

May 20, 1949.

Governor Eccles:

You may be interested in the attached memorandum to Governor Clayton regarding the exemption of investment companies under the Bank Holding Company Bill.

GBV ✓

May 19, 1949.

Governor Clayton

Bank Holding Company Bill --

Mr. Vest

Exemption of investment companies.

Referring to our recent discussion of this question, I have considered the matter further and Mr. Solomon has talked with a representative of the Securities Exchange Commission regarding the possible effect of an exemption from the divorcement provision of the bank holding company bill of an investment company registered under the Investment Company Act of 1940.

The Investment Company Act is directed at the regulation of investment companies and the restrictions imposed by that Act are in the interest of the protection of that company. They would not be of any substantial aid in accomplishing the objectives of the provision of the bank holding company bill requiring the divorcement of non-bank assets. Accordingly, the mere fact that an investment company is registered with the S.E.C. under the Investment Company Act does not seem sufficient justification for exempting it from the divorcement provision of the bank holding company bill.

There is, however, another aspect of the matter to be considered. An investment company which is registered under the Investment Company Act is one which is "primarily engaged" in the business of "investing, reinvesting or trading in securities". A company which controls or manages subsidiaries is exempt from the Investment Company Act and therefore would not fall within the exemption from the divorcement provision of our bill and would have to be disposed of by a bank holding company under our bill. The line to be drawn between what is strictly an investment type of business on the one hand and a similar business which goes somewhat further and attempts to control or manage corporations whose stocks are held by the concern in question, is a rather shadowy one and can be determined only in the light of the facts of individual cases.

Presumably the purpose of the provision in the bank holding company bill requiring the divorcement of nonbank assets is to prevent the milking of the banks by powerful affiliated borrowers subject to a common control, to prevent such powerful borrowers from being able to borrow on easier terms than competitive institutions in the community, and possibly to prevent the holding company exercising common control from using its power over credit institutions in improper ways and contrary to the public interest. An institution which is registered under the Investment Company Act and which is of a purely investment

character would probably not cut across these purposes as thus stated to too great an extent in most instances; but it is not altogether clear whether this is true even with pure investment companies. In addition, there will be some cases in which an institution may be registered under the Investment Company Act because it is engaged primarily in the investment company business but also, to a limited extent at least, may get into the control or management of the subsidiary institutions. This is particularly likely to be the case since the motivating principles and influences operating upon the S.E.C. would probably be to bring institutions under the law in doubtful cases (involving some control as well as pure investment business) rather than to exclude them from the law. Exemptions from a statute are ordinarily strictly construed. From the standpoint of the bank holding company bill, it would be desirable to resolve doubtful cases in the other direction and exclude them from the Investment Company Act so that they would then be subject to the bank holding company divorcement provision.

The present tentative exemption in the bank holding company bill from the divorcement provision is of a company registered under the Investment Company Act. If the position is taken that such an exemption might be granted in the case of any pure investment company not engaged in controlling or managing its subsidiaries, a logical case could be made for rewording the exemption to make it applicable to companies not engaged in any business except investing, reinvesting or trading in securities (regardless of whether or not registered under the Investment Company Act). While this would have some advantages, it would have the disadvantage of raising the question of fact in each case and also might exempt more institutions than would be exempt under the present language. One further alternative would be to require that the company be registered under the Investment Company Act and also that it must not be engaged in controlling or managing any company whose stock it owns.

In this connection, it is not altogether clear that the tentative amendment to the bank holding company bill will meet the situation in Kentucky in which Mr. Wilson Wyatt is interested. It is Mr. Solomon's understanding from talking with the S.E.C. representative that the investment company in this particular situation is exempt from registration under the Investment Company Act and, accordingly, that it might require some amendment to that Act to take care of the situation, even if the tentative amendment in the bank holding company bill is retained. This is because the holding company which is understood to own the stock of the investment company is engaged in businesses other than the investment business,

thereby making both companies exempt from registration. While this is our information, it is probable that Mr. Wyatt has considered this and it may be that he has found some way around this difficulty.

---

The question whether the exemption of investment companies which is contained in the latest draft of the bank holding company bill is an advisable one is, therefore, open to some doubt. I am inclined to the view that as a matter of objective policy it would be better to eliminate the exemption and thereby to require a bank holding company to rid itself of investment companies as well as other nonbanking institutions. I recognize, however, that to do this may substantially increase the opposition to the bill and it therefore becomes a question of strategy as to whether or not to include such an exemption in the bill.

I would like to discuss this with you further when you have an opportunity.

GBV:lim