

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

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For immediate release

STATEMENT OF CHAIRMAN ECCLES
BEFORE
SENATE BANKING AND CURRENCY COMMITTEE ON S. 829

Mr. Chairman and Members of the Committee:

The purpose of this bill (S. 829) is to regulate bank holding companies so that their operations will be in accordance with established banking principles and public policy.

This bill reflects the Federal Reserve System's experience over a period of approximately fourteen years in dealing with bank holding company problems. Since its introduction it has been studied and appraised by various interested banking groups. With suggested technical amendments and others, all of which are acceptable to the Reserve Board and none of which would affect its basic purposes, the bill conforms to recommendations made in reports by the Federal Advisory Council of the Federal Reserve System and by the Association of Reserve City Bankers. In addition, it has the support of the Independent Bankers Association of the Twelfth Federal Reserve District and of the great majority of the major bank holding companies.

The bank holding company problem is not a new one to the Congress. In 1933, after extensive hearings which began in 1930, Congress recognized the need for and undertook to provide effective regulation of bank holding companies. As a part of the Banking Act of 1933, Section 5144 of the Revised Statutes was amended by adding several new paragraphs applying exclusively to bank holding companies (called "holding company affiliates" in the amendment) and placing limitations and restrictions upon the right of such companies to vote the stock of member banks which they owned. Prior to 1933, this section merely defined the rights of stockholders of national banks to vote their stock in such banks.

As amended, and as it now stands, this section provides that a holding company, before it may vote its stock of a member bank, must first obtain a permit to do so from the Federal Reserve Board. The Board, in turn, is authorized in its discretion to grant or deny such a permit. As a condition to the granting of the permit the holding company is required, on behalf of itself and its controlled banks, to agree to submit to examinations, to establish certain reserves, to agree to dispose of all interest in securities companies, and its officers, directors and agents are subject to the same penalties for falsification of records as those applicable in the case of national banks.

Congress presumably felt that these amendments would be adequate to insure effective regulation. The Board's experience in administering those provisions, however, has demonstrated clearly the need for additional legislation if regulation is to be effective in correcting and preventing practices which are contrary to public policy and interest.

PRESENT LAW IS ENTIRELY VOLUNTARY

No one would suggest that in amending Section 5144 in 1933, Congress intended to bring some bank holding companies under regulation and to leave others, even though meeting the same definitions, free from regulation. Yet that is what the law now permits because it is based solely upon the voting permit. A holding company becomes subject to the law only if a voting permit is issued. But there is no mandatory requirement in the law that a holding company obtain such a permit. Undoubtedly it was believed that all would do so. All have not done so, however, because as a practical matter holding companies can in many instances control the operations of banks without the need for voting their shares in such banks. In one instance disclosed by the Board's files a holding company owns a controlling stock interest in 24 member banks, yet has obtained voting permits covering only 2 of these banks.

Whenever the Board receives an application for a voting permit, it makes a thorough examination of the holding company and its affiliates to determine what corrections, if any, are necessary to meet basic standards. If such corrections appear necessary, they are made a condition to the granting of the voting permit. In one important case, however, when advised of the need for such corrections, the applying company simply abandoned its application for a voting permit. It was able to control its banks without voting the shares which it owns in these banks, and thus was able to escape such regulation as existing law provided.

Clearly the law should apply to all bank holding companies alike. This cannot be accomplished by a law which permits a holding company to elect not to subject itself to regulation. The law must be mandatory to be effective. The proposed bill provides that all bank holding companies meeting the prescribed definition shall register with the Board and, having registered, shall be automatically subject to all of the regulatory provisions of the statute.

PRESENT DEFINITION OF HOLDING COMPANY INADEQUATE

Not only does the present law fail to reach those companies which elect not to apply for a voting permit, but it also fails to reach others because of inadequacies in the definition of a "holding company affiliate." The present definition embraces only those holding companies which control member banks. This excludes from any regulation those companies which operate in all respects as bank holding companies, but which control only nonmember banks, even though, as is frequently the case, the latter include insured banks. There are a number of companies in this category which operate numerous banking offices having substantial amounts of deposits.

Another and more important defect is in that portion of the present definition which defines a bank holding company as any company "which owns or controls, directly or indirectly, either a majority of the shares of capital stock of a member bank or more than 50 per centum of the number of shares voted for the election of directors of any one bank at the preceding election, * * *."

The purpose underlying this definition is to reach those companies which control the management and policies of banks, and with this basic premise the Board is in entire agreement. However, it has long been recognized by Congress and by the courts that effective control of one company by another does not depend upon the ownership or control of a majority of the voting shares. Control can be, and often is, exercised through the ownership of a much smaller proportion of the total shares outstanding. Sometimes it is maintained without the ownership of any shares.

Similarly, the number of shares owned or controlled, as compared with the number of shares voted for the election of directors at the preceding election is an unsatisfactory basis for determining whether a holding company relationship exists. Such a restricted test puts it within the power of the holding company to establish an absence of control when, in fact, it is at the same time exercising most effective control. The case in which regulation is most necessary is usually the case in which the attempt is made to take advantage of the existing definition to escape regulation.

The definition of a bank holding company in S. 829 conforms more nearly to the practical realities of intercorporate relationships. It is derived in large part from the definition of a holding company adopted by Congress when it enacted the Public Utility Holding Company Act of 1935. The first part of the definition extends automatic coverage to all companies which own 15 per cent or more of the voting shares of two or more banks. However, even though a company may own more than 15 per cent but less than a majority of such shares, if it can demonstrate that it does not exercise a controlling influence over the management and policies of its banks, it would not be subjected to regulation under the Act. The second part of the definition permits the Board to declare a company to be a bank holding company even though it owns less than 15 per cent, or possibly none, of the shares of two or more banks, provided the Board finds, after hearing, that the company does in fact control such banks.

The Board believes that this definition is practical and just. All companies owning the specified number of shares are affected alike. Each has a ready procedure at hand for escaping regulation by demonstrating that it does not control the management and policies of two or more banks. In the clear cases (such, for example, as insurance companies which own bank shares purely for investment purposes) absence of control may be easily demonstrated without hardship. In the close cases, the burden of proof would be upon the company to show that it is not in fact exerting the kind of influences upon banks which require that it be subjected to regulation.

REGULATORY ASPECTS

Turning now to the regulatory aspects of the problem, under the present law the only provision which implies a degree of administrative supervision relates to such examinations "as shall be necessary to disclose fully the relations between" the holding company and its controlled banks, and the further provision that for violation of the statute or of its agreement with the Board, the holding company's voting permit may be revoked. In that event, certain penalties affecting the banks in the holding company system may be applied.

These provisions, particularly when considered in the light of the voluntary aspects of the existing law, fall far short of providing effective regulation. In the first place, the Board's right to examine a holding company and its controlled banks is not coupled with the specific power to require corrections. Furthermore, the penalties for violations of the statute or of a holding company's agreement with the Board are directed primarily at the banks in the holding company group and not at the holding company itself.

The existing law contains no declaration of Congressional policy upon matters which vitally affect the entire problem. The Board feels that bank holding company legislation should include as many specific declarations of Congressional purpose as possible, and that, where the exercise of administrative discretion must of necessity be called into play, the legislative standards for the exercise of such discretion should be clearly stated. The provisions of S. 829 are designed to give effect to these principles.

NONBANKING ACTIVITIES OF BANK HOLDING COMPANIES

One of the most salutary requirements of S. 829 is that contained in Section 5, which would require that the activities of bank holding companies be limited solely to the business of banking or of managing and controlling subsidiary banks. To that end a holding company would be required within a stated period to divest itself of any securities except those in companies which are necessary and incidental to its banking operations, or which are eligible for investment by national banks.

The reasons underlying this requirement are simple. Accepted rules of law confine the business of banks to banking and prohibit them for engaging in extraneous businesses such as owning and operating industrial and manufacturing concerns. It is axiomatic that the lender and borrower or potential borrower should not be dominated or controlled by the same management. In one exceptional situation, however, the corporate device has been used to gather under one management many different and varied enterprises wholly unrelated to the conduct of a banking business.

When a bank holding company has expanded its operations into other and unrelated fields, it tends more and more to take on the characteristics of the type of institution to which the Investment Company Act of 1940 was addressed. Yet such a company, if it holds a voting permit from the Board, is exempted from the provisions of the Investment Company Act. It is necessary, in keeping with sound banking principles, that such a company should be required by law to adjust its affairs so as to become either a bank holding company or an investment company. It should not be permitted to remain a hybrid beyond a period reasonably necessary for it to adjust its affairs.

Section 5 would make it unlawful after two years, or longer if the Board deemed necessary to avoid undue hardship, for a bank holding company to own the securities of any company other than a bank or to engage in any business other than that of banking or managing and controlling banks. Exceptions are made in favor of those companies which are reasonably incidental to the business of banking, such as safety deposit companies and the like, and a bank holding

company may lawfully acquire securities from its banks when requested to do so by any Federal or State examining authorities. In addition, under an amendment which has been suggested to and approved by the Board, the holding company would also be permitted to acquire such securities as are eligible for investment by member banks.

BANK HOLDING COMPANY EXPANSION

The problem of how far bank holding company systems should be permitted to expand has long been of serious concern. There is perhaps a greater need for a positive declaration of Congressional policy on this question than on any other phase of the holding company problem. It is in this area that one of the greatest potential evils of bank holding company operations exists. That evil, which permits a holding company without legal hindrance to dominate major portions of the banking facilities of particular sections, is one which strikes at the heart of our traditional system of competitive banking.

Under existing law a chartered bank may be prevented by the regulatory agency to which it is subject from expanding its banking offices either by the establishment of new branches or by taking over and operating the offices of other banks. In order to establish branches, national banks must first obtain permission from the Comptroller of the Currency, State member banks from the Board, and nonmember insured banks from the FDIC. But the bank holding company is not subject to any such requirements. If a bank in its group is denied the right to establish an additional office, there is nothing to prevent it from acquiring the stock of an existing bank and simply adding the institution to its list of controlled banks, operating it, for all practical purposes, as a branch of the entire system.

This loophole, enabling a bank holding company to expand at its pleasure, lends itself readily to the amassing of vast resources obtained largely from the public, which can be controlled and used by the relatively few who comprise the management of the holding company, giving them an unfair and overwhelming advantage in acquiring additional properties and in carrying out an unlimited program of expansion. Such power can be used to acquire independent banks by measures which leave the local management and minority stockholders little with which to defend themselves except their own strenuous protests.

While the managements of the great majority of the important bank holding company systems have sought the Board's views, if not its approval, on proposed bank acquisitions, there is one case where a holding company management has openly defied the Board in its attempt to halt an unbridled bank expansion program. I refer to Transamerica Corporation, with its vast group of controlled banks in Arizona, California, Nevada, Oregon and Washington. The Transamerica management has publicly sought to justify itself on the ground that Congress, by withholding from the Board the direct power to curb such expansion, has thereby indicated its approval of Transamerica policies.

It may be interesting to the members of the Committee to have the latest figures on the size of the Transamerica banking empire. As of December 31, 1946, information available to the Board indicates that there are 41 banks in the Transamerica group, operating a total of 619 banking offices having aggregate deposits in excess of six and one-half billion dollars. This represents more than 40 per cent of all the banking offices and 38 per cent of all of the

commercial deposits in the five-State area. Since 1934 the Transamerica group has acquired a total of 126 banks, which have been operated either as separate units or have been absorbed by the banks in the group. In addition, 74 new branches have been established over this period. On December 31, 1933, this group served 242 towns; as of December 31, 1946, this number had been increased to 379. These figures relate only to Transamerica's banking operations. In addition, it owns and operates many other types of business with aggregate resources of more than \$275,000,000.

Section 6 of S. 829 would make it impossible for this or any other holding company system, to reach out and absorb more and more banks without first obtaining the approval of some agency of the Federal Government. Under this section any direct purchase of the stock or assets of banks by a bank holding company would have to be approved by the Board. If one of the banks in a holding company group wished to acquire the assets of a bank, the acquiring bank, if a national bank, would have to secure the approval of the Comptroller; if a State member bank, it would have to obtain approval by the Board; if a non-member bank, it would have to obtain the approval of the FDIC.

The proposed bill also enumerates the standards which would guide the banking agencies in deciding whether to approve such acquisitions. First, they would have to consider the financial history and condition of the applicant and the banks concerned; their prospects; character of management; and the needs of the communities involved. These are the considerations which are today the legislative guide for administrative action in such matters as the admission of State banks to membership in the Federal Reserve System and the granting of deposit insurance coverage. Next, they would take into consideration national policy against restraints of trade and commerce and the undue concentration of economic power. This would give effect to the anti-monopoly objectives stated in the Sherman and Clayton Acts. Finally, under an amendment suggested by the Federal Advisory Council and the Reserve City Bankers, they would consider whether an acquisition, regardless of its competitive effect, would extend the operations of a holding company beyond limits consistent with adequate and sound banking.

The Board believes that these standards would furnish an adequate guide for administrative action. Much consideration was given to various proposals on the subject, including the fixing of rigid, even mathematical, formulas governing expansion, but the Board concluded that such definitions would make the section difficult to enforce from an administrative standpoint, and, as indicated by representatives of the Justice Department, might conflict with existing governmental policy respecting the antitrust statutes. Under the Board's proposals, each case would stand on its own merits, considered in the light of standards which are deeply rooted in American traditions.

REMAINING PROVISIONS

The remaining regulatory provisions of S. 829 require little discussion. The bank holding company would be required to register with the Board and to file periodic reports. It would be subject to examination as are each of its subsidiaries. Existing provisions of law respecting the maintenance of reserves by bank holding companies would be carried over and made a part of the proposed new law. Upstream loans between a bank and its holding company would

be regulated, as well as loans involving the securities of the holding company and its other subsidiaries. The Board would be authorized to scrutinize the terms of any management or service contracts between a holding company and its banks. Finally, the Board would be authorized to make such rules, regulations, and orders as might be necessary to enable it to administer and carry out the purposes of the Act.

The proposed legislation for the first time to my knowledge in any Federal banking statute contains a provision granting a statutory right of judicial review to any one aggrieved by any action of the Board taken under any of the various regulatory provisions of the bill. This provision should help to crystallize at an early date the precise boundaries of Board authority under those sections involving the application of administrative discretion.