April 10, 1941

All Board Members

Mr. Clayton

Attached hereto is a revised draft of an outline of suggested bank holding company legislation, also a copy of a proposed statement criticizing S. 510 both of which are to be enclosed with the letter to the Secretary of the Treasury re bank holding company legislation.

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& ~~Governor~~ Ransom asks that you be advised that the letter of March 17, 1938 to you from ~~Honorable~~ Jesse Jones satisfactorily expressed his views then and now.

Form F. R. 131

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date April 10, 1941

To Chairman Eccles

Subject: Bank holding company program

From Mr. Wingfield, Assistant General Counsel

CONFIDENTIAL

Pursuant to the understanding in your office yesterday afternoon, there are attached a revision of the bank holding company program and a statement on the bill S. 310 relating to bank holding companies. These two documents have been put in suitable form to accompany the letter to the Secretary of the Treasury prepared by Mr. Clayton.

In connection with the bank holding company program, you will note that at the end provision has been made for necessary changes to coordinate "affiliate" provisions of the statutes with the proposed changes in the statutes relating to bank holding companies. I believe that it would result in confusion if some changes in the statutes relating to "affiliates" (particularly with respect to definitions) should not be made at the same time the proposed modifications are made in the holding company statutes.

Attachments 2

Confidential

OUTLINE OF SUGGESTED BANK HOLDING COMPANY BILL AND BANK AFFILIATE 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 company.

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 any subsidiary ~~of the bank holding company~~ thereof.

Bank Affiliates

1. Define "affiliate of a bank" as an organization (1) which is a "subsidiary" of the bank, (2) of which the bank is a "subsidiary", or (3) which is a related organization by reason of common ownership of more than 50 per cent of voting shares of the bank and the company or by reason of the fact that directors of the company constitute 25 per cent or more of the directors of the bank. Repeal present definitions covering all affiliates of member banks.

2. Prohibit insured banks from having "securities company" affiliates after one year, with enforcement by Board in the case of member banks (as at present under comparable provisions in the Banking Act of 1933) and by the Federal Deposit Insurance Corporation in the case of nonmember insured banks.

3. Extend provisions of section 23A of the Federal Reserve Act to nonmember insured banks.

4. Continue authority of Board and Comptroller to require member banks to furnish reports of their affiliates, except that this authority would be vested only in the Board as to affiliates which are bank holding companies. Give Federal Deposit Insurance Corporation like authority in the case of nonmember insured banks, except as to affiliates which are bank holding companies.

5. Continue authority of Board and Comptroller to examine affiliates of member banks, except that this authority would be vested only in the Board as to affiliates which are bank holding companies. Give Federal Deposit Insurance Corporation like authority with respect to affiliates of nonmember insured banks, except affiliates which are bank holding companies.

April 10, 1941

Confidential

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 ~~would seem~~ 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.

While the problem relating to companies affiliated with banks but which are not holding company affiliates of banks is closely related to the supervision of holding company affiliates, the bill S. 310 would not attempt to modify the existing statutes relating to affiliates of banks. The Board feels that, since these two problems are so closely related, when amendments are made to the holding company affiliate provisions of the statutes certain important amendments should also be made to the affiliate provisions.

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. 310 in its present form.

April 10, 1941