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Statement of C. Canby Balderston,

Vice Chairman,

Board of Governors of the Federal Reserve System,

before the

Subcommittee on Domestic Finance

of the

Committee on Banking and Currency,

House of Representatives,

June 3, 1965,

on H. R. 7372.

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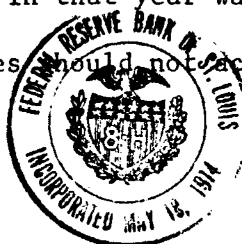
Until the end of the first World War, the American commercial banking system consisted of many thousands of separate institutions, each operating in a single location. Since that time, one of the most striking developments has been the growth of banking institutions with multiple offices. The structure of these corporate types of banking may take either of two forms: branch banking, in which a single bank operates a number of offices; or so-called "group banking," in which a corporation controls a number of banks, usually through ownership of their stock.

Branch banking has long been subject to Governmental supervision and regulation. In many states no bank is permitted to have a branch. In the states where branches are permitted, approval of the supervisory authorities must first be obtained before a new branch may be established; in many of these states branching is permitted only within limited geographical areas. No bank may establish a branch outside the state where it has its head office.

Until 1956, a very different situation existed with respect to group banking. Corporate holding companies could and did gain control of many banks, regardless of location, relatively free from Governmental restraint under either the antitrust laws or the holding company affiliate provisions of the Banking Act of 1933. In 1956, after almost two decades of consideration, Congress concluded that the public interest required more effective regulation of bank holding companies. The Bank Holding Company Act enacted in that year was based on two major principles: first, that holding companies should not acquire additional banks except



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with prior Governmental approval, and second, that bank holding companies should not engage also in nonbanking businesses.

Accordingly, the law enacted in 1956 was entitled "An Act To define bank holding companies, control their future expansion, and require divestment of their nonbanking interests." Holding companies then in existence were required to dispose of their ownership of nonbanking businesses and to secure from the Board of Governors of the Federal Reserve System approval to establish additional banks or to acquire the stock of existing ones. In addition, the law itself prohibited a bank holding company from establishing or acquiring banking facilities beyond the boundaries of its own state unless specifically authorized by state statute.

It will be noted that the title of the statute mentioned not only its two major purposes, but stated also that it was an Act "To define bank holding companies". The basic definition of a bank holding company is a corporation that "directly or indirectly owns 25 per centum or more of the voting shares of each of two or more banks". However, this definition, like other provisions of the law, was riddled by special exemptions - no less than six - which made the statute totally inapplicable in a number of cases. In fact, when President Eisenhower signed the Act, he pointed out that "as a result of various exemptions and other special provisions the legislation falls short of achieving [its] objectives", and he warned that "The exemptions and other special provisions will require the further attention of the Congress".

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The bill now before this Committee, H. R. 7372, is designed to eliminate the most objectionable and least defensible of the six special exemptions contained in the Holding Company Act. Briefly stated, this exemption makes that Act inapplicable to any company that was registered prior to May 15, 1955 under an entirely separate statute, the Investment Company Act of 1940, or to any company that is affiliated with such a registered investment company, unless the investment company or its affiliate owns directly 25 per cent or more of the shares of each of two or more banks.

The exemption was presumably based on the erroneous assumption that a company registered under the Investment Company Act is subject to such supervision and regulation under that Act as to make its regulation under the Holding Company Act unnecessary. Actually, of course, the purposes of the two Acts are entirely different. The Investment Company Act is aimed primarily at protecting investors. It does not achieve the principal objectives of the Holding Company Act, namely, to regulate the control of banks by a holding company, and to require that the control of banking and nonbanking enterprises be kept separate. There is simply no plausible reason why a company should be exempted from the Holding Company Act of 1956 merely because it is registered under the Investment Company Act of 1940, or is affiliated with a registered investment company.

The Board of Governors has consistently recommended repeal of this exemption. The first such recommendation was made by the Board in its 1958 Special Report to the Congress as required by the

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Holding Company Act; and the recommendation has been reiterated in each subsequent Annual Report.

As far as the Board knows, one corporation only, Financial General, enjoys this exemption. It has been operating as a bank holding company without being subject to the Act. It holds a majority interest in 19 banks in Georgia, Maryland, New York, Virginia, and Washington, D.C., 25 per cent or more of the stock of two banks in Tennessee and Maryland, and 14 to 20 per cent of the stock of five banks in Illinois, Virginia, and Tennessee. Of the 26 banks in the group, 17 have been acquired since enactment of the Holding Company Act. These 26 banks have deposits aggregating over $1 billion, whereas at the end of 1955, the deposits of the Financial General banks totalled about $365 million.

If this company had been subject to the Holding Company Act, it would have been required to obtain the Board's prior approval for each bank stock acquisition since 1956. In addition, it would have been required to divest itself of its interests in a number of organizations engaged in nonbanking businesses, including firms engaged in life insurance, fire and casualty insurance, industrial and manufacturing activities, lease financing, and mortgage banking.

Because of this company's exemption, it has been able to cross state lines and to acquire banks in a number of different states, as well as in the District of Columbia. As you know, the Bank Holding Company Act absolutely prohibits a holding company from acquiring banks in any state other than that in which it conducts its principal operations, unless the laws of such other state specifically and expressly authorize such acquisition.

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Although Financial General alone has so far taken advantage of the investment company exemption, other companies could utilize this exemption in order to evade regulation under the Holding Company Act. Any corporation could become exempt by acquiring a mere 5 per cent of the stock of an investment company registered prior to May 15, 1955. Such a corporation would become "affiliated" with the registered investment company and therefore would fall within the special exemption in the Holding Company Act as long as it did not own directly 25 per cent or more of the stock of two or more banks.

For the reasons stated, it is the Board's opinion that companies registered under the Investment Company Act or their affiliated companies should be treated exactly like other bank holding companies if they control two or more banks, whether directly or indirectly. Accordingly, the Board strongly favors the enactment of H. R. 7372.

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