7 Feb 1949

STATEMENT OF J. LEONARD TOWNSEND IN REPLY TO THE OBJECTIONS TO S. 2318 MADE BY MR. STEWART, COUNSEL FOR TRANSAMERICA CORPORATION.

Before commencing my discussion of the various objections raised by Mr. Stewart to S. 2318 I would like to emphasize the point made by Chairman McCabe that probably no piece of regulatory legislation has ever been subjected to such extensive scrutiny on the part of all concerned than has this bill. All interested bank holding company groups, including the Transamerica and Morris Plan groups, have been consulted by Chairman McCabe and the Board's staff. Mr. Stewart himself took part in one of those discussions as a representative of Transamerica Corporation. At that meeting there were also present representatives of numerous other bank holding companies, including representatives from the Georgia Trust Company, the Marine Midland Corporation, the Northwest Bancorporation, and the First Bank Stock Corporation. All present at that meeting were urged by Chairman McCabe to submit to the Board any amendments to the bill which in their judgment would result in a better draft of bank holding company legislation. Beyond Mr. Stewart's expression at that time that, in his opinion, there was no need for additional legislation respecting bank holding companies and his statement of general opposition to the Board's view that a bank holding company should be required to restrict its activities to banking, neither Mr. Stewart nor any other representatives of Transamerica have since that time seen fit to send their suggestions to the Board for its consideration. On the other hand, representatives of the other bank holding companies have taken frequent occasion to advise with the Board and its staff respecting the possible need for amending the bill. I am reminded of the almost innumerable discussions that Chairman McCabe and other members of the Board and the staff have had with other representatives of holding companies, the American Bankers Association, the Reserve City Bankers, the Independent Bankers groups, the Federal Advisory Council, and others. Certainly after such exhaustive, even pulverizing, analyses of the bill one would be justified in concluding that the public interest involved had been pretty well canvassed and that the basic philosophy of the bill was reasonably adapted to the protection of the public interest

That Transamerica should now present a general shotgun charge which assails the bill in practically every vital section is, in my judgment, merely evidence of its desire to sabotage this legislation. However, in order that the Board's position respecting the objections raised by Mr. Stewart may be made known to the Committee, I should like briefly to reply to the principal objections which he has made.

The first objection which he makes concerns the definition of a bank holding company contained in Section 2 of the bill. Mr. Stewart objects to that portion of the bill which allows the Board to declare that a company or a bank is a bank holding company if, after notice and opportunity for hearing, the Board finds that such company or bank exercises "such a controlling influence over the management or policies" of the required number of banks or banking offices as to make it necessary in the public interest that such company or bank be subject to the provisions of the Act. Mr. Stewart's discussion of this definition covers approximately nine pages in his prepared statement. Yet Mr. Stewart's own figures demonstrate that Transamerica owns a majority of the shares of more than 40 banks, and therefore this part of the definition can have no bearing whatever upon the status of Transamerica as a holding company, no matter what definition of a bank holding company is adopted. The only comment contained in these nine pages which, even if well taken, seems to me to raise any legitimate objection to the definition is to be found in that paragraph on page 6 of his statement which reads as follows:

> "There are no standards by which to test the Board's exercise of its discretion either to include or to exclude. A definition more open to abuse would be difficult to contrive."

In answering this objection I should like first to call to the attention of the Committee that every one with whom we have discussed the problem agrees with the fundamental position of the Board that the <u>fact</u> of bank holding company relationship should be determined by the existence or non-existence of the power to control the management or policies of one or more banks. That is because it is the power to influence the management or policies of banks which in turn gives rise to the potential misuse of the banking function. To every one who has raised objections to our definition of a bank holding company we have made the uniform reply: "Give us a better definition that reaches those companies which actually control banks and which will protect the public interest against the possibilities of the abuse of such power and we will substitute your definition for ours." To date no one has presented to the Board, or so far as I can tell to this Committee, any definition which contains a more realistic approach to the problem.

It seems to me enough on this point simply to call your attention to the fact that Congress itself, almost 15 years ago, employed the identical language which we have put in this bill in defining a public utility holding company under the Public Utility Holding Company Act of 1935. Only the other day, in response to Senator Douglas' request, I submitted for this record a memorandum prepared by attorneys in the Securities and Exchange Commission, which refers to the many decisions which have been rendered by the courts in reviewing the Commission's interpretations of this language in the public utility holding company field. I think it is important for this Committee to know that those cases establish the incontrovertible fact that the courts have found that the expression "controlling influence" affords a wholly sufficient legal standard for administrative action; otherwise, of course, the definition would have been struck down by the courts as insufficient. And while on this subject I should like to read to you just a very few observations of the Sixth Circuit Court of Appeals in referring to the phrase "controlling influence" as used in that statute. In the case of Detroit Edison Co. v. SEC, 119 F. (2) 730, the Court said:

"The Act should be so construed that those affected by it may be certain of the rules of conduct required of them under its provisions. Because of the imperfection natural in language and the obscurity and confusion so difficult to avoid in the use of words, it is sometimes hard to determine the exact meaning of phrases or words used in statutes. The words and phrases used in the present Act should have a rational construction with common sense and the Act as a whole should be construed to carry out the purpose of the Congress in its enactment. Because of the nature of the complex subject with which the Congress was dealing, it could not promulgate a Code so specific as to adapt itself to all possible contingencies and evils, which it was seeking to prevent or regulate. It was therefore necessary to delegate power to the Commission with broadly defined limits to determine the controlling relationship between holding companies and their subsidiaries.

* * *

"At the time of the enactment of the present statute, it was recognized by the Congress that the holding company was the most effective device theretofore used for combining, under single control and management, the properties of two or more hitherto independent corporations and it is also recognized that such companies were largely exempt from state regulation, because in many cases, they extended their activities beyond the jurisdiction of any one state.

* * *

"The present Act undertakes to bring within its ambit all subsidiaries subject to 'controlling influence' of a parent. This phrase should be construed in the light of the purpose of the Act of which it is a part, and when understood in this setting and in the light of its ordinary signification, it means the act or process, or power of producing an effect which may be without apparent force or direct authority and is effective in checking or directing action, or exercising restraint or preventing free action."

Mr. Stewart's next objection relates to that provision of Section 4 which would require bank holding companies to divest themselves of any interest in nonbanking organizations and to confine themselves to the ownership of banks and such other businesses as are reasonably incidental to the business of banking. The burden of his remarks on this subject is that a holding company will be in a stronger financial position in times of stress to render financial assistance to the banks which it controls if it has a diversified portfolio of assets; and that this fact requires that a holding company be permitted to be engaged in as many other nonbanking ventures as it might wish.

This argument is, of course, the one which has in the past been most often urged on behalf of those holding companies which have extensive nonbanking interests. Mr. Stewart made that argument during the course of our meeting a couple of years ago. Beyond referring to what Chairman McCabe has just said on this subject, all that I care to say in reply is that it is the consensus of opinion of every one with whom we have discussed this matter, with the exception of the Morris Plan and Transamerica groups, that it is an unhealty condition from a banking standpoint for banks and nonbanks to be operated under a single holding company management. Let me read you what a few of the banking associations have had to say on this subject. I read you a portion of the resolution of the Executive Council of the American Bankers Association, adopted in April 1948:

> "With respect to the legislation now before the Congress, dealing with bank holding companies, the ABA agrees with the principle of divorcement of nonbanking affiliates of bank holding companies, giving due recognition to the merits of individual situations."

In September 1948 the American Bankers Association, at its annual convention, adopted the following resolution:

> "The Association, therefore, urges that the Congress take prompt action designed to place under effective supervision bank holding companies, and to require the separation from such companies of all nonbanking activities."

I should also like to read to you that portion of the resolution of the National Association of Supervisors of State Banks, recently enacted by that Association:

> "Whereas, it is necessary in the public interest and in keeping with sound banking principles that the activities of bank holding companies be restricted solely to the banking business, and that they be regulated in the same manner as the activities of banks themselves; now, therefore, be it
>
> "Resolved, That this conference urges the Congress that legislation be enacted designed to supervise and effectively control bank holding companies, to regulate the creation of new bank holding companies, and to require the separation from such companies of all nonbanking activities."

I could read many others along a similar line, including the statement of this Committee in 1947 in its report on S. 829 as follows:

> "The need for this legislation is both pressing and clear. The holding-company device is particularly susceptible to abuse in the field of banking, not only because it enables the holding-company system to evade traditional limitations upon bank expansion but also because it can be used to gather under one management many different and varied enterprises wholly unrelated to the conduct of a banking business, which the committee feels is inimical to sound banking practice."

Surely these and the many other expressions which this Committee has received along similar lines are sufficient to satisfy every one that this requirement is a necessary one in this legislation and not, as Mr. Stewart has suggested in his statement, one having mere superficial appeal.Be that as it may, however, the simple answer to Mr. Stewart's plea for diversification of a bank holding company's assets is fully met by the provision contained in Section 4(e) of the bill which permits a holding company to own up to 5% of the voting shares of a nonbanking company. Surely there are enough corporations in this country, the shares of which are readily obtained by an investor, to satisfy even the most ardent seeker after diversification.

In discussing Section 4 Mr. Stewart has made a suggestion which I think is worthy of this Committee's consideration. He points out that the divorcement provisions contained in that section would require that a holding company dispose of its nonbanking assets within a maximum period of five years after the effective date of the Act. In this connection he calls attention to the fact that a holding company might be declared to be a bank holding company at some time after this five-year period. In such event he points out that the holding company might under those circumstances have to rid itself of its nonbanking assets forthwith. As I indicated above, Mr. Stewart did not see fit to send this suggestion to the Board. Had he done so I am sure that the Board would have agreed, as it now agrees, that such a possibility as Mr. Stewart apprehends ought to be protected against in the bill. We believe that such a situation could be dealt with by an amendment which would revise Section 4(a) to read as follows:

"(a) Except as otherwise provided in this Act, it shall be unlawful for any bank holding company, after two years after the effective date hereof or two years after a declaration of holding company status as provided in Section 2(a), whichever is later, to own any shares or other securities or obligations of any company other than a bank or to engage in any business other than that of banking or managing or controlling subsidiary banks. The Board is authorized, upon application by a bank holding company, to extend this period from time to time as to such company for not more than one year at a time if, in its judgment, such an extension would not be detrimental to the public interest. However, nothing herein provided shall be construed to authorize the Board to extend any such period beyond a date five years after the enactment hereof or five years after a declaration of holding company status as provided in Section 2(a), whichever is later."

I am authorized by the Board to say that such an amendment would be acceptable to it.

In further commenting upon Section 4 Mr. Stewart takes the position (at page 18 of his statement) that the divorcement provision would have the effect of defeating the desirable practice of having stockholders in banks take over undesirable assets from banks. This objection, it seems to me, overlooks that provision in the bill which is contained in Section 4(c), and which provides as follows:

"(c) Nor shall the prohibitions in this section apply to shares or securities or obligations acquired by a bank holding company from any of its subsidiaries which have been requested to dispose of such voting shares, securities, or obligations by any Federal or State authority having statutory power to examine such subsidiaries or which have been acquired from such subsidiaries with the prior approval of the Board; but such bank holding company shall dispose of such shares, securities, or obligations within a reasonable time. If, while such bank holding company owns or controls such shares, securities, or obligations, the Board, after notice and opportunity for hearing, determines that the ownership or control of such shares, securities, or obligations is resulting in the violation or evasion of any of the purposes or provisions of this Act, it may by order require such bank holding company to dispose of all or any part thereof forthwith."

This provision, as is apparent, exempts such assets as referred to by Mr. Stewart from the application of the divorcement requirements so long as the holding company does not attempt to use those assets in a way which avoids the plain purposes of the law.

Mr. Stewart also suggested (at page 19 of his statement) that the effect of the passage of S. 2318 would be to repeal those provisions of existing law which require the divorcement by bank holding company affiliates of any interest in a securities company engaged in underwriting. The Board does not so interpret S. 2318. We believe that all such affiliations would be prohibited under the blanket prohibition contained in Section 4(a) which makes it unlawful for a bank holding company "to own any shares or other securities or obligations of any company other than a bank or to engage in any business other than that of banking or managing or controlling subsidiary banks". The only exception to this prohibition which might be offered in substantiation of Mr. Stewart's point is that contained in Section 5(e) of the bill which, as we have seen, permits a bank holding company to own up to 5% of the voting shares of any company which do not have a greater value than 5% of the value of the total assets of the bank holding company. This exception, as Chairman McCabe pointed out in a previous statement, is not considered to be incompatible with the fundamental principle involved in the divorcement provision. However, as he then stated, even if the ownership of such a relatively insignificant interest in a nonbanking business enables the holding company to evade the purposes of the law, and it surely would be evaded if a securities affiliate relationship were reestablished, then the bill provides that the holding company may be required to dispose of any such securities.

I turn next to Mr. Stewart's objections to Section 5 of the bill. This is the section which purports to regulate the creation of bank holding companies and the expansion of bank holding company groups. In his first objection to Section 5 Mr. Stewart refers to the fact that the Board is currently proceeding against Transamerica Corporation under Section 7 of the Clayton Act and that this proceeding, if successful, may result in Transamerica being required to rid itself of the stock of some or all of its banks. Therefore, he argues, the antitrust statutes are adequate safeguards against improper expansion and there is no need for S. 2318 dealing with the same subject.

The fundamental fallacy of this position has probably already occurred to all of you. It is simply this: The antitrust statutes and the remedies afforded thereunder apply only after the offense has been committed, that is, only after a monopoly, as a fait accompli, has actually occurred or where there is in fact a presently existing tendency to monopoly. The remedies in such situations are therefore corrective. The purpose of S. 2318, among others, is to prevent either of these situations from occurring and to protect the public from such harm as might result during the period before the antitrust statutes could be brought effectively to bear upon the situation. As Chairman McCabe stated in his testimony, if S. 2318 had been on the statute books these past 20 years, probably there would have been no need for the Board to have instituted the present proceedings against Transamerica.

But Mr. Stewart says that the standards provided in Section 5 for the guidance of the Board and the other agencies in passing upon the creation or expansion of a bank holding company group are not consistent with existing principles of law. Inasmuch as he does not appear to quarrel with those standards in that section which are applicable today if a bank seeks to obtain Federal approval for the establishment of a branch, I pass at once to the one which requires the Board, the Federal Deposit Insurance Corporation or the Comptroller, in passing upon an application to expand a bank holding company group, either by the acquisition of a bank or by the establishment of a branch of a bank in the holding company group, to consider "whether or not the effect of such acquisition may be to expand the size and extent of a bank holding company system beyond limits consistent with adequate and sound banking and the public interest." It is Mr. Stewart's contention that the application of such a standard reads an entirely new concept into the regulatory statutes of this country. He says that for the first time size is itself made an offense, even though, as he puts it, "the law had not heretofore frowned on mere size".

There seems to me to be an element of apparent inconsistency between this position and the one which I commented upon a moment ago. Mr. Stewart apparently took the position that the Board already has authority under the Clayton Act to order divestment of banks if a bank holding company is actually tending to a monopoly. If that is so, then why should there be any objection to granting the Federal bank supervisory agencies the power to prevent such a situation from occurring in the bank holding company field, especially when that situation cannot occur until a bank holding company has attained a certain size. Of course, I agree with the proposition that mere size should not be legislated against. But Section 5 does not legislate against mere size; it legislates against dangerous size. Dangerous size, according to Section 5, is that size which violates either the anti-monopoly provisions of existing law or the tenets of sound and adequate banking. Surely, these concepts of harmful size can hardly be classified as revolutionary in our national public policy.

Mr. Stewart next argues that the banking business is the last business to which the Congress should apply any such formula for controlling expansion. In support of that argument he introduced three charts which purportedly demonstrate that there is little concentration in the banking business on a national scale; whereas such national concentration can be found in other industries. In emphasizing this contention he points out that the Bank of America, the largest bank in the world, has but 4.1% of all of the deposits in the United States.

I cannot too strongly attack the basic fallacy of this contention or the reasons which underlie it. Of course there is no significant concentration of bank deposits on a national basis. This is because the Congress and the States, thus far at least, have prevented any bank from crossing State lines, something, I might add, which they have not been able to accomplish respecting bank holding companies. Banking has been regarded as an essentially local business, although its impact upon the local economy might, and generally does, have far reaching repercussions in interstate affairs. In the light of these considerations any comparisons with national figures are completely inappropriate and misleading. A comparison which in my judgment would be appropriate is one which demonstrates the extent to which a particular bank holding company group actually dominates the banking business in any particular section of the country.

Since Mr. Stewart has referred to certain statistics, let me call the Committee's attention to a few additional ones. The Transamerica group, including the Bank of America, today consists of 48 banks operating 603 branches and serving approximately 400 communities in the five States of California, Washington, Oregon, Nevada and Arizona. The deposits of these banks total approximately six and one-half billion dollars. These figures represent about 41% of all banking offices in the five-state area, and the deposits in these offices total approximately 38% of all of the commercial deposits in that area. In addition, these banking offices have a total of just under 50% of all of the commercial bank loans in the five States. I have here a single page of statistics which demonstrates the growth of the Transamerica banking group, by five-year intervals since 1920, in banking offices, deposits and loans in the five States which I have mentioned. I ask that the Committee receive this paper as a part of the record.

The important thing to bear in mind about the expansion of the Transamerica group is that it has in large part been accomplished by the acquisition of existing banking institutions, not by the creation of de novo branches. In the period since the formation of Bank of America in 1904 down to the present time the Transamerica group and its predecessors have acquired approximately 675 existing banks or branches of banks while establishing only approximately 230 de novo branches. Their uniform system has been to buy an existing banking office and then seek and obtain permission to branch that office into one or another of their principal banks. Right at the present time, for example, Bank of America has on file with the Comptroller applications to branch some 28 banking offices which Transamerica owns in California, and the First National Bank of Portland has a similar application to branch some 16 banking offices which Transamerica now owns in Oregon.

Considering all of these facts, it seems to me a tremendously different picture is shown than when you compare, as Mr. Stewart would have you do, the total of deposits in the Transamerica banks with the total deposits of all banks in the country. And the complete absurdity of his suggested comparison is demonstrated by simply pointing out that under his theory Transamerica should be permitted, if it desired to do so, to acquire <u>all</u> of the banking offices in these five States because the total deposits of <u>all</u> banks in those States is only 12% of the Nation's total bank deposits.

Mr. Stewart next comments upon Section 7 of the bill. Here he apparently takes no issue with that portion of the section which purports to regulate the fees charged by a bank holding company to its banking subsidiaries, for, as he correctly states, Transamerica does not charge fees to its banks. He does, however, draw attention to the fact that in this section the standard for agency guidance, among other things, is based upon the need for protecting investors as well as depositors. Apparently, Mr. Stewart overlooked the fact that this standard is also included in other sections of the bill, particularly in Section 2 which defines a bank holding company. That is the section which he severely criticized on other grounds.

The general inclusion in the bill of provisions designed to protect investors has a very important origin. Under the Investment Company Act of 1940, bank holding companies are given an exemption if they hold a voting permit from the Board. Transamerica, for example, has such an exemption. The theory of this exemption presumably is that, because the bank holding company is subject to regulation by the Board, there is no need in the public interest to duplicate that regulation. The entire purpose of the Investment Company Act is to protect investors. However, such a consideration was not written into the holding company affiliate section of the Revised Statutes at the time the exemption I have referred to was provided. Hence, it appears that under existing law bank holding companies are not subject to the same regulation as are investment companies. Inasmuch as S. 2318 continues the exemption of bank holding companies from regulation under the Investment Company Act, it was felt that the Act should include protection of investors as well as of depositors as an object to be achieved in the regulation of such companies.

Finally, Mr. Stewart attacks the provisions of Section 10 of the bill. This section deals with hearings, investigations and court orders. His first objection is to the granting of the power of subpoena to the Board. His argument is that the power to examine is enough; "innocent bystanders", as he describes them, should not be required to tell what they know in aid of getting at the truth about the facts of any controversy.

May I call the Committee's attention to the fact that not one single person or organization other than Mr. Stewart has raised any question concerning this perfectly normal provision of a regulatory statute. What, I may ask, does Transamerica apprehend from the subpoena power and the need for giving testimony under oath? If, as Mr. Stewart suggests, Transamerica has nothing to fear from full and complete investigation, would you not suppose that they would welcome the opportunity to meet the tests of an investigation conducted in a manner which gives some assurances against concealment or other presently available means for avoiding disclosure of the truth?

It is enough, I think, in answering this objection merely to point out that the language of Section 10 was derived in principal part from similar language contained in the Public Utility Holding

Company Act of 1935. I suggest that the Committee simply ask its attorneys to check the language of that Act against that used in Section 10 of S. 2318. I assure you that you will find ample precedent there not only for the granting of the powers of investigation and subpoena (without which in my judgment a regulatory statute is completely impotent) but also for most, if not all, of the identical language used in Section 10. It should be added that these provisions of the Public Utility Holding Company Act, like similar provisions of most regulatory statutes, have many times been construed by the courts. There is, therefore, no lack of adequate judicial protection to a person or company against unwarranted invasions of fundamental rights.

Mr. Stewart's final point on this subject is that effective judicial review is denied under S. 2318. If there is one subject upon which I can authoritatively state the unequivocal position of the Board, it is that the Board, in asking the passage of this legislation, desires to have every one of its actions pursuant to the law subjected to the scrutiny of the courts. We thought we used language to guarantee that result. Apparently every one but Mr. Stewart thinks so, too. In any event, in our first draft of the bill we followed the exact language of the review provisions contained in a similar section in the Public Utility Holding Company Act. The only word of substance that was changed afterwards was at the request of lawyers for certain holding companies who thought that review of any "final action" by the Board would be a greater protection than a review of a "final order" of the Board. Accordingly, the words "final action" were substituted for "final order" in

Section 10. However, if it should be the view of the Committee, after its lawyers have had an opportunity to advise with it on this subject, that any other words are needed to fully protect a person adversely affected by any action or order of the Board under this bill, then I am authorized by the Board to suggest that you add words which would indicate that nothing in the review provisions of the law shall deprive such a person of any and all rights of review which he would have under the provisions of the Administrative Procedure Act. We do ask you, however, before inserting any provision which might raise difficult technical questions, to first satisfy yourself that they are actually needed. We honestly don't think they are.

So far as Mr. Stewart's suggestion that the Board might receive an application under the Act and then deny effective review by failing to act at all, I can only say that such a suggestion is almost silly. Mr. Stewart is a lawyer of great experience and versatility. Yet in making this argument to the Committee he chooses to overlook a fundamental principle of law, announced time and again by the Supreme Court that the courts are always open to compel a reluctant official or agency to perform its statutory duty. As that Court said, as late as 1943, in Addison v. Holly Hill Co., 322 U. S. 607:

> "This Court has on several occasions required the Interstate Commerce Commission to take jurisdiction when it declined to do so or to discharge a duty laid upon the Commission by statute. (citing cases) The district court would not be telling the Administrator how to exercise his discretion but would merely require him to exercise it. It is a remedy against inaction."

PERCENTAGE OF BANKING OFFICES, LOANS AND DEPOSITS OF TRANSAMERICA CORPORATION (AND PREDECESSORS) GROUP BANKS TO ALL BANKS IN SAME STATES, 1920-1947

	1920	1925	1930	1935	1940	1945	1947
Banking Offices:							
California	2.90	12.43	35.22	40.43	47.39	50.10	50.69
Oregon			1.75	18.71	32.86	33.79	36.84
Nevada				41.18	57.14	60.87	60.00
Arizona					13.16	14.29	13.73
Sub-total	2.90	12.43	30.18	37.98	44.93	47.23	47.83
Washington					4.46	4.35	4.08
Total	2.90	12.43	30.18	37.98	38.88	40.62	40.94
Loans:							
California	5.82	11.54	31.64	30.72	40.37	48.54	57.35
Oregon			15.35	26.50	44.03	41.64	43.16
Nevada				40.22	79.31	81.25	77.94
Arizona					19.89	10.94	9.28
Sub-total	5.82	11.54	30.72	30.59	40.49	47.46	55.27
Washington					5.11	6.82	6.46
Total	5.82	11.54	30.72	30.59	36.92	42.76	49.65
Deposits:							
California	6.37	12.71	32.10	30.59	35.09	41.58	43.14
Oregon			17.08	25.34	36.53	40.70	44.11
Nevada				58.41	81.36	79.67	76.90
Arizona					24.21	22.53	20.44
Sub-total	6.37	12.71	31.03	30.43	35.39	41.41	42.98
Washington					3.89	5.31	4.58
Total	6.37	12.71	31.03	30.43	31.95	36.54	38.15

Note: Some of the above ratios are based on June figures while others reflect December figures.