4/24/41

Mr. F. J. Bailey, Assistant Director
Legislative Reference
Bureau of the Budget
Washington, D. C.

Dear Mr. Bailey:

With further reference to your letter of February 11 and our reply of February 20 in regard to the bill S. 510, we are enclosing herewith a copy of a statement of our views on this bill. A copy of the statement has also been furnished today to the Secretary of the Treasury.

Very truly yours,

M. S. Eccles
Chairman

enclosure

LC/frl

April 24, 1941.

My dear Henry:

In accordance with our telephone conversation of yesterday afternoon, I am enclosing (1) a copy of the memorandum with regard to taxation together with the accompanying letter to the President, and (2) the letter and two accompanying memoranda on the bank holding company situation.

Sincerely yours,

Honorable Henry Morgenthau, Jr.,
Secretary of the Treasury,
Washington, D. C.

enclosures

ET:b

April 24, 1941

Honorable Henry Morgenthau, Jr.
Secretary of the Treasury
Washington, D. C.

My dear Mr. Secretary:

At the conclusion of the conference at the Treasury on January 21 regarding bank holding company legislation, it was agreed that the Board should transmit to you its objections to S. 510 together with an alternative program for dealing with the bank holding company situation. I advised that these two reports would be the same as would be furnished by the Board to the Senate committee if it became necessary to make a report. You stated at the time that there was no hurry and in view of more urgent matters engaging your attention as well as that of the Board, this reply has been delayed. Since, however, the bank holding company question may receive active consideration at this session of Congress, and in view of the President's request that the four banking agencies endeavor to get together on a program, I am transmitting herewith a memorandum of the Board's criticisms of S. 510 and a separate memorandum outlining an alternative program for dealing with the bank holding company problem.

While on this matter, the Board feels that it should correct what it believes to be erroneous statements made at the meeting on January 21 respecting the record on the entire bank holding company situation and the Board's position in relation thereto. The transcript of that meeting contains statements by you to the effect that S. 510 represented what was agreed to by the Interdepartmental Committee in March 1938, that you were taking up where the matter was left off, that you were taking the initiative in the matter because no one else would, that the Board, after seven years, had done nothing about it, and that the bank holding company situation was unhealthy and unwholesome.

Since the meeting referred to, the Board has made a detailed review of the record from 1933 to date, with particular reference to the discussions in 1938 and the extent of any agreement at that time. From this review, the Board has confirmed the views it has previously held in a number of particulars.

First of all, the agreement in 1938 was limited to general policy only and the report of the Committee's discussions showed disagreement on important phases of the problem. The agreement on a recommended text to be used in the President's monopoly message was coupled with the statement that a death sentence would require consideration of branch banking statutes as a part of the problem. There was no agreement whatever upon any specific bill; and as to those matters agreed to in 1938, as you and the others on the Committee were advised, Mr. Ransom expressed his own views and not those of the Board, and he asks that you be advised that the letter of March 17, 1938, to you from Jesse Jones satisfactorily expressed his views then and now. Moreover, the Board feels that whatever views it held in March of 1938 could hardly constitute a commitment as to the bill S. 310 prepared by your staff in 1941, differing drastically from any bill heretofore proposed by anyone and containing features to which the Board must inevitably object.

Bearing upon the matter of the agreement as well as the matter of the Board's position respecting the need of legislation, it is to be noted that on March 10, 1938, at a meeting in the Treasury, I handed you a memorandum containing proposals for legislation prepared by the Board's staff. Subsequently Mr. Ransom handed you additional material, relating to a possible program for new legislation. These proposals were not pressed later that year as it was made known by Senator Glass that his committee would not give active consideration to the holding company bills then pending. Nevertheless the Board in its Annual Report for 1938, called attention to the need of amendments to the holding company statutes.

The Board feels that it has fully discharged its administrative responsibility under the statutes. For nearly eight years, it has devoted time and attention to the situation and, in cooperation with other agencies of Government also having responsibility in this field has worked out solutions of many important administrative and supervisory problems. Since 1933 the number of bank holding company affiliates and the number of their subsidiary banks have decreased materially. Several bank groups have been terminated completely and some of the presently existing groups have considerably reduced the number of their banks and the cities served by them, while others have reduced to lesser degrees. Except in three relatively unimportant cases there has been no expansion outside of that occurring on the west coast. Many other improvements in the situation could be mentioned and the Board is willing to let the record speak for itself. It sees no basis for your assertion that the situation is unhealthy and unwholesome and believes that your reference to all the difficulties you have had with the bank holding company situation can relate to only one organization. In this case the Board believes that the banking aspect of the problem is not due to ownership through the holding company mechanism but

rather to a domination amounting to complete control by a single personality who has been able to maintain stockholder and director support. It is doubtful that amendments to the bank holding company statutes, even though drastic, offer the best solution to this particular kind of problem. Although the Board is fully aware of the desirability of strengthening the controls over bank holding companies, it has not felt that the situation has been of such importance in relation to other more fundamental problems in the banking field as to justify separate and prior consideration by Congress, particularly in the light of pressing reasons that have existed over this period making it inadvisable to sponsor piecemeal legislation.

The Board is most willing to confer with the other Federal banking agencies in an endeavor to work out a program. It is desirous of having its proposals subjected to practical and constructive criticism and is willing to modify them in the light of any valid criticism and hopes that the other agencies will approach the problem in the same spirit.

Yours sincerely,

(Signed) M. S. Eccles

M. S. Eccles
Chairman

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LC/frl

April 24, 1941

DRAFT OF STATEMENT RELATING TO THE BILL S. 310
SUITABLE FOR SUBMISSION TO APPROPRIATE
COMMITTEES OF CONGRESS

This refers to the bill S. 310 "To regulate the control of insured banks by holding companies and for other purposes."

For a number of reasons, the Board does not approve the enactment of this bill in its present form. It is the view of the Board, however, and has been for some time, that the existing provisions of the statutes which provide for the regulation of holding company affiliates of banks which are members of the Federal Reserve System should be amended in several respects in order that the activities of these companies may be more effectively supervised and controlled.

In its Annual Report to Congress for 1938, the Board called attention to the unsatisfactory provisions of existing holding company statutes and it has been prepared to recommend to Congress specific amendments which it feels would be desirable; but in view of the fact that the Senate Banking and Currency Committee has been authorized to conduct a comprehensive review of banking matters the Board has expected that a review of the bank holding company statutes would be included in this contemplated over-all review. In the event that your Committee desires to review bank holding company statutes independently of such an over-all review, there is attached an outline of the modifications which the Board believes should be made in these statutes.

The bill S. 310 would add to the existing duplication and overlapping of authority relating to the Federal supervision of banks and their associated companies and in this respect the Board feels that the enactment of the bill would be highly undesirable.

Since 1933, the Reserve Board has been charged by Congress with the responsibility for the supervision of holding company affiliates of banks which are members of the Federal Reserve System, and in several instances since 1933 Congress has enacted laws which recognize the Board's responsibility in these matters. The most recent instance of this kind was involved in the enactment on August 22, 1940, of the Investment Company Act of 1940. When this act was being considered by Congress, it appeared that holding company affiliates supervised by the Reserve Board might in some instances also be investment companies within the definitions contained in the Investment Company Act and subject to supervision by the Securities and Exchange Commission. Full information with regard to this problem was laid before the appropriate committees of Congress and an exception was incorporated in the bill

which exempted holding company affiliates subject to the Board's supervision from duplicate supervision by the Securities and Exchange Commission as investment companies. Without repealing the authority heretofore vested in the Board to supervise holding company affiliates, the bill S. 310 would provide for additional supervision of these companies by the Federal Deposit Insurance Corporation, and there would seem to be no warrant for this duplication of supervision of bank holding companies.

The bill would provide for the dissolution within a comparatively short time of bank holding companies which would be defined in general as any company which holds or controls more than 10 per cent of the voting securities of an insured bank. In addition to the known holding company affiliates of member banks which, in general, are defined as companies controlling a majority of the stock of the bank or a majority of the shares voted for the election of its directors or controls in any manner the election of a majority of the bank's directors, the provisions of the bill might include many companies which are not now considered holding companies of banks. While the existing definitions of holding company affiliates undoubtedly should be modified, in passing, the question is raised as to whether the holding of as little as 10 per cent of the securities of a bank is not too restrictive a basis upon which to determine that a company holding bank stock is a holding company.

The requirement for termination of holding companies within a comparatively short period might have serious effects on the banking structure. It is reasonable to believe that one of the probable results of such a requirement would be the liquidation of some subsidiary banks and the termination of banking facilities in some communities (shares of bank stock could not be sold for their actual value in some cases and the holding company would have to liquidate the assets of the bank in justice to the shareholders of the holding company). Other results might be the transfer of control of some well-managed banks to undesirable or weak management; the distribution of a small number of fractional shares of subsidiary banks to numerous shareholders resulting in a lack of any responsible group being substantially interested in the management of the banks; financial loss to many shareholders through attempts to dispose of fractional shares or a small number of shares of various subsidiary banks; and loss of confidence in some banks by depositors and the public with the possibility of weakening and wrecking them.

If Congress decides to fix a definite time within which all bank holding companies must be dissolved, it is essential, in order to avoid some of the results above referred to, that it give consideration to what modifications should be made in the statutes relating to branch banking.

In addition to the duplication of supervision of holding company affiliates, the bill would also provide for additional duplication of supervision of banks which are not members of groups of banks and are not controlled by holding companies. The bill provides for the restriction by the Federal Deposit Insurance Corporation of payment of dividends by State insured banks whether or not members of the Federal Reserve System and for the restriction by the Comptroller of the Currency of payment of dividends by national banks. The bill also provides that the Federal Deposit Insurance Corporation shall have an over-all authority to administer the provisions of the bill and to issue rules and regulations, including definition of banking, as may be necessary to carry out the provisions of the bill. The Federal Deposit Insurance Corporation would also be given authority to make investigations to determine whether any individual bank or other company has violated or is about to violate any provisions of the bill or any rule or regulation issued thereunder by the Federal Deposit Insurance Corporation. Such investigations could also be made to aid the Federal Deposit Insurance Corporation in prescribing rules and regulations under the bill or in obtaining information to serve as a basis for recommending further legislation concerning the matters to which the bill relates.

Under these broad powers, it would appear that the Federal Deposit Insurance Corporation would be vested with authority to duplicate the supervision which the Reserve Board now exercises over State member banks and the Comptroller of the Currency now exercises over national banks, not only through restriction of dividend payments of these banks (either directly or through regulations controlling the actions of the office of the Comptroller of the Currency with respect to dividend payments), but also through the examination of national banks and State member banks as well as nonmember insured banks.

The existing authority for Federal duplication of supervision of banks is highly undesirable, and this additional authority for duplication of supervision of banks appears to the Board to be entirely unwarranted.

With respect to the authority which would be vested in the Federal Deposit Insurance Corporation and the Comptroller of the Currency to prevent a bank from declaring or paying a dividend, it has been noted that such supervisory authorities could prevent such payment if in their judgment the payment "would not be compatible with the best interest of such bank, its depositors or other creditors, or with the public interest". The Board suggests that consideration be given to whether the grounds on which payment of dividends might be prevented should not be more specifically stated in the statute rather than in such broad general language.

For the above principal reasons, the Board would not favor the enactment of the bill S. 510 in its present form.

April 24, 1941

OUTLINE OF SUGGESTED BANK HOLDING COMPANY BILL

Bank Holding Companies

1. Define a "bank holding company" as an organization having at least two "subsidiary" banks, one of which is an insured bank. Provide that an organization shall be a "subsidiary" of another if 20 per cent or more of its voting shares are owned, directly or indirectly, by the latter or if the Board determines that its policy and management are subject to a controlling influence by the latter.

2. Repeal voting permit provisions and definition contained in the present bank holding company law. Require all bank holding companies to furnish Reserve Board information relating to their relationships and be subject to supervision by Reserve Board.

3. Prohibit any new bank holding company.

4. Prohibit future acquisition of any bank stocks, directly or indirectly, by a bank holding company; except acquisition of additional stock in banks more than 50 per cent of the stock of which was owned by the bank holding company on January 1, ____, where, in judgment of Reserve Board, it would be in public interest and Reserve Board grants its permission for such acquisition.

5. Prohibit acquisition of additional bank offices by a bank holding company through establishment of branches or through merger, consolidation, or purchase of non-controlled banks or their assets by banks controlled by a bank holding company.

6. Require all subsidiary banks of bank holding companies to become members of the Federal Reserve System. In this connection, authorize Reserve Board to waive requirements of law for membership where necessary.

7. Continue authority in Reserve Board to make such examinations of each bank holding company, its subsidiary banks and subsidiary companies, and to require submission of such information and reports by such institutions as it deems necessary and to require correction under its rules and regulations of unsound practices or policies by subsidiary banks.

8. With necessary minor modifications, retain present requirements of law with regard to conservation of resources and profits of each bank holding company while the value of its readily marketable assets other than bank stocks is less than the prescribed percentage of bank stocks owned by the holding company.

9. Prescribe penalties for violation, by a bank holding company or a subsidiary, of the law or the Board's regulations or orders, such as limitation on payment of dividends by subsidiary banks, limitation on payment of dividends by a bank holding company, limitation on payment of fees to a bank holding company or a subsidiary thereof by subsidiary banks, limitation on voting of stock in subsidiary banks by a bank holding company, removal of officers or directors of a bank holding company.

10. Prohibit any subsidiary bank from making a loan, directly or indirectly, to its bank holding company or to any subsidiary of the bank holding company on stock of such company or of any subsidiary thereof.

While the provisions relating to bank affiliates are closely intertwined in the existing statutes with the bank holding company provisions, no suggested changes relating to affiliates are recommended in the foregoing program since none were contained in S. 510. If bank holding company legislation is enacted, however, it may well be that some appropriate changes should be made in the affiliate provisions.