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Statement by

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before the

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of the

Committee on Banking, Housing and Urban Affairs

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I am pleased to appear before this Subcommittee, on behalf of the Board of Governors of the Federal Reserve System, to discuss the Board's reasons for recommending the enactment of legislation embodied in S. 890.

The financial experiences of the last two years have raised many significant issues with regard to the regulation and supervision of the nation's banking institutions.

One very important area that we at the Federal Reserve are giving increased attention is the development of more expeditious means of dealing with problem banks. The Federal Reserve System is strengthening its program covering banks under its jurisdiction to place increased emphasis on the identification, surveillance and timely resolution of current and potential problem bank cases. This action has had first priority among our broad sweep of studies addressing key problem areas in banking supervision and regulation. It is humanly impossible -- and even undesirable -- for supervisors to prevent all bank problems; but it is practical to aspire, as we do, to recognizing problems early and moving promptly to try to remedy them.

There remains, however, a gap in the range of feasible remedial actions that could be undertaken if preventive measures should somehow not succeed in forestalling a bank failure. In that eventuality, the best solution of the problem in most cases is for the troubled bank to be taken over by another bank. Bank mergers, where permitted by State branching laws, can sometimes serve this purpose effectively. The alternative of bank holding company acquisition of a failing bank, however, even where permitted by State laws, is substantially inhibited by two Federal statutory constraints. One enforces certain time delays in the approval and consummation of all bank holding company acquisitions. The second effectively prevents any holding company acquisition of banks across State lines.

In our view, either or both of those limitations can interfere with actions needed to protect the public interest in some cases. Accordingly, the Board has placed two separate statutory recommendations before the Congress, both of which are now embodied in S. 890.

The first recommendation essentially involves procedural amendments to the Bank Holding Company Act designed to permit the immediate or expeditious consummation of a transaction under the Bank Holding Company Act in certain problem bank and bank holding company situations. The amendments are intended to parallel existing provisions in the Bank Merger Act. The second recommendation would amend the Bank Holding Company Act to grant the Board authority to approve an acquisition of a bank across State lines by a bank holding company when the Board determines that a large bank or bank holding company controlling a large bank is in severe financial difficulty, and the public interest would best be served if the bank involved was acquired by an out-of-State holding company. I will discuss each of these recommendations in turn, referring to the current law, the main reason therefor, the key arguments for changing the law at this time, and the Board's reasons for recommending the specific amendments proposed in S. 890.

Certain time schedules for the provision of notice and hearing [1/] were enacted as part of the original Bank Holding Company Act of 1956, as a compromise between giving bank chartering authorities an absolute right to deny a holding company application

1/ Under existing law, the Board, before approving an application for the acquisition of voting shares or assets of a bank under section 3 of the Bank Holding Company Act, must: (1) give notice to the Comptroller of the Currency if the applicant or bank involved is a national or district bank or to the appropriate State supervisory authority if the applicant or bank involved is a State bank; (2) allow thirty days within which the views and recommendations of the Comptroller of the Currency or the State supervisory authority, as the case may be, may be submitted; and (3) if the supervisory authority so notifed files a written disapproval of the application within the thirty-day period, the Board must provide a hearing on the application, and base its decision on the record of that hearing.

to acquire bank and giving such authorities only an informal consulting role vis-a-vis the Board's final decision in the case.

The Board in section 1(1) of S. 890 has recommended, first, that the regular thirty-day notice period be shortened to ten days if the Board advises the supervisory authority that an emergency exists requiring expeditious action. Secondly, section 1(1) as proposed would give the Board the authority to waive notice and hearing requirements entirely if the Board finds that it must act immediately on an application to prevent the probable failure of a bank or bank holding company involved in the proposed transaction. Both of these suggested amendments parallel provisions subsequently enacted in the Bank Merger Act -- provisions which have worked well in the nearly fifty instances in which they have been used over the past ten years.

In the Board's judgment, the present requirement for thirty-day notice to the relevant bank supervisor might work against the public interest in the context of a problem bank or bank holding company situation where immediate or expeditious action is called for. From a practical standpoint, the primary supervisory authority in such a situation would be actively involved in the process of screening potential acquirers and would also be desirous of having an acquisition quickly consummated. Similarly, the protracted hearing requirements in the case of recommended disapprovals by the supervisory authority are ill-suited to a failing bank or bank holding company situation where the public interest demands that decisions be made quickly on the basis of available evidence.

There is an additional statutory delay to be dealt with. Under existing law, the Board must immediately notify the Attorney General of any approval of a proposed bank acquisition, merger or consolidation transaction under section 3 of the Bank Holding Company Act, and such transaction may not be consummated before the thirtieth calendar day after the date of approval by the Board.

This requirement was added to the Bank Holding Company Act in 1966 in order to conform with the standard consummation procedures being established in the Bank Merger Act. The purpose of the provision was to eliminate conflicts between the Board's decisions under the Bank Holding Company Act and the Attorney General's enforcement of the antitrust laws, which might otherwise require the unwinding of a transaction after that transaction had been approved under the Bank Holding Company Act.

However, the Bank Merger Act provides for an exception to this delay in problem cases, while the Bank Holding Company Act does not. The Board is recommending that, in cases involving problem banks or bank holding companies, the consummation procedures of the Bank Holding Company Act be fully conformed to those in the Bank Merger Act.

Accordingly, it is proposed that, when the Board has advised a supervisory authority of an emergency requiring expeditious action, consummation be permitted five calendar days after the date of approval. In cases where the Board has found that it must act immediately to prevent the probable failure of a bank or bank holding company, it is recommended that immediate consummation be permitted. In the Board's judgment, there appears to be no public policy reason for not having parallel consummation procedures for bank mergers and bank holding company acquisitions in problem bank situations, since the same reasons exist for not waiting thirty days for the Attorney General's competitive judgment in both cases. As a practical matter, the Federal banking agencies in such situations have regularly followed the practice of informally consulting with the Attorney General in advance in any case large enough to raise substantial competitive questions.

The existing statutory delay provisions in the Bank Holding Company Act have effectively eliminated bank holding companies from bidding in emergency situations, since a bank in severe financial difficulty may not be able to survive the thirty-day consummation delay. These provisions have thus unnecessarily limited the number of potential acquirers of a problem bank.

This can increase the anti-competitive risks in such acquisitions by often limiting the pool of potential acquirers to banks already in direct competition with the problem bank, e.g., in the case of Franklin National Bank, other New York City banks. The holding company can be a pro-competitive form of bank expansion, and its use should not be effectively foreclosed in infrequent problem bank situations because of delay requirements not similarly imposed in bank mergers. Waiver of the usual delay provisions undoubtedly would be warranted in only a small number of cases, and in those cases the waiver should produce net public benefits.

Another -- and more sensitive -- constraint on bank holding company acquisitions is geographical in nature. Under the Bank Holding Company Act, the Board may not approve any further acquisition of a bank by a bank holding company across State lines.[2/]

2/ The precise words of section 3(d) provide that the Board may not approve any application under section 3 of the Bank Holding Company Act: ". . . which will permit any bank holding company or any subsidiary thereof to acquire, directly or indirectly, any voting shares of, interest in, or all or substantially all of the assets of an additional bank located outside of the State in which the operations of such bank holding company's banking subsidiaries were principally conducted. . . ."

This provision was made part of the original Bank Holding Company Act of 1956 in order to halt the further expansion of several large multi-State bank holding companies then in existence. It was based in large part on Congress' concern that, unless this trend were halted, widespread and frequent acquisitions by major bank holding companies could eventually lead to an undue concentration of banking resources in the United States. In particular, it was thought that, absent this provision, holding companies would be used to avoid the multi-State branching provisions of the McFadden Act, and it thus was also intended to preserve the rights of the States in this area.[3/]

3/ Under the terms of this provision, a bank holding company can only acquire a bank outside of its principal State if the State in which such bank is located takes action to specifically permit such acquisition. If a State took such action, the Board would still have to decide the application under the statutory standards of the Bank Holding Company Act. At the time of this Act's passage in 1956, no State granted such permission. Except for Iowa, which has enacted a law giving a single grandfathered multi-State bank holding company permission to acquire additional banks in that State, and Maine, which recently enacted a law which would allow acquisition of a Maine bank by an out-of-State bank holding company if a Maine bank holding company is given reciprocal rights in that holding company's State, the situation remains essentially unchanged with no other States granting such permission.

The Board is of the opinion that section 3(d) could, in the case of a large problem bank or a problem bank holding company controlling a large bank, operate in contravention of both national and local interests. The limitation to in-State bidders may, in the case of a large problem bank, severely limit the number of potential acquirers and result in an increased concentration of banking resources within a State -- contrary to an intent of Congress in passing the Bank Holding Company Act. In most of our States, the number of locally-owned banks big and strong enough to absorb a large problem bank are very few. The only smaller banks strong enough to undertake such a venture may be those affiliated with powerful commercial or financial interest domiciled either in this country or abroad.

The problem created by the constraints imposed by section 3(d) has been sharpened as banks, particularly large banks, have moved increasingly from asset to liability management. This shift in emphasis has led many larger institutions to search far afield for money market funds. While this has often been of considerable benefit to the customers and communities they have served -- particularly in those areas where widespread branching is not permitted and local deposit generation is thereby limited -- liability management has increased banks' exposure to the risks created by any substantial net outflow of such nonlocal and often volatile funds.

When adverse news triggers enough outflows of funds to significantly weaken a bank, it may become necessary in the public interest to fold it into a larger and stronger institution. As you know, this occurred in New York and California, where big in-State banks were available to acquire the problem banks involved. Had institutions of the size of Franklin National or U.S. National failed in many other States, however, no banks in those States would have been large enough to acquire them. In such circumstances, the need to be able to arrange acquisitions across State boundaries would become very real.

The Board therefore recommends several amendments to the Bank Holding Company Act designed to permit out-of-State acquisitions in certain emergency and failing bank situations involving a large bank or bank holding company controlling a large bank. Under section 1(3) of S. 890 as proposed, the Board would have the authority to make exceptions to the multi-State prohibitions of section 3(d) whenever the Board finds that an emergency requiring expeditious action exists with respect to a bank or bank holding company, or that it must act immediately in order to prevent the probable failure of a bank or bank holding company. The proposed authority would be limited, however, to cases involving a bank having assets in excess of $500 million or a bank holding company controlling a bank having assets in excess of $500 million. There are three basic reasons for limiting this authority to the case of a large bank or bank holding company controlling a large bank: first, the failure of such an institution can have damaging effects in both national and international markets and on the national economy; secondly, there may be few, if any, prospective acquirers of such an institution within any State; and thirdly, the most likely in-State acquirers are likely to be institutions of comparable or greater size, which might often pose problems under the anti-trust laws and threaten an increased concentration of banking resources within the State.

The Board chose a $500 million asset cut-off figure because it would cover major money-center and regional banks, whose failure might have an adverse effect on regional, national or even international financial markets, yet would not be so extensive an exception as to create a potentially significant loophole to the multi-State prohibitions of the Act. Also, in cases involving smaller problem banks, local acquisitions where appropriate can be more readily arranged by the FDIC and State authorities than can transfers of the liabilities and assets of large institutions.

The choice of any cut-off figure involves various public policy considerations by the Congress. The Board stands ready to supply the Subcommittee with additional data on this issue if that would be helpful. On the basis of data prepared by the Board's staff, a $500 million cut-off would cover not only the large money-center and regional banks but also, in most cases, the largest bank in any State.[4/] From our analysis of cases in which emergency or failing bank procedures have been used under the Bank Merger Act, it appears only three banks acquired under emergency approval procedures have had assets in excess of $500 million (Security National Bank of Long Island, Franklin National Bank of New York, and United States National Bank of San Diego). Thus, the Board anticipates that this provision would be applicable only in rare cases where there may be significant effects upon the national and international economy.

4/ From the Board's figures as of December 31, 1974, this asset cut-off would appear to include some 210 commercial banks across the country, including the largest bank in 39 States and the District of Columbia, and the two largest banks in 35 States and the District of Columbia.

Under section 1(3) of S. 890 the Board could use this authority to approve a multi-State acquisition only when it finds, in weighing the statutory competitive and other factors, that the public interest would best be served if the bank or banks involved were acquired by an out-of-State bank holding company. The Board thus anticipates that this authority would rarely be used and only in cases presenting very special circumstances, such as those involving Franklin National Bank. In our view, these relatively rare situations would not contravene the central purpose of the multi-State prohibition of the Bank Holding Company Act, which was directed at preventing large concentrations of financial resources through frequent multi-State acquisitions of banking institutions.

The Board is sensitive to the fact that the prohibition on multi-State branching was designed to prevent the evolution of a few large banking institutions. While there would be only a very limited number of instances in which the Board would consider making exceptions to section 3(d), the amending language could be narrowed even more than was originally suggested. A strict limit could be placed on the number of acquisitions any single bank holding company would be allowed to make under such an exception. This limit should be more than one, in order not to encourage potential bidders to wait until an ideal acquisition opportunity was presented, but it could be less than five, in order to forestall excessive expansions of financial power. In our view, this kind of limit would serve to preclude any possibility of undue concentration of economic resources being created through exceptions to section 3(d).[5/]

5/ As a corollary to its recommended amendment of section 3(d), the Board has felt it necessary to also recommend an amendment in section 2 of S. 890 overriding certain provisions of State law in situations involving a problem bank or bank holding company where expeditious or immediate action is required.

Section 7 of the Bank Holding Company Act reserves to the States their rights to exercise such powers and jurisdiction which they now or in the future may have with respect to banks, bank holding companies, and subsidiaries thereof. In problem bank or (continued)

The Board hopes, of course, that no significant bank will so misbehave that it becomes threatened with

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5/ (Continued) bank holding company situations, the normal circumstances which may have led a State to enact a statute prohibiting the formation of bank holding companies within its borders or otherwise restricting the entry of out-of-State bank holding companies do not apply and therefore such provisions should not be controlling when the Board has approved such application under the immediate or expeditious action provisions recommended in S. 890. In such cases, the national interest argues that Federal law be supreme. In practical terms, even though a State may favor an acquisition by an out-of-State holding company approved by the Board under its immediate or expeditious action provisions as an alternative to failure, it would probably be impossible either for a State legislature to enact in time any necessary amendments to its laws, or for a State court to interpret the terms of an unclear statute. The delays involved in trying to pursue either of the above courses of action could be crucial. Section 2 of S. 890 would solve these problems by providing that in any case where the Board has approved an application under the immediate or expeditious action provisions of S. 890, the holding company may acquire and operate the bank involved as a subsidiary notwithstanding section 7 or any provision of State law which would otherwise prevent the acquisition or restrict the operations of that holding company.

Section 2, however, leaves intact State restrictions on multi-bank holding companies, so that an out-of-State bank holding company which acquired a bank with the Board's approval under the immediate or expeditious action provisions could not gain a competitive advantage over an in-State holding company by acquiring a second bank under those provisions. The McFadden Act restrictions on multi-State branching would not be affected by section 2 of S. 890 as such restrictions are a matter of Federal law.

failure. It would be imprudent, however, not to be prepared to deal with that eventuality. As a matter of good contingency planning, the Board recommends prompt enactment of S. 890. It will serve the public interest both by facilitating the speedy and efficient resolution of problem bank and bank holding company cases we may encounter and by increasing the likelihood of more competitive acquisitions in such situations.

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