

FEDERAL LEGISLATION

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SCHOOL OF BANKING OF THE SOUTH  
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A weekly publication reporting Washington banking news includes on the front page of each issue the following statement:

"Everything that affects the profit of a bank is determined by Big Government. All the plans that bank officers and bank directors make are but tentative. Big Government can overrule, abrogate, pass new laws, issue regulations. Credit, volume of money, allowable investments, taxes, mergers, branches, wages and hours - up and down through all of a bank's many interests -- all are determined by Big Government, centralized in Washington, D. C."

Whether we like it or not, this is substantially true. We think of banking as a private business and a vital part of our free enterprise system, and that it is. But today, more than ever before, it is also a heavily regulated business in which policies and operations are increasingly subject to the judgment of those who make and administer banking laws.

The individual banker has two choices. He can either take the attitude that government is not his concern and merely accept what is done as being inevitable, or he can make it his business to see that those who do the deciding have the benefit of his advice and experience. I am sure you will agree that the interests both of good citizenship and sound banking require that he follow the second course.

It would be impossible, in my opinion, to exaggerate the importance of this choice. As Chairman of the A.B.A.'s Committee on Federal Legislation, I

have seen at firsthand the tremendous amount of teamwork that must go into effective legislative representation in Washington. Every banker is a member of the team. To a very large extent, the success of the team effort depends upon every member playing an interested and active role.

The Financial Institutions Act, as many of you know, would clarify and revise existing laws governing not only banks but savings and loan associations and credit unions as well. It's a big Bill, in terms of size and significance. Actually, it represents a comprehensive effort to streamline the banking laws, eliminate dead wood, and provide new authority in line with modern needs and practice. Every T isn't crossed the way every banker would like, but the constructive provisions are so much in the majority that the net effect would be to greatly improve the structure and services of the banking system.

There has been no major overhaul of the Federal banking laws since the Banking Acts of the Early 30's. In the intervening period, necessary technical and substantive changes in these Federal laws have usually taken the form of isolated amendments to add or amend a single provision. There has been no effort in this long period to review the organization and collation of the law, its general effectiveness in serving and protecting the public interest, and its usefulness as an efficient tool for the banker, the lawyer and the public.

In my opinion, the design of the Financial Institutions Act is to be commended.

The bill, if enacted, would make many technical changes in existing law. For example, presently it is not clear that a national bank may make contributions to nonprofit educational and civic improvement organizations. Under Sec. 31 of Title I of the bill a national bank is expressly authorized to make such contributions.

Sec. 51 of Title I of the bill provides that no state or local statute may subject a national bank to examination or the payment of any licensing fee

to carry on the business of banking. As you know a number of states have enacted so-called small loan and installment sales statutes, which require lenders in this area to be licensed and be subject to examination

The Senate approved this provision prohibiting the licensing, but it is our understanding the House B and C Committee in Executive session provided that banks may be licensed and examined.

A controversial provision in the bill, Sec. 26 (C) of Title I would amend the existing law to make cumulative voting in the election of directors of national banks optional rather than mandatory as under present law. The use of the word "optional" may, in a sense, be misleading, as it is apparent the majority stockholders will not ordinarily vote the necessary amendment to the Articles in order to favor a minority stock interest. Efforts on the Senate floor to strike this provision were unseccessful. Advocates of the elimination of mandatory cumulative voting have long argued that it has not worked well in many cases, with the result that management is disturbed and community confidence thereby impaired.

Again, from the Executive sessions of the House B and C Committee, we understand this has been amended to adhere to the applicable state law or upon vote of 75% stock in states not covered by a statute.

Authority is provided in the bill with respect to certain lending authority of national banks. For example, the bill would amend Exception 6 of Sec. 5200 of the Revised Statutes to permit a national bank to lend one obligor not more than 25% of capital and surplus against fully insured, frozen or refrigerated, perishable, readily marketable staples, for a period not exceeding six months. The proposed amendment is simply a recognition of the growth and importance of the frozen foods industry. This is a good example of the modernization the laws affecting national banks sorely needed.

a national bank would be permitted under the bill to acquire to a limit of 25% of capital and surplus obligations of dealers in dairy cattle arising out of the sale of dairy cattle which bear a full recourse endorsement or unconditional

garantee of the dealer. The authority granted under this section of the bill with respect to such obligations merely places the financing of dairy cattle sales on a parity to similar transactions involving other livestock.

Under Sec. 36(c) of Title I of the bill, a national bank would be authorized to make temporary industrial and commercial construction loans, secured by a mortgage or lien on the real estate on which the building is being constructed, with maturities not exceeding 18 months, to finance the construction of industrial and commercial buildings, provided there is a take-out by a responsible lender on completion of the building, without such loans being considered as real estate loans.

Now with respect to so-called "working capital" loans, Sec. 36(e) of Title I of the bill would amend existing law to authorize a national bank to make loans to manufacturing and industrial business where the bank looks for repayment to the operations of the borrower's business but takes a mortgage on the borrower's real estate as additional security, without such loans being classed as real estate loans, even though the bank has taken a mortgage or similar lien on the plant real estate as supplemental security, either to provide protection against a hostile creditor who may secure a lien on part of the property of the borrower or to provide an additional cushion to the bank. This amendment is logical and desirable, since the primary security on which the lender relies in such loans is the borrower's general credit standing and the forecast of his operations, and not the real estate which is taken as supplemental security or as a precaution against contingencies. The risk that such a loan made under present law would be classed as a real estate loan could have the illogical result that the bank would finance the construction on an unsecured basis, thus depriving the lender of the possible benefit of supplemental security. This paradoxical situation is desirably corrected under the bill.

Sec. 23(b) of Title II of the bill, The Federal Reserve Act, would authorize a State member bank to invest in bank premises up to a maximum of 100% of capital

or 50% of capital and surplus, whichever is greater, without obtaining the prior approval of the Federal Reserve Board. A similar provision would apply to national banks under the proposed National Bank Act. Under present law a member bank may invest in bank premises up to 100% of capital without obtaining the prior approval of the supervisory authority, but the present law applies unevenly and inequitably as between banks having large or small capital in relation to surplus.

The bill would limit to 25% of capital and surplus the amount of negotiable or nonnegotiable recourse or guaranteed consumer installment paper which may be acquired by a national bank from one seller, unless the bank certifies in writing that it is relying on the maker rather than the endorser for the payment of such paper in which case the basic 10% limitation on obligations of the maker is the sole applicable limitation. Under present law recourse or guaranteed consumer installment paper is subject to the general 10% limitation of the statute if nonnegotiable, but is not subject to any limitation of capital and surplus if negotiable.

Sec. 23 of Title III of the bill, The Federal Deposit Insurance Act, would amend the Federal Deposit Insurance Act to enable the bank supervisory authorities to deal more effectively with merger, consolidation and assumption transactions. It would place in the bank supervisory authorities, rather than in the Justice Department, the final authority to pass on the competitive and other aspects of any such transactions.

Undoubtedly, this provision will be vigorously opposed in the House of Representatives by those who apparently favor an amendment to give the Justice Department the final say-so over bank asset acquisitions by banks. A bill to this effect, known as the Celler bill, was passed by the House of Representatives in the last Congress, but died in the Senate Judiciary Committee. The proponents of this type of bill apparently conceive that the banking agencies will not effectively regulate mergers in the banking industry and that the power over such transactions should therefore be lodged in the Justice Department.

By contrast, the provision in the Financial Institutions Act is supported by the Federal bank supervisory agencies, the Treasury, most bankers associations, the American Bar Association, and other organizations. A bill to the same effect, known as the Fulbright bill, was passed by the Senate in the last Congress, but was not acted on by the House. The proponents of this provision believe that the bank supervisory agencies are best qualified by virtue of their intimate knowledge and long experience with banks to exercise this authority. Further, they conceive it to be sound policy to avoid scattering the authority over any regulated industry among many Governmental agencies. Banking today is intensively regulated by State banking authorities and by the three Federal banking agencies. A proliferation of the number of agencies exercising substantial authority over the banking industry would likely result in divisive, confusing and burdensome regulation contrary to the public interest. Moreover, mergers in other regulated industries, such as the communications and power industries, once approved by the regulatory agency vested with authority over such industry, are not subject to Sec. 7 of the Clayton Act, and no sound reason is therefore seen for making a special case of the banking industry.

An amendment to the bill offered from the Senate floor, at the instance of one of the Federal Supervisory Agencies, and adopted by a voice vote gives the Federal Reserve Board, the FDIC and the Comptroller of the Currency, discretionary authority to require that a State member, insured nonmember, or national bank, as the case may be, be audited by an independent individual or firm approved by the appropriate agency, the expense of any such audit to be borne by the bank so audited. Such a provision is new to the Federal banking laws.

The authority granted under these provisions in the bill may be exercised when the supervisory agency deems it necessary "either because of inadequacy of examination or for any other reason." It is obvious without reflection that

the quoted language amounts to no statutory test or guide at all, and the result is a grant of arbitrary power. Whatever the merit in principle of a required outside audit, the power to impose it ought to be subject to reasonable tests and safeguards to protect the regulated and to guide the regulator. As it presently stands, the provision does not contain even a requirement of notice and a statement of reasons purporting to justify a required audit. In brief, it seems that these provisions, if justified in principle, ought to be amended to eliminate the taint of arbitrary power, and, I hope, will be so amended.

There are many technical and substantive changes in the bill with respect to savings and loan associations. Under the Senate-passed bill the branching authority of a Federal savings and loan association in any State would, generally speaking, be put on a parity with the law or practice of that State with respect to the branching authority of State-chartered Savings and Loan Associations or mutual savings banks. The House version of the bill as introduced by Congressman Paul Brown of Georgia, and so far apparently unchanged, would, in effect, add branching authority for Commercial banks as a further test for branching of Federal savings and loan associations.

The bill would also prohibit a Federal savings and loan association from establishing a branch outside the state in which its home office is located.

The bill would add to the existing law a number of provisions which would impose on Federal or insured savings and loan associations, their directors, officers, employees, and agents as the case may be, ethical standards long applicable to commercial banks under the Federal Reserve Act and the National Bank Act.

In this brief effort to cover some of the provisions of the bill, I have had to select from among the hundreds of changes which the bill makes in existing law. Of course, many of the amendments with which I have not dealt might be described as clarifying, clerical or minor technical amendments. That there should be disagreement or controversy with respect to several of the proposed changes

should startle no one in view of the great number of changes proposed in this bill.

But, I hasten to emphasize that the number of provisions to which there is disagreement or controversy is small with relation to the bill as a whole. It is by all measure the most important piece of legislation affecting banking since the passage of the banking acts of the 30's.

In view of the great importance of this bill, it is hoped that all of you will take an active and direct interest in its progress in the House Banking and Currency Committee.

Now where does the Bill stand? After four months of intensive study, it was passed by the Senate in March of 1957; after longer and equally careful study on the House side, it is still in the House Banking and Currency Committee. A few members of that Committee who may have their own reasons for wanting the Bill bottled up have so far succeeded in preventing Committee action.

The outlook for passage is uncertain. If the Bill is to be enacted into law this year, it will have to be reported out by the House Banking and Currency Committee soon - while there is time for consideration and a decision by the House itself. If it fails of enactment this year, a new bill would have to be introduced next year and the whole process begun all over again. It is obvious that even the supporters of the legislation in the Congress would not relish that situation.

The House Banking and Currency Committee will be occupied during the next several weeks with other important legislation. The Chairman, and incidentally he is quite friendly, has not yet set a date for resumption of work on the Financial Institutions Act. However, many Congressmen who recognize as he does the importance and urgency of the Bill are supporting his efforts to bring about an early decision by the Committee.

You may be interested in a quick review of other legislation vital to banking. A brand new proposal of interest to banking would authorize the



of investigation the Nation's monetary and fiscal policies and operations. It is House Resolution 587, introduced on June 2 by Representative Patman of Texas. In all likelihood, Congressman Patman would head the investigating Committee if his resolution is approved by the House. This new Patman Resolution appears to be somewhat broader in scope than its two predecessors which were voted down by his colleagues in the House during the past three years. Since Mr. Patman hasn't been considered exactly a friend of banking, such an investigating, headed by him, could become of real concern.

The American Bankers Association for a long time has recommended changes in the powers of the Federal Reserve Board over the reserve requirements of member banks in the interest of realistic and reasonable banking practice. In April of this year following several meetings we had with the Board of Governors of the Federal Reserve System the Federal Reserve Board submitted to the Congress a bill which provides for a mighty good start in this direction. In effect it would authorize the Board to permit member banks to count vault cash as part of their legal reserve, to reclassify individual banks in central reserve and reserve cities to lower reserve classifications, and to vary reserve requirements for central reserve city banks within a range of 10 to 20 percent rather than the present 12 to 26 percent.

The initial Congressional reaction to the bill appears to be favorable. While the Banking and Currency Committees of the House and Senate may not be able to take it up this year, we look forward to its reintroduction in January and favorable action by the next Congress.

Another pending measure of ranking importance to the banking industry is the Curtis Bill, which is before the Ways and Means Committee of the House. As introduced last year, this Bill would reduce the maximum tax-free reserve which mutual savings banks, cooperative banks, and savings and loan associations may accumulate from 12 percent of withdrawable accounts or deposits to 5 percent. Testifying before the Committee last winter, we recommended that Congress should

agree on a maximum figure less than 12% but greater than 2.43%; which should be applied in a uniform way to commercial banks as well as to mutual institutions. The revenue needs of the Nation and the principle of fair competition, we pointed out, can best be served by a policy of uniform tax treatment of these different types of financial institutions.

Whether the Bill will be reported out by the Committee, with or without our proposed amendments, remains to be seen. The answer will depend somewhat upon the pattern of the general tax bill that emerges in the next few weeks. It seems certain that our efforts have served to focus the attention of many members of the Congress on the serious disadvantages imposed upon commercial banks by the present taxing formula.

The winter predictions of many an expert were laid to rest several weeks ago when the Administration and the Democratic leadership of the Congress agreed that there would be no general income tax reduction. Now there are indications that the corporate tax and excise tax rates will be left at present levels. Some observers attribute this change of Congressional attitude toward tax adjustment to a lessening of the economic decline and to a renewal of concern over the national debt.

At the same time, some additional tax legislation appears to be likely. The Administration's proposals for tax relief for small business, for example, are expected to win the support of the Ways and Means Committee. These proposals include: an ordinary loss deduction of up to \$50,000 a year; authorization for small corporations to be taxed as partners; and allowance of installment payments on estate taxes over a 10-year period where the estate is tied up in a closely held business. All or some of these provisions are likely to figure in another tax bill to be reported to the House.

Committee hearings in both the House and Senate have established that the Congress is also in favor of action to stimulate the flow of equity capital to small business. The proposals range from the creation of an elaborate capital

bank system to a simple expansion of Small Business Administration authority to permit that agency to do the job.

The A.B.A. presented testimony to both Banking and Currency Committees, urging that any such program be temporary and that it be administered by an existing Federal agency. We also emphasized that private capital and local lending facilities should be used to the utmost, with the Federal Government playing a supplementary and temporary role. The Senate passed yesterday a small business capital bill. The House Banking and Currency Committee is expected to begin work next week on an equity capital bill.

I have presented just a brief summary of current Congressional activity on the banking front. The decision of the Congress in each instance will have a direct effect on many banks and an indirect effect on the industry as a whole. Bear in mind that banking is a highly complex and technical business in a highly competitive economic system; its needs and problems are not easily reduced to legislative terms, and often they are not of a kind to claim the attention or enthusiasm of a busy member of the United States Congress. There are facts of legislative life which you and I are not going to change. The sensible thing, it seems to me, is for bankers to recognize this situation as an additional reason for informing and actively interesting themselves in the cause of sound legislative procedure.

It has been said that a 5-cent pencil in the hands of an American voter is the most powerful weapon in the world. It's too bad that so many persons think only "Nuts" write their Congressmen.

Congressmen should hear regularly from sensible, solid citizens. You have not so much a duty as a right to tell the men who represent you in Congress what you think they should do.

Members of the Congress bear a very great responsibility. By and large, they desire most of all to do a good job of reflecting the wishes and aspirations of their constituents.

In order to do this, they need and want the help of bankers as well as that of other citizens.

I am convinced that we have nothing to fear from an informed Congress. The burden of providing the information is ours. It's a continuing task -- one which we not only should accept but should welcome and carry out aggressively in the interest of sound banking in a sound economy.