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MULTI-BANK HOLDING COMPANIES--DICTATOR OR SERVANT TO THE PUBLIC INTEREST

Remarks of

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of the

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at the

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Multi-Bank Holding Companies--Dictator or Servant to the Public Interest

In developing my talk to you today, I recognized that many of you are philosophically attuned to and have membership in the Independent Bankers Association. Presumably, this means that you have a strong interest in maintaining independent ownership of banking institutions throughout the United States. I have a strong interest in that same idea though at a less comprehensive level. But I suspect that you view me more as the defender of large banks and bank holding companies. Let us see if we can blend our interests to find a common ground. Of course I speak only for myself, not the Board or any other of my associates in the Federal Reserve System.

I hope to persuade you that the Federal Reserve has no intention of concentrating bank ownership to the point of monopoly control for any banking market, and that the Federal Reserve is handling the regulation of multi-bank holding companies in a responsible and effective manner. Similarly, I hope to persuade you that there is a reasonable consensus which can be reached between those who favor multi-bank holding companies and those who are primarily interested in independent bank ownership. Further, it is my hope to obtain some recognition from you that the holding company device is a means of achieving greater competition in a sheltered and restricted-entry industry, and that holding companies can increase the credit facilities for the people of this nation and through competition provide banking facilities in a broader form and perhaps at a lower cost.

I think that you will agree that some members of the banking industry have fallen short of the desired target of full service to their communities, especially the vibrantly growing sectors, and that in some banking markets competition is not a driving force.

For my part, I can freely recognize that affiliation with a multi-bank holding company is probably not the best route for all financial institutions. As a matter of fact, only 15 per cent of all banks are presently affiliated. Furthermore, I recognize that small consumer-oriented retail banks are the least likely to join multi-bank holding companies and that, especially in the suburban metropolitan areas, the continued presence of independent banks is a strong innovative and procompetitive force.

Having laid out for you my aims for this speech, let us quickly review the purposes of the Holding Company Act as amended in 1970. It will be recalled that the basic holding company legislation of 1956 did not regulate the one-bank holding company and consequently one of the specific aims of the 1970 amendments was to close that loophole of nonregulation. It was clear that the loophole had to be closed because, in the late 1960's, many large banks began to form one-bank holding companies, and some expanded their operations sharply.

Additionally, the law was amended to permit holding company entry into a substantially greater range of non-bank activities. But the range of such activities was limited by requiring that the activity must be closely related to banking and that performance of the activity by bank holding companies must be in the public interest.

This background of purpose helps explain the large number of one-bank holding companies in existence today, but why have we continued to see the expansion of the multi-bank holding company structure? There are at least three basic reasons. First, the aggregate capital of a holding company can be used to better serve the community. Laws which limit the amount of credit extended to a single borrower are mainly based upon the capital and surplus of the particular institution. Through efficient participations of overlines, the multi-bank holding company can, in effect, aggregate the capital and surplus of its banks, and thus can achieve a greater lending limit to serve the growing industries of the community. I should note here that this function is also performed through the correspondent banking system, which has served our economy well. There are certain frictions inherent in this system, however, that are not inherent in the holding company system.

The second reason for multi-bank holding company formation is structural because in states where branching is prohibited or limited, the holding company device serves as a substitute for branching. Admittedly, there are major problems in using holding company subsidiaries as substitutes for branching. Of course, legal and regulatory restrictions are usually greater for a bank than for a branch. Flow of funds restrictions, for example, would be greater between banks in a holding company than between branches in a bank; loan restrictions for the bank would be greater; and the initial capital requirement would ordinarily be higher for the bank. In addition, banks are much more difficult to open and close than are branches. With all of the panoply of a unit bank--a charter, a board of directors, individual capitalization and a variety of other limitations--opening or closing a bank is costly in terms of both time and money. Primarily because of these factors, furthermore, the psychological impact on the community of closing a bank is ordinarily high compared with closing a branch; and thus the cost to the public image of the banking organization is higher. But for the expansion-minded bank in a unit-banking state, faced with limited growth at one location, the multi-bank holding company device can be an attractive alternative.

A third reason for holding company affiliation has been the favorable tax treatments. Not only can bank owners trade their shares in for the shares of the multi-bank holding company and defer tax liabilities, but the holding company benefits from savings associated with filing consolidated tax returns. Subsumed in this argument is of course the ability of owners of the shares of small banks to achieve a more marketable stock through exchange for the more widely held multi-bank holding company shares.

With these and other basic reasons for a holding company affiliation, a large number of banks have moved into holding company status, many of them during the past four and a half years since the amendment to the Bank Holding Company Act. In the early phases of this new law the Federal Reserve,being assigned to the job of administration, had a set of conditions to clarify before the full impact of the Act could be achieved. For example, in some states there was an initial restructuring of ownership already in place. Owners of large chains of banks found it possible to move some of these banks into multi-bank ownership status. Similarly, for very large banks with partially-owned affiliates, there was an immediate effort to restructure ownership and bring these affiliates into full holding company subsidiary status. Such efforts were limited, however, and divestiture of some affiliates was required where competing positions were in evidence. For a number of major banks converting into multi-bank holding company status, there were affiliates who competed between themselves and whose aggregation into a single multi-bank holding company would have given that holding company an unreasonably large position in a single market. In those instances, a very sharply reduced level of holding company subsidiaries were permitted from the former affiliates.

Another area of administrative problems related to divestiture of bank holding company ownership of impermissible assets. For example, some bank holding companies owned shopping centers, oil wells, manufacturing companies, and a variety of other non-banking concerns. Some of the bank holding companies were required, or will be required, to divest such concerns. Similarly, divestiture agreements were sought where the basic holding company itself was in a non-banking field and did not wish to convert to a bank holding company.

Finally, in the early administration, the Federal Reserve was required to review the potential bank-related lines of activity in which bank holding companies might be allowed to engage. Such bank related lines were established usually after public hearings. For the Board and for the Federal Reserve staff, these reviews necessitated substantial educational efforts as we attempted to assimilate and digest large quantities of new information. In those activities determined to be permissible, we also had to struggle with a number of analytical problems that had not previously been considered. Perhaps the best example of such problems involved the determination of relevant product and geographic markets for those activities. Such determination was necessary to form a basis for competitive considerations.

Our recent administration of the bank holding company law has centered more upon the problems resulting from individual holding company acquisitions, than upon the expansion of permissible areas of activity. It has been the Board's position, for example, that a holding company should provide financial strength to its subsidiaries. Thus when we see a holding company applying for ownership of a subsidiary and recognize an unusually heavy debt burden for acquisition of the subsidiary, we are quite often bent in the direction of denial of that acquisition request. Similarly, where we find that the financial strength of bank subsidiaries is being diluted by transfers into the bank of less-than-fully satisfactory assets from other holding company subsidiaries, that finding has become an important consideration regarding the holding company's application to expand. Further, we have resisted the expansion of holding companies where it has been shown that capital is inadequate, earnings are weak, assets are of poor quality, or where there is an exceptionally heavy reliance on short-term interest sensitive funds.

Other problems recently addressed in the administration of the Holding Company Act include non-accrual loan problems and intra-company transfer problems. Non-accrual status has been particularly evident in loans to the real estate industry, but has been in evidence in certain business loans also. Where such loans become a heavy portion of a particular bank holding company's assets, the Board has been increasingly reluctant to approve further expansion. The intra-company transfer problem is manifest in those situations where difficult credits have been financed by either sale of the loan to the bank subsidiary or by loans from a bank subsidiary to the non-bank subsidiary.

Overriding all of these problems has been the requirement of the Board of Governors that there be a demonstration of the public benefits from acquisition of either bank or non-bank companies. We have generally insisted that there be some demonstrated public benefit in the form of improved service, more and broader outlets for credit, increased competition between credit-granting institutions, or a potential reduction in cost of credit. In those limited cases where some anti-competitive results have been demonstrated, we have approved the cases only where the public needs and benefits have been clearly evident and of sufficient importance to outweigh the anticompetitive effects.

More recently, the Board has also been especially concerned with adequate capital and liquidity, managerial strength, and ability to service any acquisition debt incurred. In case after case around the Board table, the Members of the Board have insisted that the fundamental strengths of the holding company and its banking subsidiaries be demonstrated before an expansion can be approved. The Board has paid special attention to the managerial strength of both the holding company and its subsidiaries. Similarly, we have focused attention on the ability to service debt where the holding company requests approval for an acquisition using debt as a means of payment. The Board has been insistent that a clear schedule of repayment be established and that a clearly reasonable forecast of earnings sufficient to cover that repayment be presented.

Finally, the Board has been paying careful attention to the pattern of structural development in banking within markets and states, as well as across the nation. It is almost a uniformly accepted fact among multi-bank holding companies that acquisitions of even limited size banks within any market where the holding company already holds a dominant position, are likely to be denied by the Board, barring some unusual and clearly demonstrated public benefit. Significant horizontal acquisitions for established multi-bank holding companies are, therefore, few and far between in the realm of applications coming before the Board. Instead, where a multi-bank holding company wants to expand in its own market, de novo applications are the safest rule of the day. The Board has ordinarily been disposed to approve such applications because, unlike the horizontal acquisition of an existing bank, the de novo acquisition does not immediately increase the concentration of banking resources and does not remove an independent decision-maker from the market. In my opinion, even the de novo applications may come under more severe questioning, if the application relates to a banking market where the banking office per population ratio is nearing the comparable ratio elsewhere. I recognize that the creation of an excessive number of banks or banking offices could be detrimental to the long-term public interest, if the community is already well served and if such offices were to so diminish the profitability of existing offices that the resultant banking units as a total became unprofitable and, therefore, of questionable safety and soundness. The Board has also been steadily mindful of the need to protect against over-concentration of banking in a particular market, a state, or a region. While we have set no specific percentages as limits to the level of concentration, it is clear that the Board has looked with favor upon the creation of a number of major competitive units, rather than the further expansion of a single unit or a small group of companies.

I might just mention here, however, that increased concentration in a state or region may not reflect, in the Board's view, undesirable structural developments. Holding company expansion cannot take place without some degree of increased concentration. While this increased concentration is occurring within the state, furthermore, the availability of services and intensity of competition within local markets throughout the state may also be occurring. And while the state or region may be important in a given case, it is most often the local market--to which individuals and small and medium-sized businesses are ordinarily restricted in acquiring loans--that is of greatest concern to the Board.

For the above reasons and because of limited access to capital markets, lower price earnings ratios, and possible dilutions of equity, the rate of new applications handled has fallen sharply. In the first half of 1974 there were 697 applications completed, while in the first half of 1975 the total fell about 46 per cent to 375 cases processed. Of particular interest has been the very sharp decline in completed _de novo_ non-bank applications: down 57 per cent from 339 in the first six months of 1974 to 145 in the comparable period of 1975. In contrast the _de novo_ bank applications processed decreased by only 10 per cent from 118 last year to 107 this year. The handling rate of applications for acquisitions of existing banks also fell 57 per cent while system processing of applications for acquisition of existing non-bank firms declined only 28 per cent. There were no entries into new activities ruled on in the first half of 1975, while four such cases were handled in the first six months of the past year.

As you may know, a majority of the applications processed by the Federal Reserve are handled by the Reserve Banks under a comprehensive set of delegation criteria established by the Board. One of these criteria prohibits Reserve Banks from processing under delegated authority any case in which any department of the Reserve Bank recommends denial. Thus all denials are issued by the Board. Of the 171 cases processed at the Board in the first half of 1975, denials accounted for almost 13 per cent compared to a denial rate of 9.6 per cent in the January-June period of 1974. Incidentally, approximately a fourth of the applications by existing holding companies to acquire an additional bank were denied by the Board during the first half of 1975.

Confession is good for the soul, and I admit that perfection in policy or administrative rulings is unlikely on several counts. First, one should recognize that the Board is a changing group of men. The present Board has only two members who were present for the entire time from the 1970 amendment to the Holding Company Act to date. Obviously, some of the newer members can have differing opinions from their predecessors. Second, these are human beings who can and do make mistakes, though hopefully of a small magnitude and without repetition. Thirdly, there are obviously cases where reasonable men can differ and the courts have occasionally instructed us to reconsider an opinion. Finally, other organizations including the IBAA, have sought judicial review of several Board decisions. In the past three weeks alone, the courts have rendered judgments requiring formal hearings, or a modification of a Board decision. I personally feel no animosity concerning such rulings unless they become so numerous as to constitute harassment. There is an element of this latter in the demands for formal hearings. I feel we can accommodate any individual or organization wishing to be heard in our regular protest arrangements. Excessive demands for formal hearings can only slow the machinery and create backlogs of unsolved cases. Nevertheless, the Congress did provide for such formal hearings and we will be responsive to legitimate requests.

In summary, the Board views the holding company device for which it has regulatory responsibility as a means of improving competition among credit granting units of this nation, and for providing greater public benefits. It does not view this device as a cure-all or as a panacea for all banking problems. In fact the Board recognizes that new problems have developed in some holding companies and that others may develop in the future. It has met these problems by rather significant increases in examination, reporting, and inspection analysis, and has limited expansion of those holding companies where problems have developed.

None of what I have said is likely to change the minds of those who view every holding company as an economic or credit dictator, or those who see the holding company device as a threat to the dual-banking system. But perhaps what I have said will create an open-mindedness to see some benefits coming from the holding company arrangements and perhaps a few will recognize that the Board of Governors has gone to great lengths to protect the public interest, to insure competitive conditions in the industry, and to require demonstrated public convenience and needs before approving the expansion of bank holding companies. Moreover, the Federal Reserve has attempted to insure that the holding companies themselves provide strength to their subsidiaries. In recognizing this, I would hope that you would see the value of the Board's overview in this field. But I think you should also be cognizant of the fact that the Board of Governors is administering a law passed by Congress, and that our powers of interpretation have quite definite limits in handling this administration.

The holding company approach has indeed been used rather significantly since 1970, and as of December 31, 1974, there were one-bank and multi-bank companies numbering 1,616 which accounted for 68 per cent of all banking deposits. It might be noted that there were 828 non-member banks with $30 billion of deposits and 512 member banks with $192 billion in deposits controlled by one bank holding companies. The multi-bank holding companies numbered only 276 and their bank subsidiaries totaling 2,122 were 61 per cent of all banks affiliated with any holding company but only 15 per cent of all banks in the country. The multi-bank holding company bank subsidiaries accounted for $287 billion in deposits or 38 per cent of the nation's total banking deposits.

Finally, when all is said and done today, I think we have to recognize that the verdict is still out on the holding company device. We may find that the banking industry has created in the holding company arrangements just a poor substitute for branching and has exposed the industry to additional unnecessary risks. On the other hand, we may find that the holding company arrangements have indeed created a more competitive framework for our banking industry and supply good and sufficient public benefits to warrant the continuation and perhaps even some further expansion of the present arrangements. We, at the Board, are in process of reappraising the results of the holding company arrangements. The Board has demonstrated its willingness to ask for Congressional review of developments perceived to be counter-productive to the public good or inimical to sound or progressive banking in this nation. And I can assure you that if our reappraisal of the holding company activities does raise major questions of the effectiveness in furthering the public interest, we will surface these questions with the Congress.

Meantime, I think it would be well if the bankers of this nation would be cautious about recommending additional legislative limits and particularly outright abandonment of the holding company device, for in effect, you are asking Congress and the legislatures, to place limits upon the purchase and sale of commercial bank stock. I have always thought it was a basic right of most Americans, unless badly abused, to buy or sell the stock they wished in whatever form and to whomever they wished to sell it. If the majority of the owners of the stock of a single bank wish to sell that stock to a multi-bank holding company, I have thought it to be their right to do so. If we encourage Congress or additional State legislatures to limit this transferability, I think we are entering into a dangerous field.

Limits to transferability may create a limited market, a closed industry, or even a greater danger of concentration as the weaker units fail and only the strong attract new capital investment. Such limits could sentence banking to internal growth only and to continued difficulty in meeting the credit needs of industries and communities where expansive growth is desirable.

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