAR MR. GREEN: Thank you for your letter of February 1, 1971, and attached research studies concerning the housing situation in Baltimore Maryland.

During recent years, we have been aware of the lending conditions you described with regard to Jefferson Federal Savings and Loan Association. Our past supervisory actions in this matter have consistently been directed towards curtailing further low equity hame financing, lending to real estate speculators, and any Federal lending violations by the association. The last examination of Jefferson as of March 13, 1970, covering the period from March 6, 1969 to March 13, 1970, disclosed that the association had ceased making loans to and for the type of speculators named in your report.

A current examination of the association was started on February 16, 1971 by our Federal examiners. In the course of this examination, the matters described in your report will, of course, be of major concern in our appraisal of the association's present lending policies and practices.

You have requested that the Federal Home Loan Bank Board freeze the assets of Jefferson Federal pending the confirmation of your charges against this association. Such authority is provided to the Federal Savings and Loan Insurance Corporation by the National Housing Act of 1934 in the case of default of a Federal association. This provision is included within Section 406 of the Act which reads as follows:

". . . In the event that a Federal savings and loan association is in default, the Corporation (Federal Savings and Loan Insurance Corporation) shall be appointed as conservator or receiver and is authorized as such (1) to take over the assets of and operate such association, (2) to take such action as may be necessary to put it in a sound and solvent condition, (3) to merge it with another insured institution, (4) to organize a new Federal savings and loan association to take over its assets, or (5) to proceed to liquidate its assets in an orderly manner, whichever shall appear to be the best interests of the insured members of the association in default . . ."

The merger of Republic Savings and Loan Association of Washington, D.C., which you also mentioned in your letter, was an example of a default which involved financial assistance from the FSLIC under a similar statutory provision. At this time, we have no indication that Jefferson Federal Savings and Loan Association is headed toward such a financial default. Therefore, we do not have the legal authority to freeze their assets as you suggest.

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Again, I would like to thank you for your concern with inner-city housing problems. We greatly appreciate your efforts in this area and sincerely hope that the above reply will adequately serve your purpose.

Sincerely,

PRESTON MARTIN, *Chairman.*

Mrs. SULLIVAN. Mr. McKinney.

Mr. McKINNEY. Is the Chairlady finished?

Mrs. SULLIVAN. All right, go on.

When I do this, it is usually informal.

Mr. McKINNEY. You have taken me right down the railroad track that I was hoping that we would go on with Mr. Green and Father Martinez.

I have read your reports and I think they are admirable. They are complete and total and they are a rather clear picture of what is going on. At least three cities in my congressional district, I am afraid, in some cases. But I have a feeling that your conclusion in front of this committee is slightly incorrect. And I would like to follow the Chairlady's conversation and bring us to where I think we should be.

I think it is an oversimplification for you to bring the condition of the Jefferson Savings and Loan—believe me, I would like to hear their side of it, too—however, I find your case rather conclusive from what I have seen. And interlocks, as we have been discussing in this bill, the problem as I see it in the case you have brought before us. I could give you 15 or 20 reasons that I personally deem the problem. For instance, I think one of the base problems is the fact that we don't have a Federal housing program; that is, designed totally and completely for older occupancy.

But we could go further than that. But the problem here seems to me to be the regulation of savings and loan associations.

And to go a step further than that, I believe that our problem here is that Congress in its wisdom, as we always seem to say, has not seen fit to regulate the other end of the banking or savings and loan business. We are protecting the depositors in savings and loans, but we are not, in essence, protecting people from what savings and loans do. In other words, if a savings and loan bank or a mutual savings bank is to receive the favored tax treatment that these organizations received, there should be an obligation on their part to make sure of their ability to loan money in the market, particularly in the market that they are charged basically to loan money to, which would be the individual ownership of real estate. In some States it is very specific, and in others unfortunately—maybe in there that it isn't—this is where I think you should be holding with your work. This is what we should be doing, controlling the amount of money that any savings and loan and mutual savings bank can loan to any—not the amount of money but the number of individual loans that any savings and loan or mutual savings bank can give to one individual for low cost housing.

Second, I think we should be very specific—and I don't feel that we have been—about loaning the money through savings and loans and through mutual savings bank for further dissemination as individual loans. In other words, we should assure ourselves and enact into law legislation providing that loans made by savings and loan associations, or mutual savings banks for real estate purposes are made to individuals for those purposes, not to intermediates who have done what is evident in your case in Baltimore. Quite frankly, I have heard

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other testimony and read other cases of mutual savings and loan associations and which I felt were in conflict with what I have heard in this committee. And I have found in my particular State, which is Connecticut, that the mutual savings banks were doing more with low income housing than almost anyone, including the State itself, and that we were getting a lot of this conscientious advice through the fact that we did have people who were capable and knowledgeable and, therefore, find what you call interlocks on the Board. But with good State regulations, as to the amount of business they could do with the bank involved and good State regulation as to what is done with the money the bank is loaning out, or Federal legislation, I don't care which, I think would provide the solution to the problem over what is happening in Baltimore.

Father MARTINEZ. I think it would help if this conflict of interest would at least separate out some of the people a little bit, and also if we had disclosure of who had control of the savings and loans, which we can't get, we don't know who has the deposits in them.

I would like to make it very clear that a lot of what has happened could have been avoided if we had laws instead of mere regulations, because now there is no criminal recourse for the families that have been exploited.

Mr. MCKINNEY. I think that, basically, you have to have a general overall purpose expressed in law but lived up to by the regulations controlling it, with Congress supervising their control.

Mrs. SULLIVAN. A table was given to me for the record. I think this would be a good place to insert it. So I ask unanimous consent to submit for the record the table showing the interlocking directorate situation between 29 savings and loan associations and other financial institutions in Baltimore. Between these 29 savings and loans and other financial institutions there are 77 interlocks. So we will make it a part of the record at this point.

(The table referred to follows:)

BALTIMORE—29 SAVINGS AND LOAN ASSOCIATIONS AND THEIR INTERLOCKS

Name of savings and loan Association	Commercial banks	Trust companys	Savings banks	Federal savings and loan	Building and loan	Mortgage companys	Credit corporation	Total
Advance Federal					1	1		2
Arlington Federal	2		1		2		1	6
Augusta Building and Loan	3			2	1	2		8
Baltimore Federal	2	1		1	1			5
Belmar Permanent Building and Loan						1		1
Bohemian American				2				2
Brehm Building Association	1							1
Capital	1	1						2
Century				2				2
Edmondson Federal	1							1
Fairview Federal	1							1
First Federal, of Brooklyn	1				1			2
Fraternity Federal	1							1
Germania Federal					1			1
Hamilton Federal	1			3	1			5
Homewood-Clinton	2							2
Irvington Federal	1							1
Liberty Federal	10	2						12
Loyola Federal	1							1
Midstate Federal				2		1		3
Premier						1		1
Progress Federal	1							1
Rosedale Federal				1				
State-Sun Federal			1					1

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BALTIMORE—29 SAVINGS AND LOAN ASSOCIATIONS AND THEIR INTERLOCKS—Continued

Name of savings and loan association	Commercial banks	Trust companys	Savings banks	Federal savings and loan	Building and loan	Mortgage companys	Credit corporation	Total
Union Federal	1	1						2
Vermont Federal	5				2			7
West Baltimore Building Association	1							1
Westview Federal					2			2
Wyman Park Federal				1	1			2
Total	36	5	2	14	13	6	1	71

Father MARTINEZ. Mrs. Sullivan, will we have our studies in the record, also?

Mrs. SULLIVAN. Yes, they will all be made a part of the record.

Mr. Mitchell.

Mr. MITCHELL. Madam Chairman, I would like to make some brief remarks prefacing a formal request which I will then make. It seems to me that based upon the evidence presented here before the committee, there is a need for Mr. Barrett's housing subcommittee to hold subsequent hearings to plumb the whole business of interlocks as a tie-in with the installment contracts. They are pernicious devices which really prevent people from ever becoming homeowners. It seems to me also that it would be beneficial if Mr. Barrett's subcommittee would look into the whole area of whether there is redress at the State level. I started to propose the matter of redress, relief as a specific question to both of you gentlemen, and whether or not these matters have been brought to the attention of the attorney general in Maryland. But the more I think about it the more I believe it is in proper form to have this done by Mr. Barrett's subcommittee. Therefore, I will make such a request through you as acting chairman to be relayed to the chairman. The request is that the Housing Committee do a full scale, indepth analysis of this study.

In addition, I have also been granted unanimous consent to revise and extend my remarks. I have the opportunity now, I shall extend and revise my remarks now, since it will only take a few minutes. I formally request that members of Mr. Barrett's subcommittee come to Baltimore specifically for the purpose of exploring the possibilities of remedial action, so that we won't have these thousands and thousands of black people literally swindled out of their homes.

Mrs. SULLIVAN. Without objection, it will be made part of the record. And we hope that Mr. Barrett's subcommittee can come up with some recommendations once they go into effect.

Do you have any further questions?

Mr. ROUSSELOT. Yes.

In the report published by the organization in February 1971, called "The conspiracy to defraud and explore the home buyers." On page 5, you mention that originally Valley Federal Savings and Loan changed its name to Jefferson Savings and Loan in 1964. And then you listed Jefferson's present directors. And I noticed that one is Marvin Mandel, who went off the board when he was appointed Governor. Do you feel that in any way inhibited your ability—because

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he is now the Governor—to get a fair hearing on the problems that you have discussed here today?

Mr. GREEN. I can say this, Mr. Rousselot. We have presented this problem to the State officials over and over again, and I have received no consequential action from the State at any time.

Mr. ROUSSELOT. Do you feel that this has been part of the reason that you haven't had a fair hearing, is possibly because he is now the Governor, and he was formerly a member of the board of directors; that he might somehow or not be willing to have some informaton come to light?

Mr. GREEN. From the information we have, I wouldn't think the Governor would be overjoyed to have the full revelation of what has been going on the saving and loan that he has been involved with revealed to the public, no.

Mr. ROUSSELOT. I notice another one who was a local judge. Is he still a judge?

Mr. GREEN. Who?

Mr. ROUSSELOT. Daniel Friedman.

Mr. GREEN. Yes, I believe he is.

Mr. ROUSSELOT. I sympathize with the problems that you might have.

Father MARTINEZ. It seems like you are up against everybody in a way. The Real Estate Board of Greater Baltimore, the Real Estate Brokers, all have used these people in order to avoid providing services. So everybody is sort of uptight and together about not doing anything. The Real Estate Commission does not enforce its own code of ethics. The trade organization has a code of ethics, but it is a question of the laws, how they are not enforced in the black community, they haven't been over the years. And a lot of the people involved in it, the commercial banks——

Mr. ROUSSELOT. You certainly have a very vigorous Congressman now representing you, so I am sure that he will make sure that these inequities are brought to our attention in those areas where the Federal Government can do something.

On page 2 of your testimony, you refer to the largest housing speculator in Baltimore. I do not know Mr. Goldseker. And you also refer to the Jefferson Federal Savings and Loan and you talk about the purchase of 1,768 homes and 741 were resold at an average of $6,600, roughly, and were resold again at an average of $12,000. So that we know the answer to this, I assume that you have looked into all these sales so that you know whether there was or was not some value that would really have the question of taking them, charging that amount; in other words, was there a real value? Did they remodel or something of that sort?

Mr. GREEN. Some of these properties were held as short a time as 2 months by the Goldseker Corp., and no substantial improvements of any type put in, maybe wallpaper or cleaning up the floors or something of that type.

Mr. ROUSSELOT. There was no substantial new value put into the home to justify such an increase?

Mr. GREEN. No.

Mr. MITCHELL. Will the gentleman yield?

Mr. ROUSSELOT. I would be glad to.

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Mr. MITCHELL. It seems to me the overriding factor here was the exploitation based upon changing neighborhoods. It is apparent that within that time factor that Mr. Green just alluded to, it is impossible to go through any substantial renovations of that number of homes so as to increase the value. So we are forced to assume that it was just rank exploitation based upon change in neighborhoods.

Father MARTINEZ. Also, the FHA houses in the same neighborhood must be in good condition and they were sold from $9,000 to $10,000. So the neighborhoods themselves are not run down neighborhoods, which would only be purchased for rental. But when you are going to buy and sell houses, they have to be in an attractive neighborhood and be relatively new. So these are the areas where the change occurs. He does have his expenses, of course. He gives a 1-year guarantee, and some other things like that, but the prices are fantastic.

Mr. ROUSSELOT. What about the other 1,000 houses, did you look into those, too, or is it just the one segment that you picked out, the 742?

Father MARTINEZ. He rents the rest of them, or he has them on some deceptive type of contracts where the families think they are buying them.

Mr. ROUSSELOT. I thank you gentlemen for your testimony.

Mrs. SULLIVAN. I thank you gentlemen, Father Martinez, Mr. Green, and Mr. Levine for coming, and I hope we can get some conclusions and answers or suggestions as to what we might do with your problem.

Thank you very much.

The committee is recessed until tomorrow morning at 10 o'clock.

(Whereupon, at 2:05 p.m., the committee recessed to reconvene at 10 a.m., Tuesday, April 27, 1971.)

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THE BANKING REFORM ACT OF 1971

TUESDAY, APRIL 27, 1971

House of Representatives,
Committee on Banking and Currency,
Washington, D.C.

The committee met, pursuant to recess, at 10 a.m. in room 2128 Rayburn House Office Building, Hon. Wright Patman (chairman) presiding.

Present: Representatives Patman, Barrett, St Germain, Minish, Gettys, Annunzio, Griffin, Chappell, Koch, Widnall, Johnson, Brown, Williams, Rousselot, McKinney, Lent, and Archer.

The Chairman. The committee will please come to order.

This morning we have before us three distinguished scholars who have studied several of the problems that concern this committee in connection with H.R. 5700 and related legislation.

Although there is a feeling among some that academic research in areas such as economic concentration, interlocking directorates, antitrust matters and others, are often ivory tower exercises. I have always been of the belief that the broader overall view often brought to complex problems by scholars is essential to a well-rounded consideration of legislation. Far too often we legislators inadvertently concern ourselves so much with the legalistic details and so-called practical problems, that we fail to consider the overall public policy considerations.

It is with this in mind that I welcome to the committee today, Prof. Donald Farrar, formerly of the Columbia School of Business and now with the University of Pennsylvania School of Law, who was the director of the institutional investor study recently completed by the Securities and Exchange Commission; Prof. Jerome C. Darnell of the School of Business Administration at the University of Colorado, a long-time student of various aspects of control of banks, including the phenomenon of "chain banking"; Prof. Peter C. Dooley of the University of Saskatchewan, who has studied the problem of interlocking directorates, most recently expressing his views in an outstanding article in the June 1969 issue of the American Economic Review.

Professor Farrar is here today primarily to answer questions concerning the institutional investor study, about which Commissioner Richard Smith testified before the committee last week. Professor Farrar may have a somewhat different approach to the study than the Commission does. As I understand it, Professor Farrar does not have a prepared statement. If you wish to make a few opening comments, we would be glad to hear them, and you are recognized for that purpose.

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STATEMENT OF PROF. DONALD E. FARRAR, SENIOR FELLOW, UNIVERSITY OF PENNSYLVANIA LAW SCHOOL, CENTER FOR THE STUDY OF FINANCIAL INSTITUTIONS

Mr. FARRAR. Thank you very much, Mr. Chairman.

I do have some opening comments. I must apologize for not having them in time to submit to the committee prior to its deliberations this morning.

Mr. Chairman, members of the committee.

Thank you very much for the opportunity to be here today and present my views on H.R. 5700. As the chairman indicated, I served as director of the Securities and Exchange Commission's recently completed institutional investor study. I must add, however, that my remarks today represent my thoughts alone. Commissioner Richard B. Smith, who oversaw the study as the Commission's representative, already has testified as to the Commission's official views regarding this legislation.

My remarks today can be broken into two sections. The first summarizes briefly three separate analyses reported in chapters V and XV of the *Institutional Investor Study Report*, dealing with bank trust departments and relationships between institutional investors and corporate issuers; the second reviews H.R. 5700 with these and other portions of the Study as seem appropriate, as background.

As many of you know from Commissioner Smith's testimony before the committee last Wednesday, the Securities and Exchange Commission was instructed by the Congress in Public Law 90-438 to study the impact of:

> Institutional investors of all types (including, but not limited to, banks, insurance companies, mutual funds, employee pension and welfare funds, and foundation and college endowments) . . . upon . . . securities markets, . . . the issuers of securities, and . . . the public in order that the Congress may determine what measures, if any, may be necessary and appropriate in the public interest and for the protection of investors.

The study's focus, accordingly, was on the managers of large, equity-oriented portfolios. Thus, bank trust departments, insurance companies and investment advisers were the principal institutional types covered. Bank commercial departments were studied only in so far as they affected either the behavior or the competitive position of their trust departments. I also should mention that the study's primary emphasis was on institutional trading and market impacts, although two rather important chapters do deal with impacts on portfolio companies.

CONCENTRATION

Chapter XV deals with shareholder relationships between institutional managers and the companies whose securities they hold. Part C of this chapter deals in a very simple, factual way with the extent to which the outstanding equity securities of a, hopefully, broadly representative sample of 800 corporate issuers are concentrated in the portfolios of relatively few, large financial institutions. The institutions surveyed for this purpose include the Nation's 50 largest bank trust departments, 26 largest life insurance companies, 21 largest property and liability insurance companies and a group of 97 large investment advisory firms.

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Very simple tabulations of this data show that the three largest institutional holders of common stock together hold more than 5 percent of the market value of all 800 of the stocks in the study's sample. The 10 largest institutions hold more than 10 percent of the sample's outstanding shares; the 20 largest hold more than 15 percent; and the 40 largest more than 20 percent of these shares. Of even greater interest is the fact that all 10 of the 10 largest holders of these shares are bank trust departments. By contrast, the 10 largest insurance companies hold only slightly more than 1 percent of the sample's outstanding shares and the 15 largest investment advisers less than 5 percent.

Person's views as to what constitutes an institutional investor have been affected significantly by this committee's 1968 staff report of commercial banks and their trust activities and by the Commission's institutional investor study. In each, an institution is defined not in terms of beneficial ownership as had previously been customary, but in terms of the managerial unit. Thus, a bank, or an insurance company or an investment adviser rather than a pension fund or a mutual fund is defined in these studies as the institutional "unit". The difference resulting from such a simple change in perspective can be illustrated, perhaps, by recalling a finding by the NYSL in the early sixties that the 117 largest institutional investors together held only 4.08 percent of the market value of outstanding shares listed on that exchange. Replacing 117 by 10 institutions and 4.08 percent by 10 percent of outstanding shares leaves one with quite a different impression regarding the extent to which shareholdings are concentrated in institutional hands.

As might be suspected, however, concentration is not distributed uniformly across all the Study's sampled issues. As developed quite forcefully in chapter IX, institutional portfolios themselves tend to be relatively concentrated, primarily in the shares of larger companies. Thus, in chapter XV we see that the two largest holders of IBM stock together hold more than 5 percent of the company's outstanding shares; the three largest holders account for more than 10 percent of the outstanding; six holders account for 15 percent; and 10 institutions together hold 20 percent of the company's outstanding shares. The single largest holder of Xerox common stock holds more than 5 percent of that company's shares; two largest holders account for 10 percent; three holders account for 15 percent; and six account for 20 percent. Separate tabulations for each of the study's 800 common stocks demonstrate that, although IBM and Xerox are indeed institutional favorites, they are far from alone. Indeed, the single largest institutional holder of nearly half of the study's billion dollar companies (24 out of the 55 companies of this size in the sample) holds more than 5 percent of outstanding shares. Five or fewer holders together muster 5 percent or more of the shares in nearly all these companies (48 out of 55), 10 percent or more in 37 of the 55 companies, 15 percent or more in 20 of the 55 companies, etc.

Separate tabulations for banks again demonstrate the dominance of this group in terms of holdings. Virtually all of the five or 10 largest institutional holders of most of these securities are bank trust departments.

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MULTIPLE BUSINESS RELATIONSHIPS

A second set of the study's analyses, reported in part D of chapter XV, considers not only stockholdings but also other business and personnel relationships between institutional investors and corporate issuers. Both their absolute incidence and the extent to which these links tend to cluster in the same institution-company pairs are analyzed in some detail. Again, banks are distinguished from other types of institutional investors both in terms of the number of their various relationships with corporate issuers and in terms of the degree of correlation—or clustering—exhibited by these relationships.

For example, the study's 50 largest banks possessed more than 5,300 shareholding relationships with the subset of 288 portfolio companies examined; they simultaneously possessed approximately 1,200 creditor relationships, 1,600 depository relationships, and 240 employee benefit plan manager relationships with the same set of companies. Each bank, on average, could be said to "know" through at least one such relationship more than 40 percent of the 288 companies. Each investment adviser, by contrast, "knew" approximately 15 percent of the companies (almost all because of stockholdings), each life insurance company "knew" 14.4 percent, while the average, large property and liability insurance company "knew" by this definition less than 12 percent of the covered companies. Banks also have by far the largest number of personnel relationships—deprived as officer-director interlocks—with the companies.

A second level of analysis examined not only the incidence but also the extent to which multiple business relationships tend to be focused on the same institution-company pairs. Among banks the existence of one business or personnel relationship, such as a stockholder, creditor, depositor, pension-employee benefit plan manager or personnel link at the officer-director level, is strongly correlated with the existence or the size of other such relationships. A statistician would strongly reject the proposition that these activities are independent of one another. Among other types of institutions such as investment advisers, property and liability, or life insurance companies, however, this is not the case.

Various explanations have been advanced to rationalize the greater degree of coincidence among banking relationships with corporate customers. It has been pointed out that banks typically are larger than institutions of other types; that they offer a greater variety of services and, therefore, have a greater number of potential contacts with portfolio companies, and that they have offered these services and "known" their corporate customers in several capacities over longer periods of tice than their typical, nonbank competitors. All these explanations can in fact help to explain the larger, absolute number of links between banks and portfolio companies than between otherwise comparable institutions and the same corporations: they cannot, however, explain the tendency of these relationships to "cluster" systematically among the same companies with which the other relationships exist—i.e., they cannot explain the correlation that remains between such relationships, even after attempts have been made to control for regional effects and effects traceable to the sheer size of both institution and company.

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Let me repeat and underline this finding. Investment advisers and insurance companies also have personnel links with potential portfolio companies; insurance companies also are important creditors of such companies; investment advisers and life insurance companies also manage employee benefit-pension plans; and all three types of institutions, like banks, are important stockholders in a great many publicly held corporations. Among institutional types other than banks, however, these relationships show no noticeable tendency to nourish or reinforce one another. They appear either to be unrelated in a statistical sense, or even negatively related to one another—in the sense that the presence or size of one relationship (such as a loan relationship by an insurance company) is reduced on average by the presence or size of another (such as an officer-director link between the institution and company).

A tendency for business and personnel relationships linking particular institutions and corporations to multiply should not be dismissed as of casual or academic interest only. Multiple relationships between institutions and nonfinancial corporations tend to multiply potential conflicts of interest, create difficult enforcement problems, and in some instances severe anticompetitive problems. Any such phenomenon affecting America's largest banks and industrial corporations also raises an unwelcome specter of concentrated, economic power.

DIRECT AND INDIRECT COMPENSATION

A third set of analyses that is of particular significance in this context is reported in chapter V, dealing specially with bank trust departments. An attempt is made there to calculate the fraction of total trust department revenues that can be attributed not to direct fees charged trust customers, but to indirect revenues obtained by virtue of a bank's unique ability to use cash on deposit from trust accounts, cash in "float" from transactions generated by such accounts, or deposits from broker-dealers in exchange for commissions on securities transactions originated by the trust department. The study estimates that indirect compensation from these three sources amounts to approximately 41 percent of total, direct trust department revenues. Needless to say, a 41-percent margin represents a considerable competitive advantage for bank-affiliated over non-bank-affiliated investment managers—or, for bank trust department over insurance companies and investment advisers for the management of many types of funds.

It should be recognized that the competitive advantage enjoyed by banks in their possession of corporate trust powers and their unique ability to utilize moneys on deposit or in float from trust activities does not arise inexorably, or even naturally from the economics of portfolio management; it is almost entirely a product of Government action.

Several major States grant corporate trust charters only to firms that also offer commercial banking services. Of far greater importance, however, prohibitions on the payment of interest on demand deposits contained in the Banking Acts of 1933 and 1935 provide the protection from direct price competition that forces competition for commercial deposits into nonprice, service lines, and provides the indirect com-

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pensation necessary to pay for the services rendered. Should these prohibitions be eliminated, one could expect both the need and the wherewithal to pay on a "bundled" basis for potentially separable services which include, but certainly are not limited to trust services, to be reduced substantially.

The Commission faced a closely analogous problem during the course of the institutional investor study. Fixed minimum brokerage commissions on securities transactions provide protection from direct price competition by brokers handling orders of institutional size that leads to the bundling of a variety of separable services—including fund management—into the brokerage package. Various prohibitions—against "giveups"—and admonitions—against "reciprocity"—by the Commission proved the futility of attempting to suppress nonprice competition in a basically competitive environment overlaid by noncompetitive, fixed rates. The one point at which these two industries, banking and brokerage, came into contact, of course, resulted in totally predictable types of reciprocity, as each paid in the other's currency for receipts in the form of its own—that is, brokers paid in deposits for receipts in the form of commissions, and vice versa. Admonitions by the Justice Department against such arrangements may reduce its efficiency. As long as brokers and bankers both operate under regulated rates at noncompetive prices, however, both must continue to compete for their customers by offering reciprocal services or indirect payments of some sort in exchange for the noncompetively priced services. The Commission's recognition of this fact, combined with its dissatisfaction with the types of reciprocity or "bundling" developed in the brokerage industry, led to its decision last fall to move away from a 175-year tradition of fixed commission rates toward freely negotiable or "competitively determined" rates on orders of institutional size. I would expect this decision to reduce artificial inducements to the combination of brokerage and management functions, just as I would expect elimination of the far more recent prohibition on payments of interest on demand deposits to reduce artificial inducements to the continued combination of banking and management services. The Commission, clearly, recognizes the analogy between these combinations on page xviii of its letter transmitting the study to the Congress.

With your permission, I could go ahead at this point and indicate more specifically how these analyses and others relate to H.R. 5700.

The CHAIRMAN. We can bring out many points by questioning, I suspect. But in the event we do not, you may feel free to extend your remarks and bring in any points that have been left out in your testimony.

Mr. FARRAR. Thank you, Mr. Chairman.

With these points as background, let me now turn to the second of my assignments this morning and review certain of the operative sections of H.R. 5700.

My comments will be limited to those portions of the bill dealing with personnel interlocks between institutions and corporations with which they maintain other business relationships (sections 7–9), disclosure (section 12). limitations on trust department holdings (section 13), and indirect payments for deposits (sections 19–24). My com-

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ments, of course, reflect my background as an economist; I am not a lawyer and must disqualify myself as a judge of the technical quality of the bill's draftsmanship.

Sections 7–9 would prohibit personnel interlocks between financial institutions and the corporations for whom these institutions manage employee benefit accounts, are substantial creditors or are significant stockholders. As the study's analyses (chapter XV, section D) demonstrate, personnel interlocks are a consistent portion of the pattern of interrelated points of contact through which banks (but not other types of financial institutions) are linked to their corporate clients. The probability that a bank will manage at least a portion of a corporation's employee benefit plan is increased by a factor of nearly three (i.e., by 12.7 percent from a base of 4.77 percent) by the presence of an officer-director interlock between the two. The expected fraction of a corporate issuer's common stock held by one of the fifty largest bank trust departments is, on average, 175 percent higher if the bank and company are connected by interlocking personnel (i.e., expected fractional holdings increase by 0.67 percent if an interlock exists from a base of 0.39 percent of the company's outstanding shares). The weakest of the three interrelationships, that between loans outstanding and the presence of an interlock, still is significant; the expected fraction of a corporation's loans held by a particular bank is approximately 75 percent higher if an interlock exists than if one does not (i.e., expected fractional holdings increase by 1.2 percent from a base of 1.6 percent of outstanding loans).

As indicated earlier, the multiplication of personnel and business relationships between financial institutions and nonfinancial corporations appears to be a uniquely banking phenomenon. Other types of institutions appear either to consciously avoid personnel relationships with firms for which they are plan managers, creditors or significant stockholders, or to establish such links no more frequently than one could expect on the basis of chance alone if all such links were determined independently; the likelihood that chance can explain the substantial overlap of such relationships between banks and their corporate customers, by contrast, is so remote as to be negligible.

Having made these statements with the assurance that derives from a persuasive set of empirical analyses, let me hasten to add—as does the study in its discussion of these results—that one cannot pass automatically or mechanically from statements of fact to interpretations of the underlying causal mechanism that produces the observed facts. In particular, one cannot in the present context assert that personnel interlocks are the prime mover that turns what otherwise would be arms length business relationships between institutions and corporations into the corporate equivalent of a marriage, by multiplying the number of relationships between the institution and company, increasing their joint dependence on one another, and reducing the availability of each as a potential customer for the other's competitors. Indeed, the fact that personnel interlocks are, if anything, inversely related to the frequency and magnitude of business relationships between corporations and institutions other than banks would appear to support a contradictory proposition that such interlocks typically reflect rather than confer influence by one institution or firm over another.

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Next, one should inquire as to whether combinations of personnel interlocks and any single business relationship between institutions and firms present serious conflict, competitive or regulatory problems? There are, of course, instances in which they can. On balance, however, I am not appalled by the presence of a powerful creditor, or a significant shareholder, or even a plan manager on a company's board of directors. Indeed, one of the study's persistent concerns in chapter XV is the absence of effective stockholder representation on portfolio company boards by institutions whose only interests are those of large, and presumably knowledgeable shareholders. Instead, one finds board representation concentrated among the institutional type whose potential conflicts are most numerous and whose competitive and regulatory problems are most severe.

If one accepts the propositions that:

> interlocks are more likely to reflect than confer economic power,

and that

> combinations of stockholder, creditor, and plan manager functions with each other, rather than singly with personnel interlocks, create the more serious economic and regulatory problems,

then one cannot look to prohibitions on interlocks for their solution. Instead, one should look to the banks and inquire as to why they, and they alone, have developed such a propensity for multiplying links and, thereby, potential conflicts with portfolio companies?

My own attempt to rationalize this phenomenon revolves about three separate bases, in order of importance: economic, social and regulatory.

Briefly, the primary economic incentive and basis for the "bundling" of innumerable services, including trust services, into a single banking "package" is the prohibition mentioned above on the payment of interest on demand deposits. In my view this prohibition operates to substitute relatively inflexible and inefficient forms of service competition for direct price competition in order to attract demand deposits. I do not believe such a substitution to be in the interests of either the commercial side of banking or in the interests of any of the bank's customers—including its trust customers. All would be served by the greater flexibility and allocational efficiency provided commercial banking by an opportunity to compete directly for funds and by the separate pricing of the various peripheral services that currently tend to be bundled into the deposit package. By reducing artificial inducements to the bundling of trust, commercial, and other services, of course, the public interest in reducing the conflict, concentration and regulatory problems produced by their combination also would be served.

The second of the reasons commonly given for the bundling of commercial, trust, and other services by banks is, essentially, social in nature. Banks, it is said, prefer to deal with people they "know." Few would dispute the proposition. Their customers' preferences, however, are less well known. Perhaps they also prefer the intimacy of a banking relationship to the freedom to contract separately for separate services. It is clear, however, that such relationships, like marriage relationships, confer certain restrictions as well as privileges.

The third of my hypotheses regarding the apparent willingness of banks to multiply relationships, and therefore potential conflicts, with

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portfolio companies lies in the regulatory realm. Like most persons whose regulatory experience derives largely from the securities area, I tend to associate regulation largely with disclosure. In that sense, the lack of disclosure in the past regarding the activities of bank trust departments may have contributed to the greater willingness by banks than by other institutions to multiply their points of contact and, thereby, the number of their potential conflicts with portfolio companies. Disclosure in this, as in other areas, may serve potentially valuable phophylactic purposes as well as regulatory and enforcement functions.

Section 12 deals explicitly with disclosure of trust department holdings. Here, I would like to endorse strongly Commissioner Smith's recommendations last week that this committee coordinate its proposals with other committees of the Congress as well as with affected regulatory agencies in order to assure that the legislation that finally emerges in this area satisfies two, basic requirements:

That reporting be uniform and comparable across all types of institutional investors, and

That some administrative flexibility be provided, as through rulemaking power by a regulatory body, to assure that the disclosure developed remains a viable and effective regulatory tool over changing times and circumstances.

I also believe—and to this extent go beyond the Commission's official position—that disclosure should be extended to cover, on a uniform basis, personnel and other business relationships between institutional investors of all types and portfolio companies.

Section 13 would operate to prohibit bank holdings in excess of ten percent of the stock of any corporate issuer. Although I am sympathetic to the objectives implicit in the section, I am not sympathetic to the measures proposed. It seems inconsistent to me to propose direct prohibitions on certain actions, that often serve perfectly legitimate and defensible ends, while maintaining artificial, regulatory inducements toward their existence.

Again, my focus is on the prohibition on the payment of interest on demand deposits contained in the Banking Acts of 1933 and 1935, which have contributed so importantly—in the form of an estimated 41 percent subsidy—to the gravitation of equity oriented funds, especially employee benefit funds, toward bank trust departments.

It is undoubtedly true that the elimination of this prohibition will not solve all the competitive and regulatory problems that result from the growth of bank trust departments. Neither will the elimination of fixed, minimum brokerage commissions automatically solve all the structural problems that result from the growth of institutional investors in the securities markets. By at least beginning the process of unbundling portfolio management from banking and brokerage functions respectively, however, the elimination of each can provide an important first step toward the separate pricing of separable services and away from the continued aggravation of conflict and concentration that results from their enforced bundling.

Sections 19–24 prohibit payments by banks, either directly or indirectly, to either brokers or depositors, in order to attract deposits. These sections are reminiscent of prohibitions by the Commission on

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"giveups" and admonitions against "reciprocity" between broker-dealers and their customers under a regime of fixed, minimum brokerage commissions. It is axiomatic that additional prohibition here, as there, will be futile. As long as interest rates on demand deposits, like brokerage commission rates on securities transactions, are fixed by law or regulation at unrealistic levels, attempts to compete through reciprocity or other indirect means will persist in one form or another. The precise form may change following each new round of prohibitions, but their essence will remain the same.

This completes my prepared testimony. Let me thank you for the opportunity to be here this morning, and for your time and interest.

The CHAIRMAN. Thank you very much, sir.

Professor Darnell, you may proceed, sir; in your own way, if you will, please. You have a prepared statement?

Mr. DARNELL. Yes; I do.

The CHAIRMAN. If you will abbreviate your testimony we will have more time to question the witnesses. Each member will get 5 minutes the first go-round, and then, if additional time is required he will have that too.

So you may proceed, sir.

STATEMENT OF PROF. JEROME C. DARNELL, ASSOCIATE PROFESSOR OF BUSINESS ADMINISTRATION, UNIVERSITY OF COLORADO

Mr. DARNELL. Mr. Chairman and members of the committee, it is indeed an honor and a privilege to appear before you and discuss this important legislation. First of all, I shall be apologetic for the length of my prepared statement. I trust it was somewhat instructive and not overly boring. This is my first opportunity to present my views to such a distinguished forum. Therefore, I hope you will be tolerant of my enthusiasm and the fact that I may have loaded you down with more details than you actually wanted to know.

My views do not apply to all sections of the Banking Reform Act of 1971. I have limited my statement to those sections upon which I feel most qualified to speak by virtue of my past research efforts. My remarks are confined to sections 2, 3, 4, and 10, the ones dealing with interlocking managements among various financial institutions and prohibiting mutual savings banks from owning stock in competitive financial institutions. I do have opinions about other sections of the bill, but I feel that other witnesses are more qualified than I to speak on them.

A series of associated questions about the operation of our financial institutions and the performance of their essential functions is automatically generated as we reflect on the four provisions I am dealing with. It seems to me that we should be seeking answers to such questions as the following:

1. Does the laxity in our legislation offer an opportunity for common ownership and interlocking management to evolve among financial institutions?

2. If so, has this opportunity been seized upon by enterprising individuals, as well as institutions?

3. What are the economic consequences arising from common ownership and interlocking managements?

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4. Do we approve of these consequences and do we want them to continue?

My answer to these questions are: Yes, yes, reduction in competition, and no, no.

My prepared statement gives a more detailed discussion of the reasons why I hold these positions. The first part reviews legislation now on the books, and then it goes on to consider a number of studies directly concerned with the issues I have just mentioned.

My first study was an analysis of the "Twenty Largest Stockholders of Record" to determine those cases where an individual was an owner and/or common director or officer of two or more member banks. I was trying to identify the cases we would normally refer to as chain banking; that is, an individual or individuals controlling two or more banks. The following is a partial listing of my major findings:

1. Common ownership of banks with an accompanying network of interlocking directors and officers is a widespread practice.
2. At least one-fifth of all member banks, controlling about the same proportion of member bank assets, would satisfy the definition of being a chain bank. Based on a review of earlier research, I would estimate that at least the same proportion of nonmember banks are operated with common ownership and interlocking managements.
3. Most chain systems were small in terms of number of banks linked together, nearly 70 percent of them being composed of only two banks.
4. Over one-half of the identified systems, 242 of 431, were made up of banks located in the same county. Two-thirds of these one-county systems held over 20 percent of the total deposits in the county, a number of them controlling as much as 80 percent or omre. These situations would suggest that competition may be eliminated by this practice, or at best the opportunites are certainly present for a stifling of competitive effort.
5. Chain banking has a unique feature that is not true for other forms of multiple-office banking in that it is not restricted by State laws or State boundaries. Many cases were observed testifying to the interstate operational capability of chain systems.
6. It is also a common practice for competing financial institutions, for example, other commercial banks, mutual savings banks, trust companies, and insurance companies, to be owners of commercial banks. Frequently they are multiple-bank owners.

I certainly do not claim that my findings are in any way exhaustive of the situations where banks are being operated under common management. Stockholder lists are simply not adequate for determining all family ties and cases of indirect control being exercised. And, of course, we do not have comparable data for nonmember banks. But at least we now have a better idea of the magnitude of the problems we are dealing with.

Despite these shortcomings in coverage, it is obvious that the law has been permissive in allowing common ownership and management ties to exist. This laxity has been noted by venturesome individuals, and institutions, with the consequence that we now have a number of presumably competing institutions operating under centralized control, and these conditions are generally unknown to the banking public.

I offer as evidence to substantiate the above conclusions by observa-

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tions from followup studies involving the operating policies of chain banks. As a general rule, the multiple-bank owner also combines a management position, such as being a director or an officer, with his ownership. A fairly small ownership position, probably no more than 5 percent, is adequate to insure a management voice in the operation. Most multiple-bank owners maintain their investments for several years. All of these factors enhance the probability that centralized control, and a reduction in competition, will emerge.

The best explanations for owning stock in two or more banks are:

(1) The desire to overcome State restrictions against branching.

(2) With centralized control of the banks, their competitive position can be improved.

(3) Take advantage of a growing market.

I do not accept the explanations sometimes offered that multiple-bank ownership comes about primarily to achieve diversification in a personal investment portfolio. Too often it is clear that there is concentration of investments, especially in banks that serve the same trade area. Nor can I believe that the ownership arises because it is always the most profitable investment alternative.

If so, it means that more of the profitable opportunities for investing in banks are located in unit banking States than in branching States. Thus, it is difficult to accept the argument that chain banking emerges through some accidental or unintentional endeavor. My survey leads me to believe that most multiple-bank owners have a purpose in mind when they acquire a significant ownership position in another nearby bank. They are not oblivious to the enviable opportunities awaiting them.

Another major criticism of the practice is that the public is generally unaware of the existence of common ownership and management links. Only infrequently is an attempt made to publicize the common control. I found one banker did not want to publicize his common ownership because he felt it would create an image of monopoly, and as a result be detrimental to his banks. Still another responded that publicity was unnecessary in his case because he had lived in the community all his life, and it was common knowledge that he was president of both banks in town.

Bankers will admit that common ownership of banks can be detrimental to the public, especially from the standpoint of eliminating competition when they serve the same trade area. The public is deprived of what could have been a choice among competitors.

My investigation also included a look at the county location and market shares of 47 cases of two or more banks being linked together by 25 percent ownership of one individual. A number of these exceeded the "undue percentage share of the market," assumed to be in the neighborhood of 20 percent, that the Supreme Court has determined will be presumptive of substantially lessening competition.

Common ownership of banks can and does eliminate competition just as a merger or holding company acquisition could. The legal foundations may be different among these three types of banking organizations, but the economic consequences can be the same. At least mergers and holding company acquisitions must be reviewed by a regulatory agency before approval is given. Why should we permit banks

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to achieve via common control the same anticompetitive position that would otherwise be denied to them if they were to merge?

Many of the identified chains do consist of small banks in small towns. A logical question is: Should we bother ourselves with the obstruction of competition in places where the magnitude of commerce affected would be very minimal? The High Court has ruled in the *Phillipsburg* case that customers of small banks in small towns are no less entitled to the benefits of competition than are customers of large banks. Indeed, the need for protection is even greater in the smaller communities because these patrons usually do not have the large variety of financial institutions from which to choose.

My study of mutual savings banks reveals that savings banks in the New England area frequently own sizable blocks of commercial bank stock. This is especially true when the commercial bank is located in the same trade area as the savings bank. The investment is typically accompanied by interlocking directors, trustees, and officers, producing what savings bankers refer to as a "marriage."

As one would naturally expect, and as savings bankers admit, these marriages can and frequently do eliminate competition. These institutions are presumed to be competitors for the public's savings dollar and for various types of loans. Yet they operate under common control and readily acknowledge that there may be no competition between them. As one savings banker replied: "We respect the traditional areas of each other."

It seems that the strongest argument that can be offered in defense of the ownership aspect is that it is a "profitable investment" for the savings bank. Surely there must be other worthy securities that can be substituted for this type of investment, especially when such a small investment has such a large potential for lessening competition.

The best argument set forth to justify interlocking managements seems to center on the short supply of capable director and officer talent in smaller communities. I wonder if this very indirect benefit to banking customers would clearly outweigh the loss of competition.

Interlocking managements between savings and loan associations and commercial banks is a widespread practice also. Professor Herman found that 56 percent of 808 associations had at least one management interlock with a commercial bank, and about one-third of them had two or more interlocks. He observed that the result of these management tie-ins was a reduction in competition. He concluded that the anticompetitive effects are demonstrable and would appear to be violating antitrust standards in many instances.

In conclusion, the widespread practice of common ownership of commercial banks, accompanied by a network of interlocking directors and officers, leads me to believe that competition is being stifled. The evidence is sufficient to convince me that this cannot be construed as a healthy competitive environment. Furthermore, the public is being deceived into believing it has genuine alternatives when in fact they do not exist. The harmful effects are most pronounced when the alleged competitors are serving the same trade areas.

The reduced competitive effort that necessarily follows when institutions are under common management outweighs any possible public benefit that could be derived because of management expertise or limited supply of capable talent, which are apparently the best redeeming arguments.

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The impairment of competition arising from interlocking managements between commercial banks and other types of competing institutions is just as harmful. We believe the maintenance of a competitive atmosphere will pay dividends to society. We should not allow this atmosphere to be polluted by tolerating conditions that lend themselves to reducing the competitive vigor among participants in the marketplace.

The proposed legislation appeals to me because it would help to eliminate what I perceive to be inconsistencies in the law, opportunities for exploitation, a suppression of competition, and something that is out of tune with our rationale for maintaining competition. For the reasons I have summarized here, I would support sections 2, 3, and 4, and 10 of the Banking Reform Act of 1971.

The CHAIRMAN. Thank you, sir. Do you have additional statements you would like to insert along with your remarks?

Mr. DARNELL. No, sir; I do not.

The CHAIRMAN. All right. We will place your prepared statement in the record at this point.

(The prepared statement of Mr. Darnell follows:)

PREPARED STATEMENT OF PROF. JEROME C. DARNELL, ASSOCIATE PROFESSOR OF BUSINESS ADMINISTRATION, UNIVERSITY OF COLORADO

Mr. Chairman and members of the House Committee on Banking and Currency, it is indeed a pleasure and an honor to have this opportunity to express my views on H.R. 5700, "The Banking Reform Act of 1971." I hope my remarks will prove to be a useful contribution as you deliberate on this important legislation. I believe the nature of my testimony is such that it would not be available from other sources.

My statement is not directed to all sections of the bill, only those on which I feel most qualified to speak by virtue of my past research. Specifically, the primary focus of my statement will be on Sections 2, 3, 4, and 10. These are the ones dealing with interlocking managements among various financial institutions and the prohibition on mutual savings banks from owning stock in certain financial institutions.

On a number of occasions I have felt that perhaps I was the only one besides the Banking and Currency Committee and its staff that had an interest in interlocking managements among financial institutions. I am pleased that the legislative machinery is now at work to consider the effect of interlocks among such institutions and to decide if there is a need for corrective action.

I. LEGISLATION AFFECTING INTERLOCKING MANAGEMENTS

The issue of interlocking directorates and officers among financial institutions has been a matter of concern for a number of years, as evidenced by the inclusion of Section 8 in the Clayton Act of 1914. The original Section 8 was designated to prohibit interlocking directorates and officers among national banks with $5 million in assets and located in cities of 200,000 or more in population, hardly a very restrictive prohibition. During the next 21 years, this statute was amended five times, the effect each time being to grant more and more permissiveness in the circumstances by which commercial banks could have interlocking managements. Section 8 now stands, as last amended in 1935, as the applicable statute for management interlocks among commercial banks.

Sec. 8. No private banker or director, officer, or employee of any member bank of the Federal Reserve System or any branch thereof shall be at the same time a director, officer, or employee of any other bank, banking association, savings bank, or trust company organized under the National Bank Act or organized under the laws of any State or of the District of Columbia, or any branch thereof, except that the Board of Governors of the Federal Reserve System may by regulation permit such service as a director, officer, or employee of not more than one other such institution or branch thereof; but the foregoing prohibition shall not apply in the case of any one or more of the following or any branch thereof:

(1) A bank, banking association, savings bank, or trust company, more than 90 per centum of the stock of which is owned directly or indirectly by the United

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States or by any corporation of which the United States directly or indirectly owns more than 90 per centum of the stock.

(2) A bank, banking association, savings bank, or trust company which has been placed formally in liquidation or which is in the hands of a receiver, conservator, or other official exercising similar functions.

(3) A corporation, principally engaged in international or foreign banking or banking in a dependency or insular possession of the United States which has entered into an agreement with the Board of Governors of the Federal Reserve System pursuant to section 25 of the Federal Reserve Act.

(4) A bank, banking association, savings bank, or trust company, more than 50 per centum of the common stock of which is owned directly or indirectly by persons who own directly or indirectly more than 50 per centum of the common stock of such member bank.

(5) A bank, banking association, savings bank, or trust company not located and having no branch in the same city, town, or village as that which such member bank or branch thereof is located, or in any city, town, or village contiguous or adjacent thereto.

(6) A bank, banking association, savings bank, or trust company not engaged in a class or classes of business in which such member bank is engaged.

(7) A mutual savings bank having no capital stock.

One surely must read this section in disbelief. When I first developed an interest in common ownership of banks and found this was the applicable statute, I could not believe my eyes. Later investigations convinced me my reading was indeed accurate. Clearly, this statute is no impediment whatsoever in preventing common ownership and interlocking managements among commercial banks, let alone forestalling such practices among other types of financial institutions. To say that this Section is a sieve capable of retaining only the very largest drops of water is to put the case mildly.

The problems with Section 8 as well known and have been criticized for years. For example, it applies only to member banks of the Federal Reserve System. Thus, considerably less than one-half of the banks in this country are covered. It takes a narrow view of the geographic market area of banks, considering the city, town, or village as the relevant market. The relevant market is not so restricted, especially for larger banks and many types of services. It is not applicable to mutual savings banks, savings and loan associations, credit unions, and insurance companies. These financial institutions are now recognized as substantial and potent competitors of commercial banks in many important product lines.

Perhaps the largest loophole in the entire Section is the fourth exception. This exception means that any number of member and nonmember banks can be operated with interlocking managements given that common ownership exists to the extent that the persons owning directly or *indirectly* 50 per cent of the member bank also own 50 per cent of the stock in the other banks. Such a situation is sanctioned even though the banks might be considered direct competitors. To use the recent example of Chairman Arthur F. Burns, one person may own 90 per cent of the stock of bank A and another person own 90 per cent of bank B. They can come within the statutory exception merely by each exchanging single shares of stock in their respective banks. Together they would be "persons owning 50 per cent or more of the stock in both banks. Thereafter, under the present law, there may be interlocks between the two banks even if they are located across the street from each other and in direct competition."[1]

In recent years two Federal study commissions have called for additional legislation to cover interlocking directorates. The Advisory Commission on Banking and Currency prepared a report for the Comptroller of Currency (Saxon Report, 1962) and called for legislation to guard against conflicts of interest by extending the present law to include all banks, savings and loan associations, and mutual savings banks. The Committee on Financial Institutions (Heller Report, 1963) made recommendations similar to those in the Saxon Report.

The Banking and Currency Committee is, of course, familiar with the 1965 Antitrust Subcommittee staff report, *Interlocks in Corporate Management*, which recommended the effectiveness of Section 8 be strengthened by banning interlocking managements among financial institutions.

The inappropriateness of Section 8 is further revealed by noting the absence of any court action directly involving a bank under this Section. The Federal

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[1] Letter from Chairman Burns to Chairman Patman as quoted in the *American Banker*, December 28, 1970, p. 5.

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Reserve Board has held proceedings to determine if it has been violated, but none of the orders issued under these proceedings has ever been challenged in the courts.[2]

I would now like to review briefly for the Committee some of my research findings on common ownership and interlocking managements among financial institutions. Some of these findings have appeared in published articles, and others are the result of research undertaken specifically for these hearings. I am indebted to the Committee for providing much of the basic data used in my studies.

II. STUDIES ON COMMON OWNERSHIP OF COMMERCIAL BANKS

We have noted that Section 8 contains a number of loopholes that will sanction virtually any kind of common ownership-interlocking management situation among commercial banks and other competing financial institutions. A question may be raised as to whether these situations do in fact exist and whether there is any threat to the maintenance of a competitive atmosphere when such conditions are present. Fortunately, we are not at a total loss for answers to these questions.

A. *Nature and Expansiveness of Chain Banking.*—My initial research efforts in this direction were based on the data contained in the lists of *Twenty Largest Stockholders of Record in Member Banks of the Federal Reserve System*, published by this Committee in 1964. The primary purpose of my study was to provide current descriptive measures on the dimensions of chain banking, a common term used to identify situations where one individual or a group of individuals control two or more banks.[3]

Since there is no statutory or universally accepted definition of chain banks, I developed a definition that was felt to be adequate for identifying cases where the common ownership-interlocking management ties would be sufficiently great to permit standardized or coordinated operating policies for the banks involved. The definition adopted was:

A chain system was deemed to exist when two or more banks have one or more stockholders in common (excluding banks controlled by registered bank holding companies) provided that: (1) the stockholder(s) in common is among the 20 largest stockholders in each bank, (2) the stockholder(s) in common is a director or an officer in each bank, and (3) if the stockholder(s) in common is not a director or an officer, he owns 5 per cent or more of the stock in the bank in which he is not a director or an officer.[4]

The major findings based on this definition are summarized below:

1. About one in five (19.0 per cent) of all member banks satisfied the above definition of a chain bank. These banks controlled 19.3 per cent of the member bank assets (all figures relate to June, 1962, unless otherwise noted). The best estimate for all commercial banks would be about 2,300 banks operating in chain systems, holding slightly less than 20 per cent of our banking assets.

2. Nearly one-half of the identified chains (48.5 per cent) were linked together by ownership ties of 5 per cent or more in each bank. Banks having aggregated ownership ties of 25 per cent or more in each of two or more banks represented 15.3 per cent of the total.

3. The typical bank chain was small in terms of number of banks affiliated in each system. Of 431 identified systems, nearly 70 per cent were composed of only two banks. At the other extreme, 29 systems were found consisting of five or more banks.

4. Chain banks tended to be slightly larger on the average than the typical member bank. Almost 75 per cent of the chain banks were located in population centers of 25,000 or less. Three of every four chain banks were located in areas in which the likelihood of facing competition from more than one other bank was small.

5. The concentration of bank deposits arising from chain banking was indicated by an analysis of the county location of affiliated banks. Over one-half of the identified systems (242 of 431) consisted of *all affiliated banks domiciled within the boundaries of one county*. (See Table 1.) Roughly two out of every five systems controlled over 40 per cent of the county's deposits, a number of them having from 80 to 100 per cent of the county total.

[2] Gerald C. Fischer, *American Banking Structure* (New York: Columbia University Press, 1968), p. 270.
[3] Jerome C. Darnell, "Chain Banking," *National Banking Review*, March 1966, pp. 307–331.
[4] *Ibid.*, p. 308.

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TABLE 1.—LOCATION, NUMBER, SIZE OF SYSTEMS, AND PERCENTAGE OF COUNTY DEPOSITS HELD BY CHAIN SYSTEMS WITH ALL AFFILIATED BANKS LOCATED IN 1 COUNTY, JUNE 30, 1962

State	Number of chain systems	Number of banks in system				Number of chain banks	Number of systems and percentage of county deposits held [1]				
		2	3	4	5		0–20	21–40	41–60	61–80	81–100
Alabama	2	2	0	0	0	4	0	1	0	1	0
Alaska	0	0	0	0	0	0	0	0	0	0	0
Arizona	0	0	0	0	0	0	0	0	0	0	0
Arkansas	2	2	0	0	0	4	0	1	1	0	0
California	0	0	0	0	0	0	0	0	0	0	0
Colorado	5	4	1	0	0	11	1	2	0	1	1
Connecticut	2	1	1	0	0	5	2	0	0	0	0
Delaware	0	0	0	0	0	0	0	0	0	0	0
District of Columbia	0	0	0	0	0	0	0	0	0	0	0
Florida	16	9	5	2	0	41	6	10	0	0	0
Georgia	0	0	0	0	0	0	0	0	0	0	0
Hawaii	0	0	0	0	0	0	0	0	0	0	0
Idaho	1	1	0	0	0	2	0	0	0	0	1
Illinois	34	27	6	1	0	76	18	8	7	0	1
Indiana	8	7	1	0	0	17	2	0	4	2	0
Iowa	2	2	0	0	0	4	1	0	0	1	0
Kansas	3	3	0	0	0	6	0	0	3	0	0
Kentucky	1	1	0	0	0	2	0	0	1	0	0
Louisiana	1	1	0	0	0	2	0	0	0	0	1
Maine	1	1	0	0	0	2	0	1	0	0	0
Maryland	1	1	0	0	0	2	0	1	0	0	0
Massachusetts	9	6	2	1	0	22	9	0	0	0	0
Michigan	10	10	0	0	0	20	3	2	3	1	1
Minnesota	4	4	0	0	0	8	2	0	2	0	0
Mississippi	0	0	0	0	0	0	0	0	0	0	0
Missouri	5	4	0	0	1	13	2	1	1	1	0
Montana	3	3	0	0	0	6	0	2	1	0	0
Nebraska	6	5	1	0	0	13	1	0	4	1	0
Nevada	0	0	0	0	0	0	0	0	0	0	0
New Hampshire	5	5	0	0	0	10	5	0	0	0	0
New Jersey	6	6	0	0	0	12	3	2	1	0	0
New Mexico	3	3	0	0	0	6	0	0	1	1	1
New York	12	10	1	1	0	27	5	5	1	0	1
North Carolina	0	0	0	0	0	0	0	0	0	0	0
North Dakota	1	1	0	0	0	2	0	0	1	0	0
Ohio	9	8	0	1	0	20	0	2	4	3	0
Oklahoma	12	9	2	1	0	28	2	4	4	1	1

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TABLE 1.—LOCATION, NUMBER, SIZE OF SYSTEMS, AND PERCENTAGE OF COUNTY DEPOSITS HELD BY CHAIN SYSTEMS WITH ALL AFFILIATED BANKS LOCATED IN 1 COUNTY, JUNE 30, 1962—Con.

State	Number of chain systems	Number of banks in system				Number of chain banks	Number of systems and percentage of county deposits held [1]				
		2	3	4	5		0–20	21–40	41–60	61–80	81–100
Oregon	0	0	0	0	0	0	0	0	0	0	0
Pennsylvania	23	21	1	1	0	49	10	12	1	0	0
Rhode Island	1	1	0	0	0	2	0	0	0	1	0
South Carolina	1	1	0	0	0	2	0	0	1	0	0
South Dakota	1	0	1	0	0	3	0	0	0	1	0
Tennessee	2	2	0	0	0	4	0	0	0	1	0
Texas	27	19	6	1	1	65	7	9	7	0	0
Utah	0	0	0	0	0	0	0	0	0	0	1
Vermont	0	0	0	0	0	0	0	0	0	0	4
Virginia	13	12	1	0	0	27	0	4	4	3	2
Washington	0	0	0	0	0	0	0	0	0	0	0
West Virginia	5	5	0	0	0	10	0	2	3	0	0
Wisconsin	3	3	0	0	0	6	2	0	0	1	0
Wyoming	2	2	0	0	0	4	0	0	0	1	1
Total	242	202	29	9	2	537	81	69	55	21	16

[1] County deposits include deposits of commercial banks and mutual saving banks in States where utual savings banks are located.

Sources: U.S. Congress, House Committee on Banking and Currency, "Twenty Largest Stockholders of Record in Member Banks of the Federal Reserve System," 88th Cong., 2d sess. (Washington, D.C.: Government Printing Office, 1964); "Rand McNally International Bankers Directory," final 1962 edition; Board of Governors of the Federal Reserve System, "Distribution of Bank Deposits by Counties and Standard Metropolitan Areas," June 30, 1962.

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6. Chain banking has a unique advantage over branch and group banking because a chain has an interstate operational capability. State boundaries are no deterrent in expanding the system to cover a trade area more completely. A number of interstate systems were found, and they were generally located in metropolitan areas that covered two states.

7. The definition of chain banking used in the study included systems where the link was formed by a corporate entity being a 5 per cent owner in each of two or more banks. A total of 228 banks, or 20 per cent of the chain banks, were linked exclusively by corporate holders. These banks held $20 billion in assets, or 8.6 per cent of the member bank assets.

Let us digress for a moment and consider the extent to which certain types of financial institutions showed up as a 5 per cent or more owner of at least *one* member bank.

TABLE 2.—5 PERCENT OR MORE OWNERSHIP OF MEMBER BANKS BY OTHER FINANCIAL INSTITUTIONS

Percentage of ownership	Type of institution			
	Commercial banks	Mutual savings banks	Trust companies	Insurance companies
5.0 to 9.9 percent	40	60	18	33
10.0 percent or more	52	56	20	28
Total	92	116	38	61
25.0 percent or more (included in 10.0 percent or more group)	27	6	9	15

Source: 20 largest stockholders of record.

An analysis of the stockholder lists revealed 92 instances of a commercial bank owning at least 5 per cent or more of one member bank. Mutual savings banks had similar ownership positions in 116 member banks. Note that 57 cases were found where the ownership position of the financial institution was 25 percent or more. A number of other assorted financial institutions showed up, but they occurred too infrequently to be classified neatly. These data do not include the many instances when the commercial bank is listed as the owner of its own stock, presumably representing holdings in the bank's own trust department. Also, it can be presumed that a commercial bank being listed as the stockholder of another bank means that the stock is held in the trust department.

It is clear from these findings that common ownership and interlocking managements among commercial banks is widespread, and no doubt much more prevalent than most observers would have suspected. Even these findings do not tell the entire story. For example, it is practically impossible to identify family holdings, especially in cases of different last names, and to identify family control exercised through the holdings in a corporate entity. And, of course, we do not have comparable data for nonmember banks. While it can be noted that the control of banking resources in many local markets is already virtually complete, the addition of nonmember banks to the already existing member bank chains would reveal even more concentration at the local level.

B. *Ownership Characteristics and Operating Policies.* My next study attempted to learn more about the ownership characteristics and operating policies of chain banks.[5] Data were gathered by a questionnaire sent to 239 individuals who owned 5 per cent or more of two or more banks. Usable responses were received from 28 per cent of them.

Three-fourths of the respondents indicated they were a director and/or officer in each of the banks in which they owned stock; thus, we can infer that their responses were authoritative because of their management position. Also, it would appear that an ownership position of 5 per cent is sufficient to carry with it a directorship or officership in a large majority of cases. Eighty-five per cent

[5] Jerome C. Darnell, "Chain Bank Ownership and Operation", *National Banking Review*, December, 1966, pp. 193–198.

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replied they have had multiple-bank ownership for over ten years. Fifteen of the 68 respondents indicated they had ownership in a combined total of 53 nonmember banks in addition to their member bank holdings. One respondent noted ownership in twelve nonmember banks, another owned stock in eight, and another owned stock in seven.

The evidence from the survey confirmed the belief that 5 per cent ownership is more than adequate to achieve standardized operating policies when desired. Multiple-bank ownership is usually a permanent type of investment spanning several years duration, thereby enhancing the likelihood that centralized operation will emerge. My conclusion is that the result will be a concomitant loss in real banking alternatives for the public and a reduction in competition.

A number of reasons were offered explaining the origination of multiple-bank ownership. The most positive explanations were: (1) to overcome state restrictions against branch banking, (2) to insure coordination in operating policies so that the competitive position and profitability of affiliated banks would be improved vis-a-vis independent banks, and (3) to capitalize on a growing demand for bank services. These reasons serve to corroborate long-held beliefs about the development of chain systems. Chain banking is undertaken as a general rule to achieve certain specific objectives; it is ordinarily a function of certain regulatory conditions, sometimes restrictive like antibranching laws and sometimes permissive such as the exemptions in Section 8. One must reject the argument that common ownership of banks, with its attendant net of interlocking directors and officers, arises as some random or chance phenomenon. Most multiple-bank owners admit that they have a purpose in mind when they acquire a significant investment in another nearby bank. They are not blind to the enviable opportunities that await them.

Many multiple-bank owners contended their common ownership has arisen primarily to achieve diversification in personnel investment portfiolios or merely to take advantage of particularly profitable investment opportunities rather than as a means of evading branching restrictions. No doubt these contentions are valid in some isolated instances. But if these were actually the most important reasons, it would indicate that investors in unit-banking states have different investment objectives than those in branch-banking states, giving them greater incentive to concentrate their investments in bank stocks—very often banks serving the same trade area; or more opportunities exist to make profitable investments in bank stocks in unit-banking states than in branch-banking states. This line of argument is indefensible.

An investment position in a group of banks sufficiently large to gain control of 5, 20, or 50 per cent of the stock of the banks reveals quite clearly a policy directed toward concentration of investments rather than diversification. (How do you achieve real diversification by investing in banks all located in the same city?) When this occurs, the owner is going to be vitally concerned about the management of the institutions in order that his investment does not deteriorate and the bank will be operated in such a manner as to yield the best possible return. As a consequence, it is only logical and inevitable that common operating policies should emerge among the banks in a chain. And the longer the common ownership prevails, the more likely it becomes that centralized control will be evolving. Clearly, the channel of communication is now established whereby a director or officer in one bank can transmit to the other banks knowledge regarding successful and unsuccessful operating policies. No substantial stockholder would sit by idly while watching his investment deteriorate in value. Centralized control over nominally independent and competing banks is the result, combined with the fact that bank customers have been deprived of what could have been a "choice" among competitors.

According to the survey opinions, there appear to be several aspects of operation in which banks joined by common ownership can perform better than independently operated banks. The areas of superior performance involve such practices as a better means of engaging in loan participations, better exchange of credit information, sharing specialized equipment and personnel that would be uneconomical for one bank to provide, better opportunities for policy-making officials to discuss common problems, and establishing common loan and investment policies. But as a general rule, better performance on these measures is more directly related to the size of the bank than to the particular organizational scheme.

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The degree of centralized control varies among systems. At one extreme, all operating aspects are centralized much like a branch system. In other cases, each member of the chain retains a great deal of independence in establishing operating policies.

Next let us consider some of the harmful features of chain banking, as offered by state banking supervisors and bank owners. A letter requesting information on multiple-bank ownership was sent to 22 state banking supervisors. Replies were received from 16. Most supervisors felt that chain banking activities were not sufficiently important in their state to cause alarm. Some did not even have knowledge of the identified chains in their state. A few, however, had negative opinions. One supervisor preferred not to comment because of the controversial nature of the subject in his state. Three others indicated that they regarded common ownership of banks to be a problem in their state. One said that since the practice of common ownership was not illegal, it was "a situation with which we will have to live." Another supervisor referred to the "chain banking problem" in his state, indicating he did not believe that common ownership was the most healthful atmosphere for banking operations. The other supervisor pointed out that his office did not approve of chain banking and was particularly concerned about a chain of small banks operating in the state but that no action could be taken against the owners because the law permitted the practice.

Surprisingly enough, several multiple-bank owners were very candid and specific in pointing out potentially harmful aspects of chain banking. For instance, many recognized that common ownership lends itself to the elimination of competition and a reduction in the number of independent banking alternatives for the public. Below are eight examples of some direct quotes taken from the questionnaire responses of bankers:

Interest rates could be higher for borrowers because common ownership could tend to be monopolistic. Loans in area covered by common ownership of banks could be reduced.

Unless other banking alternatives are available, the control of common ownership in banks in a specific area may have a stifling effect, depending on policy. There is the possibility of draining funds from one community to another. Absentee ownership sometimes results in a bank's taking a lesser interest in its community.

Usual evils resulting from monopoly if common ownership results in lack of competition.

This type of situation (common ownership of banks) is very vulnerable to unscrupulous practices. Safeguards must be set up to prevent the common owner shifting questionable paper from one bank to another to avoid detection by examiners.

In my mind, common ownership generally denotes absentee control in one or more localities. This can have the effect of favoring one community or one bank at the expense of the others by shifting funds and management.

Possibility of slipping into monopolistic practices. Poor competitive position if top management does not concern itself with problems of each bank's community.

It is quite easy for the banks to become burdened by red tape and reports to the common owner. The absentee owner can quite easily become more interested in profits than in the bank's own community. Eventually, this hampers the efficiency of the bank itself.

I doubt that there is any inherent advantage to the public through common ownership (of banks). . . . On the other hand, an unscrupulous owner or even an honest owner without ability can have very much more serious consequences in the case of individual ownership. To properly safeguard the public, simultaneous examinations could become necessary in many cases of multiple ownership.

In a majority of the cases, chain banks were reported to have no observable characteristics that would enable the banking public to recognize the common ownership ties. Only a few cases were noted where joint advertising was used to publicize ownership links. The lack of public awareness of ownership ties can be criticized as one of the major drawbacks of this practice. In contrast, holding company affiliations and branch offices are usually common knowledge. But regardless of organizational form, the economic consequences can be the same.

Several bankers expressed concern because the banking public does not know of bank affiliations, assuming them to be independently operated institutions

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serving the same trade area. Yet, the respondents seemed to be reluctant to take any step so inform the public. One banker stated that he did not believe common ownership ties should be made bublic because it would create an image of monopoly and, as a result, be detrimental to his banks. Another banker responded that it was unnecessary to publicize his ownership connections because he had lived in the community all of his life, and it was common knowledge that he was president of both banks in town!

C. *Additional Studies on Chain Banking.*—For the purpose of completing the record, mention will be made here of three other studies on chain banking which have been completed, although they do not have as much relevancy as the ones previously discussed.[6] One was a historical review of chain banking development in this country, covering the time span from the first recorded instances of chain banking through 1945.

Another research project was a regression and correlation analysis of structural and demand variable that would help explain the incidence of chain banking. It was found that the branching policy of a state is the most important structural determinant of the number of chain banks in a state. This finding lends credence to the generally accepted belief that chain banking, along with group banking, is used primarily as a means of circumventing branching restrictions.

The other research project compared the profitability of chain banks with nonchain member banks. The sample of chain banks proved to be less profitable than their member bank counterparts. One explanation for lower profits was the smaller size of chain banks. Differences in balance sheet structures appeared to be another influential variable affecting the profitability measures.

III. BANKS LINKED BY 25 PERCENT OWNERSHIP

Perhaps it would be instructive to consider some special ownership circumstances in greater detail, such as owners of 25 percent or more of two or more banks. According to the lists in *Twenty Largest Stockholders of Record*, there were 51 instances of two or more banks being linked by a 25 percent or more ownership position of a single individual in 1962. A follow-up study was undertaken to see how many of these situations still existed in 1968, the most recent year for which county deposits are available. Reference to *Polk's Bank Directory* shows that 47 of these ownership connections were still present, or assumed to be when the same individual's name or family name appeared among the directors and officers. Typically, the individual was listed as the chief executive officer of the banks. The missing four were traced as follows: one chain had been converted into a holding company, one chain converted into a branching system when the state law was changed, another pair of banks were merged, and one chain was terminated by the liquidation of one of the banks.

Table 3 contains the state location, names and positions of individuals, and other details regarding the linked banks. Observe that a large number of these banks are located in the unit banking states and generally would be considreed small banks. Most of them are to be found in small towns.

The chains have been segregated into two classes: those with all banks located in the same county, and those in which the affiliated banks are located in different counties. An approximate mileage between the banks is given for the latter cases to get a better view of their proximity. Although it is recognized that there are a number of pitfalls in considering the county of location as the relevant geographic market for a bank, other market data are not readily obtainable so market shares have been computed on the basis of county deposits controlled. At least this measure gives an approximation to the relative concentration that has been achieved at the local level via common ownership and interlocking managements.

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[6] Jerome C. Darnell, "Chain Banking Development in the U.S.," *Bankers Magazine*, Winter, 1970, pp. 39–49; "Determinants of Chain Banking," *National Banking Review*, June, 1967, pp. 459–468; "Profitability Comparisons Between Chain and Nonchain Banks," *Bankers Magazine*, Spring, 1968, pp. 24–32.

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TABLE 3.—NUMBER OF CASES WHERE ONE INDIVIDUAL OWNS 25 PERCENT OR MORE OF 2 OR MORE BANKS

State	Name of stockholder	Number of banks owned [1]	Percent of stock owned [1]	Class of stockholder [2]	Deposits [2] (thousands)	Percent of deposits controlled [3]	Percent of deposits controlled [4]	Approximate mileage
Connecticut	Gannuscio, A	2	51.8	4	$3,211	0.2		
			50.0	4	24,525	1.5		
Vermont	Jennings, J	2	41.2	1	3,853		5.0	Over 50 miles.
			52.0	4	3,347		2.7	
New Jersey	Sinskey, R	2	50.5	1	14,687		0.8	30 miles.
			50.2	4	38,007		6.8	
New York	Hamilton, W	2	76.1	2	7,166		8.7	Over 50 miles.
			82.3	2	3,707		3.2	
Kentucky	Kincaid, G	2	64.7	1	13,130		57.8	Do.
			51.0	3	25,523		[5] 1.0	
Alabama	Grimsley, A	2	58.8	2	5,586		30.2	Do.
			59.1	2	6,979		47.6	
Illinois	Callett, K	2	41.5	4	2,121		1.0	7 miles.
			40.7	3	1,604		1.0	
			47.3	3	28,149	5.8		
			83.6	3	12,349	2.5		
	Cuneo, J	4	93.6	3	10,500	2.0		
			27.6	3	14,840		.1	6 miles.
	Edwards, J	2	74.0	4	10,032		23.9	Over 50 miles.
			26.7	4	7,796		23.6	
	Goldberg, M	2	24.7	3	32,241	.1		
			26.8	4	380,949	1.8		
	Volle, G	2	41.0	3	3,500	6.1		
			31.6	4	1,335	2.3		
Indiana	McKee, H	2	67.8	2	7,069	13.3		
			40.0	4	2,940	5.5		
Arkansas	Couch, H	2	25.6	3	18,316		52.8	25 miles.
			25.4	3	114,821		23.3	
Minnesota	Hoel, R	2	51.7	4	5,402	1.2		
			62.6	4	3,361	1.0		
	Klein, C	4	46.1	3	9,976	23.5		
			70.5	3	6,935	16.0		
			88.0	3	8,009		37.9	12 miles.
			60.3	3	14,513		42.6	
	Kriesel	3	58.4	1	22,775		32.1	Over 50 miles.
			69.0	3	5,746		34.0	
			76.8	4	8,399		[5] 50.1	
	Peyton, O	2	40.9	3	5,372	1.2		
			34.8	3	3,629	1.0		
	Zabel, H	2	29.8	4	4,611		13.6	45 miles.
			47.8	4	3,069		[5] 7.4	

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TABLE 3.—NUMBER OF CASES WHERE ONE INDIVIDUAL OWNS 25 PERCENT OR MORE OF 2 OR MORE BANKS—Continued

State	Name of stockholder	Number of banks owned [1]	Percent of stock owned [1]	Class of stockholder [2]	Deposits [2] (thousands)	Percent of deposits controlled [3]	Percent of deposits controlled [4]	Approximate mileage
Montana	Nefsy, W.	2	66.5	4	12,710		33.4	Over 50 miles.
			51.5	3	6,752		8.0	
	Towe, E.	2	43.8	3	4,052		100.0	Do.
			48.0	4	5,869		100.0	
N. Dakota	Refling, O.	2	50.1	3	8,458		53.4	Do.
			46.4	3	4,593		30.0	
Colorado	Babcock, R.	2	80.0	3	3,121		100.0	Do.
			85.0	3	4,509		100.0	
	White, H.	3	36.7	4	4,618		39.3	Do.
			31.5	4	9,874		39.1	
			51.9	4	6,227		80.2	
Kansas	Collingswood, E.	2	41.6	4	2,476		6.3	50 miles.
			42.3	1	2,890		25.2	
	Hobbs, H.	2	48.1	3	8,682		34.4	10 miles.
			56.0	3	2,268		23.1	
Nebraska	Orshek, F.	2	52.6	3	21,683	35.3		
			51.0	3	3,988	6.4		
Oklahoma	Athey, R.	2	44.7	3	15,525		19.2	25 miles.
			74.0	3	3,570		15.7	
	Hassing, C.	2	54.0	3	939	6.0		
			51.5	4	4,626	31.1		
	Hinson, T.	2	42.7	4	3,097	8.1		
			34.6	4	6,996	17.1		
	Huckaby, T.	2	48.0	4	2,127		9.1	Do.
			81.0	4	3,475		16.6	
	Stuart, C.	2	43.4	3	3,099		29.0	Do.
			42.8	3	1,257		11.2	
	Stuart, D.	2	84.0	4	2,513		12.3	Do.
			34.8	4	1,257		11.2	
	Thurmond, J.	2	61.6	4	900		14.2	16 miles.
			27.8	2	9,253		30.0	
	Wilson, L.	2	51.6	4	6,680	16.2		
			44.0	4	4,317	10.6		
	Wooten, F.	2	50.2	3	5,782	21.4		
			63.9	2	11,882	43.2		
New Mexico	Cree, G.	2	48.0	3	15,679		57.1	Over 50 miles
			25.6	1	2,314		[5] 14.3	
	Jones, G.	2	30.8	4	3,831		13.2	50 miles.
			28.0	4	10,648		68.0	

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Texas	Bentsen, E	2	30.5	4	30,742	20.1	-------	
			33.8	1	10,681	7.0	-------	
	Collier, S	2	27.1	2	3,459	-------	2.4	5 miles.
			32.5	2	7,382	-------	4.7	
	Donegan, C	2	26.8	3	9,030	31.0	-------	
			43.9	3	5,683	19.1	-------	
	Draper, W	2	70.4	4	33,911	-------	29.2	25 miles.
			29.0	3	7,510	-------	3.2	
	Fulton, J	2	92.2	2	6,545	-------	41.4	40 miles.
			29.3	3	19,128	-------	5.6	
	Henry B	2	25.1	3	2,934	-------	47.1	Over 50 miles.
			26.1	3	3,912	-------	16.5	
	Jeffries, R	2	83.0	3	5,170	-------	8.8	40 miles.
			54.0	4	3,384	-------	28.4	
	Riddel, R	3	27.0	4	4,524	-------	100.0	20 miles.
			36.3	4	16,386	-------	53.2	
			31.6	1	6,304	-------	77.4	
	Rodman, E	2	25.6	1	50,028	-------	34.4	Over 50 miles.
			29.1	1	75,727	-------	22.0	
	Walden, G	2	35.5	3	4,996	-------	31.2	Do.
			50.0	4	3,195	-------	10.5	

[1] As of June 30, 1962.
[2] As of June 30, 1968. (1—Director, 2—Officer, 3—Other, 4—Both director and officer.)
[3] Banks located in same county.
[4] Banks located in different counties.
[5] Out-of-state bank.

Source: Twenty Largest Stockholders of Record; Polk's Bank Directory; and Summary of Accounts and Deposits In All Commercial Banks, June 29, 1968, Federal Deposit Insurance Corp.

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When do we consider a market to be so concentrated that competition is threatened? In a recent bank merger case, *U.S.* v. *Phillipsburg National Bank & Trust Co.*, 399 U.S. 350 (1970), the Supreme Court reiterated what it said in *U.S.* v. *Philadelphia National Bank*, 374 U.S. 321 (1963). In *Philadelphia* the Court said that when a merger produces a firm controlling an "undue percentage share of the market" and results in a "significant concentration of firms in the market" there is no need for elaborate proof of the merger's anticompetitive effects. *Mergers of this type are presumed to lessen competition substantially,* unless there is a clear showing of evidence to the contrary. The Court did not specify what the threshold of concentration should be to be held presumptive of substantially lessening competition. The *Phillipsburg* merger, however, would have produced a bank controlling 19.3 per cent of the banking assets in the relevant geographic market. Thus, we can infer that a market share of 20 per cent is sufficiently large to reach the threshold of illegality. (The FDIC has stated it will view 15 per cent of the market as being the critical point in weighing the antitrust aspects of a merger. *American Banker*, October 7, 1970, p. 1.)

If 20 per cent were used as an "undue percentage share of the market" and if the banks in Table 3 were independently owned and applying for permission to merge, a number of them would not pass muster under the Court's standard. Eight of the cases involve banks located in the same county with a combined market share of more than 20 per cent. Four cases can be found where the banks are in different counties but less than 50 miles apart and control 20 per cent or more of their respective county deposits. Nine cases show up where the banks are more than 50 miles apart but each controls 20 per cent or more of the county deposits. It is a safe bet that if county market shares were computed on an aggregated basis, many of the latter two groups would have a combined share in two or more counties of 20 per cent or more. And we are just considering the cases of 25 per cent ownership. Moving the ownership cutoff down to 5 per cent would involve the systems in Table 1, over one-half of which were composed of banks located in the same county.

The point I would like to make is this. Common ownership of commercial banks can and does eliminate competition between them just as a merger or holding company acquisition would. The legal foundations may be different, but the economic consequences are the same. The Supreme Court has ruled that mergers with 20 per cent of the market substantially lessen competition. Why should we permit banks to achieve via common ownership the same anticompetitive position that would otherwise be denied to them if they were to merge? (And it is likely the Federal Reserve Board will now be applying the same standard in reviewing holding company applications.)

Reference to Table 1 will remind us that over one-half of the identified chain systems were composed of banks located in the same county. Two-thirds of these single-county systems, 161 of 242, were found to have market shares of 20 per cent or more in 1962.

Should we be concerned about banking concentration in small towns where the magnitude of commerce affected would be very minimal? The High Court has ruled in the *Phillipsburg* case that customers of small banks in small towns are no less entitled to the benefits of competition than are customers of large banks. Indeed, the need for protection is even greater in the smaller community because these patrons usually do not have the large variety of financial institutions from which to choose.

A. *Chain Banking in Colorado.* A recent study of banking structure in my home state of Colorado found 20 chain systems in existence.[7] Four of these have been combined into one registered bank holding company since the study was finished. Seven of the remaining 16 are composed of two banks each, with both banks in the same county. Five of the seven have market shares ranging from 19 to 92 per cent in their counties, as of June 30, 1968. Of the remaining nine multiple-county systems, two systems consist of five banks each. One of the systems has banks with market shares ranging from 16 to 97 per cent in their repective counties, the aggregated share being 28.0 per cent. The other system of five has market shares ranging from 16 to 63 per cent of their respective counties, the aggregated share being 33.2 per cent.

[7] Eugene T. Halas, *The Banking Structure in Colorado* (Denver: Division of Research University of Denver, 1969), pp. 113–117.

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IV. OWNERSHIP AND MANAGEMENT INTERLOCKS BETWEEN MUTUAL SAVINGS BANKS AND COMMERCIAL BANKS

Mutual savings banks are permitted to invest in commercial bank equities in most of the 18 states where they exist. In addition to the ownership in a commercial bank, it is a common practice for a mutual to have interlocking managements with that commercial bank. Mutual savings banks are most likely to have an investment and accompanying interlocking managements in commercial banks located in the immediate trade area of the savings bank. Such instances are also prime candidates for ones in which competition will be impaired.

In order to investigate the above conditions and the implications on the competitive environment, an examination was made of the lists in *Twenty Largest Stockholders of Record*. Table 4 summarizes the information that was found. Attention was focused on the six New England states because New York does not permit its savings banks to invest in commercial bank stocks and because the other states permitting them do not have a large number of savings banks.

TABLE 4.—OWNERSHIP IN COMMERCIAL BANKS BY MUTUAL SAVINGS BANKS, BOTH LOCATED IN SAME COUNTY—NUMBER OF COMMERCIAL BANKS, PERCENTAGE OF TOTAL COUNTY DEPOSITS HELD, AND NUMBER OF MANAGEMENT INTERLOCKS

State	Number of banks	Percentage of total county deposits held [1]				Number of management interlocks [1]					
		0 to 20	21 to 40	41 to 60	61 plus	0	1	2	3	4	5 plus
Connecticut	21	8	9	3	1	7	2	3	2	3	4
Maine	12	6	1	4	1	7	3	0	2	0	0
Massachusetts	66	53	10	1	2	14	20	7	8	6	11
New Hampshire	24	9	11	4	0	7	3	5	4	1	4
Rhode Island	4	0	2	0	2	3	0	0	0	0	1
Vermont	2	0	0	1	1	2	0	0	0	0	0
Total	129	76	33	13	7	40	28	15	16	10	20

[1] As of June 30, 1968.

Sources: "Twenty Largest Stockholders of Record; Polk's Bank Directory; Summary of Accounts and Deposits in All Commercial Banks," June 29, 1968, and "Summary of Accounts and Deposits in All Mutual Savings Banks." June 29, 1968, Federal Deposit Insurance Corporation.

The Table gives the number of mutual savings banks in each of the six states which were found to be an owner of stock in one or more commercial banks, the latter being located in the same city or county as the savings bank owner. Next, we have a distribution of the percentage of the mutual savings bank deposits plus commercial bank deposits in the county controlled by this "marriage." For example, 24 mutual savings banks in New Hampshire were found which had ownership in one or more commercial banks located in the same county as the mutual. Of these 24, nine of the marriages held less than 20 per cent of the combined mutual and commercial bank deposits of the county. Fifteen of the mutual-commercial combinations held more than 20 per cent of the total county deposits.

Also included in the Table are the number of management interlocks that were found to exist in 1968. Forty of the 129 combinations had no interlocks. At the other extreme, 20 had five or more. One case in Connecticut had 12 common directors, officers, and trustees; another in New Hampshire had ten. It seems that the presence of just one common management tie is adequate to forge a communication link between these competitors. The presence of more than one would seem to offer strong evidence of an attempt to have more than just clear lines of communication; it would suggest an attempt to develop common operational goals for the overall benefit of the marriage.

A total of 113 cases were found where a mutual savings bank owned at least 5 percent or more of the stock of a commercial bank, either located in the same county or outside. (Some of the cases in Table 4 had less than 5 per cent ownership.) Massachusetts and New Hampshire banks were dominant on this measure. (See Table 5)

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TABLE 5.—5 PERCENT OR MORE OWNERSHIP OF MEMBER BANKS BY MUTUAL SAVINGS BANKS IN NEW ENGLAND

State	Number of banks	Percentage of ownership	
		5.0–9.9	10.0 or more
Connecticut	10	7	3
Maine	7	5	2
Massachusetts	62	36	26
New Hampshire	30	10	[1] 20
Rhode Island	2	1	[2] 1
Vermont	2	1	1
Total	113	60	53

[1] Four cases where a mutual savings bank owned 25 percent or more.
[2] One case where a mutual savings bank owned 25 percent or more.

Source: Twenty Largest Stockholders of Record.

The next step in my research was to try to learn something about the competitive significance of these stock investments and interlocking managements. A letter and questionnaire were sent to a sample of 100 mutual savings banks (33 usable returns were received) asking for information or opinions on the following:

A. Descriptive data on number of banks in which stock is currently owned, location of banks, number of management interlocks, number of years having ownership, and deposit size of commercial banks.

B. Reasons for investing in particular banks stocks, especially those serving the same market area as the mutual savings bank.

C. Public awareness of a mutual savings bank's investment in commercial banks serving the same market area.

D. Degree of coordination of operating policies between the savings and commercial banks.

E. Product lines in which the two types of banks compete and the degree to which competition is influenced by the ownership.

F. The degree of competition existing between the savings and commercial banks on each of the following product lines: real estate mortgages, savings deposits, consumer loans, and overall operations.

G. An opinion as to the impact on the *banking public* and on *savings banks* if legislation were enacted: (1) to prohibit mutual savings banks from investing in commercial bank stocks, and (2) to prohibit management interlocks between mutual savings banks and commercial banks.

One would naturally expect the responses to points D through G to be hedged and perhaps not as candid as we would like to see since these are touchy subjects at best. Despite the probing nature of the questions, it was gratifying to receive a number of detailed, illuminating responses. Below is a brief summary of the usable returns:

A. The typical mutual savings bank owned stock in 13 commercial banks, three of which were in-state banks. About 10 per cent of the commercial banks were located in the same city or county as the savings bank. A total of 74 management interlocks were reported in the 33 replies, 68 of them were interlocks with a commercial bank located in the same county as the savings bank. On the average, bank stock has been owned 16 years. The average size of the commercial banks was about $150 million in deposits.

B. The most frequently cited reason for investment was the profitable return compared with alternatives. A few indicated their state laws gave them the privilege, and a few indicated a desire to help the local bank and the local community. Several indicated they do not use the same criteria for investing in a local bank as in a bank at some distance.

C. Eight respondents said the public is aware of their ownership in local banks because of advertising, published statements, and common lobbies. Others said public awareness was not present. Eleven said they did not believe the public should be informed because the intent might be misunderstood.

D. Apparently a number of operating activities are coordinated when the banks have interlocking managements. Those most frequently mentioned were sharing common facilities, exchanging credit information, provision of personnel

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fringe benefits, sharing specialized equipment and personnel, and engaging in common promotional activities.

E. As expected, product lines where competition is keenest are savings deposits, mortgages, and consumer loans. Twenty-seven indicated the ownership tie had no influence on competition in these lines; six replied that competition was reduced because of the ownership link.

F. Below is a summary of the number of responses to the statement "Characterize the degree or intensity of competition in the following areas between your bank and the commercial bank(s) located in your trade area in which it owns stock."

	Very competitive	Moderately competitive	Very little competition	No competition
Real estate mortgages	4	5	12	10
Savings deposits	17	3	4	7
Consumer loans	14	4	4	7
Overall operations	5	9	3	9

G. Responses to the impact on the banking public if savings banks were prohibited from investing in commercial bank stocks were: 11—harmful; 0—beneficial; 7—unobservable. The impact on savings banks: 6—harmful; 1—beneficial: 0—unobservable. Responses to the impact on the banking public if management interlocks were prohibited: 4—harmful; 4—beneficial; 9—unobservable. Impact on savings banks: 0—harmful; 3—beneficial; 4—unobservable. Generally, the respondents felt the impact of such legislation on the banking public would not be very noticeable one way or the other. On balance, the general feeling was that the legislation would be harmful to the savings banks because it would deny them a profitable investment outlet and impose a hardship in finding competent people to serve as directors and officers.

It seems that the strongest argument that can be advanced in support of interlocks between savings and commercial banks is the short supply of capable director and officer talent in smaller communities. Therefore, prohibiting interlocks would impose a burden on the institutions in finding qualified management. Even presuming this argument to be valid, does it *clear outweigh* the loss in actual and potential competition that will result?

The result of this survey do not prove that all investments by savings banks in commercial banks lead to diminished competition, but there is little question but what the investment can be used, and in a large number of cases is used, to stifle competition between these alleged competitors. We are aware of the manner in which interlocking managements can be used to lessen competition. These institutions are supposed to be competing for the public's savings dollar and for various types of loans. Yet, they have been allowed to operate with common policies that deny the fruits of competition.

One recent study has found that New Hampshire commercial banks affiliated with savings banks had significantly lower savings deposit ratios and significantly lower participation in the residential real estate market than unaffiliated banks.[8] The implication is that the savings bank and the commercial bank, via the common management interlocks, have divided the market so that the savings bank takes the savings deposits and makes the real estate loans, while the commercial bank concentrates on the remaining functions. In the words of one savings banker responding to my questionnaire: "We respect the traditional areas of each other."

A prohibition on mutual savings banks owning commercial bank stock does not seem as restrictive on the industry as one might at first suspect. About a third of the eighteen states with mutual savings banks already have such a prohibition. The number of savings banks affected by this measure would be somewhat over 70 per cent, but this group holds less than 40 per cent of savings bank assets. The investment of savings banks in commercial bank stocks is less than 1 per cent of their total assets. The dominant savings bank state, New York, has this prohibition now, and the savings banks there have apparently been prosperous without investing in commercial bank stock. Surely there must be other worthy securities

[8] Alan S. McCall and Robert A. Eisenbeis, "Some Behavioral Consequences of Affiliations Among Mutual Savings Banks and Commercial Banks," Federal Deposit Insurance Corporation, 1970, mimeographed.

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that can be substituted for the small amount now invested, especially when such a small investment has such a large potential for lessening competition and fostering conflicts of interest.

V. CONFLICTS OF INTEREST BETWEEN SAVINGS AND LOAN ASSOCIATIONS AND COMMERCIAL BANKS

My research efforts have not been concerned with interlocking directorates between savings and loan associations and commercial banks. However, I would like to review some of the contents of the 1969 study on conflict of interest in the savings and loan industry.[9]

This study found that interlocks between savings and loan associations and other financial institutions were a common practice. A 1968 sample of 808 associations revealed that 56 per cent of them had at least one interlock with a commercial bank and 8.6 per cent had at least one interlock with another association. A number of interlocks were also found with mutual savings banks (18), mortgage banks and mortgage companies (15), finance companies (9), credit unions (4), and other assorted financial institutions.

Included within the group of associations having at least one interlock with a commercial bank were 256 associations with two or more interlocks. "Since two or more interlocks with the same bank are strongly suggestive of common control, it would be a very conservative statement to say that at least one in five insured associations are probably under common control with a commercial bank." [10]

A number of situations were discussed where the management interlocks between the associations and banks may prove injurious. Too often the top management group is interested primarily in the commercial bank and the association suffers from neglect and inattention. The tendency may be to run the association as a branch of the bank.

Another problem is the reduced competitive effort that necessarily follows when the institutions are subject to common control. "Once the local bank obtains control over the local association, we would expect the competitive efforts of the association to be kept under restraint. This might be observable in various measures of competitive effort, such as the level of advertising expenditures, rates charged on loans and paid on shares, and the growth rate of the association." [11] A number of case discussions follow in the study which serve to underscore this point.

Particularly important is the possibility that the association may be used as a depository for poor assets or doubtful mortgage loans that the controlling bank no longer wants in its portfolio. The association may also be required to sell the bank loans on favorable terms to increase the bank's income. Another practice may be to keep compensatory balances in the bank that are larger than necessary. A number of cases were found where bank-controlled associations had balances well above those of comparable institutions. Other actual and potential abuses were noted in the study which were attributable to the interlocking managements between savings and loan associations and commercial banks. The author concluded:

. . . the anticompetitive implications of savings and loan interlocks and common control with commercial banks are so clear that a sizeable number of such linkages would appear vulnerable to antitrust attack on structural grounds alone. Regulation has been seriously inadequate in the area and is in need of a drastic overhauling.[12]

VI. POSITION ON PROPOSED LEGISLATION

The widespread practice of common ownership, with accompanying interlocking managements, among commercial banks leads me to conclude that competition is being stifled. Furthermore, the public is being deceived into believing that it has genuine alternatives when in fact they do not exist. The harmful effects are most pronounced when the alleged competitors are serving the same trade area. The

[9] Edward S. Herman, "Conflict of Interest in the Savings and Loan Industry," in *Study of the Savings and Loan Industry* (Washington: Federal Home Loan Bank Board, 1969), pp. 771–969.
[10] *Ibid.*, p. 872.
[11] *Ibid.*, p. 876.
[12] *Ibid.*, p. 885.

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reduced competitive effort that necessarily follows when institutions are under common management far outweighs any possible public benefit that might be gained from the improved expertise on the part of management or because of the limited supply of capable talent in smaller communities.

The impairment of competition arising from interlocking managements between commercial banks and other institutions, especially the depositary institutions, is just as harmful. We believe the maintenance of a competitive atmosphere will pay dividends to society. We should not allow this atmosphere to be polluted by tolerating conditions that lend themselves to reducing the competitive vigor among participants in the marketplace.

For the reasons set forth in this statement, I would support Sections 2, 3, 4, and 10 of the Banking Reform Act of 1971.

If this legislation is passed, I believe three outcomes are predictable. First, an extremely large amount of bank stock will have to be placed on the market. Second, the Federal Reserve Board will need to increase its staff in order to handle the flood of applications for registered bank holding companies. Third, many bankers will condemn the law as an unwarranted intrusion on the part of big government and as an injurious disruption of banking practices that have existed for decades, furnishing the basis for the great expansion in our free enterprise, competitive economy.

The CHAIRMAN. Professor Dooley, we are glad to have you, sir. We would like to hear from you at this time.

STATEMENT OF PROF. PETER C. DOOLEY, UNIVERSITY OF SASKATCHEWAN

Mr. DOOLEY. Mr. Chairman and members of the committee, H.R. 5700 covers a variety of reforms which are intended to improve the performance of the financial markets. I should like to restrict my remarks to those sections of the bill dealing with the interlocking relations of financial institutions, because this is the area with which I am most familiar. These interlocking relations affect the control of corporations, tend to restrict competition, and involve conflicts of interest.

Since Berle and Means wrote their classic work "The Modern Corporation and Private Property," the hypothesis that corporations are management controlled has been widely accepted.

The facts on which the management control hypothesis is based are fairly clear:

(1) The common stock of most large corporations is widely held. Few individuals or families own as much as 50 percent of the stock in any of Fortune's 500 largest corporations. However, where stockholders are very widely spread, much less than 50 percent is necessary for control. Probably even less than 10 percent, the figure used by R. J. Larner and J. R. Vernon, is needed for control.

(2) The board of directors cannot be expected to supervise the daily operations of a giant corporation. However, that is not their function. They set general policies: pricing policies, financing policies, labor policies, and so on.

(3) Major corporate decisions are complex and require the work, advice, and approval of a variety of technically competent people. However, not all these people are employees of a single corporation. Management frequently turns to outside specialists to assist in legal, advertising, engineering, and financial decisionmaking. Decisions are group decisions, but the group is larger than a single corporation.

This committee has been concerned with intercorporate relations in

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the financial community since the turn of the century. In 1913 Mr. Pujo submitted his report on the concentration of control of money and credit. The report focused its attention on interlocking relations among the major New York banks and financial houses, which, at that time, were dominated by J. P. Morgan & Co. and the Rockefeller interests.

Five major financial institutions—J. P. Morgan & Co., Guaranty Trust Co., First National Bank, National City Bank, and Bankers Trust Co.—were found to have 23 pairwise interlocking directorates held by only 11 men. In addition, these same five institutions interlocked with 34 other bank and trust companies, 10 insurance companies. 32 transportation systems, 24 producing and trading companies, and 12 public utilities. The striking feature of these interlocking relations was the central role played by particular wealthy individuals: J. P. Morgan, George Baker, and so on.

In 1935, the National Resources Committee investigated interlocking directorates among the 200 largest nonfinancial corporations and the 50 largest financial corporations ranked by assets. Of the 250 corporations, only 25 did not share a common director with any of the others. The remaining 225 corporations were joined together by 1,423 pairwise interlocking directorates.

These interlocking directorates were not randomly distributed, but formed eight clearly defined interest groups. Five of these groups were identified by family name (Morgan, First National, Rockefeller, Kuhn-Loeb, Mellon, and Du Pont). The other three represented local or regional interests (Chicago, Cleveland, and Boston).

In contrast to the Pujo report, the interest groups listed by the National Resources Committee were not simply the instruments of particular individuals. Instead, several of them represented concentrations of economic power that did not depend upon particular individuals at all.

I repeated and extended the 1935 investigation for 1965. The study appears in The American Economic Review (June 1969), a copy of which follows my prepared statement.

The most prevalent type of interlock in 1965 involved corporations with their head offices in the same commercial center. Within each of seven cities (New York, Chicago, San Francisco, Pittsburgh, Los Angeles, Cleveland, and Detroit) tightly knit groups of corporations interlocked four or more times. An additional eight cities were found in which more loosely knit interlocking relations existed. These city-based interlocking interest groups shared a common characteristic.

Banks and life insurance companies formed a central core about which other members of the group were arranged. These local networks accounted for most of the 753 interlocks with financial institutions and explain why financial corporations were interlocked more frequently than other corporations.

The nature and extent of these local interest groups requires a restatement of the simple management control hypothesis. It is true that the typical modern corporation is not dominated or controlled by particular wealthy individuals or by the local money trust, though examples of both exist. For all practical purposes the Ford family owns and controls the Ford Motor Co., and for all practical purposes the network of interlocking relations centered in Pittsburgh is associated

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with the Mellon family. However, the world of J. P. Morgan and J. D. Rockefeller, which the Pujo report discussed, no longer exists, It is also true that decisionmaking in the large corporation is the function of groups, not individuals.

As Galbraith says, "* * * it is known that retirement, death, and replacement, however important to the individual involved, have not the slightest effect on General Motors or Continental Can". However, group decisionmaking extends beyond the employees of the lone corporation. This is especially true in the field of finance, where most nonfinancial corporations depend upon a continuing line of credit. The local interest group is the measure of the importance and influence of the financial community on the nonfinancial corporation.

RESTRICTION OF COMPETITION

To a certain extent, all financial institutions are competitors. Commercial banks, savings and loan companies, mutual savings banks, credit unions, life insurance companies, and other financial institutions face one another in a large number of markets. Table I in my prepared statement shows the holdings of U.S. Government securities, State and local obligations, corporate and foreign bonds, home and other mortgages, consumer credit, and bank loans for the end of 1970.

The strongest case that interlocking relations restrict competition exists where a borrower and a lender interlock. If, for example, a bank officer sits on the board of directors of an industrial corporation, both the bank and the industrial firm stand to gain. The bank gains because it has continuing access to inside information about the operations of the manufacturer. Even if the bank charges the manufacturer the same rate of interest that it charges similar corporations, the expected profit of the bank is increased because it has reduced the risk of default by having more complete information. The industrial corporation gains because the bank can afford to lend it more funds or lend it funds at a lower interest rate than it can afford to lend to another corporation of exactly the same credit worthiness.

If, on the basis of technical analysis, the bank is at the margin of indifference whether it should lend to one or another corporation, its own self-interest will lead it to deal with that corporation about which it has the best knowledge. In view of the importance of good credit information to banks and of the necessity of credit to many corporations, it is not surprising that so many lender-borrower interlocking relations exist. An industrial corporation which does not enjoy such a relation is at a competitive disadvantage.

H.R. 5700 does not and should not limit its prohibition of interlocking relations to bank directorships alone. It extends its prohibition to trustees, officers, and employees as well as to other types of financial institutions. Section 8 of the Clayton Act has always been easily circumvented because it prohibits interlocking directorates alone. Surely an officer or employee can represent the corporate interest as effectively as a director. This committee's report, "Control of Commercial Banks and Interlocks among Financial Institutions," clearly indicates that interlocking relations extend to stock ownership and cover insurance companies, mutual savings banks, savings and loan companies, and

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other entities in addition to commercial banks. If interlocks by commercial banks are to be prohibited, then interlocks by all independent financial institutions ought to be prohibited.

Indeed, I think that could be carried one step further. If interlocks between, say, Ford and General Motors are prohibited under section 8 of the Clayton Act, it is only fair that interlocks between a large insurance company and a large bank be prohibited for the same reason, they are competitors.

CONFLICT OF INTEREST

Interlocking relations involve several different types of conflicts of interest. Before the passage of the Clayton Act, Justice Brandeis wrote that interlocking directorates tend "* * * to disloyalty and to violation of the fundamental law that no man can serve two masters."

This is especially true if the two masters are supposed to be dealing at arm's length. Where a bank lends money to an industrial firm, the interests of the two companies are opposite. The bank wants the highest rate of return on its funds that it can obtain consistent with sound banking principles, while the industrial firm wants the lowest possible interest charge and the easiest possible terms. If the two companies have a common director, that director cannot conceivably represent the best interest of both companies at the same time.

By their very nature interlocking relations provide inside information to outside interests. In such a situation, the interests of the ordinary stockholder is not being protected. Where a brokerage firm, trust department of a bank, or insurance company have inside information about the operations of another company on a continuing basis, the other stockholders of that company are at an extreme disadvantage in making investment decisions.

It may be that an interlocking director or employee never transmits inside information to the financial company he represents, but such behavior is contrary to his narrow interests. It is not reasonable to suppose that all men are so virtuous.

CONCLUSION

One of the best statements against prohibiting interlocking relations among companies was made in a minority report to the Pujo report by Henry McMorran. He stated:

> No real evil has been shown to result from the existence of such directorates. The adoption of this provision, although it involves no serious consequences, would deprive certain banks of real advantages they now enjoy.

No one doubts that interlocking relations involve real advantages for the parties concerned, otherwise they would not occur. No one can doubt either that the extensive networks of interlocking relations which exist today could be used to the detriment of innocent individuals and corporations. The potential to do harm is great. The autonomy of corporations which is essential to undertaking new and risky ventures may be weakened. Competitors may not have equal access to credit. Stockholders may not be provided with the same information about the operations of their company.

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Whether the interlocking relations covered by H.R. 5700 are used for good or bad at the present time is entirely at the discretion of private individuals. If no great harm is done, it is because all of the hundreds of individuals involved are extraordinarily virtuous and do not pursue their own narrow interests.

Our free enterprise system is based on the profit motive, on the pursuit of self-interest. Where the maximization of profits is contrary to the public interest, the Government should regulate business activity so that the private interest coincides with the public interest. For this reason, H.R. 5700 should be enacted.

The CHAIRMAN. Thank you very much, sir.

(The prepared statement of Mr. Dooley with an attached study entitled, "The Interlocking Directorate" follows:)

PREPARED STATEMENT OF PROF. PETER C. DOOLEY, UNIVERSITY OF SASKATCHEWAN

Mr. Chairman and members of the committee, H.R. 5700 covers a variety of reforms which are intended to improve the performance of the financial markets. I should like to restrict my prepared remarks to those sections of the bill dealing with the interlocking relations of financial institutions, because this is the area with which I am most familiar. These interlocking relations affect the control of corporations, tend to restrict competition, and involve conflicts of interest.

CONTROL OF CORPORATIONS

The prosperity that Americans now enjoy was made possible by the corporations. Protected by the privilege of limited liability, the corporate form of organization has facilitated the accumulation of the financial and real capital which is essential to modern mass production methods. As the corporation has increased in absolute size, its dependence on the financial and personal resources of particular individuals has diminished. Since late in the last century it has not been necessary and probably not been profitable for the giant corporation to be wholly owned, managed, and controlled by a single individual or family.

Berle and Means stated in their classic work, *The Modern Corporation and Private Property*,[1] that—

. . . parallel with the growth in the size of the industrial unit has come a dispersion in its ownership such that an important part of the wealth of individuals consists of interest in great enterprises of which no one individual owns a major part.[2]

As a corollary, they deduced that corporations are management controlled. Where ownership is sufficiently sub-divided, the management can thus become a self-perpetuating body even though its share in the ownership is negligible. This form of control can properly be called "management control." [3]

Simply put, management runs the corporation because the owners do not .

The hypothesis that the modern corporation is management controlled is widely, but not unanimously, accepted. R. A. Gordon in his study, *Business Leadership in the Large Corporation*,[4] expanded on this hypothesis and argued that, since the management of a large corporation is so complex and requires such a minute supervision of detail, not even the board of directors are as powerful or influential as the salaried executives. J. K. Galbraith accepts this view in the *New Industrial State*.[5] Indeed, he carries the hypothesis one step further by describing the decision-making process as one which originates among various scientific, technical, and management groups buried deep within the corporate organization. He views decision-making as a group function, not an individual function.

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[1] A. A. Berle and G.C. Means, *The Modern Corporation and Private Property* (New York: Macmillan, 1932).

[2] *Ibid.*, p. 66.

[3] *Ibid.*, p. 87.

[4] R. A. Gordon, *Business Leadership in the Large Corporation* (Berkeley and Los Angeles: University of California Press, 1945), p. vii.

[5] J. K. Galbraith, *The New Industrial State* (Boston: Houghton Mifflin, 1967), Chp. 6.

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The facts on which the management control hypothesis is based are fairly clear. (1) The common stock of most large corporations is widely held. Few individuals or families own as much as 50 percent of the stock in any of *Fortune's* 500 largest corporations. However, where stockholdings are very widely spread, much less than 50 percent is necessary for control. Probably even less than 10 percent, the figure used by R. J. Larner[6] and J. R. Vernon,[7] is needed for control. (2) The board of directors can not be expected to supervise the daily operations of a giant corporation. However, that is not their function. They set general policies: pricing policies, financing policies, labor policies, and so on. (3) Major corporate decisions are complex and require the work, advice, and approval of a variety of technically competent people. However, not all these people are employees of a single corporation. Management frequently turns to outside specialists to assist in legal, advertising, engineering, and financial decision-making. Decisions are group decisions, but the group is larger than a single corporation.

This Committee has been concerned with inter-corporate relations in the financial community since the turn of the century. In 1913 Mr. Pujo submitted his *Report*[8] on the concentration of control of money and credit. The *Report* focused its attention on interlocking relations among the major New York banks and financial houses, which, at that time, were dominated by J. P. Morgan and Company and the Rockefeller interests. Five major financial institutions—J. P. Morgan and Company, Guaranty Trust Company, First National Bank, National City Bank, and Bankers Trust Company—were found to have 23 pairwise interlocking directorates held by only 11 men. In addition, these same five institutions interlocked with 34 other bank and trust companies, 10 insurance companies, 32 transportation systems, 24 producing and trading companies, and 12 public utilities.[9] The striking feature of these interlocking relations was the central role played by particular wealthy individuals: J. P. Morgan, George Baker, and so on.

In 1935, the National Resources Committee[10] investigated interlocking directorates among the 200 largest nonfinancial corporations and the 50 largest financial corporations ranked by assets. Of the 250 corporations, only 25 did not share a common director with any of the others. The remaining 225 corporations were joined together by 1423 pairwise interlocking directorates.[11] These interlocking directorates were not randomly distributed, but formed eight clearly defined interest groups. Five of these groups were identified by family name (Morgan-First National, Rockefeller, Kuhn-Loeb, Mellon, and Dupont). The other three represented local or regional interests (Chicago, Cleveland, and Boston).[12] In contrast to the Pujo *Report*, the interest groups listed by the National Resources Committee were not simply the instruments of particular individuals. Instead, several of them represented concentrations of economic power that did not depend upon particular individuals at all.

The writer repeated and extended the 1935 investigation for 1965. The study appears in the *American Economic Review* (June, 1969),[13] a copy of which is attached to this statement. Of the 250 largest corporations in 1965, only 17 did not have at least one common director. A total of 562 multiple directors formed 1240 pairwise interlocks. Five different, but not mutually exclusive, reasons for the existence of this system of interlocking directorates could be supported by empirical evidence. (1) The larger the corporation, the more frequently it interlocked with the other corporations. The average company with less than $500 million in assets interlocked six times, while the average company with assets of $5 billion or more interlocked 23.7 times with the other corporations. (2) As management control of the corporation increased, the corporation tended to interlock fewer times. Here management control was measured by the proportion of officers on the board of directors, not by the stock ownership criterion used by

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[6] R. J. Larner, "Ownership and Control of the 200 Largest Nonfinancial Corporations, 1929 and 1963," *American Economic Review* (September, 1966).

[7] J. R. Vernon, "Ownership and Control among Large Member Banks," *Journal of Finance* (June, 1970).

[8] U.S. Congress, House Committee on Banking and Currency, *Report . . . to Investigate the Concentration of Control of Money and Credit* (Washington: Government Printing Office, 1913).

[9] *Ibid.*, Exhibit 134–B.

[10] U.S. National Resources Committee, *The Structure of the American Economy* (Washington: Government Printing Office, 1939).

[11] *Ibid.*, p. 299.

[12] *Ibid.*, p. 161.

[13] P. C. Dooley, "The Interlocking Directorate," *American Economic Review* (June, 1969).

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Berle and Means and their followers. (3) Banks and life insurance companies tended to interlock more often than nonfinancial corporatios. Banks averaged 16.1 interlocks and life insurance companies 13.6 interlocks, while nonfinancial corporations interlocked an average of 8.6 times. (4) Competitors interlocked a total of 297 times. This finding was partly based on the report of the House Committee on the Judiciary, "Interlocks in Corporate Management".[14] (5) The interlocking interest groups which were discussed in the Pujo *Report* and by the National Resources Committee were still found to exist in a modified form.

The most prevalent type of interlock in 1965 involved corporations with their head offices in the same commercial center. Within each of seven cities (New York, Chicago, San Francisco, Pittsburgh, Los Angeles, Cleveland, and Detroit) tightly knit groups of corporations interlocked four or more times. An additional eight cities were found in which more loosely knit interlocking relations existed. These city-based interlocking interest groups shared a common characteristic. Banks and life insurance companies formed a central core about which other members of the group were arranged. These local networks accounted for most of the 753 interlocks with financial institutions and explain why financial corporations were interlocked more frequently than other corporations.

The nature and extent of these local interest groups requires a restatement of the simple management control hypothesis. It is true that the typical modern corporation is not dominated or controlled by particular wealthy individuals or by the local money trust, though examples of both exist. For all practical purposes Henry Ford II owns and controls the Ford Motor Company, and for all practical purposes the network of interlocking relations centered in Pittsburgh is associated with the Mellon family. However, the world of J. P. Morgan and J. D. Rockefeller, which the Pujo *Report* discussed, no longer exists. It is also true that decision-making in the large corporation is the function of groups, not individuals. As Galbraith says, ". . . it is known that retirement, death and replacement, however important to the individual involved, have not the slightest effect on General Motors or Continental Can."[15] However, group decision-making extends beyond the employees of the lone corporation. This is especially true in the field of finance, where most nonfinancial corporations depend upon a continuing line of credit. The local interest group is the measure of the importance and influence of the financial community on the nonfinancial corporation.

TABLE I.—SELECTED FINANCIAL ASSETS BY TYPE OF FINANCIAL INSTITUTION, DEC. 31, 1970

[Amounts outstanding at end of year in billions of dollars]

	Commercial banks	Savings and loan	Mutual savings banks	Credit unions	Life insurance	Pension funds
U.S. Government securities	74.8	12.5	4.7		4.0	3.2
State and local obligations	70.4		.2		3.3	
Corporate and foreign bonds	2.4		8.5		74.2	28.0
Home mortgages	41.8	125.5	37.6	.8	26.7	4.2
Other mortgages	30.2	25.1	20.5		47.6	
Consumer credit	50.1	1.5	1.2	12.5		
Bank loans, n.e.c.	155.5					

Source: Board of Governors, "Federal Reserve Bulletin" (March 1971).

To a certain extent, all financial institutions are competitors. Commercial banks, savings and loan companies, mutual savings banks, credit unions, life insurance companies, and other financial institutions face one another in a large number of markets. Table I shows the holdings of U.S. government securities, state and local obligations, corporate and foreign bonds, home and other mortgages, consumer credit, and bank loans for the end of 1970. While each type of financial institution tends to specialize in particular markets (e.g., commercial banks in business loans, savings and loan companies in home mortgages), all of them are active in two or more markets. Competition exists between different types of financial institutions (e.g., insurance companies and banks), between different financial markets (e.g., corporate bonds and bank loans), and between particular institutions of a given type (e.g., one bank and another).

[14] U.S. Congress, House Committee on the Judiciary, *Interlocks in Corporate Management* (Washington: Government Printing Office, 1965).
[15] J. K. Galbraith, *op. cit.*, p. 95.

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The fact that two interlocked companies are competitors does not necessarily imply that they have either the capacity or the inclination to restrict competition. In general, the smaller the firms relative to the size of the market, the less will be their influence on the market. Two country bankers in a small community can be ignored, for all practical purposes, in any discussion of the competition for Treasury bills. They can not be ignored, however, in their own community where they may be the principal sources of short-term credit. A local merchant could have the growth of his business limited (or could even be ruined) if both banks refused his loan application. He has a right to expect that each bank will assess his prospects separately and independently. It is doubtful that this would always occur if an interlocking relation existed that served any purpose at all.

Competition could also be restricted on a larger scale where an industrial giant has the opportunity to borrow from a score of large banks in half of a dozen financial centers. The major banks in New York, Chicago, San Francisco, and twelve other important financial centers interlock, either directly or indirectly, with other major banks and insurance companies within each city. At the same time, the interlocking groups within each city also interlock with similar groups in other cities. For example, in 1965 the Chase Manhattan Bank interlocked 22 times with other giant New York companies and, in addition, interlocked with a number of Chicago companies. This extensive network of interlocking relations has the potential for restricting competition on a vast scale. While the network may never actually be used to restrict competition by, say, setting the prime rate, its use or abuse is presently at the discretion of private individuals who are not effectively regulated by government.

The strongest case that interlocking relations restrict competition exists where a borrower and a lender interlock. If, for example, a bank officer sits on the board of directors of an industrial corporation, both the bank and the industrial firm stand to gain. The bank gains because it has continuing access to inside information about the operations of the manufacturer. Even if the bank charges the manufacturer the same rate of interest that it charges similar corporations, the expected profit of the bank is increased because it has reduced the risk of default by having more complete information. The industrial corporation gains because the bank can afford to lend it more funds or lend it funds at a lower interest rate than it can afford to lend to another corporation of exactly the same credit worthiness. If, on the basis of technical analysis, the bank is at the margin of indifference whether it should lend to one or another corporation, its own self-interest will lead it to deal with that corporation about which it has the best knowledge. In view of the importance of good credit information to banks and of the necessity of credit to many corporations, it is not surprising that so many lender-borrower interlocking relations exist. An industrial corporation which does not enjoy such a relation is at a competitive disadvantage.

H.R. 5700 does not and should not limit its prohibition of interlocking relations to bank directorships alone. It extends its prohibition to trustees, officers and employees as well as to other types of financial institutions. Section 8 of the Clayton Act has always been easily circumvented because it prohibits interlocking directorates alone. Surely an officer or employee can represent the corporate interest as effectively as a director. This Committee's report, "Control of Commercial Banks and Interlocks among Financial Institutions," [16] clearly indicates that interlocking relations extend to stock ownership and cover insurance companies, mutual savings banks, savings and loan companies, and other entities in addition to commercial banks. If interlocks by commercial banks are to be prohibited, then interlocks by all independent financial institutions ought to be prohibited.

The so-called "indirect" interlocking relation is not covered by H.R. 5700 and yet it may be used to restrict competition. Where there are three companies (a bank B, a manufacturer M, and a retailer R), R and M could be closely related, and B and M could be closely related, but there need be no direct relation between B and R. Nonetheless, the bank would be interlocked indirectly with the retailer by way of the manufacturer. Perhaps this possibility can not be prevented without prohibiting interlocking relations in general.

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[16] U.S. Congress, House Committee on Banking and Currency, *Control of Commercial Banks and Interlocks among Financial Institutions* (Washington: Government Printing Office, 1967).

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CONFLICT OF INTEREST

Interlocking relations involve several different types of conflicts of interest. Before the passage of the Clayton Act, Justice Brandeis wrote that interlocking directorates tend" . . . to disloyalty and to violation of the fundamental law that no man can serve two masters."[17] This is especially true if the two masters are supposed to be dealing at arm's length. Where a bank lends money to an industrial firm, the interests of the two companies are opposite. The bank wants the highest rate of return on its funds that it can obtain, while the industrial firm wants the lowest possible interest charge and the easiest possible terms. If the two companies have a common director, that director can not conceivably represent the best interest of both companies at the same time.

By their very nature interlocking relations provide inside information to outside interests. In such a situation, the interests of the ordinary stockholder is not being protected. Where a brokerage firm, trust department of a bank, or insurance company have inside information about the operation of another company on a continuing basis, the other stockholders of that company are at an extreme disadvantage in making investment decisions. It may be that an interlocking director or employee never transmits inside information to the financial company he represents, but such behavior is contrary to his narrow interests. It is not reasonable to suppose that all men are so virtuous.

CONCLUSION

One of the best statements against prohibiting interlocking relations among companies was made in a Minority Report to the Pujo *Report* by Henry McMorran. He stated:

No real evil has been shown to result from the existence of such directorates. The adoption of this provision, although it involves no serious consequences, would deprive certain banks of real advantages they now enjoy. A man who has broad experience, who knows the standing of all the individuals and firms in a community, may render a real service on the boards of various financial institutions, and it is altogether unlikely that he would be retained on such boards if he used his influence to suppress competition or for the advancement of his own selfish interests.[18]

No one doubts that interlocking relations involve real advantages for the parties concerned, otherwise they would not occur. No one can doubt either that the extensive networks interlocking relations which exist today could be used to the detriment of innocent individuals and corporations. The potential to do harm is great. The autonomy of corporations which is essential to undertaking new and risky ventures may be weakened. Competitors may not have equal access to credit. Stockholders may not be provided with the same information about the operations of their company. Whether the interlocking relations covered by H.R. 5700 are used for good or bad at the present time is entirely at the discretion of private individuals. If no great harm is done, it is because all of the hundreds of individuals involved are extraordinarily virtuous and do not pursue their own narrow interests.

Our free enterprise system is based on the profit motive. Where the maximization of profits is contrary to the public interest, the government should regulate business activity so that the private interest coincides with the public interest. For this reason, H.R. 5700 should be enacted.

[From the American Economic Review, June 1969]

THE INTERLOCKING DIRECTORATE

(By Peter C. Dooley*)

Early in this century interlocking directorates were publicly attacked from many quarters. Louis Brandeis, one of the most outspoken critics and one of President Wilson's chief advisers on the trust problem, described interlocking directorates with the following words:

[17] L.D. Brandeis, *Other People's Money* (New York: 1914), p. 51.
[18] U.S. Congress, *Report . . . op. cit.*, p. 254.
*The author is an assistant professor at the University of Saskatchewan. He wishes to thank Anne Moore Dooley and Irene McClean who performed much of the clerical work in the study and an anonymous referee for his helpful suggestions.

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The practice of interlocking directorates is the root of many evils. It offends laws human and divine. Applied to rival corporations, it tend to the suppression of competition and to violation of the Sherman law. Applied to corporations which deal with each other, it tends to disloyalty and to violation of the fundamental law that no man can serve two masters. In either event it leads to inefficiency; for it removes incentive and destroys soundness of judgment. It is undemocratic, for it dejects the platform: "A fair field and no favors,"—substituting the pull of privilege for the push of manhood [4 p. 51].

The Clayton Act of 1941 prohibited interlocking directorates among competing corporations, but it did not condemn the practice in general.

In the 1930's the National Resources Committee found that 225 of the 250 largest U.S. corporations had at least one director who sat on the board of at least one other of the largest corporations. It further discovered that 106 of these corporations belonged to ". . . eight more or less clearly defined interest groups [24, p. 161]." These findings have provoked repeated studies and comment by the government [21] [22] [23], by economists [7] [11], by sociologists [9] [13] and others [5] [12]. Paul Sweezy, who helped prepare the National Resources Committee study, has recently stated that the network of interlocking directorates has changed since the 1930's and that the concept of the interest group is now obsolete [1, pp. 17–20].

This paper investigates the nature of interlocking directorates and interest groups for 1965, compares the 1935 findings of the National Resources Committee with the current situation, and examines several reasons for the existence of interlocking directorates.

I. INTERLOCKS: 1935 AND 1965

The National Resources Committee studied the 200 largest nonfinancial corporations and the 50 largest financial corporations ranked by assets.[1] This paper uses a similar group of corporations thirty years later. The list of corporations was taken from the Fortune Directory [15]. Of course, membership in the top 250 corporations changed substantially over this period. Only 140 of the largest corporations in 1965 can readily be identified on the 1935 list, though the actual overlapping is greater than this due to mergers and reorganizations. The 200 largest nonfinancial corporations are here further subdivided into 115 industrial, 10 merchandising, 25 transportation, and 50 public utility corporations. The financial group includes 32 banks and 18 life insurance companies. The list of directors for these companies was obtained from Standard and Poor's *Register* for 1965 [20].[2]

TABLE 1.—DISTRIBUTION OF DIRECTORSHIPS

Number of directorships held by 1 man	1935 [1]		1965	
	Number of men	Number of directorships	Number of men	Number of directorships
1	2,234	2,234	2,603	2,603
2	303	606	372	744
3	102	306	123	369
4	48	192	49	196
5	19	95	13	65
6	6	36	5	30
7	6	42		
8	3	24		
9	1	9		
Total	2,722	3,544	3,165	4,007

[1] U.S. National Resources Committee, "The Structure of the American Economy." Washington 1939, p. 158.

The frequency of interlocks in 1935 and 1965 is remarkably similar. In 1965 a total of 4007 directorships were held by 3165 men. While most of these directors sat on a single board, 562 sat on two or more boards. Five men held six directorships each. In all, 1404 directorships were held by multiple directors. In 1935 there were somewhat fewer directors and directorships, though the distribution of multiple directorships was slightly more concentrated than in 1965 (Table 1).[3]

[1] Most studies have measured size by assets [2] [7] [8].

[2] Moody's *Manuals* [16], [17], [18], [19] and the House Antitrust Subcommittee's *Interlocks in Corporate Management* [22], were used as cross checks when additional information was needed to identify individual directors.

[3] The Gini index of concentration is .20 for 1935 and .18 for 1965, where .00 indicates perfect equality.

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More of the top 250 corporations were interlocked in 1965 than in 1935. In the earlier period 25 corporations did not interlock at all, while only 17 were not interlocked in the later period (Table 2). In 1965 these noninterlocked companies consisted of eleven industrials, four utilities, one merchandiser, and one life insurance company.

The number of interlocks per corporation was unevenly distributed. Three companies in 1965 had directors who held 40 or more outside directorships, while 19 additional companies interlocked 20 or more times with other corporations among the top 250. Financial companies interlocked more frequently than did nonfinancial companies. In 1965 banks interlocked an average of 16.1 times compared to 9.9 times for all 250 corporations (Table 3).

II. WHY DO INTERLOCKS OCCUR?

The institution of the interlocking directorate has continued to exist since the early days of corporate capitalism. This is of some interest in itself, because it is doubtful that it would have survived without serving some material purpose. The critical question is what purpose (or purposes) does it serve.

Like many social phenomena, the interlocking directorate is shaped by a multitude of tangible and intangible forces. Yet interlocks occur with sufficient order to permit an empirical analysis of some of the more obvious forces. In this study five different factors were found to be significant: (1) the size of the corporation, (2) the extent of management control, (3) the financial connections of the corporation, (4) the relationship with competitors, and (5) the existence of local economic interests.

TABLE 2.—INTERLOCKING DIRECTORATES AMONG THE 250 LARGEST U.S. COPORATIONS IN 1935 AND 1965

	1935 [1]		1965	
	Number of companies	Number of companies interlocked	Number of companies	Number of companies interlocked
Industrial and merchandising	107	91	125	113
Transportation	39	38	25	25
Utilities	54	46	50	46
All nonfinancial	200	175	200	184
All financial	50	50	50	49
Total	250	225	250	233

[1] U.S. National Resources Committee, "The Structure of the American Economy." Washington 1939, p. 159.

Size: The largest corporations tend to have the most interlocks (Table 4). This may occur because the directors of the largest corporations are the most knowledgeable, the most capable, and the most accomplished men available. Other corporations would naturally seek their advice and would rather have them on their board than men of less ability. This may also occur, however, because of factors unrelated to managerial ability. The director of a giant corporation undoubtedly has more personal influence with other companies, with potential investors, and with the government than the common man. Having the director from a large corporation on your board may also lead to profitable business with that corporation.

TABLE 3.—DISTRIBUTION OF INTERLOCKS BY KIND OF BUSINESS, 1965

Number of interlocks per corporation	Industrial	Merchandising	Transportation	Utility	Nonfinancial	Banks	Life insurance	Financial	Total
0	11	1	0	4	16	0	1	1	17
1 to 15	27	2	8	25	62	8	5	13	75
6 to 10	30	3	6	14	53	4	4	8	61
11 to 15	29	3	5	3	40	7	2	9	49
16 to 20	13	0	4	2	19	5	2	7	26
Over 20	5	1	2	2	10	8	4	12	22
Total companies	115	10	25	50	200	32	18	50	250
Average number of interlocks	9.1	9.7	10.6	6.2	8.6	16.1	13.6	15.2	9.9

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Management control: Management controlled companies, where management control is measured by the proportion of officers on the board of directors,[4] tend to avoid interlocks with other corporations. The frequency of interlocks with other corporations declines as the proportion of active company officers (president, vice president, treasurer, etc.) on the board of directors increases (Table 5).[5,6]

TABLE 4.—AVERAGE NUMBER OF INTERLOCKS BY SIZE OF CORPORATION, 1965[1]

	Assets in billions of dollars							
	Less than 0.5	0.5 to 0.9	1.0 to 1.4	1.5 to 1.9	2.0 to 2.9	3.0 to 3.9	4.0 to 4.9	5.0 and above
Nonfinancial	6.0	7.5	7.6	9.2	13.6	14.6	16.0	17.3
Financial	(1)	(1)	4.3	9.5	10.3	18.0	21.0	26.8
Total	6.0	7.5	6.8	9.2	12.4	16.4	19.1	23.7

[1] No financial corporations with assets under $1,000,000,000 are among the largest 50.

Note: The simple correlation coefficients for number of interlocks in relation to size are .316, .489, and .467 for nonfinancial, financial, and all 250 corporations, respectively. However, since the relationship does not appear to be linear, these coefficients tend to understate the degree of correlation.

TABLE 5.—AVERAGE NUMBER OF INTERLOCKS IN RELATION TO MANAGEMENT CONTROL, 1965

	Percentage of directors who are officers[1]									
	Less than 10	10 to 19	20 to 29	30 to 39	40 to 49	50 to 59	60 to 69	70 to 79	80 to 89	90 to 100
Nonfinancial	7.1	7.7	10.1	9.7	7.1	6.6	1.7	3.5	2.0	(2)
Financial	19.0	11.0	11.5	(3)						
Total	13.6	8.6	10.2	9.7	7.1	6.6	1.7	3.5	2.0	

[1] Officers are defined to exclude the chairman of the board.
[2] No nonfinancial corporations had 90 percent or more of their board of directors made up of officers.
[3] No financial corporations had 30 percent or more of their board of directors made up of officers.

Note: The simple correlation coefficients for number of interlocks in relation to management control are —.195, —291, and —.292 for nonfinancial, financial, and all 250 corporations, respectively. For the 115 manufacturing corporations alone the coefficient is —.422. However, the relationship does not appear to be linear.

Financial interlocks: For nonfinancial corporations roughly one third of all interlocks are with financial institutions. For financial corporations the proportion is somewhat less (Table 6). These financial interlocks occur for several reasons.

First companies that are in financial difficulty, particularly those occasionally threatened with insolvency, tend to form a close association with one or more financial houses. By electing a banker to the board of directors, a company may expect to have more ready access to bank funds, while the banker can watch over the operation of the company and reduce the risk of lending to a distressed borrower.

Second, banks apparently find it advantageous to become associated with large companies by electing company officers to the bank's board of directors. This may attract large deposits as well as secure a reliable customer for bank loans.

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[4] Management control is a qualitative matter that can not be directly measured. A. A. Berle and G. C. Means [2] and R. J. Larner [8] measured management control by the percentage of stock held by a single interest. Using 1963 data, Larner classified a corporation are being controlled by its management if no interest held 10 percent or more of its stock. By this criterion 169 of his 200 largest nonfinancial corporations were management controlled. There is, however, no significant relation between his 10 percent stockownership criterion and the officer-director criterion. Both the Berle and Means and the Larner studies may simply indicate how little stock is required to control a large corporation rather than how many large corporations are management controlled.

[5] These data are reported in Standard and Poor's *Register* [20].

[6] Size (as measured by assets) and management control (as measured by the percentage of directors who are officers) are virtually independent. The simple corraltion coefficients for the industry subgroups are the following; manufacturing and merchandising .090; transportation, —.032; utilities, —.110; and all financial, .002.

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TABLE 6.—INTERLOCKING DIRECTORATES AMONG THE 250 LARGEST U.S. CORPORATIONS, 1965

	Number of interlocks	Interlocks with financial institutions	Interlocks with competitors [1]	Interlocks within the same commercial center
Industrial	1,049	378	133	500
Merchandising	97	32	0	51
Transportation	265	90	25	63
Utilities	309	116	2	148
Total nonfinancial	1,720	616	160	762
Banks	514	82	82	283
Life insurance	246	55	55	117
Total financial	760	137	137	400
All 250 corporations	2,480	753	297	1,162

[1] For financial institutions interlocks with other financial institutions and with competitors are identical.

A multiple regression analysis of the relationship between the financial position of the 200 nonfinancial corporations and the number of interlocks with financial corporations indicates that the incidence of interlocks between the two increases as the nonfinancial corporation becomes less solvent and as the assets of the nonfinancial corporation become larger.[7] Thus many corporations are partially dependent on financial houses for credit and in turn, financial institutions depend on the larger corporations for a substantial portion of their business.

While the modern corporation typically finances a large proportion of its new investment out of internally generated funds, the volume of outside financing is still large. For all 200 nonfinancial corporations, total liabilities were 62.0 percent of equity. This percentage ranged from 102.0 for the 50 utilities to 50.8 for the 115 industrials. The importance of outside funds is further illustrated by the fact that on December 31, 1965, the total liabilities of the nonfinancial business

[7] Two separate regression equations were calculated: one for all 200 nonfinancial corporations and one for the 50 utilities. Solvency was measured by the acid test ratio—quick assets (cash, marketable securities plus receivables) divided by current liabilities. This measure was chosen in preference to the current ratio, because the inventory element of current assets is often a cause of insolvency.

The original equation for all 200 corporations included 10 dummy variables to isolate, so far as possible, differences in the acid test which arise from differences in the kind of business. The 10 industries singled out were airlines, railroads, gas pipelines, electric power, telephone, merchandising, electrical equipment, chemicals, petroleum, and durable goods manufacturing, not elsewhere classified (n.e.c.). All other kinds of business were lumped together. Only the gas pipeline, electric power, petroleum, and durable goods manufacturing industries had significant coefficients at any point in a step-wise regression. The fitted equation is the following:

$$If = 3.11 - \underset{(.398)}{.486R} + \underset{(.000071)}{.000446A} - \underset{(.86)}{1.66G} - \underset{(.54)}{1.33E} - \underset{(.61)}{1.96P} + \underset{(.471)}{.755M}$$

$R^2 = .251$ F=9.21, significant at the .000005 level where $N=200$.

Where:

If—number of financial interlocks
R—acid test ratio
A—assets in billions of dollars
G—gas pipelines
E—electric power
P—petroleum
M—durable goods manufacturing, n.e.c.

While both the acid test and asset coefficients are of the expected sign, only the asset coefficient is significant at the 5 percent level. The lack of significance of the acid test coefficient can partly be explained by the fact that the sample included corporations conducting vastly different kinds of businesses and requiring vastly different acid test ratios. In order to eliminate this diversity and illustrate the importance of the acid test, a second regression was calculated for the 50 utilities—the largest group of corporations engaged in a similar kind of business. The fitted equation is the following:

$$If = 2.74 - \underset{(.95)}{1.80R} + \underset{(.000100)}{.000564A}$$

$R^2 = .448$ $F = 19.1$, significant at the .00001 level where $N=50$.

Both coefficients are significant at the 5 percent level using a one-tailed t test.

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sector in the Flow of Funds Accounts was $461.9 billion. Of this $276.1 billion was in the form of corporate bonds, mortgages, bank loans, and other loans, most of which was held by banks and life insurance companies. In turn, the business sector held $20.3 billion on deposit in commercial banks [14, pp. 734–35].

Third, these financial interlocks also arise from the trust operations of banks [23]. The trust departments of the major banks are often the principal stockholders of the largest corporations, because they gather together with wealth of many individuals. Consequently, they gain representation on the board of directors of other corporations.

Competition: Nearly one in every eight interlocks involves companies which are competitors (Table 6).[8] The proportion is highest among life insurance companies, banks, and manufacturers; and lowest among merchandisers and utilities. While illegal under the Clayton Act, the law has not been effectively enforced,[9] so that the institution of interlocking directorates continues to provide a vehicle for restricting competition. Perhaps it is not often used. Perhaps it can easily be abandoned when antitrust spokesmen raise their voice. Nontheless the framework exists today as it existed earlier in the century.

Local interest groups: The most prevalent type of interlocks involves companies which have their head offices in the same commercial center (Table 6).[10] Indeed, almost half of the largest 250 corporations belong to one of 15 clearly identifiable local interest groups each of which is held together by a network of interlocking directorates. In other words, the interest groups reported by the National Resources Committee in 1935 still exist today, but in a modified form. Of the eight major groups identified by the Committee, five were associated with names of well known financial and industrial families (Morgan-First National, Rockefeller, Kuhn-Loeb, Mellon, and duPont). The remaining three groups could only be identified by their location (Chicago, Cleveland, and Boston) [24, pp. 160–163]. Today all have a local identity. Only one, the Mellon-Pittsburgh group, is clearly dominated by a single family, though the Rockefeller family occupies a position of primary importance in the New York group.

The 15 interest groups were identified by the number of times their numbers were interlocked together. They include corporations with head offices outside of the group city. Seven groups were classed as *tight-knit* because the corporations in those groups interlocked four or more times, while eight groups were classed as *loose-knit* because they interlocked only two or three times. New York is actually in a class by itself. So many corporations interlocked with the New York group that it was necessary to raise the cut-off point for membership in the group to six or more interlocks (Table 7).

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[8] The FTC compiled a list for the House Antitrust Subcommittee of industrial corporations which had interlocking directors and which did business in the same five digit SIC classification [22]. While this is not conclusive evidence that they are competitors—they could do business in separate localities, for example—it is a first approximation. Moody's Manuals were used to determine whether merchandising, transportation, and utility companies were competitors. Merchandising firms were considered to be in competition if they sold the same line of goods in one common city. None of those that interlocked were competitors. Transportation firms were considered to be competitors if they served two terminal points in common. By law utilities can not compete. However, two interlocking gas pipelines were found that shipped from one common region to another. All banks and life insurance companies were assumed to be competitors, because they deal extensively in federal obligations and because most of them deal in related state, local, and corporate loans and securities. It would not be surprising, for example, to find a single large manufacturer with a line of credit at most of the 32 banks in the survey. Thus, in the case of financial institutions an interlock with a *financial interest* can not be distinguished from an iterlock with a competitor.

[9] In 1965 the Antitrust Subcommittee of the House Judiciary Committee concluded after a lengthy study of interlocks among competitors that

> In operation, the body of Federal legislation has not effectively prevented interlocks in corporate managements in the fields it covers. Enforcement of the Clayton Act's prohibitions against interlocking directorates was neither prompt nor vigorous . . .
>
> From its enactment on October 15, 1914, to January 1965, the FTC had filed a total of 13 complaints under section 8 of the Clayton Act. Only one of these complaints resulted in a cease-and-desist order and this was by consent; the remainder were dismissed when the directors involved discontinued the prohibited relationship.
>
> The Department of Justice did not undertake a systematic program with respect to interlocking directorates until after World War II, and the first cases to be litigated to a decision by a court were not filed until February 27, 1952, 38 years after the enactment of the Clayton Act. As of January 1965, the Department of Justice had instituted a total of 10 cases to enforce section 8, and 5 cases to enforce section 10 [22, pp. 226–227].

[10] A commercial center was defined to include a metropolitan area and its immediate environs so that suburban head offices would not be left out.

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Nearly all the groups share certain common characteristics. Banks or life insurance companies form the central core of the group and have the greatest number of interlocks with other members of the group. Local public utilities form a second ring about the central core and have the second greatest number of interlocks. Finally, an outer ring is made up of manufacturing, merchandising, and transportation companies that do a substantial portion of their business in the region of the group city.

Table 7—Interest Groupings

	Number of Corporations
Tight-knit groups: [a]	
New York	38
Chicago	14
San Francisco	13
Pittsburgh	8
Los Angeles	6
Cleveland	5
Detroit	4
Loose-knit groups: [b]	
Hartford	6
Philadelphia	4
Milwaukee	7
Portland, Ore.	4
Minneapolis-St. Paul	3
Boston	3
Dallas	2
Houston	2
Unallocated [c]	3
Total	122

[a] Interlocked four or more times, except for New York where all corporations were interlocked six or more times.
[b] Interlocked two or three times.
[c] Interlocked four or more times with two groups and allocated to either group. The three are Pan American World Airways, the Pennsylvania Railroad, and Union Oil.

The New York group is, in part, an exception to this general pattern. It contains the major New York banks, life insurance companies, and utilities, but it also contains a large number of companies whose business is clearly nationwide.[11]

In 1935, the National Resources Committee designated two major New York City groups, the Morgan-First National and the Rockefeller. Today it is not possible to separate these groups. For that matter, it has not been easy to distinguish between them since the turn of the century, as John Moody observed in 1904:

> It should not be supposed, however, that these two great groups of capitalists and financiers are in any real sense rivals or competitors for power, or that such a thing as a "war" exists between them. For, as a matter of fact, they are not only friendly, but they are allied to each other by many close ties, and it would probably require only a little stretch of the imagination to describe them as a single great Morgan-Rockefeller group [10, pp. 492–93].

The Chicago group and the Pittsburgh group contain many of the companies they did in 1935. The Chicago group is made up of 14 corporations that have

[11] The New York group centers around six large banks—[the number in the parentheses indicates the number of times the corporation interlocks with others in the same group] Chase Manhattan (22), First National City (14), Chemical Bank (18), Manufacturers Hanover Trust (20), Banks Trust (10), and Morgan Guaranty Trust (11); four life insurance companies—Metropolitan (19), Equitable Life Assurance (23), New York Life (15), and Mutual of New York (15); and several long established industrials and utilities—A.T.&T. (13), Consolidated Edison (15), U.S. Steel (11), General Electric (12), Union Carbide (12), General Foods (13), International Paper (11), Phelps Dodge (11), Corn Products (10), Chrysler (15), American Smelting and Refining (11), U.S. Rubber (10), Ford Motor (10), and National Distillers and Chemical (10). Each of these 24 corporations interlock 10 or more times with other corporations in the group. The following corporations cmplete the group: National Dairy Products (8), Allied Chemical (6), IBM (9), B. F. Goodrich (7), Irving Trust (7), American Electric Power (6), Southern Railway (9), Union Pacific (9), Panhandle Eastern Pipe Lines (6), Socony Mobil Oil (6), Western Electric (7), F. W. Woolworth (6), Borg-Warner (7), and Texaco (9).

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been prominent in the economic history of the city,[12] while the Pittsburgh group includes the principal corporations that have long been associated with the Mellon name.[13] San Francisco did not appear as a group in the 1935 study, however, today it is third in size. Like Chicago, the San Francisco group is dominated by local banks and utilities and by other important regional corporations.[14] The remaining groups follow the same general pattern.[15]

The arbitrary rules used to establish these groups involves three serious problems. First, 15 corporations qualified for membership in two groups, none qualified for membership in three. Such inter-group corporations were not allocated to any group unless there was a clear connection to a particular group in terms of location, ownership, or number of interlocks.[16] Second, some corporations were included in groups with which they have little in common (location, products, ownership) and from which they may be independent in every respect except the coincidence of their common directors. General Motors, for example, is included in the Pittsburgh group simply because two directors sit on its board who are multiple directors in the Pittsburgh group. Third, many significant interlocks and interlocking groups were omitted by restricting the study to just the 250 largest corporations. W. L. Warner, D. B. Unwalla, and J. H. Trimm have found in a sociological study of interlocks that 5776 directors of their 500 large representative corporations interlocked a total of 8872 corporations, ranging in size from less than a million dollars in net worth to over a billion dollars in assets [13, pp. 130–34].

While these three definitional problems affect the number, size and membership of groups, it is doubtful that they affect the nature of interlocking groups in general. The tight-knit groups in particular are interwined too many times to be significantly rearranged by minor changes in definition.

III. CONCLUSION

The institution of the interlocking directorate is extensive and enduring. Most of the larger corporations have been interlocked with other large corpora-

[12] The Chicago group includes three major banks—Continental Illinois (17), First National Bank of Chicago (13), Harris Trust (9); two utilities—Commonwealth Edison (11) and Peoples Gas Light and Coke (5); two meat packers—Swift (14) and Armour (6); two mail-order/department store chains—Sears, Roebuck (10) and Montgomery Ward (6); plus International Harvester (21), Standard Oil of Indiana (6), Pure Oil (4), Inland Steel (10), and the Illinois Central (11).

[13] The Pittsburgh group contains: Mellon National Bank (21), Gulf Oil (13), Alcoa (8), Westinghouse Electric (7), Consolidation Coal (5), Jones and Laughlin (9), and Pittsburgh Plate Glass (5). The group also includes General Motors (6).

[14] The San Francisco group is made up of the following: Bank of America (5), Wells-Fargo (7), Crocker-Citizens (7), Bank of California (8), Pacific Gas and Electric (11), Pacific Lighting (4), Kaiser Aluminum and Chemical (7), Kaiser Industries (4), Safeway Stores (5), FMC (6), Southern Pacific (10), Tennessee Gas Transmission (7), and Caterpillar Tractor (7).

[15] The remaining groups are the following: Los Angeles, United California Bank (10), Security First National (4), Southern California Edison (12), North American Aviation (7), Lockheed Aircraft (5), and American Metal Climax (4); Cleveland, Cleveland Trust (6), Cleveland Electric Illuminating (6), Republic Steel (4), Baltimore and Ohio (6), Chesapeake and Ohio (4); Detroit, National Bank of Detroit (4), Detroit Bank and Trust (4), Detroit Edison (4), and National Steel (5); Hartford, Travelers (4), Aetna (3), Connecticut General (2), Connecticut Mutual (2), Southern New England Telephone (8), and United Aircraft (9); Philadelphia, First Pennsylvania Banking and Trust (4), Philadelphia National Bank (2), Penn Mutual (6), and Philadelphia Electric (3); Milwaukee, Northwestern Mutual (9), Wisconsin Electric Power (3), Allis-Chalmers (8), Kimberly-Clark (5), American Can (2), American Natural Gas (3), and Chicago, Milwaukee, St. Paul and Pacific (2); Portland, Oregon, U.S. National Bank of Oregon (4), Pacific Power and Light (2), Weyerhaueuser (3), and the Great Northern (3); Minneapolis-St. Paul, Northern States Power (2), Chicago, Burlington and Quincy (2), and the Northern Pacific (2); Boston, First National Bank of Boston (4), John Hancock Mutual (2), and New England Life (2); Dallas, Republic National Bank of Dallas (2) and Texas Utilities (2); and Houston, El Paso Natural Gas (2) and Transcontinental Gas Pipe Lines (2).

[16] Thirteen of the 15 inter-group corporations were interlocked four or more times with the New York group. They were the following [the first number in parentheses indicates the number of New York interlocks, the second number indicates the number of interlocks with the second group]: New York-Chicago, Chase Manhattan (22,4), New York Life (15,4), and First National Bank of Chicago (6,13); New York-San Francisco, Southern Pacific (10,10); New York-Pittsburgh, Mellon National Bank (4,22), Westinghouse Electric (6,7), Consolidation Coal (7,5) and Pan American World Airways (6,5); New York-Detroit, Chrysler (15,4); New York-Hartford, Chase Manhattan (22,4), First National City (14,4), Travelers (10,4), and United Aircraft (6,9). The remaining two inter-group corporations were the following: San Francisco-Los Angeles, Union Oil (5,6); and Pittsburgh-Philadelphia, Pennsylvania Railroad (5,6).

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tions for many decades. This suggests that the structure of the American economy is markedly different from what is commonly supposed. The widely accepted views of A. A. Berle and G. C. Means [2], R. A. Gordon [7], R. J. Larner [8], and J. K. Galbraith [6] that the modern corporation is an independent and self-sufficient organ ruled by its own self-perpetuating management needs to be modified on several points.

The extreme view holds that: "Major corporations in most instances do not seek capital. They form it themselves [3, p. 40]." This view contains an important element of truth, but it overlooks the fact that the total liabilities of nonfinancial business approach one-half trillion dollars, that about one-third of the assets of the 200 largest nonfinancial corporations are financed on credit, and that these 200 corporations interlock 616 times with the 50 largest banks and life insurance companies alone. Stock and bond issues, mergers and acquisitions, and other questions of high finance require expert counsel. Such questions are not the daily business of the salaried executives of nonfinancial corporations, the men who Gordon claims make ". . . the essential business decisions . . . [7, p. viii]," nor do the anonymous men of Galbraith's "technostructure" have the opportunity to develop competence in handling such occasional and specialized questions. This does not mean that a small clique of bankers controls every detail of corporate activity. However, the presence of knowledgeable men of finance on the board of directors can not help but influence policies within the sphere of their competence and responsibility.

The presence of outside local business leaders on the board of directors must also force management to consider the interests of the local community, both in terms of its economic growth and in terms of its social and political development. In addition, the presence of competitors in the board room must direct the attention of the management to certain matters of common interest.

Thus, while it is accepted that the modern corporation is the central unit of production and capital accumulation today, its autonomy is a matter of degree. Its autonomy increases as management control over the board of directors increases, for then management can isolate itself from other points of view. For the typical corporation this control is far from absolute. Within its own walls it faces the constraining influence of the financier, the local interest, and the competitor.

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The CHAIRMAN. Professor Darnell, considering your entire statement, where do you feel the Nation's banking and financial institutions are headed unless H.R. 5700 or some similar legislation is enacted into law?

Mr. DARNELL. I would expect that this situation would continue. I do not see anything on the horizon that would tend to reduce it in the future. I cannot believe that we will always have these virtuous individuals that Mr. Dooley just spoke of and expect them to react always in the public interest, I believe the individual interest is going to be overriding, and we need legislation to improve the competitive environment.

The CHAIRMAN. Could you give the members of the committee your definition of chain banking?

Mr. DARNELL. Yes, sir; I will. My definition of chain banking is that of two or more banks—certainly they do not have to be just member banks—but two or more commercial banks that are linked together by the common ownership of one individual or a group of unincorporated individuals, closely allied individuals, let us say.

The CHAIRMAN. Does it relate only to stockholdings?

Mr. DARNELL. No, sir. I would include situations of directors and officers as well. Usually, though, I would expect, if you are a director, that you do combine ownership with it.

The CHAIRMAN. Chain banking usually occurs in States that prohibit branch banking, is that correct?

Mr. DARNELL. Yes, sir. It is more likely to occur there. I performed a statistical analysis of this, and I found that there was a statistical relationship between the State restriction against branching and the incidence of chain banking.

The CHAIRMAN. Therefore I assume that chain banking is principally found in Texas and Illinois and States like that, is that correct?

Mr. DARNELL. Yes; that is right.

The CHAIRMAN. And what other States are prominent in that direction?

Mr. DARNELL. Texas, Illinois, Oklahoma, my home State of Colorado, Kansas, Nebraska, Missouri—generally the prominent unit banking States. I haven't included all of them.

The CHAIRMAN. Do you believe that branch banking is a good thing for the country?

Mr. DARNELL. Well, sir, that is a question that has several aspects to it. From the standpoint of the individual who may be provided with more convenient banking access, and perhaps more offices, I believe it is. From the standpoint of whether or not branch banking in a State is going to enable that State to make some great leap forward or raise personal incomes or provide a sound basis for economic growth, I

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frankly have found no study that can verify that. Many people argue that if you will just allow branch banking, or in some cases holding companies, this will do great things for your region, for your State. I am sure I have not seen all the studies. But the ones I am acquainted with cannot verify this.

The CHAIRMAN. Which would you prefer, branch banking or chain banking?

Mr. DARNELL. I would prefer branch banking.

The CHAIRMAN. Branch banking, where you have more and better supervision, I assume?

Mr. DARNELL. Yes. And it is well recognized that this situation exists. This is one of the major criticisms I have with chain banking, that generally it is not known, the public is not aware that two banks are operating under common ownership. They are presumed to be competitors.

The CHAIRMAN. That is correct. In our State I know that, say, the directors of a certain big bank will decide that each one of them will obtain an interest in certain banks for themselves in the interest of the big bank that they represent. And they can acquire a certain amount of stock but not enough to be covered under the holding company law.

Mr. DARNELL. Yes, sir.

The CHAIRMAN. What about the use of trust funds to make up the differences.

Mr. DARNELL. I am not sure how frequently the use of trust fund investment would be used to make up the rest of the difference. Let me say this. When I did my initial study, I did find a number of instances where an institution, perhaps a bank trust department, would own more than 25 percent of one bank, but then maybe have others that it owned 24.9 percent of.

The CHAIRMAN. Most of them had 24.9 so as not to get under the umbrella.

Mr. DARNELL. Yes, sir. Of course, that would be removed now with the amendment of 1970.

The CHAIRMAN. That is right.

Now, Professor Farrar, I would like to ask you this question. As your excellent report on institutional investors noted, the percentage holdings of common stocks by institutional investors is clearly on the rise. In view of this trend don't you think it advisable to clearly separate the role of the bank trust department as an investor from any potential role in the management of the company, so that financial institutions do not dominate portfolio companies? What do you say to that, Professor Farrar?

Mr. FARRAR. I could not support that statement as it is expressed in its entirety. Power over corporate affairs exists somewhere, whether in the hands of a financial institution which has assumed a position of very substantial stock ownership, or through direct relationships, or personal interlocks, or other relationships, or in the hands of corporate managers themselves.

Berle and Means in their original work pointed out that corporate managers were basically answerable to no one. I am not overly concerned at this point with the fact that concentrated institutional holdings are now, for the first time, beginning to challenge the hegemony of nonfinancial corporate managers.

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I am somewhat concerned by the fact that very large fractions of these holdings are gravitating toward bank trust departments, where the conflicts are greater than they are among other institutions. The sheer size of institutional stockholders alone however, is not at this point a matter of great concern to me. Institutions to date have not actively exercised their power as far as we can tell, except in transfer of control efforts. I frankly would like to see how financial institutions do in fact choose to exercise their power in the future before I would make a dramatic decision to tilt the balance of power one way or the other from institutions to corporations, or vice versa.

The CHAIRMAN. Thank you, sir.

Professor Dooley, what percentage of the New York Stock Exchange market, we will say, do the institutional investors have? It has been estimated from 50 to 60 and 70 percent, the report that I have received. What would be your estimate of the percentage of the market that is controlled by the institutional investors?

Mr. DOOLEY. I really do not have any statistics on that, Mr. Chairman. The remarks and summaries that I have read dealing with that indicate the proportions of transactions they carry out is much larger than their proportion of holdings of all the stocks on the New York Exchange.

The CHAIRMAN. Mr. Farrar, maybe you could give us some light on that. You have given special attention to it, I believe?

Mr. FARRAR. Right; yes, sir. Your figures are approximately correct regarding transactions, which apparently now are accounting for more than 60 percent of total public volume on the New York Stock Exchange. Regarding holdings, however, a recently completed New York Stock Exchange survey shows institutional investors to account for something like 40 percent of total stockholdings of shares listed on that exchange. By contrast, institutional holdings of all equities in the country amount to some 30 percent of the total. Institutional holdings clearly are concentrated in the shares of larger publicly held corporations on the New York Stock Exchange, and within that exchange even more so in the shares of the larger companies.

The CHAIRMAN. Thank you. My time is up. So I will yield to Mr. Widnall at this time.

Mr. WIDNALL. Thank you, Mr. Chairman.

I too want to welcome all of you on the panel this morning. And thank you for coming before the committee and offering your testimony today. I am sure it will be very helpful.

I just have a few questions.

Professor Dooley, on page 8 of your statement you suggest that interlocks permit banks to reduce risks and increase profits from corporations with which they are interlocked. If you have not seen our investigation of the Penn Central Railroad I commend it to you. In this case your hypothesis fails to protect the banks. And I suspect that if we only knew about it we would find hundreds of similar cases. Your entire statement is full of "coulds" and "mays." And I wonder if you can testify honestly that you have found any patterns of harmful acts of discrimination in your studies?

Mr. DOOLEY. First, let me remark about the Penn Central report that the committee issued. I tried to get hold of a copy, but was unable to

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obtain it. I agree with your remark that if my supposition is correct, that interlocking relations give financial institutions better information than the average person, that the financial institutions did not do very well in this case. But they apparently did better than the ordinary investor. If I can believe the report that appeared in The Wall Street Journal, The Chase Manhattan Bank, among others, got out of the Penn Central stock in their trust departments before common knowledge of the bankruptcy was available to ordinary stockholders.

Mr. WIDNALL. Did you find any patterns of harmful acts or discrimination in your studies?

Mr. DOOLEY. No, sir; not at all. I would hope that this committee will be able to obtain that sort of information. As a private individual the only information to which I have access is that which is published and generally available to anyone. The sort of question which you ask, and I think it is of the greatest importance, requires the work of an investigative staff and committee with power of subpena.

Mr. WIDNALL. Professor Darnell, when Dr. Arthur Burns testified yesterday he recommended an exemption from the prohibition against interlocks for chain banks on the basis that interlocks do not restrict competition among banks already under the same control. As the question of permitting chain banking is subject to the control of the State governments, and I do not think we want to change that, wouldn't you agree with Dr. Burns' recommendation?

Mr. DARNELL. No, sir; I would not. First of all, I do not think that chain banking is subject to any State regulation at all. I think maybe the State of Mississippi is the only one that says specifically it is prohibited. But as I understood Dr. Burns' testimony yesterday, he was arguing more or less that the 50 percent ownership exemption should be retained. And I do not believe that for a minute. I do not think it should be retained. I do not think the mere fact that two individuals own 50 percent or more of the two competing banks in town should exempt them. My prepared statement refers to Dr. Burns' letter to Mr. Patman in which he indicates concern about this permissive exemption.

I see a great harm here for competition.

Mr. WIDNALL. Do you have any examples of that that you have found in your own research?

Mr. DARNELL. Yes, sir; I do. It is in my prepared statement. (In particular, see pt. II, sec. B of Mr. Darnell's prepared statement.)

Mr. WIDNALL. To both Dr. Dooley and Dr. Darnell, when Arthur Burns testified yesterday he cautioned us to proceed with extreme caution because none of us really knows very much about the true nature of the operations of the thousands of boards of directors around the country. All of the studies that you gentlemen cite, none of which documents any evil, are based on the largest corporations about which you can get information, and largely because they operate in a fish bowl. Most of them would feel that they could not afford to indulge in shenanigans and make public all the information that they do. Wouldn't you think extending requirements for disclosure on a broader basis would provide adequate protection?

Mr. DARNELL. Shall I answer it?

Mr. WIDNALL. Would you both answer that.

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Mr. DARNELL. First of all, Mr. Congressman, my studies do not relate just to large institutions. Most of them involve smaller institutions. I do not have evidence of what actually goes on in board meetings. But I do have evidence from bankers that I have surveyed testifying to the fact that competition is reduced because of this common ownership common director situation. I cannot speak for what the large institutions are doing, or to the extent to which their records may or may not be accessible. But I think we do have information about what can go on in the smaller places. I do not think they should be exempt just because they are small. I believe, as the Supreme Court has noted, that the patron in the small town is no less entitled to the benefits of competition than are the customers of larger institutions.

Mr. WIDNALL. Professor Dooley.

Mr. DOOLEY. Yes. In answering that question I agree with your comment that there is no way that private individuals are going to be able to find out what is going on in the board rooms of even the largest corporations, not to mention the thousands of smaller corporations involved. And for that reason I qualified most of my statements, as you observe, with "coulds" and "mays."

The argument that I would use, the strong argument that I would use in supporting this legislation is presumptive, that is, if the individuals involved in, say, a conflict of interest situation, do pursue their own self-interest as they are expected to do, the public interest would probably be damaged. Therefore I would prefer to have the Government pass legislation which sets the guidelines and permits companies to compete freely, to pursue their own self-interest freely, without having to worry on the one hand whether they are serving the public interest and on the other hand whether they are pursuing their own best interest. I prefer to let them do their own business as best they can but have it channeled.

Mr. WIDNALL. Dr. Farrar, unfortunately I was not here when you testified, and you did not have a prepared statement, and I have not been able to look back at it. But I do understand that you have done considerable work in this field yourself. Would you care to comment on it?

Mr. FARRAR. Not particularly in the field of interlocks, Mr. Widnall. The study did consider personnel interlocks along with other types of business relationships connecting financial institutions to nonfinancial corporations. I have discussed this to a certain extent, in my opening statement.

Mr. WIDNALL. That is all, Mr. Chairman.

The CHAIRMAN. Mr. Barrett.

Mr. BARRETT. Thank you, Mr. Chairman.

I do want to welcome a great Philadelphian here today. Dr. Farrar is hanging on the end of my district in Philadelphia.

And Dr. Dooley and Dr. Darnell, we are happy to have such outstanding brains here this morning.

I am trying to get fixed in my mind, Dr. Farrar—you made a statement in which you made three major points. How would you say they related to the bill, and what would be the aspects of the study that was made by the committee on H.R. 5700—how do you compare your study with ours?

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Mr. FARRAR. Are you speaking about your 1968 study on trust activity?

Mr. BARRETT. Yes.

Mr. FARRAR. Well, our study was considerably larger in that it considered institutional investors of all types and their impact on the market as well as on corporate issuers. It also considered their impact on corporate issuers as a source of capital as well as in their roles as large and often influential shareholders.

Mr. BARRETT. What I would like to know, sir, is how your testimony relates to the bill, H.R. 5700.

Mr. FARRAR. This question can be answered most expeditiously, Mr. Barrett, by referring to the second portion of my prepared testimony, inserted in the record immediately following my opening statement.

Mr. BARRETT. I notice Dr. Darnell indicated that he supports section 2, 3, 4, and 10. You are not in a position now, I would say, to be able to say that you would support those until you make further study on this?

Mr. FARRAR. I guess that is true. It is my understanding that these sections do contain some technical problems. I believe that Commissioner Smith discussed some of them. Technical problems with language aside, I am sympathetic to the ends most sections of the bill are designed to accomplish. As indicated in the second portion of my prepared remarks, however, I do have reservations regarding certain of the proposals contained in the bill and believe that other proposals—such as the direct payment of interest on demand deposits—might more effectively accomplish its legislative objectives.

Mr. BARRETT. Dr. Darnell, I would like to ask you a question for the record.

On page 4 of your statement you discussed section 8 of the Clayton Antitrust Act, the prohibition that provides against interlocking directors and agent officers in given geographical areas. You conclude that the section is completely inadequate. What in your view should the geographic area within which you would prohibit interlocking officers and directors, and what institutions should be included in the prohibition that would apply?

Mr. DARNELL. Let me answer that in reverse, if I may, sir.

The institutions I would be most concerned about are the depository-type institutions. Granted the others do compete, but I think especially mutual savings banks, savings and loans, commercial banks, and, say, credit unions, are the ones that we should be vitally concerned about.

In terms of a geographic location, this is a different one. For the smaller banks which are engaged primarily in retail banking activities, their market area is going to be very local. We are guilty of using the county as a relevant geographic market, and we know this is not true. But a county, a trade area, a standard metropolitan area, something of this nature in which the smaller retail-type banks operate should comprise the geographical area of competition. When we get to the larger banks that are engaged in wholesale banking activity, though, it may be that the geographical limitation is the Nation as a whole. Maybe in some cases it might even be international. I think it would be difficult to formulate a rule or guideline that could apply in a comprehensive fashion.

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Therefore I would be in favor of, let us say, not having any interlocks whatsoever, because of the tremendous burden that is going to be required in trying to determine what is the appropriate market for each banking connection. Is it the county, the city, the State, and so on. In terms of an actual geographic mileage limitation as was proposed to Chairman Burns yesterday, I do not know how you could say 25 or 50 miles. In Wyoming and Colorado there may be no intervening banking institutions whatsoever for 50 miles. They may be 50 miles apart but still very definitely competitive.

My primary concern, and I believe the primary concern of this committee, should be to insure that institutions we want to compete are in fact competitors. Competitors should not be allowed to have any common directors, officers, or anyone else in a position to select his man—someone responsible to a common owner—for the common management of the institutions.

Mr. BARRETT (now presiding). Thank you, sir.

Mr. Johnson.

Mr. JOHNSON. Thank you.

We are always glad to have you gentlemen, particularly college professors, to give us the academic viewpoint, which I think is refreshing, to say the least. And we welcome you here.

Dr. Farrar, I have a question to ask you. There is a rather novel provision under the provision against equity participation, which defines an equity participation as shadow warrants entitling the lender to compensation based upon changes in the market price of the borrower's stock over a specified period. Have you ever heard of a shadow warrant before in your life?

Mr. FARRAR. I have not heard of them. But there is very little that the ingenuity of man cannot do to devise securities, or claims that very closely resemble securities.

Mr. JOHNSON. Have you ever read the provisions of a shadow warrant? Do you know what they are like, what they look like?

Mr. FARRAR. No, I don't. I assume it would simply be a private contract between two parties, that it would not be a transfer of negotiable documents. But that is pure supposition on my part. The terminology is new.

Mr. JOHNSON. It provides, let us say, that if the stock goes down on the market, and I was the lender, I would have to indemnify the borrower for a drop in the market price. It is a real novel thing. I am just wondering whether it exists or not. I doubt if it does. I think it is a figment of somebody's imagination.

Mr. FARRAR. This is not covered in H.R. 5700, is it?

Mr. JOHNSON. Yes, on page 16.

While you are looking that up, Dr. Dooley, I wish you would kindly identify yourself. Someone said you are from Canada. Are you from the University of Saskatchewan? Is that correct?

Mr. DOOLEY. That is correct; in Saskatoon.

Mr. JOHNSON. And are you a native Canadian?

Mr. DOOLEY. No; I am a U.S. citizen.

Mr. JOHNSON. Are you just teaching up there in Canada; is that what you are doing?

Mr. DOOLEY. That is correct, sir.

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Mr. JOHNSON. And does Canada have this frightful situation of interlocking directorates that is said to be stifling competition?

Mr. DOOLEY. I do not know how amazingly frightful it is; but if the situation in the United States is amazingly frightful, the situation in Canada is positively horrid. They have only eight principal banks, and they are all related many more times than you would ever find in the United States.

Mr. JOHNSON. Interlocking directorates and common stock ownership and everything, I guess, up there?

Mr. DOOLEY. I am not familiar with the common stock aspect of it, but certainly the institution of interlocking directorates is very widespread.

Mr. JOHNSON. Now, carrying on what Mr. Widnall brought out, it seems to me, in reading your various statements on the evils of interlocking directorates—I know you say, Dr. Darnell, from your study it leads you to conclude that competition is being stifled, and you may cite a few instances in your prepared statement. But I walk down the streets of New York City, and I see all these huge banks, the Bank of Manhattan, the First National City Bank of New York. And I would say from my experience, and having been on a bank board for some 24 years before I resigned when I came on this committee, that competition is really bitter among the banks in New York City. And it is bitter among the banks in Pittsburgh. And I would imagine that that is true all over the country.

I cannot conceive that because of the fact that there is some interlocking of directorates that there is not tremendously vital competition among the banks in this Nation. Do you want to comment on that, Dr. Darnell?

Mr. DARNELL. Yes, sir. When you sat on the board of one bank, did you also sit on the board of another bank? And if you had, would this have made any difference in what the competitive environment may have been?

I would conclude from the fact that since 20 percent of the member banks have some common ownership and directors linking them together, this is not something that we should disregard. It seems to me like that is a tremendous amount of common ownership and interlocking arrangements. And of course we do not know about the nonmember banks. I would speculate that it is probably more widespread among nonmember banks. Just the fact that we may see them competing on the outside as we walk down the streets does not tell us the entire story, Mr. Congressman. I think what we perceive to be some competition on the outside may have already been settled in a boardroom.

Mr. JOHNSON. Take a little country town—the inference of your testimony is that you think that smallness has nothing to do with it—now, you take a little country town where, let us say, the Ford dealer is on the bank board, and there are other garage dealers in this country town. And I take it you would not have this Ford dealer on the board of this bank because the bank, if it is a one-bank town, it might discriminate against the other automobile dealers; isn't that just about the gist of your argument?

Mr. DARNELL. No, sir; I do not think that is it at all. What I am concerned with was primarily the interlocking between two or more

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commercial banks, say, in the same town. I was not concerned with the interlock between the industrial firm and the commercial bank. That kind of an interlock is certainly a way of life, and has its arguments pro and con. I am not as concerned, though, about the owner of the Ford dealership sitting on the board of the commercial bank as I am the same individual or a number of individuals owning the two banks in town and having two or three or four common directors.

Mr. JOHNSON. My time has expired.

Mr. BARRETT. Mr. Brown.

Mr. BROWN. Thank you, Mr. Chairman.

And thank you, gentlemen, for being here this morning.

It seems to me that the testimony each of you has given here this morning is like some of the other testimony we have heard, in that it is suggested there is guilt by and in association. Yet Dr. Burns yesterday—and I am quoting him—said: "Our experience"—talking about the Federal Reserve Board experience—"has convinced us that there is nothing inherently wrong about interlocking directorates."

And then later on he went on to say: "The cross-fertilization which director interlocks have provided American corporations has been manifestly healthy for business in the United States."

And further on in his testimony he says: "The Clayton Act was designed to prohibit only those interlocks which tend to diminish or eliminate competition."

If there is nothing inherently wrong with interlocking directorates, do you feel that the broad prohibitions of H.R. 5700 really equate the benefits to be derived by the cross-fertilization that Dr. Burns speaks of with the potential abuse that can occur because of such interlocks?

I would be happy to have each of you answer individually on it.

Mr. DARNELL. Shall I start?

Mr. BROWN. Yes.

Mr. DARNELL. First of all, I would not agree with Dr. Burns's statement, that there is nothing inherently wrong. I think it may depend upon the institutions involved. And it seems to me like, if it is two commercial banks——

Mr. BROWN. Doctor, may I stop you there. Are you speaking of associations in which you have been involved where you have examined and found that in these associations there is something inherently wrong because in each case there is an anticompetitive attitude developed, or are you speaking academically?

Mr. DARNEL. I suppose I am speaking academically in one sense, but I did make a rather extensive survey among comon owners of commercial banks to get their feelings, get their viewpoint as to what actually went on as a result of their common ownership, how they used their common ownership to operate the banks.

Does that answer your question, sir?

Mr. BROWN. Yes, certainly.

Mr. DARNELL. To continue on, then, I believe in this situation there is something inherently wrong when two or three or four individuals control two or more banks in the same town or county or located nearby, serving the same market area. If they are not serving the same market area, as was suggested yesterday, I think maybe a small

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bank in Maine having a common director with one in Oregon, which is kind of far out, perhaps that has no detrimental effect to it whatsoever.

I also, as I mentioned just a moment ago, am not so concerned about the interlocks between the business firms in town and the commercial banks. I am concerned about the interlocks between the financial institutions in town that are direct competitors. And therefore, I believe the Clayton Act should have been amended long ago, or some other law substituted for it that would have prevented these kind of situations from developing, because they are here, they are widespread, and they have gone on for many years.

Mr. BROWN. Is it then your conclusion that it is impossible to in effect ferret out and handle separately the instances of anticompetitive activity? And, since you are unable to do that and legislate in that area, it is essential that you legislate against the association itself?

Mr. DARNELL. I believe that would be the essence of my thought, Mr. Congressman. Certainly we could spend a great deal of time and effort and review case by case those that involve anticompetitive effect. The Justice Department is already covered up with this kind of operation, and the Federal Reserve Board. It can be done, but it would be a tremendous burden, when basically I can see no good argument for it existing in the first place. Why not legislate——

Mr. BROWN. Then you do not agree with Dr. Burns' statement that cross-fertilization, as he calls it, can be beneficial to those upon whom it applies?

Mr. DARNELL. You put me in the position of disagreeing with Dr. Burns again, which I do not like to do——

Mr. BROWN. You think there is no benefit derived from the interlocking directorates and the experience that goes with it?

Mr. DARNELL. I think it is minimal at best, and does not outweigh the loss of competition.

Mr. BARRETT. Will the gentleman yield to me?

Mr. BROWN. If you are not taking my time.

Mr. BARRETT. I think Dr. Burns pointed out here yesterday that the interlocking relationship was healthy. But he was concerned with the competition. I think that is what you are talking about.

Mr. DARNELL. Yes, sir; I am.

Mr. BROWN. I appreciate the Chairman attempting to rehabilitate the witness.

Let me move on.

You may comment, Dr. Dooley, if you will, too, but there is one thing that I wanted to check with you on. In your statement at the bottom of page 8 and the top of page 9 you commend H.R. 5700 for including employees as well as directors and officers, and so on. It seems to me that covering employees would have the effect of preventing a messenger boy by day for an insured bank from, say moonlighting as a janitor for an insured savings and loan after hours, because in both instances he is an employee, is he not?

Mr. DOOLEY. Yes.

Mr. BROWN. I am being facetious, of course, but this is not what you mean, is it?

Mr. DOOLEY. That is correct, sir; it is not.

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To go to your earlier question about whether the institution of interlocking directorates is universally evil, I would say that I do not hold that view, that it is conceivable that some good can come from it. Along those lines I think for the most part H.R. 5700 is concerned with those areas whether either competition may be restricted or conflicts of interest may occur, rather than saying point blank, there shall be no more interlocking directorates or employees or trustees or officers whatever among financial corporations. It is qualified in that sense.

Mr. BROWN. Dr. Farrar, I do not know if you want to comment on this or not.

Mr. FARRAR. I do not believe there is anything useful I could add to them. One is really arguing about the practical problem of designing a piece of legislation. Everyone agrees that when interlocks reduce competition, or interject serious types of conflict, that they are to be avoided, and when they are not, there may be some benefits to be obtained.

There remains a question of fact, I suppose, as to the circumstances in which either of these occur, and basically a question of judgment as to whether or not you wish to create an administrative structure that is capable of making judgments, or prefer to pass a statute that, perhaps, proscribes too much.

Mr. BROWN. But, gentlemen, isn't the ultimate result of legislation in this area, isn't the result really to say that there is guilt by association, that we are not going to look at the conduct, that we are incapable of legislating against improper activities, and since we are so inadequate, we therefore must preclude the association which could in effect lend itself to guilt.

My time has expired. Thank you.

Mr. BARRETT. Mr. St Germain.

Mr. ST GERMAIN. Professor Farrar, at the end of chapter 15 of the report for the SEC you state:

The likelihood that these financial interrelationships between banking companies occurring entirely by chance is extremely remote.

Given that, what in your opinion is the cause for the tremendous amount of interlocking directorships?

Mr. FARRAR. I was talking not simply about interlocking relationships, Mr. St Germain, though that is a portion of it. I was talking about combinations of business relationships which included stockholdings, creditor relationships in the case of banks, depository, relationships, pension management relationships, and personnel relations. The finding, stated in its most flatfooted fashion, is that there is strong intercorrelation between all these relationships when a bank is the institution involved, that in that sense banks tend to "know" their companies very well, whereas all other institutions do not apparently share the intensity of the relationship with the corporation.

I have attempted to rationalize this finding in the second portion of my prepared testimony by reference to three factors:

The bundling of trust, commercial and other services by banks in the "deposit package" through prohibitions on the payment of interest on demand deposits contained in the Banking Acts of 1933 and 1935,

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The often stated preference of banks and bankers to deal only with persons they "know" through other relationships, and

The absence of sufficient disclosure in this area to inhibit persons from entering into multiple and occasionally conflicting relationships with the same corporate customers.

Mr. St Germain. Mr. Dooley, there are some who testified before us who in their testimony characterize H.R. 5700 as implying that interlocking directors are less than honest. Would you comment on this type of argument that has been given. Actually they are arguments against.

Mr. Dooley. I did not quite catch the last part of your question.

Mr. St Germain. Some of the witnesses, in discussing the section H.R. 5700, referring to interlocking directorships, have stated that this section implies that interlocking directors are per se less than honest. Do you in analyzing H.R. 5700 come to this same conclusion?

Mr. Dooley. I am not certain I know what it means to be less than honest in this context. But I think that the director is placed in a very difficult situation when he has to serve two very separate interests. He may try to do that honestly. How it would be done is a mystery to me.

Mr. St Germain. Are you referring now to two separate entities, meaning two financial institutions?

Mr. Dooley. Any two institutions that deal with one another which may be interlocked vertically or horizontally.

Mr. St Germain. Nothing further, Mr. Chairman.

Mr. Barrett. Thank you, Mr. St Germain.

Mr. Williams.

Mr. Williams. Thank you, Mr Chairman.

Mr. Dooley, your statement covers only interlocking relations of financial institutions. Yet you conclude with a blanket endorsement of H.R. 5700. How do explain that?

Mr. Dooley. I really have no explanation for it at all, other than that I should have put a qualifying phrase in that last sentence dealing with those sections 2 through 10, with which I am most familiar.

Mr. Williams. In other words, you are endorsing only those sections of H.R. 5700?

Mr. Dooley. That is correct, sir. I am not familiar with the others.

Mr. Williams. Mr. Farrar, section 21 of H.R. 5700 prohibits anyone receiving anything of value from an insured bank or an insured savings and loan for investment in the institution. Would you agree that obtaining funds for investment in the institution would preclude an underwriter from selling equity or debt securities of the institution?

Mr. Farrar. Section 21 is concerned with broker deposits, isn't it, and in that sense it specifies the type of funds that are to be——

Mr. Williams. Section 21 is broker deposits or investments.

Mr. Farrar. Will you repeat your question. Would this preclude underwriting of equity securities?

Mr. Williams. Would you agree that obtaining funds for investment in the institution would preclude an underwriter from selling equities or debt securities of the institution?

Mr. Farrar. I suppose so, though as a non-lawyer I am often surprised at what various forms of the law do or do not say.

Mr. Williams. Let me say this, I think all of us were surprised at some of the provisions in H.R. 5700. And I was interested in Mr. Johnson's question to you concerning shadow warrants.

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Mr. Darnell, H.R. 5700 as written would place the operation of our financial institutions in a virtual straitjacket, and would be harmful to our economy. You do deal with this to some extent in your statement. Do you believe that we could intelligently amend the Clayton Act and the Bank Supervisory Act of 1966, and intelligently eliminate some of the conditions which you have referred to in your testimony which may be harmful?

Mr. DARNELL. First of all, I do not agree with the first part of your statement that H.R. 5700 would place the operation of our financial institutions in a virtual straitjacket and be harmful to our economy. I believe certain sections of it, which I have identified, would be very beneficial, would be procompetitive for our economy. These sections would hardly qualify as a straitjacket.

Do I believe we could amend the Clayton Act in order to take care of the situations I am concerned with?

Mr. WILLIAMS. The Clayton Act and the Bank Supervisory Act of 1966?

Mr. DARNELL. Yes, sir, I believe it could be amended in such a manner as to take care of these situations. I am not sure that I would want the job of drawing up the final piece of legislation. But, I believe it could be accomplished.

Mr. WILLIAMS. Mr. Brown started out with a question about conclusions of all three of you gentlemen being based on experience or academic review. How much actual experience have you had with financial institutions and the operation of financial institutions? Or another way to put it is, are your conclusions based largely on academic review?

Mr. FARRAR. My conclusion is based primarily on the results of the Institutional Investors Study, which involved a great deal of data collected only under the power of subpena and not available to the public and not available for academic purposes. This also involved a great deal of fieldwork and interviews with the manager of financial institutions and other types of security firms or organizations. In that sense it is not academic.

Mr. DOOLEY. My work has been almost entirely academic in the sense in which you asked that question. I have not worked for any consultant to a financial institution.

Mr. DARNELL. Much of mine has been of the academic variety also. But I would like to add that I have had considerable experience as a consultant to bankers on such things as holding company legislation, holding company applications, and I have spoken before banker groups on the structural questions we are concerned with here. I have also worked on bank charter feasibility studies. I have talked informally with a number of bankers about these questions. Invariably their attitude is that at present it is not illegal, and I would agree. But the time has come to reconsider our position.

I would also like to remind the Congressman that my prepared statement contains a review of an extensive survey conducted among a large group of bankers from all parts of the country. I have surveyed by questionnaire and interview State banking supervisors on these questions. I have also obtained the opinions of a large number of mutual savings bankers on these questions.

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Thus, both academic research and direct association have served as the bases for my conclusions.

Mr. WILLIAMS. I certainly want to thank you gentlemen for appearing here this morning. That is all I have, Mr. Chairman.

Mr. BARRETT. Thank you, Mr. Williams.

Mr. DOOLEY. I have two questions I would like you to answer in writing if you will. I will give you these questions to take with you. I am doing this in the interest of time.

(The following are written questions submitted by Mr. Barrett to Mr. Dooley, along with Mr. Dooley's answers:)

Question. In your discussion of interlocking directorates you mention the interlocking relationships between banks and insurance companies, on the one hand, and commercial and industrial corporations, on the other. The bill before us defines competing financial institutions as including insurance companies.

Do you feel that insurance companies are competitors of commercial banks and do you feel that these interlocking relationships between banks and insurance companies should be prohibited?

Answer. Insurance companies and commercial banks compete at many levels. First, they compete for the consumer's savings dollar, because a consumer has the alternative of investing his funds for retirement or for his heirs in a life insurance policy or with a bank in a time deposit or trust account. Second, they compete as investors in stocks, bonds, mortgages and other financial instruments.

One important problem that is raised when competing financial institutions are joined together by interlocking relations is whether they might substantially restrict competition. In the case of the market for the consumer's saving dollar, so many alternatives exist that it is doubtful that any bank-insurance company interlock could substantially affect the market. However, the competition of major financial institutions for particular security issues is another matter. The largest institutional investors in the securities of major corporations hold a sufficient proportion of those securities to substantially lessen competition.

An interlocking relation between an insurance company and a bank could also permit the bank to acquire an indirect voice in the operation of other banks, if the stock of the other banks was held by the insurance company. The Pujo Report suggests that J. P. Morgan used such a device.

For these reasons, interlocking relations between banks and insurance companies ought to be prohibited.

Question. You discuss at length the management control concept as developed by Berle and Means. However, some more recent studies, such as the one conducted by a subcommittee of this Committee in 1968 and the one just completed by Professor Farrar for the Securities and Exchange Commission, discuss the potential for control through the heavy concentration of stockholdings by various financial institutions, particularly banks.

Doesn't this growing trend tend to give these financial institutions a greater opportunity to control major nonfinancial corporations?

Answer. The evidence is convincing that the opportunity for financial institutions to control nonfinancial corporations through the management of investment funds has increased in recent years. However, the extent to which they exercise this control in a deliberate manner is not clear.

The manager of an investment portfolio has three options available to him. (1) He can routinely vote the management's proxy. (2) He can join the opposition to management. (3) He can initiate action to force management out. Casual observation leads me to believe that the first option is typically, the second occasionally, and the third rarely exercised.

As a historical note, it appears that the influence of financial institutions over nonfinancial corporations has risen whenever the government closed its eyes and let business go on as usual. In the first 30 years of this century the rise of the large banks and insurance companies, the development of holding companies, and the merger of many small corporations tended to increase the concentration of economic power in the hands of financiers. However, with the passage of legislation during the 1930's to restrict the activities of banks and holding companies, financial corporations became less powerful. In recent decades, the

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growth in mutual funds, pension funds, the trust departments of banks and one-bank holding companies indicates that the major financial corporations have increased their potential for controlling nonfinancial corporations.

Mr. BARRETT. We will now recognize Mr. McKinney.

Mr. MCKINNEY. Gentlemen, it is very nice to have you here.

I also want to take advantage of you, if I may, and strictly on a voluntary basis. You will receive a transcript of all that has been said here, so that I think you can review these questions. And as professors of economics, I would like your answers, which I will then put in the record, if you feel so disposed, but it is entirely voluntary, because I realize that you too are busy men.

This bill, I think I said yesterday, is a little bit like swatting a mosquito with a sledge hammer. And it implies so many other things besides interlocks and the stifling of competition that I am very interested in, having read about your background and your obvious knowledge of the economic and banking world. I am very interested in your feelings on equity participation, which is very strongly alluded to in this bill. I am very interested in your feeling as to what would happen to the municipal-county-governmental-Federal bond market should the FDIC or similar institutions totally insure all deposits, and banks would no longer be required to carry that type of collateral.

I would be very interested in your expertise—that is particularly yours, Dr. Farrar—as to how, if we limit the trust department's participation in corporate ownership, that trust department is to make the moral decision of whose stock it is going to sell, or should it through the acquisition of a new trust become overburdened with one corporate stock, how it is to make the moral decision, if that stock is the best stock that they feel they can buy, or should they buy something else that may not be as good for the people whose money they are supervising. This is something that Dr. Burns entered into yesterday. And we really just did not get very far. He is going to give it some more thought. We are all going to give it some thought, because I think we are in this bill creating a situation that—in which banks would be forced, or at least trust departments would be forced, into very arbitrary exchanges, more than some of what they now indulge in.

Mr. FARRAR. Would you like me to respond to that?

Mr. MCKINNEY. We have a time problem. I think it is easier for you to see the question in print and then respond.

Second, I am very much aware and very much in agreement that brokered deposits tied to loans are a definite danger. But I would be interested in your opinion as to the total elimination of brokered deposits, since it seems to me that it is one of the ways, in this rare Nation of ours where we manufacture capital, of moving that capital quickly to places where it is needed.

Last but not least, I am very concerned in the interlock discussion—and as I gathered from your testimony, you have fairly well limited your feelings on prohibiting interlocks to banks that are in competition with each other, or financial institutions in competition with each other—I am very concerned about this bill in essence destroying the smalltown bank, because it really is eliminating in the case of the smalltown or medium city bank the expertise of the surrounding financial community in that area.

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Last but not least, I think you answered the question—I think we do have time for an answer for this—don't you feel that the competitive problems we are talking about could be better handled by rewriting or amendment of the Clayton Act or the Bank Supervisory Act, coupled with far more authoritative and far more open reporting laws for financial institutions as to their transaction?

You may answer that if you would like to now, any one of the three of you.

Mr. DOOLEY. I will try to answer the last one briefly.

I would have preferred to have seen section 8 of the Clayton Act give a simple statement that interlocking relations which may tend to restrict competition, or which involve conflicts of interest, shall be prohibited, and let it go from there. But as you are no doubt aware, sections 8 and 10 of the Clayton Act have been amended so many times, and there is so much legislation on the books, that it may well be that H.R. 5700 is the most expedient way to try to fill in some of the gaps in existing legislation.

Mr. DARNELL. I think my feeling would be very similar to that. I would go the section 8 way and amend it. But it would simply be with a simple statement embodying the language, perhaps, of section 7, in that these interlocking relationships are to be prohibited when the effect may be a substantial lessening of competition, or something like that. I know this is going to put a tremendous burden on the agencies to police this.

Mr. MCKINNEY. You have all mentioned the lack of availability of information. What about more comprehensive reporting laws? It seems to me that this is one of our problems. What we are talking about is, we do not know, we assume, we guess, we conjure. It would seem to me that probably one way to answer this would be through better reporting laws.

Mr. DARNELL. Yes, sir; I would subscribe to that really. It seems to me like we have not had the information we need in order to make these kinds of important decisions. If we did have better reporting, maybe our opinion would change.

Mr. MCKINNEY. The sledge hammer is about to fall on me. So my time is up. Thank you very much.

Mr. BARRETT. Thank you, Mr. McKinney.

(In response to Mr. McKinney's questions, the following replies were received for submission in the record:)

REPLY RECEIVED FROM MR. DOOLEY

Answer to question on equity participation.

Equity participation has long been used in cases where one private individual lends to another individual. And I see no problem with this sort of arrangement.

However, where the lender is a large institution which may be dealing with hundreds or thousands of borrowers, a very real possibility exists for that institution to obtain an ownership voice in a large number of competing companies.

Also, once an institution has obtained an equity position in one borrower in a certain business, it faces a conflict of interest problem in dealing with the competitor of that borrower.

Answer to question on insuring all government deposits.

The proposal in sections 25 and 26 would reduce the risk to the depositor, not the banker. The banker must still remain sufficiently liquid to meet withdrawals.

I see no problem for the markets for various government obligations in this proposal.

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In answer to the question on limiting the holdings of trust departments to 10 percent of any class of stock.

This limitation on the trust activities of banks would, no doubt, force trust departments to acquire less of certain stocks than they desire. However, there are several adverse side effects which might occur where their holdings of particular stocks become too large.

(1) It has been the intention of American banking legislation to avoid the formation of Zaibatsu-like concentrations of economic power. The larger trust departments today are already large enough to create such super-corporate combinations. Furthermore, present legislation could not stop them.

(2) With even a 10 percent limitation, it would be possible to control by proxy two or more competing corporations.

(3) Where fund managers, including trust department officers, hold large blocs of stock, their freedom to trade is limited. If they try to dispose of a large percentage of an issue outstanding, they will tend to break the market. As a result, they may not be able to serve their clients as effectively as they could with smaller holdings.

In answer to the question on brokered deposits:

I would expect regional interest rate differentials to transfer funds to where they are most needed more effectively and more securely than brokering deposits.

In answer to the question on small town banks:

If the small town bank is not viable because of poor management, you face a dilemma. In order to survive, it may be forced to develop interlocking relations with a competitor or be absorbed by a competitor. In either event, market forces will tend to eliminate it as an independent agent.

I would prefer to see it absorbed, because, in that way, its management would be improved most.

REPLY RECEIVED FROM MR. DARNELL

1. On the question of equity participations.

I would strongly support a provision that insures commercial banks do not engage in equity participations of any kind. I do not believe banks have any busiiness speculating or gambling with other people's money. As for equity participations for other nonbank institutions, I have no strong feelings on this matter one way or the other.

2. On the question of impact on municipal bond markets if governmental deposits are insured 100%.

Perhaps bankers are the most qualified to speak on this issue since they know more about what they would or would not do in the bond market if they did not have to use these bonds as collateral to obtain governmental deposits.

My thoughts would be that municipal bonds are probably good investments in their own right or the banks would not acquire them. I think it is doubtful if municipal bonds would suffer if governmental deposits were insured. I think it is doubtful that a banker reckons his purchase on the basis of how many governmental deposits will be available now that the municipal portfolio is larger.

I really believe the influence on the municipal bond market would not be noticeable. As for the effect on the U.S. Government securities market—no effect whatsoever.

What difference does it make if the monopolists exploiting you from two offices or one? If we are going to be serious about competition, then let us get on with it and let the chips fall where they may. This argument of management expertise is just a smokescreen designed to cloud the real issue, and that is, "We can make more money by cooperating than by competing." These prohibitions on interlocking managements are not going to destroy any small-town banks. If they can survive only by collusion, then I would argue we are better off without one of them. I see no reason to have any exception to the rule.

Why don't we express the same concern for the poor bank customers who are denied the benefit of competition because we have decided that there are not enough smart people in a particular town who are capable of running two independent banks? (Would it be related to the fact that customers are not as well organized to get their position across as the bankers?) Are we going to have no compassion for this customer? Whose welfare are we most concerned about, bank customers or bank stockholders?

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3. On the question of brokered deposits.

There must be some instances when brokered deposits would serve a useful function and are entirely legitimate. These situations should not be bothered. It is the situation where loans are tied to brokered deposits that may cause the problem. I believe the legislation should be directed toward prohibiting the tying arrangements.

4. On the question of prohibiting interlocking managements and the impact on small towns.

When banks and other financial institutions are operating in the same market, there should be no interlocking management whatsoever. I do believe the "short supply of capable talent argument" in the small town is valid. I cannot believe that a town large enough to support two financial institutions is so deficient on management talent that it would not be able to come up with ten people, say five on each board, in order to operate the institutions independently and in a profitable manner. And furthermore, the small banks in small towns tend to be more of a one-man show. The available expertise is not being utilized anyhow.

If the town is large enough to support two truly independent institutions, with independent managements, then there should be no opportunity to delude the public into believing there are two alternatives for financial services when in fact there is only one.

Mr. BARRETT. Mr. Chappell.

Mr. CHAPPELL. Do you gentlemen feel that insurance companies should be included among the competing financial institutions that should not be permitted to interlock?

Take it in order, if you will.

Mr. DARNELL. Yes, I would include insurance companies.

Mr. CHAPPELL. What about you, Mr. Dooley?

Mr. DOOLEY. Yes. I have a brief statement here included in my report which says, for example, in the area of home mortgages, we have commercial banks holding $41.8 billion; savings and loan $125.5 billion; mutual savings banks $37.6 billion; and life insurance $26.7 billion, with a similar magnitude of holdings for other mortgages. I think they are very much in competition.

Mr. CHAPPELL. How about you, Dr. Farrar?

Mr. FARRAR. Yes, I would agree, although my interest primarily is in the equity management area. But here again, life insurance companies are directly in competition with the banks. I noted the absence of investment advisers among the enumerated institutional types. In many of the sections of this act one would frankly——

Mr. CHAPPELL. One further question. What is the opinion of each of you with reference to the disclosure provisions of H. R. 5700?

Mr. FARRAR. I think I have already answered that, in that I think the disclosure it terribly important, that it be drafted with great care, and that comparable types of disclosure for all types of financial institutions be developed. Iwould prefer it to be developed within an administrative framework that permits changes in disclosure requirements to adapt to changing needs without the need for legislation, which always is a very burdensome tak, and I am totally sympathetic to the commission's views to this topic.

Mr. CHAPPELL. But you would not write it as it is written in this bill?

Mr. FARRAR. No. This bill deals only with banks. And there is no coordination with disclosure provisions of any other type of institution.

There also are no provisions for administrative flexibility in the development of rules and the development of disclosure requirements. Certainly at a later date I would like to see disclosures of stockholders

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augmented by disclosures of other business relationships connecting institutional investors to corporate managers.

Mr. CHAPPELL. Thank you, Doctor. Mr. Dooley.

Mr. DOOLEY. Yes, I would generally support that view. One of the difficulties that no doubt this committee has, and that individual researchers have, in trying to make an assessment of what is going on the financial world, is that there is not sufficient disclosure of information. And I would support even more disclosure than is contained in the present bill.

Mr. CHAPPELL. Than in this bill?

Mr. DOOLEY. Yes.

Mr. CHAPPELL. Mr. Darnell.

Mr. DARNELL. I am not sure I know what you are referring to on the disclosure—is that trust department holdings?

Mr. CHAPPELL. I believe it is section 27 in the bill on page 17.

Mr. DARNELL. That dealing with trust department holdings, am I correct on that?

Mr. CHAPPELL. Yes, sir.

Mr. DARNELL. I really do not have any strong opinion on that one way or the other. But I generally am in favor of disclosure of those more or less publicly endowed institutions. It seems like we should now.

Mr. CHAPPELL. Thank you, gentleman.

Mr. BARRETT. Are you finished, Mr. Chappell?

Mr. CHAPPELL. Yes, I am finished.

Mr. BARRETT. We want to thank you three gentlemen for coming here today. You have been very helpful in your testimony and in formulating this bill. I want to say thanks to you and wish you Godspeed back home—I know you have traveled long distances.

All time has expired. We will again meet at 10 a.m. tomorrow morning.

(Whereupon, at 12:05 p.m. the committee recessed, to reconvene at 10 a.m., Wednesday, April 28, 1971.)

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