Marriner:

Here is copy of memo on Holding company affiliates you asked me for in connection with tax bill.

Gloyd.

Gloyd.

HOLDING COMPANY AFFILIATES OF BANKS

The restriction on or the prohibition of branch banking in many of the states resulted in the establishment prior to 1933 of a number of holding companies whose principal business was the holding of bank stock; the banks being located in the trade area of the principal bank of the group.

This type of banking became known as "group banking" as distinguished from "chain" and "branch" banking. The principal and larger holding companies were located in the Northwest and in the states of Florida, Georgia, Michigan, New York, Wisconsin and Utah. In most of these groups, all the capital stock of the banks except qualifying shares of directors are owned by the holding companies.

When Congress considered the proposed Banking Act of 1933, it first approached the problem of holding companies from a standpoint of their possible abolition but it found that as a practical matter, the best approach was one of control and it was also evident with the exception of the Michigan groups that the holding companies through their resources had kept the banks of the various groups in reasonably good shape and had been able to stabilize the situation during the depression. It was decided in view of the various factors that the logical way of handling the situation was to control these holding companies. Accordingly in the Banking Act of 1933, Congress defined holding company affiliates and provided that they could not vote their stock in member banks without first obtaining voting permits from the Board of Governors of the Federal Reserve System and that in obtaining such voting permits they must agree to certain conditions such as examination by the Comptroller of the Currency or the Federal Reserve banks and the rendering of reports as called for by the supervisory authorities and also provided:

> "(b) After five years after the enactment of the Banking Act of 1933, every such holding company affiliate (1) shall possess, and shall continue to possess during the life of such permit, free and clear of any lien, pledge, or hypothecation of any nature, readily marketable assets other than bank stock in an amount not less than 12 per centum of the aggregate par value of all bank stocks controlled by such holding company affiliate, which amount shall be increased by not less than 2 per centum per annum of such aggregate par value until such assets shall amount to 25 per centum of the aggregate par value of such bank stock; and (2) shall reinvest in

readily marketable assets other than bank stock all net earnings over and above 6 per centum per annum on the book value of its own shares outstanding until such assets shall amount to such 25 per centum of the aggregate par value of all bank stocks controlled by it;

"(c) Notwithstanding the foregoing provisions of this section, after five years after the enactment of the Banking Act of 1933, (1) any such holding company affiliate the shareholders or members of which shall be individually and severally liable in proportion to the number of shares of such holding company affiliate held by them respectively, in addition to amounts invested therein, for all statutory liability imposed on such holding company affiliate by reason of its control of shares of stock of banks, shall be required only to establish and maintain out of net earnings over and above 6 per centum per annum on the book value of its own shares outstanding a reserve of readily marketable assets in an amount of not less than 12 per centum of the aggregate par value of bank stocks controlled by it, and (2) the assets required by this section to be possessed by such holding company affiliate may be used by it for replacement of capital in banks affiliated with it and for losses incurred in such banks, but any deficiency in such assets resulting from such use shall be made up within such period as the Board of Governors of the Federal Reserve System may by regulation prescribe and the provisions of this subsection, instead of subsection (b), shall apply to all holding company affiliates with respect to any shares of bank stock owned or controlled by them as to which there is no statutory liability imposed upon the holders of such bank stock;"

Thus it will be seen from the above that the holding companies are required by Federal law to build up reserves of readily marketable assets and are limited to dividends of 6 per cent per annum while such readily marketable assets are below specified amounts and that it was intended by Congress that such reserves be used for three purposes; namely, (1) to replace capital in affiliated banks, (2) to pay losses incurred in such banks, and (3) to meet the individual liability imposed on any shares of stock held by it. Actual experience has shown that it has been necessary for these holding companies in many cases to save the banks in their various groups by putting funds into these banks, new capital, etc., taking out losses and in some cases where the assets of the holding company were practically exhausted through such method, the holding companies have borrowed either from the Reconstruction Finance Corporation or elsewhere to secure the necessary funds to maintain the banks of their group and thus protect their depositors.

Apart from the statutory requirements, these holding companies are also subject to requirements as laid down by the Board of Governors of

the Federal Reserve System through the medium of their regulations and agreements in connection with voting permits as required under the "Banking Act of 1933," of which about 50 such permits have been issued. In addition, some of the holding companies have entered into agreements as to reserves with the Reconstruction Finance Corporation.

It would seem, therefore, that it would be necessary to make some provision in the proposed tax bill to take care of this situation.

It is, therefore, suggested that the following would take care of the situation:

"That such part of the net income of any 'holding company affiliate' of a member bank of the Federal Reserve System as defined by Section 2 of the Banking Act of 1933 (U.S.C. Title 12, Section 221a) shall be treated as distributed income, (1) which such affiliate retains and invests in readily marketable assets in compliance with, or in anticipation of compliance with, the provisions of Section 5144 of the Revised Statutes (U.S.C. Title 12, Section 61) or (2) which such affiliate under the advice of the Board of Governors of the Federal Reserve System, the Comptroller of the Currency or the Federal Deposit Insurance Corporation, so invests, retains, or contributes towards the strengthening of the capital structure of any affiliated bank, or (3) which such affiliate retains as required by agreement with the Reconstruction Finance Corporation restricting the dividends of such affiliate."

(Note: The words "or in anticipation of compliance with" are important, because Congress in the Banking Act of 1933 provided that the reserve should be 12 per centum at the end of 5 years from the enactment of that Act, intending that the holding companies should build up to the required figure during that period.)