Statement on

H. R. 2747, H. R. 2856, H. R. 4004, and H. R. 1539
Bank Holding Company Matters

Presented to

Subcommittee on Financial Institutions Supervision,
Regulation and Insurance

of the

House Committee on Banking, Finance and Urban Affairs

House of Representatives

by

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Time is short in this session of Congress and the issues raised by these four bills are complicated and difficult. The FDIC, in consultation with other regulators, is in the very preliminary stages of exploring two additional major issues which we feel should be considered with any bank holding company legislation.

First is the question of restructuring the supervision of bank holding companies so that the supervisor of the lead bank can coordinate the examination and other supervisory functions of all segments of the holding company. Second is the question of permitting out-of-State acquisition of troubled or failed banks in specific, narrowly defined situations.

Since enactment of the pending legislation does not appear to be a matter of urgency for this year, we recommend that the agencies be allowed more time to explore these major related areas before bank holding company legislation is put into final form by your Committee.

Now I would like to briefly review the bills before this Subcommittee, H. R. 2747, H. R. 2856, H. R. 4004, and H. R. 1539 relating to bank holding company matters.

H. R. 2747 would --

(1) prohibit any acquisition which would give a bank holding company the control of 20 percent or more of the banking assets in a particular State;

(2) prevent the Federal Reserve from disapproving the formation of a bank holding company where the primary supervisor has approved the transaction, including the character

of the proposed management and adequacy of the bank's capital, or where a bank stock loan is involved if it was made on nonpreferential terms;

(3) prohibit bank holding companies from --

(a) engaging in insurance activities (with certain exceptions),

(b) underwriting or selling securities (again with certain very limited exceptions),

(c) sponsoring or providing investment advice to any collective investment fund,

(d) issuing, directly or through a subsidiary, any type of investment instrument bearing interest at a rate higher than that permissible for commercial banks under Regulation Q,

(e) engaging in real estate brokerage, management, appraisal, or similar types of activities, and

(f) engaging in the business of leasing motor vehicles;

(4) prohibit a subsidiary bank of a holding company located in another State from merging with any other bank in such bank's home State; and

(5) prohibit national banks from engaging, directly or indirectly, in any type of activity not permissible for bank holding companies.

H. R. 2856 is similar to H. R. 2747, but differs from it in the following respects:

(1) it applies the 20 percent cap on Statewide banking assets to bank mergers, as well as holding company acquisitions;

(2) instead of requiring the Federal Reserve to approve formation of a bank holding company approved by the primary supervisor, this bill would specifically authorize the appropriate Federal regulator to disapprove a bank merger or holding company acquisition on competitive grounds even though it would not violate antitrust laws or the bill's 20 percent cap on Statewide concentration;

(3) the only specific prohibition on bank holding company activities in H. R. 2856 is that relating to insurance activities;

(4) H. R. 2856 does not contain the prohibition in H. R. 2747 banning mergers by out-of-State bank subsidiaries of bank holding companies.

H. R. 4004 consists solely of a provision of the type contained in H. R. 2747 which would prevent the Federal Reserve from disapproving formation of a bank holding company where the primary supervisor has approved the transaction, including the proposed management and adequacy of the capital of the bank involved, or solely because the transaction involves a bank stock loan having a term of 25 years or less.

H. R. 1539 would allow banks to underwrite revenue bonds. It would amend paragraph Seven of Section 5136 of the Revised Statutes (12 U.S.C. 24) to permit commercial banks to underwrite and deal in revenue bonds issued by State and local governments if such bonds could be purchased as an

investment by a national bank. We note that this would have the opposite effect of a provision in H. R. 2747 which would prohibit bank and bank holding company underwriting of revenue bonds with limited exceptions. In this connection, the bill would impose the following restrictions on such dealing and underwriting.

(1) A bank's aggregate holding of the revenue bonds of any one maker or obligor, including such bonds held as a result of underwriting, dealing or purchasing from its own account, would be limited to 10 percent of the bank's capital and surplus.

(2) A bank acting as fiduciary would be prohibited from buying revenue bonds for its trust accounts from the bank acting as underwriter or dealer unless directed by court order.

(3) A bank as fiduciary would be similarly prohibited from purchasing revenue bonds for its trust accounts from other members of a syndicate underwriting such bonds if the bank is participating therein, until the syndicate has closed.

(4) A statement disclosing the fact that the bank is acting as an underwriter or dealer would be required in conjunction with any sales of revenue bonds by a bank to its depositors, borrowers or correspondent banks.

(5) A bank would generally be restricted during the underwriting period from purchasing for its own investment account revenue bonds which it or an "affiliate" purchased as an underwriter. However, this restriction would not apply

in cases where the bank was the sole underwriter or where it purchased revenue bonds directly from the underwriting syndicate or from other members of the syndicate.

(6) Banks would not be authorized to underwrite industrial revenue bonds payable solely from rental payments of private entities.

(7) The bill would require the Secretary of the Treasury to submit to Congress annual reports on the distribution of underwriting business in the revenue bond market between commercial banks and investment banking firms.

While the restrictions on underwriting and dealing in securities in the paragraph of the Revised Statutes that would be amended by H. R. 1539 refer only to national banks, the effect of section 21(a)(1) of the Banking Act of 1933 is to apply these provisions to all State-chartered banks as well. Thus, H. R. 1539 would have the effect of permitting national banks and State banks, insofar as Federal law is concerned, to underwrite and deal in revenue bonds.

MAJOR ISSUES

Basically, these bills involve the following major issues: (1) establishing a list of prohibited bank holding company activities, (2) imposing a 20-percent limit on bank holding company control of bank assets in a State, (3) limiting the authority of the Federal Reserve to disapprove formation of a one-bank holding company where the primary supervisor has approved the transaction, (4) expanding the so-called Douglas Amendment to the Bank Holding Company Act of 1956 to prohibit mergers

by banks controlled by an out-of-State bank holding company, (5) permitting banks to underwrite revenue bonds, and (6) reorganizing the structure of bank and bank holding company regulation. I shall discuss each of these issues separately.

LIST OF PROHIBITED ACTIVITIES

H. R. 2747 would reverse the policy of the Bank Holding Company Act by enacting a negative laundry list prohibiting bank holding companies from engaging in specific activities. This approach was the subject of extensive congressional deliberations when the Bank Holding Company Act Amendments of 1970 were under consideration. Instead, however, the Congress at that time opted for granting the Federal Reserve discretion to determine what bank holding company activities should be permitted. We believe this discretionary approach has worked reasonably well.

20 PERCENT LIMIT

The 20 percent cap on Statewide expansion of bank holding companies imposed by H. R. 2747 and H. R. 2856 could also have severe anticompetitive results. Such a limitation would not in our view make a meaningful contribution toward keeping the concentration of banking within bounds that are compatible with the maintenance of competitive banking markets. The limitation, at least on its face, would permit five firms to hold all of the banking assets in a particular State, with one such firm holding an absolute monopoly of banking assets in a particular local banking market within the State -- thus potentially resulting in a group of five linked oligopolies

blanketing the State.

Furthermore, if you set a ceiling, it tends to become the floor.

LIMITS ON AUTHORITY TO DISAPPROVE BANK HOLDING COMPANY APPLICATIONS

The provision in H.R 2856 and H. R. 4004 requiring the Federal Reserve to approve the formation of a bank holding company where the primary supervisor has approved a transaction and preventing the Federal Reserve from disapproving such a transaction solely on the grounds that a bank stock loan was involved would in our opinion be contrary to the basic purpose of the Bank Holding Company Act, which was to give the Federal Reserve primary jurisdiction to approve or disapprove the formation of bank holding companies. In our judgment, in the context of current law the Federal Reserve should have full authority to take into account all relevant aspects of a proposal to form a bank holding company. It should not be precluded from denying such application solely because another regulatory agency may have come to a somewhat different conclusion with respect to one aspect of the overall proposal.

EXPANDING DOUGLAS AMENDMENT PROHIBITION

The so-called Douglas Amendment to the Bank Holding Company Act of 1956 prohibits interstate expansion of bank holding companies except with the specific statutory sanction of State law. An exception to this prohibition, however, permits out-of-State bank subsidiaries of a bank holding company

which were in existence when the Bank Holding Company Act was enacted to expand by merger with other banks in the State where such banks are located. A provision in H. R. 2747 would prohibit further mergers of this type. We oppose this result because it would place banks affiliated with out-of-State holding companies at a serious competitive disadvantage vis-a-vis other banks in the States where they operate. In our view, this is a carefully considered exception to the Douglas Amendment prohibition which has not produced serious inequities during the 23 years it has been in effect and which should not be lightly stricken from the Bank Holding Company Act without very careful study.

As you know, the Administration's McFadden Study which is expected to be reported to Congress next month includes an examination of the Douglas amendment.

REORGANIZATION OF BANK AND BANK HOLDING COMPANY SUPERVISION

H. R. 2747 and H. R. 2856 contain at least two provisions which could have very fundamental effects on the structure of banking regulation at the Federal level. One such provision would prohibit national banks from engaging, directly or indirectly, in any type of activity not permissible for bank holding companies. The other such provision appears to give the Federal Reserve authority to determine capital adequacy for all subsidiaries of a bank holding company, including bank subsidiaries under the primary jurisdiction of another Federal regulator.

We believe that reorganization of the Federal bank regulatory structure is an issue which deserves very careful congressional scrutiny and is too significant to be dealt with in an indirect, piecemeal fashion.

We have testified extensively on the restructuring issue. For example, in our testimony last February 28 on S. 332, the "Consolidated Banking Regulation Act of 1979," we underscored the inadequacies of the present system for regulating bank holding companies in which supervision is divided among as many as four agencies. This system has contributed to some of our largest bank failures. Both the Comptroller of the Currency and the FDIC have repeatedly asked for the reform of holding company regulation.

In our February testimony on S. 332, we recommended that the supervisor of the lead bank (or the sole bank, in the case of a one-bank holding company) be assigned the supervision of the holding company itself and its non-bank affiliates and that the lead supervisor be authorized to coordinate the examination of non-lead-bank affiliates by their respective supervisors. This arrangement would mean that the entire system would be examined and monitored as a single unit, but each bank would be reviewed by its primary regulator. The Federal Reserve would retain its present role of determining permissible activities for bank holding companies and the responsibility for approving holding company formations and acquisitions.

In accordance with our earlier testimony, therefore, we would oppose any statutory changes of the type contained in H. R. 2747 and H. R. 2856 which could serve only to further complicate the existing regulatory structure for bank holding companies. Instead, if this issue is to be retained as part of this proposed legislation, we would recommend a step in the direction of consolidating bank holding company regulation along the lines outlined above.

UNDERWRITING OF REVENUE BONDS

The Glass-Steagall Act was designed to separate commercial banking from investment banking. An exception was made to permit commercial banks to underwrite U. S. Government bonds and general obligation bonds of State and local governments. At the time, revenue bonds were rarely used as instruments of municipal finance. Since 1933, municipalities have used revenue bonds more and more as a source of funds.

The FDIC is concerned about the safety and soundness risks of banks getting into this new area. Given current economic uncertainties and the lack of urgency to act on this matter, the agency would urge Congress to postpone action on the legislation this year.

Since the Congress is already taking a comprehensive look at the Glass-Steagall Act, the FDIC believes that underwriting of revenue bonds should be included for study under the broader issues of what constitute appropriate securities activities for banks.

CONCLUSION

We hope that our thoughts on the major issues involved in these pending bills will be of use to your Subcommittee in its continuing consideration of these matters. If we can be of any further assistance in providing more specific comments on any particular aspect of this proposed legislation, please do not hesitate to let us know.