April 18, 1950.

To: Board of Governors

From: Mr. Vest

Subject: Comments on the Revised Draft of Bank Holding Company Bill.

Attached is a draft of a proposed memorandum expressing views and comments on the revised version of the bank holding company bill which was prepared at Senator Robertson's request. An informal request has been received from a member of the Senate Committee's staff for our comments by Thursday, for the use of Senator Tobey in considering this revised draft. The question arises as to what response should be made to this request.

DRAFT

VIEWS OF FEDERAL RESERVE BOARD ON PROPOSED REVISION OF BANK HOLDING COMPANY BILL -- DRAFT OF APRIL 14, 1950

There are set forth below the views and comments of the Board of Governors of the Federal Reserve System regarding the April 14 draft of the proposed revision of the Bank Holding Company Bill, copies of which were distributed at a meeting on April 14 in Senator Robertson's office to representatives of the Comptroller of the Currency, the FDIC, and the Board of Governors.

BRIEF SUMMARY OF THE PRINCIPAL PROVISIONS OF THE BILL

Existing Law. - The revised draft does not repeal, modify, or change in any way the provisions of existing law relating to holding company affiliates, but leaves these provisions intact in the law. The proposed revision would superimpose its provisions upon the provisions of existing law.

"Bank Holding Company". - The draft would define a bank holding company in much the same way as the term "holding company affiliate" is defined in existing law, except that it would apply to the ownership or control of insured banks instead of merely member banks. Thus, a company would be a holding company if it owns or controls 50 per cent of the shares of a bank, or 50 per cent of the shares voted at the last election of directors, or controls in any manner the election of a majority of the directors. A company which, under this definition, is a holding company on April 15 or thereafter would always be a holding

company; and so long as it owns or controls more than 5 per cent of the shares of any insured bank, would be subject to the restrictions of the bill.

Expansion of Holding Company. - A bank holding company would be prohibited from acquiring the shares of any bank except with the approval of (a) the Board if the bank to be acquired is a State member bank, (b) the Comptroller of the Currency if the bank to be acquired is a national bank, or (c) the FDIC in the case of any other bank.

Nonbank Investments. - A bank holding company would be prohibited, after five years from the date of the law, from holding stock in any nonbanking corporations, except those engaged in a safe deposit or a fiduciary business, and from holding any obligations except investment securities which national banks are permitted to purchase under the National Bank Act; but these provisions do not apply to bank holding companies which are themselves banks. No bank holding company could acquire any shares of a State bank if this would be contrary to State law.

Standards. - In passing upon requests for bank holding companies to purchase shares in banks, the appropriate Federal supervisory agency would be required to take into consideration the financial condition of the bank, adequacy of capital, earnings prospects, character of management, needs of the community, and whether or not the corporate powers are consistent with the law relating to insurance of deposits. It would also be required to take into account the policy of Congress "in favor of local ownership and control of banks and competition in the field of banking, and in opposition to excessive concentration of

power in the field of banking through undue expansion of multiple-office banking systems". The various factors enumerated above would apparently have to be taken into consideration also by a Federal supervisory agency in considering applications for branches.

Enforcement. - There is no sanction or provision for enforcement of the bill except criminal penalties. Willful violation of any provision of the bill would be subject to a maximum punishment of $1,000 a day in the case of a corporation or any other organization, and a maximum of $10,000 fine or one year imprisonment, or both, in the case of an individual.

Federal Reserve Districts. - The bill also contains certain restrictions upon the acquisition by a bank holding company system of more than 25 per cent of the deposits or banking offices in a Federal Reserve District and upon the acquisition of shares in banks in other Federal Reserve Districts. It is understood, however, that these provisions are being omitted from the bill.

COMMENTS ON VARIOUS PROVISIONS OF THE BILL

Definition of Bank Holding Company. - One of the principal objections to the existing law is that the definition of "holding company affiliate" is not broad enough to reach many companies which control the management and policies of banks. Ownership or control of 50 per cent of the stock of a bank is entirely unrealistic as a basic test for determining whether a holding company relationship exists,

because it is common knowledge that one company may exercise a controlling influence over another company without owning or controlling a majority of its stock. The continuation of this 50 per cent test of a bank holding company relationship would facilitate evasion of the law.

The test of a bank holding company based on "control in any manner" of the election of directors of a bank has very little practical meaning. In the first place, it is extremely difficult to prove such control, and no supervisory agency of the Government would be vested with any authority to make any determination in this regard. The question could be settled only by resort to the criminal courts through the Department of Justice. Of course, the law would be construed strictly against the Government, as all criminal statutes are. Moreover, even though a company might be a bank holding company because of "control in any manner" of a bank, it would not be subject to the restrictions of the law unless it also owns or controls more than 5 per cent of the stock of some bank.

The Board feels, therefore, that the definition of a bank holding company proposed in the revised draft of bill is impractical and will be unsatisfactory in accomplishing the desired results. If, however, notwithstanding, Congress should feel it desirable to use this general type of definition in any holding company legislation adopted, the Board feels that it is most important that a percentage substantially less than the 50 per cent now prescribed in the definition be specified.

Absence of Provision for Exemptions. - The definition of "bank holding company" does not contain any provision for exemptions similar to the provision in the existing definition of "holding company affiliate". As a result, the bill would apply to a large number of cases in which a company controls only one small bank and to other insignificant cases where there is no real reason for regulation. Aside from this being a nuisance as an administrative matter, the results might be quite unfortunate in some instances where large commercial or manufacturing concerns own and operate small banks as a matter of convenience for their employees and customers.

Diffusion of Administrative Responsibility. - The revised bill provides that a bank holding company, in order to acquire the shares of any bank must obtain the approval of the Board if the bank is a State member bank, the Comptroller of the Currency if the bank is a national bank, and the FDIC if the bank is a nonmember bank. This diffusion of authority, the Board believes, is impractical, will lead to conflicting policies, and will hamper the effective administration of the law. If Congress is unwilling to place the responsibility for passing upon the expansion of bank holding company groups in a single agency of the Government, the Board feels that rather than have the diffusion of authority proposed in the revised draft, it would be much preferable that the three agencies act as a unit and that unanimous approval of all three be required for any expansion that might be proposed by a holding company group.

Expansion through Purchase of Assets. - Expansion and tendency toward monopoly can be attained not only by the purchase of shares by a bank holding company but also by the acquisition of assets of other banking institutions by banks in a holding company group. The revised draft of bill, however, omits completely any provision requiring a banking subsidiary of a bank holding company, or a bank holding company which is itself a bank, to obtain the approval of any supervisory agency before purchasing the assets of any other banking institution. It is true that, if after such a purchase of assets the holding company desires to convert the institution so acquired into a branch of one of the banks in the group, it would ordinarily have to obtain permission. No such permission is required, however, where the bank whose assets are taken over is to be liquidated. The acquisition of assets of a bank, coupled with its liquidation, can be a very effective means of eliminating competition in a given community. The Board feels, therefore, that legislation for regulation of bank holding companies can be effective only if it includes restrictions on the purchase of assets of banks. It is noteworthy in this connection that the House of Representatives has passed, and a subcommittee of the Senate Judiciary Committee has approved, a bill to make certain provisions of the Clayton Act restricting stock purchases by corporations applicable also to purchases of assets of other corporations where the effect is a lessening of competition or tendency to monopoly.

Creation of New Bank Holding Companies. - The bill does not provide adequate control over the creation of new bank holding companies, and it would be possible, for example, for a newly organized corporation to acquire all of the banks controlled by two or more existing bank holding companies without approval by any supervisory agency. Through this device it would be possible to consolidate two or more holding company systems, thus permitting an increased concentration of banking and consequent tendency to monopoly.

Divestment of Nonbanking Shares and Obligations. - The revised draft would prohibit a bank holding company, after five years, from holding shares of nonbanking organizations and from holding obligations other than investment securities which national banks may hold. There is no exception which would permit the ownership of 5 per cent or less of the securities of any one company. Such an exception, the Board believes, is a justifiable one because it permits a bank holding company to continue to have diversified investments where the amount of each such investment is so small that it does not contravene the basic objective of the bill. Moreover, the revised draft apparently does not permit a bank holding company to own assets which it has acquired from a subsidiary bank in a case where the bank has been asked by the appropriate supervisory authorities to rid itself of certain undesirable assets. Also, under the revised draft it is not clear that a bank holding company could own a corporation organized for the purpose of providing bank premises. These would all seem to be desirable exceptions to the restrictions on holding of nonbanking investments.

Standards in Connection with Expansion. - In addition to the other standards set forth in the bill, the supervisory agencies in passing upon requests for expansion of a bank holding company must take into consideration the policy of Congress "in favor of local ownership and control of banks and competition in the field of banking, and in opposition to excessive concentration of power in the field of banking through undue expansion of multiple-office banking systems." While the Board has no opposition to this requirement and feels that in large measure it is a very desirable and constructive one, it would have no objection to omitting the language "excessive concentration of power in the field of banking".

Branches. - As we interpret the revised draft, the standards set forth are required to be taken into consideration by any Federal bank supervisory agency in passing upon applications for branches. We believe this is a very important and desirable requirement and should be clearly stated in any legislation on this subject.

Authority to Make Investigations. - The bill contains no authority for an administrative agency to make investigations in order to determine what institutions may or may not be bank holding companies within the meaning of the definition prescribed and, therefore, subject to the restrictions imposed by the legislation. Without such authority to make investigations, institutions which should be regulated may be able to avoid the law entirely. It seems obvious that a power of investigation, with appropriate subpoena power, should be vested in the appropriate agency of the Federal Government.

Judicial Review. - There is no judicial review provided, so that when a supervisory agency acts upon a request of a bank holding company for acquisition of shares and denies it, the decision is final. The Administrative Procedure Act does not help, because the latter does not prescribe judicial review in case of discretionary action. Consequently, a holding company would have no choice but either to accept the position of the supervisory agency or to be prosecuted criminally, with the virtual certainty of being convicted.

Tax Provisions. - It is understood that appropriate provisions are to be incorporated in the revised draft to insure that companies and their shareholders will not be subjected to unfair taxation as a result of action taken in order to conform to the new legislation. The Board feels that such provisions are most desirable in any holding company legislation.

Indirect Control. - It is not clear whether the provisions relating to the acquisition of additional bank stock by holding companies applies to the acquisition of control "directly or indirectly", as well as to the direct purchase of bank shares. If not, the bill would be open to ready evasion. There is a similar question in connection with the provisions relating to the acquisition and retention of shares in nonbanking organizations.

Lack of Correlation with Present Law. - One of the most confusing effects of the proposed revised draft results from the fact that the new law would be superimposed upon the old law without

any change in the latter. This would mean that some holding companies would be technically holding company affiliates under the old law and subject to all its restrictions and at the same time bank holding companies under the new law and subject to all its restrictions. Other companies, however, for example, those owning or controlling nonmember banks only, would not be subject to the old law but only to the new law. There is no justification for such a distinction.

Examinations of Bank Holding Companies. - Although existing law authorizes examinations of bank holding companies where member banks are involved, the revised draft contains no provisions with respect to examinations. Accordingly, a holding company which owns or controls only nonmember banks would not be subject to examination by any Federal agency. Obviously, there should be an appropriate provision for examination of all bank holding companies.

Voting Permit Procedure. - The principal requirement of the existing law is that a holding company must obtain a voting permit from the Board if it wishes to vote the stock which it owns in a member bank. As has been previously pointed out, this provision is impracticable because it leaves with the company the option as to whether to obtain a voting permit, and the law is not applicable to a company unless it chooses to get such a voting permit. It is sometimes possible for a company to operate satisfactorily and to control its banks without a voting permit. This unsatisfactory procedure is left unchanged by the revised bill. Moreover, this situation makes for

possible conflicts since conceivably the Comptroller might permit a holding company to acquire the stock of a national bank under the provisions of the revised draft and the Board, under existing law, might refuse to grant the holding company a permit to vote the stock in the national bank so acquired. It seems most important that the voting permit procedure be eliminated and that all of the requirements of the law, whether new or old, be made uniformly applicable to all bank holding companies.

Miscellaneous Subjects Not Covered. - In addition to the comments made above, it should be noted that the bill does not contain any provisions to restrict loans made to a bank holding company by a subsidiary nonmember insured bank; any provisions requiring a bank holding company to maintain a reserve of readily marketable assets where member banks are not involved; any provisions providing regulatory control by a supervisory agency over the charging of excessive management or service fees by holding companies against their subsidiary banks; or any provisions for registration of holding companies or the making of reports by them.