

BANK SERVICE CORPORATIONS

REPORT

OF THE

COMMITTEE ON BANKING AND CURRENCY

HOUSE OF REPRESENTATIVES

EIGHTY-SEVENTH CONGRESS

SECOND SESSION

TOGETHER WITH

DISSENTING VIEWS

ON

H.R. 8874



JULY 30, 1962.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

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BANK SERVICE CORPORATIONS

REPORT

OF THE

COMMITTEE ON BANKING AND CURRENCY

BRENT SPENCE, Kentucky, *Chairman*

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ROBERT R. POSTON, *Counsel*

THOMAS A. GRAHAM, Jr., *Counsel*



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87TH CONGRESS }
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REPORT
No. 2062

BANK SERVICE CORPORATIONS

JULY 30, 1962.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. SPENCE, from the Committee on Banking and Currency, submitted the following

REPORT

together with

DISSENTING VIEWS

[To accompany H.R. 8874]

The Committee on Banking and Currency, to whom was referred the bill (H.R. 8874) to authorize certain banks to invest in corporations whose purpose is to provide clerical services for them, and for other purposes, having considered the same, report favorably thereon with an amendment and recommend that the bill, as amended, do pass.

The amendment is as follows:

Strike out all after the enacting clause and insert the matter which appears in *italics* in the bill herewith reported to the House.

WHAT THE BILL WOULD DO

H.R. 8874 would enable banks to utilize modern equipment through stockownership in a jointly owned service corporation. At the present time nine States have enacted legislation specifically authorizing State banks to invest in bank service corporations, and in New York and possibly other States, State banks are authorized to invest in such service corporations under general provisions of the code. However, Federal law prevents national banks and certain other federally supervised banks from sharing this privilege because of investment restrictions in the applicable Federal statutes.

The bill removes all limitations and prohibitions of Federal law exclusively relating to banks, regardless of how owned, which would otherwise prevent banks from investing up to 10 percent of their capital and surplus in bank service corporations. The bill requires that initially, at least two banks must own stock in any such corpora-

tion, but provides that if one bank ceases to own stock and participate in a bank service corporation, the remaining bank may continue to hold stock in it.

Provision is made that a bank service corporation must, if requested, furnish its services to competing banks unless comparable services at competitive cost are available to the applying banks from another source, or unless the furnishing of the services sought by the competing bank would be beyond the practical capacity of the corporation. If required to furnish such services the corporation would have the option of either issuing stock and furnishing bank services on the same basis as to other stockholders, or furnishing the services at cost (including the reasonable cost of capital). Bank service corporations are prohibited from performing more than one-half of their services for persons other than banks.

The last section of the bill provides that whenever a federally supervised bank has bank services performed for it, regardless of whether they are performed by an affiliated service corporation or by some wholly independent enterprise, the performance of such services must be subject to examination, and performed in accordance with regulations of the supervisory agencies, to the same extent as if the bank itself were performing them on its own premises. Quite apart from the investment problem dealt with in the preceding sections of the bill, it would obviously be unwise to permit banks to avoid the examination and supervision of vital banking functions by the simple expedient of farming out such functions.

THE NEED FOR THE BILL

The demand for bank services is increasing at an extremely rapid rate. Many banks have found it difficult to acquire adequate personnel to handle this mounting workload. Testimony indicated that the volume of checks in circulation has increased tremendously during the past two decades. The estimated check volume in 1939 was 3.5 billion. The volume is increasing at the rate of about one-half billion items per year. By 1970 the number of checks is expected to be at an annual rate of 22 billion. In addition to check handling there is a need for automation of other bank services. Some banks are now processing their savings accounts, computing payrolls, calculating other credits and charges, and preparing and mailing statements through the use of automatic equipment. For the majority of banks the high cost of equipment makes this impossible.

Larger banks are generally able to afford this automatic equipment, but smaller institutions find the cost prohibitive. According to a study made by the Federal Reserve System, nearly all large banks in the group they surveyed are presently using some form of automated equipment or plan to do so within the next 3 years. However, the ratio of automating banks to the total number of banks falls rapidly as one moves down the scale in bank size. Thus, it is becoming more and more difficult for smaller banks to compete with larger banks in offering complete and efficient banking services to their customers. Testimony was received which indicated unless a satisfactory means is devised whereby smaller banks may acquire benefits of automated equipment, many of them may be absorbed by larger banks.

Under this bill two or more banks would be able to pool their resources through the corporate device in order to gain the benefits

of this expensive equipment for themselves and for the people in their communities.

IEWS OF THE FEDERAL BANK SUPERVISORY AGENCIES

All of the bank supervisory agencies have submitted reports on the bill. The reports are as follows:

APRIL 26, 1962.

HON. BRENT SPENCE,
*Chairman, Committee on Banking and Currency,
House of Representatives, Washington, D.C.*

DEAR MR. CHAIRMAN: This is in reply to your request for the comments of this Department on H.R. 8874, to authorize certain banks to invest in corporations whose purpose is to provide clerical services for them, and for other purposes.

The bill would authorize national banks, district banks, and State member banks to invest in a corporation organized to perform clerical services for two or more banks.

The Treasury Department is in accord with the objectives of the proposed legislation but feels that its scope should be extended in two respects. Clerical services are not the only services which might be performed better or at less cost by a service corporation. Furthermore, no reason appears why a corporation organized to provide services for a single bank should be excluded from the benefits of the proposed legislation.

The Treasury, therefore, recommends (1) that the committee give consideration to other services which a service corporation might properly be authorized to perform and (2) that such corporation be authorized to perform services for one or more.

The Department has been advised by the Bureau of the Budget that there is no objection from the standpoint of the administration's program to the submission of this report to your committee.

Sincerely yours,

ROBERT H. KNIGHT, *General Counsel.*

JULY 25, 1962.

HON. BRENT SPENCE,
*Chairman, Committee on Banking and Currency,
House of Representatives, Washington, D.C.*

DEAR MR. CHAIRMAN: Reference is made to your request for the views of this Department with respect to committee amendments to H.R. 8874, a bill to authorize certain banks to invest in corporations whose purpose is to provide clerical services for them, and for other purposes, as amended.

This bill would authorize national banks, district banks, member banks, or nonmember insured banks to invest an amount not in excess of 10 percent of capital and surplus in the stock of a corporation organized to perform services for two or more banks. The bill, as amended, subjects the service corporations to regulation by existing Federal banking agencies and also prescribes certain other limitations on the activities of the service corporations.

The Department prefers the original bill, which was designed to remove the impediment in existing law to investment in the stock of such service corporations. The Department believes that H.R. 8874, as amended, by incorporating a number of additional restrictions on such investment, unnecessarily limits the possibilities for banks to obtain the benefits which were intended to be afforded under the original bill. These restrictions have been discussed in detail by members of my staff and the staff of your committee. The Department will be glad to supply a memorandum setting forth its objections to the proposal, should your committee so desire.

In view of the need for the expedition of this report, it has not been possible to obtain the customary Bureau of the Budget clearance prior to its submission.

Sincerely yours,

ROBERT H. KNIGHT, *General Counsel.*

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM,
Washington, March 1, 1962.

HON. BRENT SPENCE,
*Chairman, Banking and Currency Committee,
House of Representatives, Washington, D.C.*

DEAR MR. CHAIRMAN: This is in reply to your letter of August 28, 1961, asking for a report from the Board on the bill H.R. 8874, to authorize certain banks to invest in corporations whose purpose is to provide clerical services for them, and for other purposes. If enacted, the bill would be cited as the "Bank Service Corporation Act."

While it favors the objective of the bill, the Board wishes to emphasize the relatively new and rapidly developing field to which the bill addresses itself. Suggestions as to changes in some of the features of the bill are set forth in the latter part of this letter.

The basis for the bill is the improvements in recent years in data processing through the use of electronic and related equipment designed for that purpose. This equipment is being utilized by more and more banks. For example, some banks have purchased the equipment because, notwithstanding the high initial cost, its use makes possible operating economies and improvements in services not otherwise attainable. Other banks have service contracts with data processing centers operated by private commercial concerns. H.R. 8874 undertakes to make the benefits of such equipment available to banks through an additional device that might be attractive especially to many smaller or medium sized banks.

"Banks service corporation" is defined by the bill as "a corporation whose primary purpose is to perform for two or more banks, each of which has an investment in such corporation, services such as check and deposit sorting and posting, computation and posting of interest and other credits and charges, preparation and mailing of statements, notices, and similar items, or any other similar clerical or bookkeeping function."

H.R. 8874 would permit any national bank, any bank organized under the law of the District of Columbia, and any State bank that is a member of the Federal Reserve System and is authorized to do

so under State law, to make investments in a bank service corporation, either by the purchase of its stock or by loans or advances thereto. In the absence of such an authorization, investments of this kind by member banks would be prohibited or restricted under various provisions of the Federal banking laws. But, if a State member bank had no authority under the applicable State law to invest in a bank service corporation, State enabling legislation would be necessary, notwithstanding enactment by Congress of legislation like the present bill. It is understood that enabling legislation has been enacted thus far by six States; i.e., Connecticut, Iowa, Maine, Michigan, Ohio, and Pennsylvania.

The bill limits the total amount of investments outstanding at any one time in a bank service corporation by any such bank to 10 percent of its capital and surplus, unless approved by the Comptroller of the Currency in the case of a National or a District bank, or by the Board of Governors of the Federal Reserve System in the case of a State member bank. Investments in excess of that limitation may be approved by the Federal supervisory agency concerned if, in its judgment, (1) the investment is reasonable and prudent in relation to the financial strength of the bank; (2) the corporation may be reasonably expected to effect for the bank reduced clerical costs or improvements in customer services sufficient to justify the investment; and (3) the appropriate Federal supervisory agency receives satisfactory assurances that, whenever the 10-percent limitation is exceeded, (a) the corporation will make such reports to the agency as it may require, and (b) the corporation's charter, capitalization, scope of operations, or schedule of charges for services will not be changed materially without the agency's approval.

Bank service corporation.—The definition of "bank service corporation" in section 2(a) of the bill is quoted above. As the definition recognizes, the efficiency of a bank service corporation and the resulting benefits to the investing banks might be increased in some circumstances if the corporation were not limited to serving the banks exclusively. The Board believes, however, that the definition should be changed to make it clearer that over one-half of the corporation's business would have to be that of serving the investing banks, and to limit any business of the corporation with others to serving them in the same way permissible as to banks. These suggestions might be accomplished by substituting for the language "whose primary purpose is to perform" in line 7 on page 1 of the bill, the language "(1) whose principal purpose is to perform"; and by adding at the very end of the definition new language reading "and (2) whose other purposes, if any, are limited to the performance of comparable services for others."

The definition of "bank service corporation," includes an enumeration of the services to be performed for the banks, followed by the language "or any other similar clerical or bookkeeping function." (See p. 2 of the bill, lines 2 and 3.) In order to assure the maximum benefit from the operations of a bank service corporation, it is suggested that the language just quoted be broadened to read "or any other similar clerical, bookkeeping, accounting, or statistical function related to the business of the banks."

State nonmember insured banks.—Despite the provision of the bill, section 6(a)(1) of the Bank Holding Company Act (U.S.C., title 12,

sec. 1845) would continue to preclude a State nonmember insured bank that is a subsidiary of a bank holding company from investing in a bank service corporation that is also a subsidiary of the holding company and is not engaged solely in serving the holding company or its subsidiary banks. It is believed that this could be remedied by an amendment to section 3 of the bill which would include State nonmember insured banks among the banks which may invest in bank service corporations, and by an appropriate change in section 2(d) of the bill. The Board would have no objection to amendments to the bill in these respects.

Investments exceeding the 10 percent limitation.—In connection with approval by the Federal supervisory agency concerned of total investments by a bank in a bank service corporation in excess of 10 percent of the bank's capital and surplus, section 4(2) requires the agency, among other things, to be satisfied that "the corporation may reasonably be expected to provide a reduction in clerical costs, or an improvement in the services offered by the bank to its customers, or some combination thereof, which is sufficient to justify the investment." At the same time, section 4(1) would require the agency to be satisfied that "the investment is reasonable and prudent in relation to the financial strength of the bank." The Board suggests that section 4(2) be deleted. The detailed nature thereof would not only be conducive to administrative difficulties, but the provision itself is not necessary in view of the broad scope of section 4(1).

Section 4(3)(B) requires, in effect, that whenever the 10-percent investment limitation is exceeded, "no amendment shall be made to the charter, and no substantial change may be made in the [bank service] corporation's capitalization, scope of operations, or schedule of charges for services without the approval of" the Federal supervisory agency concerned. It is suggested that the language just quoted be changed to read "no substantial change may be made in the capitalization or operations of the corporation without the approval of such agency." This simplified provision would seem entirely adequate to protect the investing banks.

Reports and examinations.—Under section 4(3)(A) of the bill, the Federal supervisory agency concerned is entitled to reports from the bank service corporation whenever the bank's total investment therein exceeds the 10-percent limitation. The Board believes that the purpose of a provision for reports from a bank service corporation would be better effectuated if the provision were broadened to include also examinations of such corporations and certain regulatory safeguards, and if the provision, as so broadened, were made applicable irrespective of the 10-percent limitation. This might be accomplished by deleting section 4(3)(A) of the bill and adding at the end of section 3 a new sentence such as the following:

"No investment shall be made pursuant to this section unless the bank first obtains from the bank service corporation an agreement that it will permit examiners appointed by the Federal supervisory agency concerned to make such examination of the corporation as the agency may deem necessary, will make such reports to the agency as it may require, and will comply with such regulations as the agency may prescribe as necessary or appropriate to assure

both to the bank and the corporation adequate systems of insurance protection and internal audit and control."

Relations with other data processing organizations.—As pointed out above, some banks have already availed themselves of services of the kinds contemplated by H.R. 8874 for bank service corporations, through contractual arrangements with data processing centers operated by private commercial concerns. It would seem reasonable to expect the number of such banks to increase. The Board believes that its suggestion above with respect to examinations, reports, and regulations in the case of bank service corporations should be made applicable as well to other data processing organizations serving banks. If the foregoing suggested addition to section 3 of the bill should be adopted, the latter suggestion might be accomplished by adding to the bill a new section 5 along the following lines:

"SEC. 5. No bank of a kind referred to in section 3 of this Act shall enter into any contract or other arrangement for the purpose of obtaining services described in section 2(a) of this Act from any person other than a bank service corporation, unless the bank first obtains from such person an agreement of the kind required by the last sentence of section 3 of this Act. As used in this section 'person' includes an individual, corporation, partnership, association, and any other organization whether or not incorporated."

In addition to the above suggestions, the Board's staff will be glad to discuss with your staff a few minor suggestions relating solely to technical or drafting matters.

It is hoped that the foregoing may be helpful in connection with such consideration as your committee may give to H.R. 8874.

Sincerely yours,

WM. McC. MARTIN, Jr.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM,
Washington, July 25, 1962.

HON. BRENT SPENCE,
*Chairman, Committee on Banking and Currency,
House of Representatives, Washington, D.C.*

DEAR MR. CHAIRMAN: This is in response to your request for the Board's views on the substitute amendment to H.R. 8874, adopted yesterday by Subcommittee No. 1 of the House Banking and Currency Committee.

As indicated to you in the Board's report submitted under date of March 1, the Board favors the objective of this bill. The substitute amendment adopted by the subcommittee in substance would carry out the suggestions made by the Board in its earlier report, and the Board is especially pleased to note that the new bill includes in section 5 provisions that are needed to insure adequate regulation and examination of bank services performed off the bank's premises. The Board, accordingly, recommends enactment of the bill as amended.

Sincerely yours,

WM. McC. MARTIN, Jr.

FEDERAL DEPOSIT INSURANCE CORPORATION,
OFFICE OF THE CHAIRMAN,*Washington, April 25, 1962.*

HON. BRENT SPENCE,
*Chairman, Committee on Banking and Currency,
House of Representatives, Washington, D.C.*

DEAR MR. CHAIRMAN: The Corporation has been requested to express its views on H.R. 8874, a bill introduced in the House of Representatives on August 23, 1961, by Mr. Spence. The proposed bill would permit national banks and State member banks, when authorized by State law, to invest not exceeding 10 percent of the bank's capital and surplus, or such additional sum as might be approved by the appropriate Federal supervisory agency, in stock in a bank service corporation, established to provide clerical and bookkeeping services to the banks participating in the establishment of the corporation and in the services to be rendered by the corporation.

The capacity of the banking system, to adequately service the needs of commerce and industry, depends on its ability to expeditiously process daily a mountainous volume of paper instruments evidencing approximately 95 percent of all business transactions. The bank clearing system is under heavy strain due to the tremendous expansion in the national economy and also by reason of the very great enlargement in bank services which has taken place during the past 15 years.

The electronic computer, with related equipment, is ideally suited to the accounting needs of banks, but unfortunately is so costly that only the large banks can afford the machines. Were the small banks, and 10,000 of the 13,400 banks of the country are classed as small banks, unable to utilize the electronic computer because of cost, they would be placed at a serious disadvantage and ultimately have to become a part of a larger banking system in order to survive.

Fortunately, the great speed and capabilities of computers make it possible for one installation to perform the accounting function for several smaller banks located within a county or regional area possessed of good communications. By sharing the expense, two or more banks may enjoy the benefits of a computer system on a par with large banks. For these reasons we should recommend that national banks, and insured State banks when authorized by State law, be enabled to invest in bank service corporations up to 10 percent of the bank's capital and surplus, without prior approval of Federal bank supervisory agencies, and to such additional amount, and under such conditions, as the Federal bank supervisory agencies may permit.

The Corporation endorses in principle the proposal outlined in the subject bill. However, it offers for consideration the following amendments thereto that appear to improve the proposal:

(a) For purposes of more accurately defining the functions of the bank service corporation, it is recommended that the word "accounting" be added to line 2 of page 2 (sec. 2(a)) between the words "clerical" and "or."

(b) The definition of Federal supervisory agency at line 11 through line 15 on page 2 (sec. 2(d)) should be expended to include the Federal Deposit Insurance Corporation for insured State nonmember banks.

(c) The authorization appearing in section 3 on page 2 should be extended to include "any insured State nonmember bank."

(d) There should be added a new section—"Section 5"—which would provide for the examination, visitation and supervision by State and Federal bank supervisory authorities to the same extent as the banks, or any of them, which are serviced by the bank service corporation, are subject.

(e) There should be added another new section, which should provide that no insured bank could contract for services, such as those provided by a bank service corporation, unless the servicing party agrees to and, in fact, does permit the State and Federal bank supervisory authorities to exercise the right of visitation in the same manner and to the same extent as contemplated in the preceding paragraph.

With these amendments, the Corporation would favor the bill's enactment. We would be glad to have our Legal Division assist your staff in drafting the provisions of these amendments, if they meet with your approval.

We have been advised by the Bureau of the Budget that it has no objection to the submission of this report from the standpoint of the administration's program.

Sincerely yours,

ERLE COCKE, Sr., *Chairman.*

FEDERAL DEPOSIT INSURANCE CORPORATION,

OFFICE OF THE CHAIRMAN,

Washington, July 24, 1962.

HON. BRENT SPENCE,

*Chairman, Committee on Banking and Currency,
House of Representatives, Washington, D.C.*

DEAR MR. SPENCE: In accordance with your request, we have examined the committee print of H.R. 8874, dated July 24, 1962, as amended by Subcommittee No. 1, a bill to authorize certain banks to invest in corporations whose purpose is to provide clerical services for them, and for other purposes, and recommend its enactment.

Sincerely yours,

ERLE COCKE, Sr., *Chairman.*

BANK SERVICE CORPORATIONS

(c) The authorization appearing in section 3 on page 2 should be extended to include any insured state nonmember bank.
(d) There should be added a new section—"Section 5"—which would provide for the examination, visitation and supervision by State and Federal bank supervisory authorities to the same extent as provided for in section 4.

**DISSENTING VIEWS OF HON. WRIGHT PATMAN AND HON.
HENRY B. GONZALEZ**

We dissent to H.R. 8874 on seven grounds:

(1) The bill raises serious problems under the antitrust laws and may open the door to restraints of trade, price fixing, and bank mergers. This very important question was not raised in the hearings. We are presenting an opinion of Judge Lee Loevinger, Assistant U.S. Attorney General, Antitrust Division, Department of Justice, herewith, that is convincing that further study be given this proposal.

(2) Inadequate hearings were held to guide us in this very new pioneering venture. More time should be given for developments and experience.

(3) Billions of dollars are involved in this bill that is presented in very short hearings where limited information was presented and where few questions were asked. This is a bonus to the banks since it allows 10 percent of their capital funds to perform double duty. Banks' capital can also be diluted by investments in small business investment companies. Capital funds are sacred and should be carefully guarded.

(4) No foundation has been laid for the necessity for banks to invest in service corporations as the only means of securing the advantages of electronic clerical services.

(5) The bill as written is tailor-made to benefit particularly branch and holding company banking.

(6) Banks should not be permitted to dilute their capital structure in this fashion, when the banks already complain about inability to make loans because of insufficient capital.

(7) It is doubted that small or independent banks will permit even friendly competitors to have access to their confidential transactions and business, so we can reasonably expect that only branch and holding company banks will utilize the provision, with the result that they will have an advantage over their small and independent competitors. The bill thus would have consequences which its sponsors claim they are preventing.

BILL RAISES SERIOUS QUESTIONS UNDER THE ANTITRUST LAWS

The committee might well have elicited testimony from the Chief of the Antitrust Division of the Department of Justice to explore the possibility of problems this bill might create under the antitrust laws. Mr. Patman undertook to ask Judge Loevinger about this and received the following reply—which speaks quite eloquently of the problems this bill might raise:

JULY 27, 1962.

Hon. WRIGHT PATMAN,
House of Representatives, Washington, D.C.

DEAR CONGRESSMAN PATMAN: This is in reply to your request for my views on the possible antitrust consequences of H.R. 8874, a bill to authorize certain banks to invest in corporations whose purpose is to provide clerical services for them, and for other purposes.

While I do not disagree with the basic objectives of this bill, you may wish to consider possible abuses which might raise questions under the antitrust laws.

The exchange of confidential business information among competitors carries with it the possibility that such information will be used for anticompetitive purposes. Thus the exchange of information concerning interest rates and charges to particular customers could result in an elimination of competition for the account and an artificial stabilization of interest rates at noncompetitive levels. Past experience has illustrated that such anticompetitive results have in fact occurred in the operation of many bank clearing house associations. To avoid this possibility, it would be desirable to provide that no information furnished to the service corporation may be made available to participating banks other than the bank directly involved.

Moreover, such jointly owned corporations could become vehicles through which large banks could enhance their dominant position in the market. Competition in the offering of services is one of the most important types of competition which the antitrust laws seek to preserve. Frequently, service competition is the principal means by which small businesses, including banks, are able to attract and maintain business. Any diminution in the incentives to small banks to engage in competition of this type would be of serious concern to the Department of Justice.

In view of the fact that the formation of such corporations is not exempted from the antitrust laws, any antitrust violations occurring in the operation of the service corporations would, of course, be subject to prosecution by the Department of Justice. If, for example, the acquisition of stock in any of these corporations should substantially lessen competition or tend to create a monopoly, section 7 of the Clayton Act would be fully applicable.

Time has not permitted a detailed analysis of the bill or coordination of these views either within the Department or with the Bureau of the Budget. However, I hope that these observations may be of some help in your consideration of this matter.

Sincerely,

LEE LOEVINGER,
Assistant Attorney General,
Antitrust Division.

Judge Loevinger raises the question about the possible "exchange of confidential business information among competitors" and the possibility that this procedure might "be used for anticompetitive purposes."

This is obviously a serious matter, as witness the statement made by Mr. Wolcott:

The bank service corporation will have in its possession records and data of two or more banks, *confidential in nature*

and vital to the banks' operations. For that reason the supervisory agency must be put in a position of immediate control of any conduct by the bank service corporation constituting a violation of any provision of the bill or of any regulation thereunder.¹ [Emphasis added.]

Thus, both the supervisory agencies and the Antitrust Division would, under this bill, be required to undertake additional burdens; namely, to observe very carefully the conduct of any bank service corporation, to determine whether they would involve any violations of law.

Judge Loevinger speaks of the danger of jointly owned corporations becoming:

* * * vehicles through which large banks could enhance their dominant position in the market.

He also stresses that:

Competition in the offering of services is one of the most important types of competition which the antitrust laws seek to preserve.

Further, he notes that:

Frequently, service competition is the principal means by which small businesses, including banks, are able to attract and maintain business. Any diminution in the incentive to small banks to engage in competition of this type would be of serious concern to the Department of Justice.

Finally, Judge Loevinger points to the danger of monopolistic mergers. There is a tremendous merger movement underway among banks. The growing monopoly of money and credit—the lifeblood of our economy—poses an ominous threat particularly to opportunities for small business. The Congress should not take steps to accelerate this trend.

HEARINGS INADEQUATE FOR SUCH A PIONEERING VENTURE

H.R. 8874 would permit any two or more National banks and State member banks, when authorized by State law, to invest not exceeding 10 percent of each bank's capital and surplus in stock of a bank service corporation, established to provide clerical and bookkeeping services.

The hearings were exceedingly brief. Testimony was heard from the Chairman of the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, and a Director of the Federal Deposit Insurance Corporation (Mr. Wolcott). Statements were also filed by counsel of the Connecticut Bankers Association and by the executive vice president of the Massachusetts Bankers Association. Very few questions were raised by committee members. Comptroller of the Currency Saxon termed the bill:

* * * purely a technical, procedural one in essence, and intended primarily to meet the requirements of smaller institutions.²

¹ Hearings on H.R. 8874, p. 47.

² Hearings, p. 40.

He commented further that:

The proposal is not an earthshaking thing * * *³

Comments of the banking officials notwithstanding, this is a serious pioneering venture for banks into nonbanking fields. More thorough testimony should be elicited and more time should be given for development and experience in this area before taking the major step the bill provides.

BANKS SHOULD NOT BE PERMITTED TO DILUTE CAPITAL STRUCTURE

It need hardly be documented, in view of the complaints we have heard in increasing volume in recent years, that banks—particularly small banks—feel that their capital ratios are inadequate. It is contended that inadequate capital ratios are an impediment to making much needed loans.

The 1961 Annual Report of the Federal Deposit Insurance Corporation, a copy of which I have just received, reveals a further decline in the capital ratio of insured banks. This is shown by the following tabulation:

Ratio of total capital accounts to total assets other than cash and U.S. Government obligations (percent), of all insured banks in the United States, Dec. 31, 1958, through Dec. 30, 1961.

Call dates:	Percentage
Dec. 31, 1958	14.1
June 10, 1959	13.9
Dec. 31, 1959	13.5
June 15, 1960	13.6
Dec. 31, 1960	13.7
Apr. 12, 1961	13.9
June 30, 1961	13.9
Sept. 27, 1961	13.9
Dec. 30, 1961	13.6

Source: Annual Report of the Federal Deposit Insurance Corporation, 1961, p. 107.

As shown above, the ratio of capital accounts to total assets other than cash and U.S. Government obligations has declined in recent years. As of December 30, 1961, it stood at 13.6 percent as compared with 14.1 percent at the end of 1958. During this same interval, total loans and discounts (net) of all insured banks rose from \$117 billion at the end of 1958 to over \$150 billion at the end of 1961.

That investment in service corporations will dilute the capital structure of banks is reflected in the efforts of the Comptroller of the Currency to raise the effective limit to 25 percent.

Already, the capital funds of the banks are doing double duty, since they can be diluted by investments in small business investment companies.

³ Ibid.

QUESTION NOT EXPLORED AS TO WHETHER BANKS COULD SECURE ELECTRONIC CLERICAL SERVICES WITHOUT INVESTING IN SERVICE CORPORATIONS

Were this a matter simply of enabling banks to secure the cost-saving benefits of electronic devices, it would not cause any great concern. However, it is in the means of securing such services that serious problems arise. Is it essential that banks secure an ownership interest in a service corporation in order to have the benefit of electronic services? No testimony was heard on this point. The matter was not raised by any of the members of the committee.

The limited testimony was to the effect that only by being permitted to join together with other banks and investing in service corporations would the smaller banks be able to secure the cost-saving efficiency of electronic bookkeeping.

Mr. Wolcott testified:

The electronic computer, with related equipment, is ideally suited to the accounting needs of banks, but unfortunately is so costly that only the large banks can afford the machines. If the small banks, and 10,000 of the 13,400 banks of the country are small banks (under \$10 million), were unable to utilize the electronic computer because of cost, they would be placed at a serious disadvantage.

Fortunately, the great speed and capabilities of computers make it possible for one installation to perform the accounting function for several smaller banks located within a county or regional area possessed of good communications. By sharing the expense, two or more banks may enjoy the benefits of a computer system on a par with large banks * * *⁴

Mr. Saxon stated:

Many of them singly lack the capital required to undertake these extensive programs in view of the cost of the equipment.⁵

Mr. Martin stated:

Under the bill, two or more banks would be able to pool their resources through the corporate device in order to gain the benefits—for themselves and for their customers—of this expensive equipment.⁶

Electronic devices have been so publicized in recent years that one would think that nothing can be done without them. They are thought to be so efficient and so magnificent that merely to suggest their use is to induce enthusiasm. Maybe this is the reason why no questions were raised as to whether the only way banks could utilize such electronic equipment would be to own them. But this overlooks a very important fact; namely, that the major electronic companies provide these services through their own service bureaus. It is not necessary to own the equipment. Indeed, it is rare that the more expensive computers are purchased. It would be most uneconomical

⁴ Hearings, p. 46.

⁵ Id., p. 40.

⁶ Id., p. 34.

to own some of the more expensive machines unless the load factor were extremely heavy.

In short, until it is demonstrated that electronic clerical services can be secured only through the *owning* of service corporations, banks should not be permitted to join together for this purpose. Moreover, we should have some information as to the number of people in small communities that might be thrown out of work by the introduction of these electronic services.

BILL BENEFITS BANK HOLDING COMPANIES AND BRANCH BANKS

It is clear that the great beneficiaries of this bill are the bank holding companies and the branch banks. They are the ones who have the financial resources to undertake investment in service corporations. But more significant, the independent banks guard carefully information on their confidential accounts. Once other banks gain access to such information, the way is paved for overt merger, bank holding company takeover, or covert branching.

It is significant that no testimony was heard on H.R. 8874 from representatives of the small banks. The Independent Bankers Association did not testify on behalf of the bill. We have not received a single letter from banks in our districts recommending that the bill be passed.

In view of the serious questions raised by H.R. 8874, it is our sincere belief that it should be rejected.

Respectfully submitted.

WRIGHT PATMAN.
HENRY B. GONZALEZ.

