

Confidential

June 6, 1938

AMEND S. 3575 TO READ AS FOLLOWS:

A BILL

To prohibit new bank holding companies; to control and regulate existing bank holding companies and prevent the expansion of their control of banking facilities; to control and regulate relationships between insured banks and their affiliates; 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 23A of the Federal Reserve Act, as amended, is amended to read as follows:

"Sec. 23A (a) For the purposes of this section --

"(1) 'Bank holding company' shall mean any company of which two or more banks are subsidiaries, provided that one of such banks is an insured bank.

"(2) 'Insured bank', 'State member bank', and 'District bank' shall have the meanings assigned to them in section 12B of this Act, as amended.

"(3) 'Company' shall mean any corporation, business trust, association, or other similar organization, not wholly owned by the United States.

"(4) 'Subsidiary' of a specified company shall mean --

"(A) Any company 20 per cent or more of whose outstanding voting shares (excluding shares owned

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by an organization wholly owned by the United States) are owned by the specified company; or

"(B) Any company the management or policies of which, after a reasonable opportunity for hearing, the Board of Governors of the Federal Reserve System determines to be subject to a controlling influence by the specified company.

"(5) Shares of a company shall be deemed to be owned by a specified company --

"(A) If they are owned by any subsidiary of the specified company;

"(B) If they are held by trustees for the benefit of the specified company or its shareholders; or

"(C) If their transfer is conditioned upon the transfer of voting shares of the specified company.

"(6) Shares of a company shall not be deemed to be owned by a specified company if they are held by the latter as fiduciary and neither it nor its shareholders have a beneficial interest therein.

"(7) 'Voting share' shall mean any share of stock, capital note or debenture, or evidence of proprietary interest which entitles the holder thereof to vote at all elections of directors.

"(8) 'Affiliate' of a specified bank shall mean any company --

"(A) Which is a subsidiary of the bank;

"(B) Of which the bank is a subsidiary;

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"(C) 50 per cent or more of whose voting shares are owned by persons who own 50 per cent or more of the voting shares of the bank (exclusive in both instances of shares owned solely by an organization wholly owned by the United States);

"(D) Which is a subsidiary of a company which is an affiliate of the bank within the meaning of subdivisions (B) and (C) hereof; or

"(E) Directors of which constitute 25 per cent or more of the directors of the bank.

"(9) 'Person' shall mean any individual or company.

"(10) 'Director' shall mean any director, trustee, or other individual exercising similar functions.

"(11) 'Effective date' shall mean the date of the enactment of the Act containing this amendment.

"(b) It shall be unlawful for any bank to become a subsidiary of a bank holding company.

"(c) (1) It shall be unlawful for any bank holding company to become the owner of voting shares of any bank: Provided, That a bank holding company may become the owner of additional voting shares of a bank which is a subsidiary of the bank holding company and was a subsidiary thereof on January 1, 1938, if it first obtains the Board's permission. The Board shall grant or withhold such permission as the public interest may require.

"(2) After one year after the effective date, it shall be

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unlawful for any bank holding company to continue to own any voting shares of any bank of which it has become the owner subsequent to January 1, 1938, and prior to such effective date: Provided, That the Board shall have authority to grant a bank holding company permission to retain any such shares in like circumstances as permission to acquire shares.

"(d) After one year after the effective date, it shall be unlawful for any bank holding company to have any subsidiary bank which is not a member bank.

"(e) If as a result of a determination by the Board under subsection (a)(4)(B), a bank becomes a subsidiary of a bank holding company, or there exists any other relationship or ownership of bank shares forbidden by subsections (b), (c), (d), or (n), the action necessary to correct such improper relationship or ownership of bank shares shall be taken within a period of one year from the date of such determination: Provided, That if the Board finds that the facts upon which such determination and any such resulting relationship or ownership of bank shares are based existed on January 1, 1938, the continuance of the relationship or ownership of bank shares shall be authorized, unless it is such as is forbidden by subsection (d) or (n).

"(f) It shall be unlawful for any bank to establish any branch while it is a subsidiary of a bank holding company.

"(g) (1) Within 60 days after the effective date, each bank holding company shall file with the Board a statement showing (A)

name and address of each of the bank holding company's subsidiary banks and address of each branch thereof; (B) name and address of each other bank of which the bank holding company owns shares; (C) number of shares of each class of stock which the bank holding company owns of each bank; (D) detailed information concerning the manner in which such shares are owned; and (E) name, address, and nature of business of each of the bank holding company's subsidiaries, other than banks, and the manner in which the relationship arises; and (F) detailed information concerning all changes in the foregoing which have occurred since January 1, 1938, including dates thereof.

"(2) Each bank holding company shall furnish to the Board such reports as may be required by the Board from time to time. Such reports shall contain such information concerning the bank holding company and its subsidiaries as the Board shall deem necessary to disclose fully the relations between such companies, the effect of such relations upon the affairs of the subsidiary banks, and whether the provisions of this section have been complied with.

"(h) Each bank holding company and each subsidiary thereof shall be subject to such examinations by examiners selected or approved by the Board as shall be necessary to disclose fully the relations between such companies, their effect upon the affairs of the subsidiary banks, and whether the provisions of this section have been complied with. The expenses of any such examination

may, in the discretion of the Board, be assessed against the bank holding company and, when so assessed, shall be paid by such bank holding company.

"(i) Each bank holding company shall take such action within its power as may be necessary to cause each of its subsidiary banks to pursue sound practices and maintain a sound financial condition and to cause the net capital and surplus funds of each such subsidiary bank to be adequate in relation to the character and condition of its assets and to the deposit liabilities and other corporate responsibilities of such subsidiary.

"(j) After December 31, 1938, each bank holding company shall use, to the extent necessary, its net earnings over and above 6 per centum per annum of the book value of its own shares to create and maintain a fund of cash or readily marketable assets, other than bank shares, in an amount equal to 12 per centum of the aggregate par value of all bank shares owned by it. A bank holding company shall allocate additional amounts to such fund as it shall see fit or as shall be necessary in order to comply with other provisions of this subsection. Assets comprising such fund shall be so identified in an appropriate manner and shall be kept separate and apart from other assets of the bank holding company. Such assets shall be free and clear of any lien, pledge or hypothecation of any kind or nature. Such assets may be used by the bank holding company to replace capital of its subsidiary banks and to eliminate losses and depreciation from the assets of such banks

but shall not be used for any other purpose. Any amounts so used shall be made up within such period as the Board shall prescribe. For the purposes of this subsection, bank shares shall not be deemed to be owned by a bank holding company if they are also owned by a subsidiary of such bank holding company which is also a bank holding company.

"(k) If, after a reasonable opportunity for hearing, the Board finds that any director or officer of a bank holding company has knowingly participated in or assented to the violation by such bank holding company or any subsidiary thereof of any provisions of this section or of any rules, regulations, or orders of the Board pursuant thereto, the Board may order that such director or officer be removed from office. A copy of such order shall be served upon such director or officer. A copy of such order shall also be served upon the bank holding company of which he is a director or officer, whereupon such director or officer shall cease to be a director or officer of such bank holding company. Any such director or officer removed from office as herein provided who thereafter participates in any manner in the management of such bank holding company shall be fined not more than \$5,000 or imprisoned for not more than five years, or both, in the discretion of the court.

"(l) If, after a reasonable opportunity for hearing, the Board finds that a bank holding company has violated any of the provisions of this section, or rules, regulations, or orders of

the Board pursuant thereto, or knowingly permitted or assented to such violation by any subsidiary, the Board may order, as the public interest may require, that during such period as is fixed by the order or pending further order by the Board --

"(1) The bank holding company shall not pay dividends to its shareholders;

"(2) No insured bank of which the bank holding company owns any shares shall pay dividends on such shares or pay or become liable to pay to the bank holding company or any of its subsidiaries any compensation for supervision or other services; or

"(3) Shares of insured banks owned by the bank holding company shall not be voted and the bank holding company shall not in any manner participate, directly or indirectly, in the management of any insured bank.

Such an order may contain any one or more of the foregoing numbered provisions.

"(m) No insured bank shall (1) make any loan or extension of credit to, or purchase securities under repurchase agreement from, any of its affiliates; or (2) accept the capital stock, bonds, debentures or other such obligations of any such affiliate as collateral security for advances made to any person; or (3) invest any of its funds in the capital stock, bonds, debentures, or other such obligations of any such affiliate or any company which will become an affiliate upon said investment: Provided, That the provisions of



this subsection shall not apply to a company (1) engaged on June 16, 1934, in holding the bank premises of the bank or in maintaining and operating properties acquired for banking purposes prior to such date; (2) engaged solely in conducting a safe-deposit business or the business of an agricultural credit corporation or live-stock loan company; (3) in the capital stock of which a national banking association is authorized to invest pursuant to section 25 of this Act, as amended, or a subsidiary of such company, all the stock of which (except qualifying shares of directors in an amount not to exceed 10 per centum) is owned by such company; (4) organized under 25(a) of this Act, as amended, or a subsidiary of such company, all the stock of which (except qualifying shares of directors in an amount not to exceed 10 per centum) is owned by such company; (5) engaged solely in holding obligations of the United States or obligations fully guaranteed by the United States as to principal and interest, the Federal intermediate credit banks, the Federal land banks, the Federal Home Loan Banks, or the Home Owners' Loan Corporation; (6) where the relationship has arisen out of a bona fide debt owed to the bank prior to the date of the creation of such relationship; or (7) where the relationship exists by reason of the ownership or control of any voting shares thereof by the bank as executor, administrator, trustee, receiver, agent, depositary, or in any other fiduciary capacity, except where such shares are held for the benefit of all or a majority of the shareholders of the bank; but as to any such company the bank shall continue

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to be subject to other provisions of law applicable to loans by such bank and investments by such bank in stocks, bonds, debentures, or other such obligations. The provisions of this section shall likewise not apply to indebtedness of any company for unpaid balances due a bank on assets purchased from such bank, or to loans secured by, or extensions of credit against, obligations of the United States or obligations fully guaranteed by the United States as to principal and interest.

"(n) After one year after the effective date, no insured bank shall have any affiliate which is engaged principally in the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail or through syndicate participation, of stocks, bonds, debentures, notes, or other securities.

"For every violation of this subsection, the bank involved shall be subject to a penalty not exceeding \$1,000 per day for each day during which such violation continues. Such penalty may be assessed by the Board, in its discretion, in the case of a member bank, and by the board of directors of the Federal Deposit Insurance Corporation, in its discretion, in the case of any other bank, and, when so assessed, may be collected by the Federal Reserve bank in the district in which the bank is located or the Federal Deposit Insurance Corporation, respectively, by suit or otherwise.

"If any such violation shall continue for six calendar months after the bank shall have been warned by the Board, in the case

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of a member bank, or by the board of directors of the Federal Deposit Insurance Corporation, in the case of any other bank, to discontinue the same, (1) in the case of a national bank, all the rights, privileges, and franchises granted to it under the National Bank Act may be forfeited in the manner prescribed in section 2 of this Act, as amended, or (2) in the case of a State member bank, all of its rights and privileges of membership in the Federal Reserve System may be forfeited in the manner prescribed in section 9 of this Act, as amended, or (3) in the case of any other bank, the insurance of its deposits may be terminated in the manner prescribed in subsection (i) of section 12B of this Act, as amended.

"(o) Each insured bank shall obtain such reports of such of its affiliates (other than insured banks) as (1) in the case of a State member bank, may be required by the Board; or (2) in the case of a national bank or a District bank, may be required by the Comptroller of the Currency; or (3) in the case of any other insured bank, may be required by the board of directors of the Federal Deposit Insurance Corporation. Each such report shall be filed with the authority requiring it within the time prescribed. Such report may be required as in the judgment of the respective authorities shall be necessary to disclose fully the relations between the banks and their affiliates, the effect of such relations upon the affairs of the banks, and whether the provisions of this section have been complied with. The authority requiring

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any such report may require that it be published by the bank as such authority may direct. Any bank which fails to obtain and file or publish any such report as required shall be subject to a penalty of not more than \$100 for each day such failure continues. Such penalty may be assessed in the discretion of the authority requiring the report and, when so assessed, may be collected (1) by the bank's Federal Reserve bank if assessed by the Board; or (2) by the Comptroller of the Currency if assessed by him; or (3) by the Federal Deposit Insurance Corporation if assessed by its board of directors.

"(p) Examiners selected or approved by the Board, the Comptroller of the Currency, or the board of directors of the Federal Deposit Insurance Corporation and authorized to examine an insured bank shall be authorized to make, in connection with the examination of the bank, such examinations of affiliates of the bank as shall be necessary to disclose fully the relations between the affiliates and the bank, the effect of such relations upon the affairs of the bank, and whether the provisions of this section have been complied with. The expenses of any such examination may be treated as expenses of examination of the bank. If any affiliate shall refuse to permit any such examination or shall refuse to give any information required in the course of any such examination, the bank shall be subject to a penalty of \$100 for each day such refusal continues. Such penalty may be assessed in the discretion of the Board, the Comptroller of the Currency, or the board

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of directors of the Federal Deposit Insurance Corporation, upon whose authorization the examiners are acting, and, when so assessed, may be collected (1) by the bank's Federal Reserve bank if assessed by the Board; or (2) by the Comptroller of the Currency if assessed by him; or (3) by the Federal Deposit Insurance Corporation if assessed by its board of directors.

"(q) The Board shall have the authority to make, issue, amend and rescind such rules, regulations and orders as it may deem necessary to effectuate the provisions of this section in accordance with its purposes and to prevent evasion of such provisions. The Board may assign to designated members of the Board or officers or representatives of the Board or to Federal Reserve banks, under rules and regulations prescribed by the Board, the performance of such functions as in its judgment will facilitate carrying out the provisions of this section."

Sec. 2. The paragraph of section 4 of the Federal Reserve Act, as amended, which commences with the words "The Board of Governors of the Federal Reserve System shall classify" is amended by striking out all following the colon and inserting in lieu thereof the following: "Provided, That whenever any two or more member banks within the same Federal Reserve district are subsidiaries of the same bank holding company within the meaning of section 23A of this Act, participation by such member banks in any such nomination or election shall be confined to one of such banks, which may be designated for the purpose by such bank holding company."

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Sec. 3. The eleventh paragraph of section 9 of the Federal Reserve Act, as amended, which commences with the words "In order to facilitate", is amended by inserting after the words "which is required" the following: "under subsection (d) of section 23A of this Act to become a member of the Federal Reserve System or is required."

Sec. 4. The sixteenth, seventeenth, eighteenth, twenty-first, and twenty-second paragraphs of section 9 of the Federal Reserve Act, as amended, are repealed.

Sec. 5. (a) The second sentence of the first paragraph of section 5240 of the Revised Statutes, as amended, is amended by changing to a period the colon following the words "Comptroller of the Currency" and by striking out the proviso which follows the colon.

(b) The last two sentences of the first paragraph of section 5240 of the Revised Statutes, as amended, are amended by striking out the words "or affiliate" in each sentence.

(c) The second paragraph of section 5240 of the Revised Statutes, as amended, is amended by striking out the first three sentences, including the proviso at the end of the third sentence, and by striking out the last two sentences.

(d) The fourth sentence of the second paragraph of section 5240 of the Revised Statutes, as amended, is amended by striking out the words "and affiliates thereof therein provided for" and "or affiliates thereof".

(e) The fifth sentence of the second paragraph of section 5240 of the Revised Statutes, as amended, is amended by striking out the words "and/or affiliates".

Sec. 6. The last paragraph of section 21 of the Federal Reserve Act, as amended, is repealed.

Sec. 7. Subsections (b) and (c) of section 2 of the Banking Act of 1933, as amended, are repealed.

Sec. 8. Section 20 of the Banking Act of 1933, as amended, is repealed.

Sec. 9. (a) The first sentence of section 5144 of the Revised Statutes, as amended, is amended by inserting the word "and" immediately before "(3)" and by changing to a period the comma preceding "and (4)" and striking out that which follows in such sentence.

(b) The second paragraph and all succeeding paragraphs of section 5144 of the Revised Statutes, as amended, are repealed.

Sec. 10. The second paragraph of section 5211 of the Revised Statutes, as amended, is repealed.

Sec. 11. (a) Subsection (d) of section 26 of the Revenue Act of 1936, as amended, is amended to read as follows:

"(d) Bank Holding Companies. - In the case of a bank holding company (as defined in section 23A of the Federal Reserve Act), the amount of the earnings or profits which the Board of Governors of the Federal Reserve System certifies to the Commissioner has been devoted by such company during the taxable year to the

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acquisition of cash or readily marketable assets, other than bank stock, in compliance with subsection (j) of section 23A of the Federal Reserve Act. The aggregate of the credits allowable under this subsection for all taxable years shall not exceed the amount required to be devoted under such subsection (j) to such purposes."

(b) Subdivision (1)(C) of subsection (a) of section 14 of the Revenue Act of 1936, as amended, is amended to read as follows:

"(C) In the case of a bank holding company (as defined in section 23A of the Federal Reserve Act), the amount allowed as a credit under section 26(d)."

(c) Subdivision (1)(D) of subsection (c) of section 102 of the Revenue Act of 1936, as amended, is amended to read as follows:

"(D) In the case of a bank holding company (as defined in section 23A of the Federal Reserve Act), the amount allowed as a credit under section 26(d)."

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NOTE: The above was prepared by Mr. Baumann in collaboration with Mr. Wingfield as a possible substitute for the Bill S. 3575, in the event that there should be an opportunity to make suggestions to Congress on that Bill. This draft has not been criticized by other members of the Staff or members of the Board. An earlier draft, which did not include a revision of the affiliate provisions of the law, as distinguished from holding company affiliate provisions, was submitted to members of the Staff and Governor Ransom, and the suggestions received have been considered in preparing this draft.

B.M.W.

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