

**FEDERAL RESERVE RULINGS REGARDING LOAN  
PRODUCTION OFFICES AND PURCHASES  
OF OPERATING SUBSIDIARIES**

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**HEARINGS**  
BEFORE THE  
**COMMITTEE ON BANKING AND CURRENCY**  
**HOUSE OF REPRESENTATIVES**  
NINETIETH CONGRESS  
SECOND SESSION  
ON  
FEDERAL RESERVE RULINGS REGARDING LOAN PRODUCTION  
OFFICES AND PURCHASES OF OPERATING SUBSIDIARIES

—————  
SEPTEMBER 24 AND 25, 1968  
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# FEDERAL RESERVE RULINGS REGARDING LOAN PRODUCTION OFFICES AND PURCHASES OF OPER- ATING SUBSIDIES

TUESDAY, SEPTEMBER 24, 1968

HOUSE OF REPRESENTATIVES,  
COMMITTEE ON BANKING AND CURRENCY,  
*Washington, D.C.*

The committee met, pursuant to notice, at 10 a.m., in room 2128, Rayburn House Office Building, Hon. Wright Patman (chairman) presiding.

Present: Representatives Patman, Reuss, Stephens, Gonzalez, Minish, Gettys, Rees, Bingham, Bevill, Griffin, Williams, and Wylie.

Chairman PATMAN. The committee will please come to order.

Will the members who are present please take their places?

We realize that it is very difficult to get a quorum now. In fact, yesterday is the first time in a long time that we failed to get a quorum on the floor of the House. We lacked about 34 Members of getting a quorum—which is very unusual. The Senate had the same experience for a while.

Today, we have enough members to begin this hearing, and we will proceed.

Today the full Committee on Banking and Currency begins hearings into the August 14, 1968 administrative action taken by the Federal Reserve Board, in which the Board reversed its longstanding position on two vital subjects—acquisition by banks of operating subsidiaries through stock purchases and perhaps even more important, a ruling which overturns more than 35 years of policy whereby banks may establish loan production offices—in effect branches—throughout the United States.

These two policy changes made by the Federal Reserve Board are, in my opinion, exceedingly important in two respects. First, the importance of the decisions themselves on our banking structure in the United States, and secondly what I consider the seizure by the Federal Reserve Board of the legislative function.

I intend to develop this matter in greater detail tomorrow when we will have before us representatives of the Federal Reserve Board.

Our witnesses today represent the Independent Bankers Association of America. The president of this fine organization will speak for the group of independent bankers in the United States.

He comes from Athens, Ga., which is the home of a distinguished member of our committee, an old friend of our witness, and I would like for you, Mr. Stephens, to introduce the witness, please.

Mr. STEPHENS. Thank you, Mr. Chairman. I want to welcome Mr. Milner to our committee again.

As you who are here have heard me say before, he and I went to college together, and then after World War II we joined hands and started a new law firm together in Athens, Ga. He and I as young men endeavored to start to practice law and we decided that it was nice to have somebody to hold your hand when you step out into the cold water. We practiced together for nine and a half years and then Mr. Milner became the president of the National Bank of Athens. I said at that time he ought to take the job and I would get his hand out of my pocket but I was going to keep my hand in his.

We are happy to have Mr. Milner. He has been a leader in the banking circles of Georgia and in the United States and is now the president of the Independent Bankers. I want to say that he has been before our committee on several occasions and I hope he will be before us again.

I would suggest since we do have him here frequently maybe we should get him a printed sign instead of the one with pencil.

Chairman PATMAN. We are glad to have you, Mr. Milner, and you may proceed in your own way.

**STATEMENT OF THOMAS H. MILNER, JR., PRESIDENT, INDEPENDENT BANKERS ASSOCIATION OF AMERICA**

Mr. MILNER. Thank you, Mr. Chairman, and my good friend Bob Stephens.

If I might say before beginning my remarks, it is a real honor again to appear before this committee of Congress, a most important and vital committee, and also to say how happy I am for the first time since Bob has been in politics, he doesn't have any opposition. So this is a real fine tribute to him, I think.

Chairman PATMAN. May I interrupt there to say that a lot of us have plenty of opposition, but it happens we do not have any opponents this time.

Mr. MILNER. Yes, sir.

My name is Thomas H. Milner, Jr., and I am president of the National Bank of Athens, which was organized shortly after the Civil War, in 1866, and has been in continuous operation since that time under its original charter, with some amendments, and under its original name, and except for one move in the original location.

Today I am here representing the Independent Bankers of America, which is an association of independent bankers and was organized for the purpose of providing a voice for the independent bankers of America. We have some 6,500 members in 40 different States.

Much of what I will have to say will refer to pertinent law bearing on the subject of this hearing. As a lawyer, as well as a banker, I will make reference to certain laws as well as to practical banking practices. Seated with me at the table is Horace R. Hansen of St. Paul, Minn., our attorney, and Howard Bell, of Sauk Centre, Minn., executive director of our association. We are at your disposal this morning for whatever questions you may have at the end of my statement.

I would like to preface my remarks that I have personally always believed in the independence of the Federal Reserve System. I think it has served the Nation well, but we feel that in this instance they have perhaps stepped beyond the authority of the law in this ruling with

respect to loan production officers and we are somewhat forced in the position because of rulings by the previous Comptroller of the Currency in this area, and did so in order to permit State member banks the same latitude of activity to compete with national banks.

Our association stands for restriction of multioffice banking so as to preserve, to the greatest extent, meaningful competition in the banking industry. We feel that the banking industry is unique and is unlike other types of businesses.

Multiple-outlet banking leads to concentration of control of bank credit and a lessening of competition. This occurs because larger banks can better afford to establish and promote additional offices. As large banks grow larger by this process, they move to a dominant position in banking markets. In this circumstance, smaller banks are placed at such a competitive disadvantage that ultimately many sell out to these large complexes, either voluntarily or by the force of the economic situation that they find themselves in.

While it has been the longstanding policy of Congress to preserve competition in banking in the national interest, our observation is that the Federal bank regulatory agencies seem to be following an opposite course of action. In the past 7 years, particularly, we have seen these agencies issue an increasing number of rulings which expand the powers of banks they supervise. These rulings tend to give to large banks and bank systems more and more privileges, leading to a greater concentration in the control of money and credit.

We will develop in this statement that these rulings amount to administrative legislation and a usurpation of the power of Congress to establish national banking policies. This trend, which received its greatest impetus from the Comptroller who was the immediate predecessor of the incumbent, has gone so far and is so serious as to now call for decisive action by Congress to halt these practices. There is clear need to strengthen national banking laws so as to stop legislation by edict. The plain fact is that the individuals running these agencies have taken the law into their hands by strained construction of the clear import of the laws of Congress.

The rulings they issue are accorded the dignity of law and are regarded by the banking industry as the law. Actually, however, we are observing an erosion of the rule of law. It is one thing for an agency to adopt rules and regulations to carry out the will of Congress, quite another to legislate new banking policies never considered or authorized by Congress.

My opinion is that both the Federal Reserve Board and the Federal Deposit Insurance Corporation, jarred by the stream of rulings from the Comptroller's Office, in many instances have been forced to react defensively by adopting similar rulings. Thus the "competition of laxity" among regulatory agencies is enhanced.

The time has come to put a stop to rule by edict in such an important and sensitive field as banking, which so profoundly affects us all.

In our opinion, the loan production offices are unauthorized branches.

An edict issued by the Federal Reserve Board on August 14, 1968, purports to authorize "loan production offices." As defined in the ruling of the Board, these offices are nothing more than branches, in violation of the law, as we will demonstrate.

The National Bank Act states that a national bank shall operate only "in the place specified in its organization certificate and in the branch or branches, if any, established or maintained by it in accordance with the provisions of section 35 \* \* \*" (12 U.S.C. 81) section 36 states that a national bank may establish branches where it operates only to the extent permitted by the State law to State banks (12 U.S.C. 36(c)). A "branch" is defined "to include any branch bank, branch office, branch agency, additional offices, or any branch place of business \* \* \* at which deposits are received, or checks paid, or money lent."

The courts have held that this definition is not exclusive, or even complete, and must take into consideration the law of the State in which the national bank operates as to the authority to establish branches. (See *First National Bank v. Walker Bank*, 385 U.S. 252, decided in 1966; *Jackson v. First National Bank of Valdosta*, 349 F. 2d 21, decided by the Fifth Circuit Court in 1965, and *Dickinson v. First National Bank in Plant City, Florida*, decided by the Fifth Circuit Court on September 12, 1968.)

The appellate decision in the *Florida* case above referred to, rendered only 12 days ago, involved the use of an armored car which stopped at many locations during the day, picking up deposits and delivering cash to customers, with the intent ultimately to conduct a "full service branch." The Comptroller of the Currency and the national bank in that case contended that the transactions were not completed until closed at the main office of the bank. The court rejected this argument, as it did in the *Valdosta* case, which is a Georgia case, and observed that while part of the process of banking was conducted at various places where the armored car stopped, and the rest of the process was completed at the bank, the operations of the armored car constituted branching in violation of law. In referring to the definition of "branch" in the National Bank Act, this court stated, and I quote :

If we construed Section 36(f) as permitted paper evasions from State anti-branching laws, we would be letting the left hand give and the right hand take away. Statutory construction has not fallen to such legalistic depths.

In the ruling of the Federal Reserve Board on "loan production offices" the same law applies. The processing of loans at these additional offices of the bank constitutes operation of a branch in violation of law. The Federal Reserve Board attempts to rationalize that "loan production offices" are not additional offices of the bank because the loan transaction is completed at the main bank office.

The Board in its "ruling" states that "soliciting loans on behalf of a bank (or a branch thereof), assembling credit information, making property inspections and appraisals, securing title information, preparing applications for loans (including making recommendations with respect to action thereon), soliciting investors to purchase loans from the bank, seeking to have such investors contract with the bank for the servicing of such loans, and other similar agent-type activities" do not constitute branching "when loans are approved and funds disbursed solely at the main office or a branch of the bank \* \* \*"

I might inject here that in most of these instances that it has been my understanding that the banks will usually require a compensating balance during the period of time that the loan is in effect. This could conceivably be a solicitation of deposits by virtue of and under the

terms of a contract of a loan. So conceivably it could broaden the powers not really spelled out or intended even in this ruling of the Federal Reserve Board.

This is the same legal legerdemain and play on words used by the Comptroller of the Currency in authorizing mobile branches in Florida, which the court found in violation of the branching laws.

In 1963, the Supreme Court of Utah considered the making of automobile loans by insurance agents in many locations throughout the State. It was claimed that these off-premises operations were not restricted by statute, and that in any event the loans were not completed until they reached the bank office. The State statute involved was practically identical with section 36(f) which defines branches. The court in that case found that the insurance agents "are in fact agents of the Bank in conducting its business \* \* \*" and further stated: "\* \* \* the Commissioner answers the bank's question regarding the whereabouts of its 'branches' by responding that mobile or door-to-door branch banking is as violative of the statute as though specific street addresses for such 'branches' were had." (*Continental Bank & Trust Co. v. Taylor*, 384 P. 2d 796.)

Even without the court decisions I have cited, it is plain commonsense that the loan processing described in the Board's ruling is an essential and indispensable part of the approval and disbursing of the loan at the main office of the bank. Conversely, a loan cannot be completed at the bank without the credit file material which bank examiners require in the orderly operation of a bank. Therefore, loan processing in the field, for example by an insurance agent or an automobile or appliance dealer, is an essential and integral part of the lending business of a bank and the field offices that conduct such operations are branches of the bank. The function of processing in one place and approval in another adds up to two places of doing the business of banking.

This ruling, in our opinion, violates the principles of competitive equality.

As stated earlier, section 81 of the National Bank Act provides that a national bank may operate its banking business only at its main office and at branches established in accordance with section 36 of the act. Court decisions I have cited interpret section 36 to the effect that no off-premise banking is authorized except under section 36, which in turn incorporates the law of each State as to branching. Thus, if a State law by its definition and interpretation of branching would not permit "loan production offices" for State banks, then national banks operating in that State likewise may not operate such offices.

However, the Board ruling of August 14, 1968, provides that State banks that are members of the Federal Reserve System, as well as national banks, "may establish and operate, at any location in the United States, a 'loan production office' \* \* \* operated by the bank either directly, or indirectly through a wholly-owned corporation."

In other words, the Board is saying that national banks and State-member banks may operate such branches regardless of the State law in which the national bank has its main office and, further, may operate such branches anywhere in the United States.

This ruling follows precisely the ruling of the Comptroller made in November 1966 (the Comptroller's Manual for National banks, par. 7380). Thus, both the Comptroller and the board have legislated that their regulated banks may operate branches for producing loan business regardless of the one-location law, the branching laws and the State law.

In the same manner, the Federal regulatory agencies authorized mobile branching. First was the "ruling" of the Comptroller of the Currency in 1964 stating that an armored car by a national bank could collect deposits and cash checks at locations away from the bank if the customer would sign an agreement that the personnel on the truck were his agents and not the agents of the bank. (Comptroller's Manual, par. 7490). A few months later the Federal Reserve Board made a similar "ruling." (12 C.F.R., sec. 208.110).

Following these rulings, a national bank in Florida advertised "full service branching at your doorstep" and started operating an armored car, the curb side of which was provided with space for two tellers behind bullet-proof glass and with push-out drawers, for conducting the banking business at parking lots and other locations.

As I said a moment ago, I feel that banking is a unique type of business and is not like other types of business.

Under Florida law, State banks are limited to one location and cannot operate such mobile branches. The on-wheels branching of a national bank in Florida resulted in the lawsuit and recent decision of the Fifth Circuit Court that I have cited to you.

This situation is developing in other States as well. For example, in my home State of Georgia, a bank in the northeast is operating a similar mobile branch unit in four counties and into parts of North Carolina. Another lawsuit in Georgia is challenging the ruling.

The attorneys in that case representing the contesting banks have asked the judge to issue a summary judgment and an injunction, following the decision of the *Florida* case, and it is my understanding that there will be a hearing on this motion in the next few days.

If these two rulings are permitted to stand—one authorizing mobile units to pick up deposits and deliver cash, and the other authorizing loan production offices—the effect will be disastrous to the stability of the banking industry.

The major functions of banking—receiving deposits, cashing checks and making loans—could then be conducted at any number of locations in any number of States by a single bank, all without regard to the State laws involved.

Larger banks, having the finances to purchase and operate such mobile units, or to set up separate corporations for loan production offices, or to set up others to operate such offices, and to advertise and promote all of these activities, would quickly have a competitive disadvantage over the smaller banks.

Smaller banks would lose business as customers found it easier to do business with larger banks having such convenient facilities.

State laws governing branching would be broken down and destroyed. This would follow because it is cheaper to operate armored cars and loan production offices than it is to establish authorized brick and mortar branches at fixed locations.

The States then would have no alternative but to permit similar activities to State banks so they could compete. The ultimate result would be the destruction of the dual banking system that has served us so well for over 100 years. This system involves the principle of competitive equality between National and State banking systems, a principle made necessary because neither level of government may preempt the entire field of banking under our Constitution.

In the *Walker Bank* case, decided by the U.S. Supreme Court in December 1966, the entire history of national branching laws and their relation to State branching laws was exhaustively reviewed and the Court stated, and I quote:

It appears clear from this résumé of the legislative history of paragraph 36(C) (1) and (2) that Congress intended to place National and State banks on a basis of "competitive equality" insofar as branch banking was concerned. (385 U.S. at 261.)

The *Florida* case we have cited followed the *Walker Bank* case in holding that State laws must be observed when determining what constitutes branching by national banks under Federal law. The appellate court stated that to hold otherwise "would allow the U.S. Comptroller by means of oracular definitions, to distort what States believed was banking into nonbanking." Referring to the operations of the armored car in Florida, this court stated:

Unless we were to cast away all concepts of the functional "business" of a bank, we would have to conclude that First National was "doing business" with its extra services.

This reasoning applies with equal force to "loan production offices." If a substantial part of the work of processing a loan on the one hand, or receiving a deposit on the other, is conducted away from the location of the bank, then the bank is conducting the business of banking away from its main office. Thus, the bank is engaged in branch banking and, unless authorized by the Federal law which incorporates the State law, it is violating the law. The law being violated is statutory law, enacted by Congress. It is clear that Federal agencies, by the device of so-called rulings, cannot permit banking operations in violation of statutory law.

It is indispensable in our opinion to maintain equality between National and State banks by the control of bank locations—specifically the places where banks are authorized to operate. Without control of bank locations the dual system would not work.

A bank's location is a most important franchise right, in effect a preemptive right to carry on banking operations at the place specified in its charter. As a prime asset, vital to the success of a bank, location is strictly controlled by both Federal and State laws. Other factors being equal, a bank located at a place convenient to its present and prospective customers will tend to prosper and grow. One located in an inconvenient place may have difficulty maintaining soundness. Locations are therefore highly prized and avidly sought by those interested in organizing banks.

Bank supervisors use great care in licensing a bank at a given location and take many economic factors into consideration in passing upon an application to locate a bank at a certain place. Convincing proof is usually required to show that a bank would prosper at the proposed location.

The reasons for such care are obvious. The prime concern is with safety of deposits of the public's money. The economic indicators must persuasively show that there will be a sufficient volume of business at the proposed location to assure soundness and at the same time not endanger the solvency of the neighboring banks.

In summary, these "rulings," if permitted to stand and to be accorded the force and effect of law, would permit operations by national and State-member banks contrary to one-location laws (sec. 81 and like State laws), branching laws (sec. 36 and corresponding State laws), change of location laws (sec. 30 and corresponding State laws), as well as the principle of competitive equality between the national and State bank systems.

We have observed that "rulings" of this type have been issued increasingly since 1961 and most of them were originated by the Comptroller of the Currency and later followed by the Federal Reserve Board and the FDIC. The motivations of the Comptroller have been documented in hearings before this committee and the Senate Banking Committee. He was in favor of Federal legislation giving increased power and privileges to national banks, regardless of State law. When he was unable to obtain this kind of legislation, he issued "rulings" to accomplish this purpose.

The Comptroller of the Currency has attempted to justify such "rulings" under (a) the implied power of his office or (b) by his interpretation of the implied powers clause applying to bank corporations contained in 12 U.S.C., paragraph 24 (Seventh).

We are dealing actually with two kinds of implied powers: those applying to the agency itself, and those applying to a bank corporation.

We also concede that a Federal supervisory agency has the implied power of office to issue rules and regulations to carry out its supervisory functions and to enforce existing statutes.

We cannot concede, however, that this power of office carries with it any authority to nullify or change the effect of existing statutes, or to legislate new bank policies, this being the sole province of Congress.

We also concede that an agency has the power to interpret the extent of the implied powers clause contained in the statute listing the corporate powers of a bank, but again such right to interpret cannot be used to authorize violation or evasion of existing statutes, or to legislate new bank policies, this being the sole province of Congress.

We also concede that an agency has the power to interpret the extent of the implied powers clause contained in the statute listing the corporate powers of a bank, but again such right to interpret cannot be used to authorize violation or evasion of existing statutes, or to legislate for banks new and additional corporate powers that have never before existed and have never even been considered by Congress.

This corporate powers clause in its pertinent parts states that a national bank may "exercise . . . all such incidental powers as shall be necessary to carry on the business of banking. . . ." We submit that it is not "necessary" to the business of banking at the location of the bank authorized under section 81 or at branch locations authorized under section 36, to operate mobile units or loan production offices at a multiplicity of locations.

However, the inherent limitation of the implied powers clause does not deter the Federal agencies. National banks have been permitted by "rulings" to underwrite revenue bonds, to act as insurance agencies, to sell shares in a commingled securities fund, to operate travel agencies and to operate nationwide credit card systems. These "rulings" have been challenged in court, some successfully while others are still pending. These "rulings" serve to illustrate the extent to which Federal agencies will go in their attempt to enlarge the powers of banks under their supervision and to give them competitive advantages.

One will search in vain for any statute giving the Federal bank agencies any authority to enlarge the powers of the banks they regulate. These powers are specifically limited by Federal statute. The listed powers of a bank may be expanded only by operation of the implied powers clause, and then only to the extent that such additional powers are a necessary incident to the business of banking. Many courts have interpreted such implied powers clauses and nothing in these decisions can possibly justify the operation by a bank of mobile branch units and loan production offices, without limit as to number or location throughout the entire United States.

It is obvious that there is a compelling need for Congress to call a halt to the issuance of rulings enlarging the powers of banks in all directions. We specifically suggest the following:

1. Tightening the language of the laws governing the location of national banks and the location of branches, when and where permitted by State law, in the light of experience and court decisions interpreting the Federal and State statutes.

2. Limiting more precisely the incidental powers clause of the Federal Banking Act contained in 12 U.S.C., paragraph 24 (Seventh). We should know by now what constitutes the "business of banking" and we have many guidelines in the court decisions on this subject matter.

3. Requiring that any rule or regulation governing banking operations, by whatever means, shall be properly promulgated by specific procedures such as those set forth in the Administrative Procedures Act. At least this would give interested and affected parties due notice, opportunity to be heard in a public hearing and a right to test the proposed regulation in court. The "rulings" we have been discussing were issued by the agencies without notice or hearing, in most cases.

Our view is that Congress must retain its control over the Federal bank agencies. What good is it to have statutes carefully considered by Congress and enacted after hearings in both Houses, with the final and cautious application of the President's approval, when individuals in our Federal bank agencies issue czar-like edicts, the effect of which is to evade or nullify the acts of Congress?

We were pleased to see that two members of the Federal Reserve Board in a dissent to the August 14 ruling stated that Board authorization to "establish loan production offices anywhere in the United States, is to take such a long step toward fundamental change in our banking structure as to call for legislative consideration—even if its legality were unquestionable, which is not the case. Congress, rather than bank supervisors, should decide whether nationwide systems of loan production offices are to be permitted in the United States \* \* \*

As if to underscore this statement, the Fifth Circuit Court of Appeals in the *Florida* case I have cited, in commenting upon national banks which are restricted by State law, stated that “\* \* \* their recourse must be to Congress which legislated ‘competitive equality,’ not to the courts who must follow it.”

We appreciate the opportunity to appear before this committee on this crucial matter.

Thank you for your attention.

Chairman PATMAN. Thank you, my dear sir. You have made one of the most interesting and substantive statements I have ever heard as a Member of Congress, on banks, banking and branches, the authority of banks, and the duty of the supervisory agencies.

Mr. MILNER. Thank you, sir.

I am indebted to my attorney, Mr. Hansen here, Mr. Bell and our Washington manager, Herschel Schooley, who did all the legwork.

Chairman PATMAN. It is a wonderful statement. It has more of the things I have advocated over a long period of time than I have heard in any one statement before. I am not saying that because I have advocated it, but over the years, as you know, I have been a critic of the banks and bank supervisory agencies in America. I felt like they were going too far. I realize the importance of banks, you can't do without them in our system. We need them. They have done a good job both in times of war and in times of peace. But we have complaints, you know, of their exceeding their powers, and you, Mr. Milner, have pointed out some complaints that certainly should have the attention of Congress until they are corrected.

I just want to read a few comments from your statement. It is so wonderful and so well prepared.

For instance, “multiple-outlet banking leads to concentration of control of bank credit and a lessening of competition. This occurs because larger banks can better afford to establish and promote additional offices. As large banks grow larger by this process, they move to a dominant position in banking markets. In this circumstance, smaller banks are placed at such a competitive disadvantage that ultimately many sell to these large complexes.

“Your committee files contain the records that demonstrate the decline in the number of independent banks in the past 20 years and a tremendous increase in multioffice banking.” It could be 30.

You know, the largest number of banks we ever had was about 50 years ago. More than twice as many banks as we have today.

Now, normally, you would expect that as a country expands and grows, the number of banking facilities to accommodate business and commerce would also expand and grow. Notwithstanding that logic and reasoning, in the last 50 years the number of banks have steadily declined until we only have much fewer than half of what we had then. We only have about 13,000 compared to about two and a half times that number 50 years ago, which shows there has been something abnormal going on in our banking system. Greater concentration.

This not only lessens competition—I am reading further—“in the banking industry, but means that the business community has fewer alternate sources of credit.”

It makes it harder on everybody. And may I suggest, Mr. Milner, it is a sad day in our country today when there is no source of big capital

available in the United States except through certain large banking institutions that also have on their boards of directors, directors of the largest manufacturing and industrial and business concerns in America. If you are to receive capital you must go through these bottlenecks. It makes it almost impossible to get large amounts of capital for the purpose of going into competition with large business. All your testimony here bears directly on that.

Reading further: "While it has been a longstanding policy of Congress to preserve competition in banking in the national interest, our observation is that the Federal bank regulatory agencies seem to be following an opposite course of action."

You are absolutely right. During the past 5 or 6 or 7 years, the Comptroller of the Currency has passed more laws than the Congress has passed in 50 years, vitally affecting banking. That is something that should never be allowed.

Now you are complaining about it, and your complaints, of course, are in order.

"In the past 7 years, particularly, we have seen these agencies issue an increasing number of rulings which expand the powers of banks they supervise. These rulings tend to give to larger banks and bank systems more and more privileges, leading to a greater concentration in the control of money and credit."

One of the worst things I have witnessed during my more than 30 years as a member of this committee was when the biggest banking lobby in the United States, the American Bankers Association, employed a person, a public relations lobbying person from a Chicago bank, to get the banking laws recodified. That was the front that was used. But it was far from that. The attempt really was to get the laws changed so that the big banks would have exactly what they wanted under the so-called Financial Institutions Act of 1957. And this person spent a lot of time, more than a year, several years, in getting Congress in the mood of passing this bill. It passed the other body and came to the House. It looked like it was sure to pass. But a few of us on this committee took issue with it and we finally defeated that bill. But the main things in the bill, the most detrimental things, were later written into the laws by regulation, as you pointed out here, in the Federal Register, which represents the laws that all the banks must comply with, and this same lobbyist got to be Comptroller of the Currency, of all people. He should have never been. And then he by rules and regulations put it in the Federal Register, made the laws to conform to what he tried to get done as a representative of the American Bankers Association. Not your organization—the big bankers association. You represent the smaller banks and you are to be commended for the work you and your fine association are doing.

But he got these made into laws that way. That is a terrible thing. It is one of the worst scandals that happened in the history of this country. And today if this were to become vital law, and it is designed, tailor made, to become law, by going into the Federal Register, and I predict if we don't do something that is decisive, why it will become law very soon after Congress adjourns.

It is customary in this Nation—and I have been in Congress long enough to know—and, of course, that is 40 years now, that the bureaucrats and the people who run the different agencies, they don't like

to act on devastating things while Congress is in session. It is a dangerous thing for them. They wait until after the session is over and then they do it.

You take, for instance, in 1932, when they had what they called the bonus marchers, and they didn't attempt to run them out of town until after Congress adjourned. But as soon as Congress got home they, of course, turned the Army loose on them, tear gas, rifle fire, bayonets, everything else. But that was after Congress adjourned. I can give you many other instances. And if we don't do something about this, after Congress has adjourned you are going to see this become law by administrative dictate. I believe that if this should become the law, it will be one of the most devastating blows that the dual banking system has ever had, and one that we will possibly be unable to recover from. It could possibly be the fatal blow to the dual banking system.

This change is the most drastic change that has been proposed in our banking laws in 100 years, and I think you have made the best statement that could have been made in the commencement of these hearings, Mr. Milner, I shall look forward to the testimony that will be produced tomorrow by the agency that is the cause of what I consider this major evil here in our private enterprise system and our great democracy of the United States of America.

I have taken so much time that I will not ask any more questions now. I have some here that I would like to file with you and you may answer them for the record, if you please, Mr. Milner. Will you do that, please?

Mr. MILNER. Yes, sir.

(The following letter was received by the committee:)

INDEPENDENT BANKERS ASSOCIATION OF AMERICA,  
Sauk Centre, Minn., October 5, 1968.

HON. WRIGHT PATMAN,  
Chairman, House Banking and Currency Committee,  
Washington, D.C.

DEAR MR. CHAIRMAN: It is a pleasure to answer the written questions you submitted to me regarding the impact of the Federal Reserve Board ruling on loan production offices.

1. Would you care to further expand on the observation that this ruling by the Federal Reserve could and probably will bring about the domination of banking in this country by a handful of large banks?

In his statement to your committee, Mr. Chairman, William McChesney Martin, Jr., Chairman of the Board of Governors, said the "Board's position is that a domestic loan production office of that type is not a branch of a bank within the meaning of Federal law."

Subsequently, the National Association of Supervisors of State Banks endorsed the Board's ruling. Therefore, commonsense and logic indicate that whenever it is possible for a supervisor to construe State law as permitting loan production offices, this will be done.

Currently, despite whatever inhibiting effect State law has on branching, the five biggest banks hold more than 50 percent of the commercial bank deposits in every large metropolitan area. The concentration exceeds 75 percent in most areas and goes to 90 in some.

The largest banks have the resources of money and manpower to locate outlets in the most strategic locations to increase their share of the key market areas. With the loan production office edict in effect nullifying branching laws, it seems to me that the already dangerous level of concentration will accelerate sharply.

2. You suggest that the "incidental powers" clause should be defined more specifically as to what banks should and should not be allowed to do. Could you be more specific? Will you at his time, and you can supply further information

for the record, indicate to us what powers other than the direct banking powers of receiving deposits, savings and making loans banks should or should not have?

I would suggest that the following language be added to 12 U.S.C. § 24 (Seventh):

"Provided that said incidental powers shall be exercised only to carry into effect the powers expressly granted by statute and shall not be exercised in any manner to enlarge any express statutory power."

The addition of this clause at the end of 12 U.S.C. § 24 (Seventh) together with a strongly worded committee report, citing court decisions and criticizing examples of administrative legislation by rulings as background, should serve to nullify and slow down the effectiveness of such rulings.

3. Your organization represents, by and large, the smaller banks in the United States. Have any of your members sought to secure national bank charters in recent years? Representing, as you do, smaller banks, many of whom are members of the Federal Reserve System, did the Federal Reserve Board consult with you or the Independent Bankers Association before these new regulations were announced?

We are aware of individual instances of IBAA member banks converting to national charters in the past few years, but do not have a record of how many such conversions have occurred from within our membership. The most highly publicized conversions have involved large banks not affiliated with the IBAA.

The Federal Reserve Board did not consult with me or other officials of the IBAA before announcing its August 14 rulings on operations subsidiaries and loan production offices.

Thank you for the opportunity of adding this material to the record, Mr. Chairman.

Respectfully submitted.

T. H. MILNER, Jr.

Chairman PATMAN. Mr. Reuss.

Mr. REUSS. Thank you, Mr. Chairman.

My recollection, like the chairman's, of this ruling of the Federal Reserve can be summarized by saying, "wow." I agree this is a fantastic change by an administrative agency in the whole banking structure. I am talking about the loan production office.

Mr. MILNER. Yes, sir.

Mr. REUSS. Let me see whether I sufficiently comprehend what has been done here.

Am I right in thinking that under this new interpretation any National bank and any State member bank in the Federal Reserve System, which includes, I think, more than 90 percent of the total assets in our State and National banking systems, can, starting at once, set up physical institutions in every city, suburb, or any place in the country they see fit, a structure which looks exactly like a bank, which carries the name on it of the Wall Street Bank or LaSalle Street Bank or Montgomery Street Bank of San Francisco, and underneath it "Loan Production Office," and that office can then do all the things commonly understood by the phrase, "Making a bank loan," except that there has to be a last-minute touching of base through perhaps a teletype with the Wall Street, LaSalle Street, or Montgomery Street office, and then the check for the amount of the loan is simply sent to the borrower from the central office.

Is that a fair description of what you have?

Mr. MILNER. That is my interpretation of what has been authorized. And, as I think we pointed out, this follows an earlier ruling by the Comptroller which permitted only national banks to do these things.

And, as I understand it, this will now permit all State member banks, in addition to the National banks, to do this.

It seems to me that it just wipes out entirely the effectiveness of our present branch banking laws.

Mr. REUSS. Now, traditionally, to the laymen who make up the Banking and Currency Committee, banking consists of two things: One, lending the money; and, two, getting the money. And traditionally banks get their money by demand deposits. However, that part of the operation is in a state of change and, increasingly, the big banks get their money by certificates of deposits and arrangements which trench on what used to be called time deposits, so that increasingly the demand deposit method of getting the money which a bank lends is being superseded, is it not, by various forms of time instruments?

Mr. MILNER. I think that is true. I think, as a practical matter, with communications like they are, people read the Wall Street Journal, or the Chicago papers, or wherever they may be, and they may voluntarily decide they want to place a deposit with a particular bank in some other far locale.

What we are talking about represents an extension of the attempt to solicit banking business more directly and through people who establish an office in the locale, which would, by the method you suggest, put them in direct competition with local banks. Banks operating such offices would not go out into the smaller areas but would concentrate, for example, in our section in places like Atlanta, or maybe Dallas, the large economic centers, but they wouldn't be rendering any particular service to every man on the street.

Maybe the Congress will decide that this is good. If they do, then we will follow the law. But we feel that this is within the prerogative of the Congress and not the agencies to make this decision.

If, after the hearings and investigations, it is determined that this is the way that our banking should be conducted, we will certainly abide by the rulings of or the laws of this Congress and the laws of the State, as best we can.

We don't object to change. We have got to either change or we are going to dry up. But we don't feel like that it is within the legal prerogative of these agencies to handle this change in this manner. I think they should approach the Congress and let the Congress make this decision.

Mr. REUSS. This authorization to all national and all State member banks to maintain loan production offices anywhere in the country they please, this comes pretty close to allowing universal branching anywhere, because while the loan production office doesn't let the sponsor bank accept time deposits, that is increasingly less necessary than it used to be to operate a complete bank?

Mr. MILNER. Well, I think so. But if our experience with some of our correspondent banks in loan participation is any criterion, they will insist on our maintaining a certain amount of compensating balance with them during the period of the loan.

As I pointed out in my statement, a part of the condition of making this loan would be that the local corporation carry, say, a 15-, 20-, or 25-percent compensating balance with the bank making the loan, to continue as long as the loan is in effect. This is another way of really making a larger return on this particular loan because the bank has 20 or 25 percent of the funds which the person having the loan is paying interest on, and then in turn the bank can lend those funds to somebody else and make an additional amount of return on that investment.

And, too, as I read the Fed's news release on the ruling, a bank would be authorized to do this either directly or indirectly through wholly owned subsidiary corporation. So a big bank in New York might open up a subsidiary in the Athens, Ga., area, and in fact drain off some of the top business out of Athens.

Mr. REUSS. They don't even have to open a subsidiary, do they?

Can't they simply set up—

Mr. MILNER. No, sir, they could do it through an individual. But they could open up a subsidiary office.

It has always been my understanding that our bank couldn't own any stock in any other corporation. But I frankly don't know the status of this restriction now.

Mr. REUSS. But leaving subsidiary aside, under this ruling, cannot all the big banks in New York, Chicago, San Francisco, and elsewhere, tomorrow, without any administrative procedures whatever, start construction on beautiful new Doric, Ionic, or Corinthian bank buildings across the street from yours, which say "Loan Production Office," and can't they then conduct substantially the same lending business which your institution conducts, the only handicap being that they can't accept demand deposits at that institution?

Mr. MILNER. So far as I know, your interpretation is correct. The bank of which I am president already has one, over a billion dollar bank, across the street. I would hate to have another across on the other street. Of course, I don't know what would be the resulting payment of taxes in the local area to help support the community. It would be a pittance, I would think, as compared with what the existing banks are doing at the present time in the way of trying to develop our own communities and pay our fair share of the local taxes to contribute to our local institutions and make our institutions grow.

Mr. REUSS. As you have said, this is a matter that ought to be decided by the Congress. And I have felt for some time that Congress ought to put its mind on the whole question of plural or multiple banking.

The Federal Reserve action, it seems to me, forces our hand in this and really requires the banking committees to address themselves to the entire question. And in that regard, there is, of course, a conflict. There are two sets of considerations which are present in the minds of people on this committee.

One, we want to consider the interests of borrowers and customers of banks. And there, by and large, the more competition the better.

We also want to consider the interests of bankers, and there there is a strong case for preserving independent banks, preserving local banking, preserving the opportunity for financially smaller local people to start a bank and to continue an existing bank.

How would you resolve those two conflicts?

Mr. MILNER. Well, that is a pretty tough question and smarter minds than mine have been debating this, I guess, ever since we have had banks.

The regulatory climate determined by Congress and administered by the supervisory agencies must be nondiscriminatory if existing smaller banks are to survive and new ones are to be chartered with a reasonable prospect for success. Basic to a good regulatory climate is careful control of the number of offices that may be established by any

one bank. Our position is that the Fed ruling permitting "loan production offices" discriminates in favor of the giant banks against the small.

A recent Federal comptroller said repeatedly that branching laws protect local monopoly, where there is only one bank in town. I wish to point out, however, that with a phone call or a matter of a few minutes driving, an individual denied credit at such a bank could drive to an adjoining community and secure a competitive judgment on his loan application.

But if this loan applicant is denied credit in a chain system where that bank in an adjoining town and all towns nearby are just branches of a central office, if he is denied credit there, he is a lost ball in the high grass. If you have ever played golf, you know what I am talking about.

Having alternate sources of credit is essential to the well-being of our economy. At the same time, I happen to believe that lending money is not the primary function of banks. I think the primary function is to keep this economy turning and to protect the interest of the depositors—not the interest of the borrowers nor the shareholders, but the depositors.

Mr. REUSS. Thank you, Mr. Chairman.

Chairman PATMAN. We have a member of the minority with us now. We didn't have him at the beginning.

Mr. Williams, you are entitled to recognition, if you would like to be recognized.

Mr. WILLIAMS. Thank you, Mr. Chairman.

As I understand your position, Mr. Milner, you believe that this recent ruling by the Federal Reserve, as spelled out in this news release on August 14, 1968, would be a bad thing for bankers in general?

Mr. MILNER. Well, I don't know that it would be bad for all the banks, because the ones able to support this type of activity would have a decided advantage. These banks could get an army of scouts, so to speak, to fan out all over the country, to come into any and all areas and set up these offices, and you would get to a point where you really would need but one banking system. It seems to me it would be sort of a termite operation destroying the dual banking system.

Mr. WILLIAMS. I obviously should have stated my question in a different fashion.

Do you believe that this proposed ruling by the Federal Reserve, the ruling that has been made by the Federal Reserve, would be harmful to all bankers except those bankers big enough to engage in the type of operation you have just described?

Mr. MILNER. Well, this gets into a relative thing, as you know, and just off the top of my head I would think the answer to your question would be in the affirmative. But as time goes on, I think that perhaps banks our size—ours is about between \$30 and \$35 million—would in self-defense, so to speak, have to do some limited amount of this within lesser areas. I think the key objection that we have is the overall bad effect that the ruling would have on the dual banking system.

Mr. WILLIAMS. Well, of course, when I said this would be harmful to everybody except the type of banks that you describe, what you really have described is a big bank operation that could afford to send these scouts out and establish all of these other offices.

But, in my opinion, the crux of the thing is spelled out by your comment that under this ruling a New York bank could come into Athens, Ga., where you already have competitive banks, and set up a loan production office, which in effect would drain off the cream of the crop.

I think I heard you make that statement.

Mr. MILNER. That is right; in the large loan areas; yes, sir.

Mr. WILLIAMS. That is all I have. Thank you, Mr. Chairman.

Chairman PATMAN. Now Mr. Stephens.

Mr. STEPHENS. Thank you, Mr. Chairman.

I have listened with great interest to the testimony of Mr. Milner and, as he stated, to commence with, he has continuously been an advocate of the independence of the Federal Reserve System.

As you know, Mr. Chairman, I have taken pretty much that position myself to such an extent that it has been almost embarrassing on one or two occasions when I had to oppose you and some of the others in the committee because of my belief in that very deeply. But in the instant case we are considering, I find I must defend the independence of the Congress as well.

Chairman PATMAN. Would the gentleman yield just for a brief comment?

Mr. STEPHENS. Yes.

Chairman PATMAN. I think there is a difference of opinion about this matter of independence. I don't think there is a difference among the people and the type of independence that we usually refer to.

I don't believe anyone wants the Federal Reserve, which is an agency of the Government, to be independent from the Government of the United States.

Mr. STEPHENS. I agree with that. It is a degree of independence that we have disagreed upon.

Chairman PATMAN. That is right; that is where the dispute is.

Mr. STEPHENS. But I would say, too, to be consistent, I would insist upon the feeling that the Congress needs to maintain its independence. I have said it on a number of occasions with respect to interpretations made by the Supreme Court of the United States, that it has in many instances, in my opinion, usurped the prerogatives of Congress to pass laws.

I complimented the President of the Export-Import Bank when he came before this committee and made an appeal to Congress to change what had been considered for years by the Export-Import Bank the intent of Congress on a policy that they had set in making loans.

That bank maintained that perhaps they may have initially had the power to make a different kind of loan, but that in interpretations that have been made for 20 years or more, that it had become a fact that the interpretations so made were actually the law which Congress had intended. So even though it might have had some doubt about whether or not it could change that lending policy, it nevertheless believed it should come to us and let us make these changes.

I think that we have had many examples of that since 1961, since I have been in Congress, where the courts and the administrative agencies have overlooked the principle of law that you and I learned many

years ago—which is a serious principle, and past courts have made decisions upon it, which is the principle of *stare decisis*—that once an accepted pattern has been set by the community, then even though there may be some room for a doubt, when people have come to rely upon that set of circumstances, then that is what the interpretation was and the court will not upset it. And I think that the Federal Reserve has done this in this particular instance. They have upset the principle that once it is settled everybody agrees that is what it is; and the rules and regulations have been conformed to, and people have become used to making a pattern of it, that in order for it to be changed there should be statutory change, not the change at the whim of the next man that comes into that office.

The other thing that I would like to comment on—what the committee should do now—is a question of meeting these matters head on and let them be the subject of hearings and let them be the subject of legislation. I prefer to see legislation on doubtful areas and that legislation be proposed and discussed. I think you get a great deal more of an opportunity to understand what the problems are, rather than cause your people who are concerned to go into court on expensive battles to make a decision. In a way, Congress is abdicating its job when it requires people affected by its law to go into court to make these decisions.

I think we ought to meet it head on ourselves. We have done that in the branch banking laws ever since 1961, I believe. We have let the banking industry go into court and litigate these matters, rather than meeting it head on ourselves.

I appreciate the opportunity here of reiterating what I think is highly important, and that is that Congress should not abdicate its independence.

Thank you.

Chairman PATMAN. Mr. Gonzalez.

Mr. GONZALEZ. I think this session of the House Banking and Currency Committee is a very important one and I wish to thank or add my thanks to those already expressed to Mr. Milner on this particular issue, which is right in line with the previous issue that I know I have raised, about 3 years ago, extensively, with respect to a ruling by the Comptroller in his interpretation, which was devoid, as far as I could find, of any historical or statutory precedent with respect to the interest rates that a national bank could charge, regardless of the State law.

And it was to no avail. I don't think that we were able to prevail; and, therefore, this type of ruling that concerns you is right in line with the precedent established by the Comptroller in his interpretation, which was unique and actually, even from a legal standpoint, highly questionable, about his permitting or decreeing that a national bank, regardless of any statutory limitations in a State, would have no limits in effect as to what interest rates it could charge. And, in effect, it was said that a national bank, under his ruling, would be permitted to charge the highest allowable interest rates permitted by law in a State, even though the State law would have restricted, for example, small-loan legislation to certain categories. So this has raised quite a number of issues in at least two States. And it is in line with this tendency for the rulemaking process to encroach upon the legisla-

tive or the Congress prerogatives. I think it is a very, very immediate issue and one that deserves the attention of the Congress.

I want to thank you for your presentation.

Mr. MILNER. Thank you.

Chairman PATMAN. Mr. Gettys.

Mr. GERTYS. Thank you, Mr. Chairman.

I would like to join my colleagues, Mr. Milner, in thanking you and your staff for a very splendid statement on a very important matter.

This ruling by the Federal Reserve Board seems to me to be another instance of erosion of the checks-and-balances system provided by our Constitution. But it is in line with the teachings of many of our modern-day visionaries who have been led to the top of the mountain, and it is sort of the order of the day not to obey a law if you do not agree with it.

So that is the teaching that we are living with today; and it has to be regretted, in my opinion, that the Federal Reserve Board in its August 14 ruling has apparently delegated to itself a legislative function. I think that is more or less the essence of your argument in this matter.

It appears that the lawmaking functions of our Government have been taken over by "Speaker" Warren and his activist Court. And I call him "Speaker" advisedly, by the legally binding guidelines written by HEW, by the bureaucracy of the executive department whose regulations and directives have the effect of law but are not based on statutory authority granted by congressional action. And the blame for all this erosion of congressional authority and constitutional prerogatives lies right at the doorstep, Mr. Chairman, of our committee and of the Congress as a whole. It is natural that legislative functions should be usurped and exercised by the other three branches of government, the executive, the bureaucracy, and the judiciary, if we don't do something about it.

And I think this instance right here is a good starting place to put a stop to it.

Now, I want to keep my mind open on this ruling until, of course, the Board members themselves have had opportunity to present their position tomorrow.

But it represents to me a fundamental thing that is wrong with the United States of America today. We as Members of Congress have very little to do with what goes on in the lawmaking branch and enforcement of law in this country, and I appreciate it personally as a member of this committee and of Congress, your very splendid representation of the position of your organization on this particular ruling of the Federal Reserve Board.

Thank you.

Chairman PATMAN. Mr. Bingham.

Mr. BINGHAM. Thank you, Mr. Chairman.

I, too, would like to thank Mr. Milner and his associates for a very interesting presentation. And by way of comment I would like to say that I think the banks should pay careful note to what has been said here at this hearing today by members of the committee, and should go very slow about acting on these regulations that have been issued, or interpretations that have been issued. In fact, I would go so far as to say that the banks would act at their peril if they proceed on the

basis of these interpretations, in the light of the obvious unfavorable reaction by the members of this committee. And I find it quite incredible that the Federal Reserve Board apparently proceeded to take this action without any consultation with this committee.

Now, I would like to ask a couple of questions. We have before us, among the papers that were prepared for this hearing, a copy of the story in the New York Times of August 20 about a meeting that was held, apparently a secret meeting, between the heads of the various top State banks and bank superintendents and the Federal Reserve Board. It appears from this story that a part of the case that was made, for some such interpretation as was made, was that the State banks were operating under unfair competition, or that the national banks had an unfair advantage over the State banks in regard to the operation of such things as these loan production offices.

Would you comment on that, Mr. Milner?

Mr. MILNER. Mr. Bingham, I think that I stated that perhaps the Federal Reserve was to some extent guided in its action by this very thing. The Fed felt that State banks were at a competitive disadvantage if the national banks were permitted to do this.

I was not aware of that secret meeting that you read about there in the newspaper. I might say I wasn't at that meeting. I didn't know they had such a meeting.

I do know that we were not invited to any hearings before the Federal Reserve to express this view and, of course, as you know, sir, there were two dissents from this ruling on the very point that is at issue, as to who has the constitutional and legal authority to make decisions in this area.

As I stated a moment ago, we will be happy to appear and present our story at any time that would be convenient to the Congress, and discuss this matter on the issues with the big banks or little banks or the foreign banks, or any of the rest of them. But we think that we should at least be able to reasonably rely on what the law is and not wake up one morning and find that the law is something by these Federal agencies.

Mr. BINGHAM. I certainly agree with that.

But getting back to the question of whether there was unfair competition here, would it be a fair statement that, if there was unfair competition, it was because the Comptroller of the Currency had already allowed the national banks to proceed with the establishment of these loan production offices, by his regulations, and that it was that that put the State banks in a difficult position?

Mr. MILNER. I think that is exactly a fair statement, because, as I understand it, one of the functions of Congress is to provide an atmosphere in which all banks can freely compete. And if the national banks have been authorized to go all over the country and set up these offices, certainly the State banks should be allowed to do it. And we feel like that it is not authorized under the law at this time.

Mr. BINGHAM. Mr. Milner, how common are these loan production offices today?

Mr. MILNER. Well, I don't know of any down in our section at the present time. I am sure there must be some. We have always had, of course, the larger banks that have their people calling on us on a correspondent relationship. But so far as I know they have never come into

our community and sought loans, to make loans to our customers, without our invitation. In other words, through the local bank initiating the loan and then the larger bank handling the overline which, of course, you are familiar with.

This has been a common practice through the years.

We had a visit not too long ago from a North Carolina correspondent bank representative and I was kidding him. They have unlimited branch banking up there and I said, "You have run out of people to call on there, either you encounter your branches or branches of your competitors, so you come down to Georgia to still try to maintain some semblance of a correspondent relationship."

So this is one of the inherent dangers, as I see it, in this whole expansion program, is the concentration of monetary power in the hands of a few.

Mr. BINGHAM. One further question.

I am not entirely clear in my own mind as to just where you would draw the line between a loan production office and what, let's say, an agent of a bank might do, going out and visiting an industrial plant, a concern that has relationships with the bank, and at the offices of this concern preparing papers and going over financial statements and so forth, all of which is, I take it, an acceptable activity. I am not quite sure at what point you would say there is a violation. Is it at the point where an office is set up, a permanent office is set up to carry on that kind of activity?

Mr. MILNER. Well, this is, of course, a very gray area in which I don't think you can really answer in black and white. I think it is a matter-of-courtesy thing with banks not to solicit business directly in a community or an area that is normally serviced by a local bank. And if this ruling becomes law, or if it has the effect of law, then the local banks would have to live with this and know that they have additional competitors, the other 13,000 or 14,000 banks throughout the country, that could or would be authorized to do this sort of thing.

Whether as a practical matter it would be economically sound for them to do it is, of course, another question.

But in answer to your question, this is something relatively new. We haven't been bothered with it.

And, of course, the movement of large industries is a factor; for example, Westinghouse recently moved, within the last 10 years, into Athens. Naturally, they have banking connections in Pittsburgh and throughout the country. So they may be borrowing money, I am sure, through their central general treasurer from banks from all over the country.

Mr. BINGHAM. And those banks may be sending their aides down to ask Georgia to discuss these matters with them.

Mr. MILNER. Yes.

But, naturally, we are not naive enough to think that if Westinghouse is going to make a \$100 or \$200 million loan that they would initiate the loan through our bank, which has a lending capacity of \$145,000.

We could participate in a \$200 million loan to the extent of \$145,000. Probably that amount wouldn't pay the interest for a day or two.

This Fed ruling may be a real fine innovation in banking. But I think if it is, if it is a good idea, if it is something new, if it is something that is good for banking, and if it is good for this country, then why not bring it before this committee of Congress and let the Congress decide this. This is the real issue here, as I see it.

Mr. BINGHAM. I would like to ask one final question, Mr. Milner. Would you agree with me that, in the light of the *Dickinson* case which you describe here, these interpretations are likely to be overturned by the courts in due time? It seems to me that, if the mobile office is a violation of law, then the loan production office is certainly going to be.

Mr. MILNER. This would be our thinking. And, of course, this decision, this case originated in the Federal district court in our part of the country and has been affirmed by the Fifth Circuit Court of Appeals. This is sort of a brush-fire type of thing and I think we have got another case pending in Georgia involving exactly the same question. And, as I said, we feel that the district judge down there will issue a summary judgment in that case and permanently enjoin this Georgia bank from operating this mobile facility.

But in principle I see no difference between this loan production office and the mobile bank. I don't think a loan production representative needs to have an office. He could probably do it out of his automobile, his hotel room, just come in and out as the occasion presented itself.

Mr. BINGHAM. Well, I would like to say, as I said at the outset, that, in the light of the *Dickinson* case, and in the light of the feelings expressed by the members of the committee here today, if I were a lawyer advising a bank, I think I would tell them to go awfully slow about following these interpretations.

Thank you very much.

Mr. STEPHENS (presiding). Mr. Griffin.

Mr. GRIFFIN. I have no questions, Mr. Chairman, but I wish to compliment Mr. Milner on his fine statement.

Mr. STEPHENS. Mr. Williams said he would like to ask a question.

Mr. WILLIAMS. Yes.

Mr. Milner, on the first page of this Federal Reserve news release dated August 14, point No. 2 states that "State banks that are members of the Federal Reserve System, as well as national banks, may establish and operate, at any location in the United States, 'loan production offices.'"

Now, do the laws of the State of Georgia, as they are presently written, permit you to establish branches for loan production offices any place in the State of Georgia?

Mr. MILNER. No, sir. The only place that we can have a loan production office or facility or branch is within the municipal corporate limits of the town in which the parent bank or branch of that bank is located.

Mr. WILLIAMS. In other words, you are restricted to the municipal limits of Athens, Ga.?

Mr. MILNER. Yes, sir.

Mr. WILLIAMS. Are there any States that have laws which permit the establishment of loan production offices everywhere in the State by any bank?

Mr. MILNER. I am not certain that they are described as a loan production office. I know North Carolina, for example, permits statewide branch banking. I am not familiar with the details of it.

But if it follows the practice of most States, banks there must qualify in certain respects as to capital and this sort of thing before they establish a branch in a given locality.

Virginia, for example, permits, as you know, statewide branching by acquisition or mergers.

In the short time this has been permitted, six banks and holding companies have increased their share of bank deposits in the State from one-third to one-half of the total.

Mr. WILLIAMS. I would like to say, too, relative to Mr. Gettys' remarks about the Federal agencies and some agencies that come under the executive branch of the Government doing things that are legislative in nature, I completely concur in that statement. I would like to suggest, however, that much of the legislation that Congress has passed has been written in such a way as to confer, upon these Federal agencies and agencies of the executive branch of the Government, powers which rightfully belong to the Congress. So that I don't think that the Congress is entirely without blame in this matter.

Mr. GETTYS. I thank the gentleman for your concurrence. And that was the point I was making. It is our fault. It is the Congress fault. We are delegating, we are throwing away our constitutional powers illegally, and I don't think we have the authority to do it.

Mr. WILLIAMS. Mr. Milner, I want to thank you for a most excellent presentation.

Mr. STEPHENS. Along the line of what Mr. Williams said, the Administrative Procedures Act that was passed in the middle 1940's has been one of the vehicles upon which Congress has abdicated its legislative powers.

We passed a law—and I say “we”, I wasn't here at that time—that said that Congress would retain only an executive function, which is to veto a ruling made by an administrative agency. And from time to time we have had on the floor of the Congress a piece of legislation that requires us to vote “aye” if we want to vote “nay.” Such proposal on the floor is to disagree with the rule proposed by an agency. If you disagree with the agency you vote “aye” in order to vote “no,” on the rule proposed. It is confusing, especially I know the first time I had to do that. But we have retained only an executive function which is a veto power, and the Administrative Procedures Act is the chief criminal in that particular thing and in the kind of thing that we are dealing with now.

Does anyone have any more questions?

Mr. MILNER. I would like to make this last comment, if I may.

If I haven't already done so, I suggest you take a look at Europe and see what has happened over there so far as disappearance of small business and banks is concerned. Canada, our neighbor to the north, has only eight banks and more than 6,000 branches. It now appears England soon will have only three banks with more than 5,800 branches. So this is the thing that really is disturbing, the possibility that our only recourse against this move would be nationalization of the banks, and I don't believe that anyone would want this to come to pass.

Mr. STEPHENS. I need not further say how the committee has responded to the fine presentation that you and Mr. Bell and Mr. Hansen have made, and we thank you very much for coming before us.

The committee will have a session tomorrow at 10 o'clock when we will hear from Mr. Martin, and other witnesses on this matter, from the Federal Reserve Board.

If there are no other questions, we will stand adjourned until tomorrow at 10 o'clock.

(Whereupon, at 11:45 a.m., the hearing in the above-entitled matter was recessed, to reconvene tomorrow, Wednesday, September 25, 1968, at 10 a.m.)

## FEDERAL RESERVE RULINGS REGARDING LOAN PRODUCTION OFFICES AND PURCHASES OF OPER- ATING SUBSIDIARIES

WEDNESDAY, SEPTEMBER 25, 1968

HOUSE OF REPRESENTATIVES,  
COMMITTEE ON BANKING AND CURRENCY,  
*Washington, D.C.*

The committee met, pursuant to notice, at 10 a.m., in room 2128, Rayburn House Office Building, Hon. Wright Patman (chairman) presiding.

Present: Representatives Patman, Barrett, Sullivan, Reuss, Moorhead, Gonzalez, Gettys, Bingham, Bevill, Griffin, Widnall, Clawson, Stanton, Mize, Brown, and Williams.

Chairman PATMAN. The committee will please come to order.

This morning the full committee continues hearings on the August 14 ruling of the Federal Reserve Board on "loan production offices" and bank "subsidiary stock holdings." We have with us this morning Chairman of the Federal Reserve Board, Mr. Martin who, along with four other members, voted in favor of these rulings, and Vice Chairman Robertson who, along with Governor Brimmer, voted against the rulings.

I am sure, Mr. Martin, that your people informed you of the drift of the discussion and position taken by the members of the committee who were here yesterday when Mr. Milner of the Independent Bankers Association testified on this subject. In case there is any lack of knowledge on your part as to my position on this subject, let me restate it for you in one or two sentences.

First of all, I concur wholeheartedly in the position taken by Governors Robertson and Brimmer and what I believe was almost if not the unanimous position taken by this committee yesterday in that you have in this instance, to say nothing of other instances, usurped the legislative powers and prerogatives of the Congress in this matter.

Secondly, I wish to state to you that the Board's action has, in my opinion, if the action is not reversed, heralded the beginning of the end of our dual banking system and will rapidly lead us down the road whereby, as is true in so many European and other countries, we will find a handful of banks, four, five, or 12, completely controlling and dominating the banking industry in the United States.

Some of these nations have so few banks that they could have their bankers association meeting in a telephone booth.

It is recognized, of course, that this is a serious prediction but I believe one which has historical support, as witnessed by what has happened in banking in other industrialized nations of the world.

The trend in banking in this country, as you know, Mr. Martin, has been for fewer and fewer banks, a rapid increase in chain banking, a rapid expansion in nonbanking activities carried on by banks, and a rapid expansion in the establishment of one-bank holding companies leading to entrance of banks into businesses in which they have no right to be.

On August 14, the Federal Reserve Board announced two new rulings. Specifically, the Board ruled that State member banks can buy "shares of corporations to perform \* \* \* functions that the banks are empowered to perform directly," and second that they "may establish and operate, at any location in the United States, 'loan production offices.'"

I would hope, Mr. Martin, that in your presentation this morning you would cover some of the following points and questions which I raise to you at this time. I trust this will not be hard for you to do, since many of these questions, I am sure, must have been raised by you and other Board members and staff in your deliberations preceding the conclusions you arrived at in your August 14 decision.

How important, Mr. Chairman, do you and the Board believe these rulings are?

Will they affect the structure of the Nation's banking business in any essential or profound way?

What effects will these rulings have on the structure of banking in our economy in respect to:

(a) The number of banking offices in the country and their location by population center; (b) the number of banks, that is, corporate entities doing a banking business, in the country; (c) competition for loans and deposits; (d) the extension of banking services to the public; (e) the viability of correspondent banking and, (f) the distribution of banks by deposits and loans?

Governors Robertson and Brimmer stated, in their dissents to the rulings of August 14, that these rulings are important enough to resolve through legislation. I'm sure you will agree that Governors Robertson and Brimmer are prudent men and genuinely concerned that the Federal Reserve not usurp Congress' legislative powers. But what I am unable to understand and want you to explain is why, in view of the fact that two members of the Board believed that these rulings make new laws—why—the Board did not come to the Congress—to the committee—and ask whether, in our opinion, the rulings make new law or simply interpret and administer existing legislation. This failure to consult the Congress on whether its powers are usurped strikes me as arrogance in the extreme. Obviously, you have no desire to cooperate with the Congress. You do not care what the members of this committee think about this or anything else that you do. If you did, you would consult with us and elicit our opinions, especially when some of your associate Governors believe you are usurping our powers. But you did not seek our advice and consent. Rather, you threw down the gauntlet. You acted and said, in effect, that if we don't like it, we can change the law. This is not the way to strengthen our democratic institution; rather it is the way to wage war upon the Congress.

Now I want to know, therefore, and please cover this in your testimony, why you went your own way without consulting this com-

mittee, without, and surely this is the height of your arrogance, so much as telling us what you were contemplating or informing us what you had done but rather making us find this out by reading the newspapers.

I understand that before the rulings of August 14 were issued, you consulted with leaders from the banking industry. Now I would like to know, and I want names, who these leaders were that you consulted. What banks did they represent? What are the sizes—in deposits and loans—of their banks?

To pursue this matter, tell us why so many big bankers were consulted and so few small bankers. Also, tell us who, among bank customers—that is, borrowers—was consulted on this matter. I'd like names.

Also, be sure and tell us in your testimony why you decided to consult experts from the banking community but not from the Congress before issuing these rulings. Did you think bankers have a greater stake in the matter than the Congress or is it that you believe bankers are more competent and fairminded than Members of the Congress?

I have brought up a number of times about you being a dues-paying, card-carrying member of the biggest banking lobby in this country, and I reiterate it because it looks like this is par for the course, for you to confer with these big bankers first. They are the ones who run the American Bankers Association lobby, and I assume it is par for the course for you to confer with them first.

But what gets me even more is the fact that you used taxpayers' money to pay your dues, money that would go into the U.S. Treasury otherwise.

We are glad to have you gentlemen. This is a very important question before us today. I think it is one of the most important we have had before Congress in many years.

If this goes through the way people have interpreted, and the way I personally interpret it, it means that a few banks very quickly will control the banking system of this country.

Your comments will be very much appreciated and you may call upon your colleagues as you desire.

**STATEMENT OF WILLIAM McCHESNEY MARTIN, JR., CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM; ACCOMPANIED BY J. L. ROBERTSON, VICE CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM, AND FREDERICK SOLOMON, DIRECTOR, DIVISION OF EXAMINATIONS, FEDERAL RESERVE SYSTEM**

Mr. MARTIN. Well, Mr. Chairman, I start by denying all of the charges that you make in this opening statement, and then I will now read the responsory statement.

On August 14, 1968, the Board of Governors of the Federal Reserve System announced that it had concluded that Federal law does not prohibit a State-chartered bank that is a member of the System from establishing operations subsidiaries—that is, separate corporations wholly owned by the bank performing functions that the bank is authorized to perform directly at domestic locations where the bank is allowed to do business.

Previously, the Board had interpreted the statutes involved as generally preventing State member banks from purchasing the stock of corporations, including those created to perform functions the banks could perform themselves.

At the same time, the Board reversed another earlier position by announcing that a loan production office established by a member bank will not be considered a branch if it engages solely in certain preliminary and servicing functions in connection with loans that are approved and disbursed at the bank's main office or a branch.

I might say, parenthetically, we did not discuss with the Congress the rulings at the time we made the first ruling, and I saw no reason to discuss it with Congress the second time. This was a reinterpretation of the same statutes and the same law.

In reaching its decision regarding operations subsidiaries, the Board reexamined its previous interpretations of two statutory provisions, paragraph 20 of section 9 of the Federal Reserve Act and section 5136 of the Revised Statutes.

The 20th paragraph of section 9 of the Federal Reserve Act provides that "State member banks shall be subject to the same limitations and conditions with respect to the purchasing, selling, underwriting, and holding of investment securities and stock as are applicable in the case of national banks under paragraph 7 of section 5136 of the Revised Statutes \* \* \*"

This section of the Revised Statutes lists the corporate powers of national banks, including (in par. 7) the power to exercise "all such incidental powers as shall be necessary to carry on the business of banking." After this reference to "incidental powers," paragraph 7 specifies other banking functions, such as receiving deposits and making loans. Provisions specifying some limitations on investments by a national bank for its own account are then stated, followed by this sentence: "Except as hereinafter provided or otherwise permitted by law, nothing herein contained shall authorize the purchase by the association [meaning the national bank] for its own account of any shares of stock of any corporation."

The Board has the responsibility of interpreting, as to State member banks, the meaning of the sentence last quoted. Its interpretation, as announced last month, is that the incidental powers granted to national banks by paragraph 7 include the power to choose among alternative forms of organization of their operations, and to select the form they think is most efficient. One method of organization is through a department of the bank; an alternative is a subsidiary wholly owned by the bank. The decision as to which of the two is more efficient is one that bank management is best qualified to make, and one that our free enterprise system normally leaves to management in the absence of some overriding public interest. It should be emphasized that the question is purely one of organizational structure, since the subsidiary is strictly limited to functions the bank is already authorized to perform.

Obviously, opinions may differ as to how to interpret such a broad phrase as "such incidental powers as shall be necessary to carry on the business of banking." Some light on its meaning may be shed, however, from an examination of legislative history and judicial interpretations.

In 1927, the Congress amended paragraph 7 to include a proviso limiting investment by a national bank in a particular kind of operations subsidiary—a corporation organized to conduct a safe deposit business—to 15 percent of its capital and surplus. The report of the House Committee on Banking and Currency accompanying that legislation commented that this proviso “recognizes and affirms the existence of a type of business which national banks are now conducting under their incidental charter powers,” adding that “this is a business which is regularly carried on by national banks and the effect of this provision is \* \* \* primarily regulative” (H. Rept. No. 83, 69th Cong., first sess., pp. 3, 4). In other words, in 1927 the Congress recognized the authority of national banks under the incidental powers clause to establish an operations subsidiary. The question remains whether the sentence regarding purchase of stock for a bank’s own account, which was added in 1933, was intended to repeal this authority.

To repeat, that sentence reads as follows: “Except as hereinafter provided or otherwise permitted by law, nothing herein contained shall authorize the purchase by the association for its own account of any shares of the stock of any corporation.” One way to construe this sentence would be to read it as saying: “A national bank shall not acquire the stock of any corporation unless the acquisition is for the account of a customer, or unless the acquisition is authorized expressly, and not by implication, by a Federal statute.” Another way would be to read it as: “Nothing in the preceding sentences regarding purchases of investment securities by national banks shall be construed to include purchases of stocks.”

The first interpretation would mean reading the sentence as overriding the authority to exercise incidental powers, insofar as such incidental powers include the power to acquire stock. But such a construction would be disruptive, and could hardly have been intended by Congress. For the courts have long recognized that a national bank may, “as incidental to the power to loan money on personal security \* \* \* accept stock of another corporation as collateral, and by the enforcement of its rights as pledgee it may become the owner of the collateral \* \* \*” *California Bank v. Kennedy*, 167 U.S. 362, 366 (1897). If the sentence relating to purchases of stock were intended to override the incidental powers clause, it would negate not only the power to establish an operation subsidiary, but also the power to purchase stock pledged as collateral where the acquisition is necessary to protect the bank against loss.

Doubtless other ways of reading this sentence will occur to you. I have no desire to try to convince you that there is only one correct way to read it, since the Board, itself, has had a great deal of difficulty in grappling with it. But it does seem clear that reasonable men may, and have, come to differing conclusions as to what the language means.

We should try, therefore, to discover from the legislative history of the Banking Act of 1933 what interpretation would best carry out the purpose of Congress in enacting it. The Senate committee report (S. Rept. No. 77, 73d Cong., first sess. p. 2) informs us that the committee had decided “to defer the preparation of a completely comprehensive measure for the reconstruction of our banking system,” in

order to concentrate instead on legislation needed "to correct manifest immediate abuses." High on the list of abuses cited as needing correction was the involvement of commercial banks in speculation in corporate stocks. Thus, the committee report included at page 8 the following comments:

The outstanding development in the commercial banking system during the prepanic period was the appearance of excessive security loans, and of overinvestment in securities of all kinds.

\*            \*            \*            \*            \*            \*            \*

[A] very fruitful cause of bank failures, especially within the past 3 years, has been the fact that the funds of various institutions have been so extensively "tied up" in long-term investments. The growth of the investment portfolio of the bank itself has been greatly emphasized in importance by the organization of allied or affiliated companies under State laws, through which even more extensive advances and investments in the security market could be made.

To correct these conditions, the 1933 act included provisions for "more careful restriction of investments," in the words of the committee report, including amendments to paragraph 7 permitting national banks to "purchase and sell investment securities for their customers to the extent as heretofore, but hereafter they are to be authorized to purchase and sell such securities for their own account only under such limitations and restrictions as the Comptroller of the Currency may prescribe, subject to certain definite maximum limits as to amount."

Unfortunately, neither the House nor the Senate committee reports refer specifically to the sentence regarding purchase of stock for the bank's own account with which we are now concerned. But I find it difficult to conclude that a Congress concerned with correction of "manifest immediate abuses" intended to repeal national banks' authority to establish operations subsidiaries, let alone to repeal their authority to acquire stock pledged as collateral where necessary to collect a loan. Rather, the Congress seems to have been concerned with bank investments and certain kinds of subsidiaries and other affiliates, particularly those "which devote themselves in many cases to perilous underwriting operations, stock speculation, and maintaining a market for the banks' own stock often largely with the resources of the parent bank," to quote the Senate committee report (p. 10).

Moreover, the Congress obviously intended, when it subjected State member banks to the restrictions contained in paragraph 7, to achieve uniformity of regulation, not to subject State member banks to stricter regulation than national banks. And as you know, the Comptroller of the Currency interprets paragraph 7 as not preventing national banks from establishing operations subsidiaries.

The Board accepts the responsibility for interpreting the statutes that we enforce as to State member banks. After the careful review outlined above the Board concluded that State member banks are not prohibited from establishing operations subsidiaries to perform functions that the banks are authorized to perform directly. Taking into account the Comptroller's views, this interpretation also achieves the congressional purpose of establishing uniform rules rather than conflicting ones.

The other interpretation announced on August 14 relates to "loan production offices," that is, domestic offices where the following functions are performed: soliciting loans on behalf of a bank, assembling credit information, making property inspections and appraisals, se-

curing title information, preparing loan applications, soliciting investors to purchase loans from the bank, seeking investor contracts with the bank for servicing such loans, and other similar agent-type activities.

The Board's position is that a domestic loan production office of that type is not a branch of a bank within the meaning of the Federal law. A State member bank, consequently, need not obtain Board approval to set up such an office. Such offices will, however, be subject to supervision and examination through the regular bank examination procedures of the Board. Activities of a loan production office will be taken into account at the time of each bank examination.

The interpretation involves section 5155(f) of the Revised Statutes (12 U.S.C. 36), which provides that the term branch "shall be held to include any branch bank, branch office, branch agency, additional office, or any branch place of business \* \* \* at which deposits are received, or checks paid, or money lent." This section applies to State member banks through paragraph 3 of section 9 of the Federal Reserve Act. Under the statute, an office at which any of the three enumerated functions is performed must be regarded as a branch. None of these three functions would be performed at a loan production office covered by the Board's interpretation.

The Board's August 14 interpretation reverses a position taken in 1967 and so far as Federal law is concerned places State member banks on essentially the same footing with national banks in regard to loan production offices. A loan production office of the type described in the ruling may be established and operated by a bank either directly, or indirectly through a wholly owned subsidiary corporation.

All of you know that many large banks have for years sent traveling representatives to all parts of the Nation to solicit loan business. The loan production office gives the traveling representative—who does not approve loans or disburse money but merely engages in preliminary and servicing functions—a place to hang his hat.

A traveling representative is unable to meet certain specialized needs, such as servicing mortgage loans. The loan production office would provide a fixed location where these loans may be serviced with greater convenience to the customers. But for the most part, the loan production office would perform much the same function as the traveling representative which banks have used for years.

The question of whether a State member bank may establish such an office will now depend solely on State law. If the law of the State where the bank is chartered, as interpreted by State authorities, prohibits the bank from conducting its operations in this fashion, that will end the matter. If advance approval of the supervisor must be obtained in each case under State law, that requirement will continue to apply; if, on the other hand, the State law provides general authority for the bank to establish such offices without specific approval of the supervisor in each case, that law will apply, as to offices established in the home State. Of course, if the bank seeks to establish an office in another State, it will have to comply with the laws of its home State as well as those of the State where the office is to be located, including advance approval of the supervisor if the laws of that State so provide.

The Board is barred by law from authorizing a bank to establish a branch where State law prohibits branching. In a State which pro-

hibited branches but did not classify a loan production office as a branch, the Board's 1967 interpretation, therefore, prohibited a State member bank from establishing such an office even though the State permitted it.

This, I may say, concerned me right from the start. It thus had the effect of overriding State laws to one class of State banks—those that are members of the Federal Reserve System—but not as to other State banks. And the Federal statute involved was interpreted at the same time by the Comptroller of the Currency as permitting national banks to establish such offices. On reconsideration, the Board concluded that this result is neither required by the language of the statute nor warranted by considerations of public policy underlying the statute.

Since the establishment of loan production offices by banks is a relatively new development, there is little evidence available to enable us to determine what, if any, effect it will have on competition. But it seems to me that the burden should be on those who are concerned about this form of competition to prove that further restrictions on its use are needed to protect the public, rather than simply to protect one competitor from another. And this may well be an area in which primary reliance should be placed on the State legislatures in determining whether further restrictions are needed to maintain the kind of banking structure best suited to conditions in each State.

The loan production office, instead of stifling competition, may well encourage it and thus improve the efficiency of the banking system in meeting credit needs. A bank which sets up a loan production office would know from the start that it is limited in its ability to attract banking customers as such since it is unable to offer a full range of services—namely to receive deposits, cash checks, and lend money on its own premises. Managers of such offices would consequently seek to increase efficiency to as high a level as possible to attract business. This, in turn, could be expected to stimulate competing lenders to improve their services or lower their costs, to the ultimate benefit of the consumer in the form of lower interest rates and better terms.

If the Congress should conclude that loan production offices should be prohibited or controlled more stringently than they now are under Federal and State law, whatever additional rules are established should, of course, apply across the board rather than to State member banks alone.

The question of authority to establish loan production offices is, of course, only one facet of the much broader question of the extent to which banks should be authorized to expand their services.

I assume that there is wide agreement that banks should be allowed some latitude to meet their customers' constantly changing needs. The Board continues to believe, however, that this movement, growing more apparent each day, has its reasonable limits, unless appropriate financial services are to become merely the incidental rather than principal character of banking. I feel obliged, therefore, to point out to your committee that this could happen if banks are allowed to establish one-bank holding companies in order to move further and further into other fields. We believe that the recent trend toward the establishment of such companies by banks underscores the need for a reexamination of the Bank Holding Company Act. The Board is currently studying this important question which has so many ramifications, not only for banking but for the basic structure of our economy.

This concludes my prepared statement, Mr. Chairman.

I would like to just make one or two observations with respect to the charges that you have made regarding so-called secret meetings and pressures by large bankers—which I deny categorically.

Let me say that when this ruling was first made there was some question about it in the Board and some disagreement among lawyers about it. I am not a lawyer and I am not sure what the proper interpretation of some of these things should be. But I have assumed that we should not come running to the Congress to help us out, unless we are convinced that we cannot handle by administrative action within the law problems which are arising.

Now, because you have introduced this question of a secret meeting, I want to say that from the time this ruling was first made, I have had discussions with numerous people about it, and I have had considerable concern, particularly about the point that I made about production offices where we were overruling a State law and had a difference of judgment with the Comptroller, who also has competent legal staff, and this concerned some of us on the Board right from the start.

Now, we have not been namby-pamby about our rulings and we are prepared, as we were in the question of underwriting revenue bonds, to go all the way to the court for a decision.

But in this case, speaking for myself, I came gradually to the view that we had an honest difference of judgment here that should be resolved by administrative action; and that there was a legal difference of judgment.

Now, with respect to consultations on this, I have talked to probably 30-odd people from time to time, casually, about this aspect of it, and as to the so-called secret meeting that you refer to I will be glad to give you the names of the people that attended that.

But this was brought about because we had a series of discussions.

We have a Federal advisory council established by statute that comes in from time to time and we discuss these matters with them, and I have considered it my duty as chairman to try to keep liaison with all aspects of the business, and I have talked to Frank Wille, the superintendent of banks in New York, who has had some interest in this.

I first had quite a long serious talk with him in the early part of this year, which was followed up by a meeting at Dorado Beach that the American Bankers Association sponsored, and there was a discussion of all supervisory activities at one of the seminars of that meeting. Mr. Wille was there, I was there, and I talked with him.

He has some views on this and I am sure he will be glad to give them to your committee at any time you wish to call him.

Following that meeting, which occurred in the latter part of May, May 19 to 23, Mr. Wille called me on the telephone and wanted to come down and talk with me further. I had expressed some interest in this. I suggested to him that I was too busy at that time, but asked if he could do it a little later. And we finally got together on the afternoon of May 17. We had a long discussion of it. And in the course of it, he said he thought it would be very desirable if we could have an informal go around with the National Association of Supervisors of State Banks, of which he is a representative, and with the Board. I have always welcomed that. I welcome that with Congressmen and

with others. I think it is desirable for us to have meetings of this sort from time to time.

After consulting the Board, and learning they were agreeable, I asked him for July 29. He couldn't make it on July 29, because we were not going to have a full attendance and he couldn't get his people together and I couldn't get my people together, and we had a meeting of the Federal Open Market Committee on the morning of August 13 and that seemed a convenient time to have this meeting in the afternoon, and he was able to arrange that with his people. I will be glad to submit to you a list of their names. The entire Board was there. There was no pressure put. This was a go around but this was a matter that had been discussed for a long time. There was nothing secret about it of any sort and we had consulted with large and small and intermediate banks on this subject continuously. I think it is one aspect of a much larger question that I mentioned at the conclusion of my testimony, the question with respect to the ramifications of one-bank holding companies, and the erasure of the line between commerce and banking, where banking and nonbanking business get together. This, I believe, is basically an important problem. The operation subsidiaries and loan production offices I personally consider to be a minor problem.

I just wanted to put that on the record.

Chairman PATMAN. Since you brought that up, Mr. Martin, I want to add to the information that we would like to have.

Did you consult with bankers on these rulings before August 14, as reported by the newspapers?

If you did, we would like to have the same information about who was there and——

Mr. MARTIN. I am not going to submit to this committee a list of all the people that I have talked to in the last year.

Chairman PATMAN. I didn't say the last year. I said on these rulings preceding August 14.

Mr. MARTIN. Preceding August 14, I have talked to any number of people about this.

Chairman PATMAN. And also include anybody that was representing the public interest, if you consulted anybody who represented the public interest. You made it very plain that you consulted with these banks. But you have not mentioned anyone representing the public interest. I would like to have that information.

One other thing. Evidently your competent legal counsel that you referred to gave you opinions on these matters. We would like to see copies of those opinions.

Mr. MARTIN. We have differences of opinion on this, but I don't see that we ought to be asked to submit working memorandums of the Board on any problem. We are giving you our conclusions. We are giving you our judgment and the basis on which the judgment was made. The working memorandums of the Board, I just don't——

Chairman PATMAN. I didn't ask for the working memorandums. You put words in my mouth. I am asking for the opinions you got from your counsel. You state you are not a lawyer and you had to depend upon them. I want to know what you depended upon. Would you furnish it to us?

Mr. MARTIN. I will give you what I can.

Chairman PATMAN. Governor Robertson, if you will comment at this time, after you gentlemen have finished each member will be allowed to interrogate you.

**STATEMENT OF J. L. ROBERTSON, VICE CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM**

Mr. ROBERTSON. Mr. Chairman and members of the committee, I am pleased to have this opportunity to tell your committee why I dissented from the Board's action reversing its interpretations on "operations subsidiaries" and "loan production offices," but I would like to say, before I read the balance of the statement, I think this hearing should have been held a long time ago on the Comptroller of the Currency's ruling which preceded these rulings, because the issue was raised at that time and not at this time.

Nevertheless, I think it is very appropriate that there be hearings with respect to this matter, because I think it is important and I think it is one in which the Congress should take a position.

Chairman PATMAN. I must clarify your statement that the hearing should have been earlier. We did have hearings on Mr. Saxon's rulings—not only this one ruling but many more where we thought Mr. Saxon was legislating via regulation.

Mr. ROBERTSON. I would like to have seen legislation resulting from those, Mr. Chairman. But, as I say, I am delighted to have this sort of hearing because I think the issue is important.

Let me say that, as recently as 1966, the Board reexamined and confirmed a longstanding position that the so-called stock-purchase prohibition of section 5136 of the Revised Statutes, which is made applicable to member State banks by the 20th paragraph of section 9 of the Federal Reserve Act, forbids the purchase by a member bank "for its own account of any shares of stock of any corporation," except as specifically permitted by provisions of Federal law or as comprised within the concept of "such incidental powers as shall be necessary to carry on the business of banking," referred to in the first sentence of paragraph "Seventh" of Revised Statutes 5136.

I would like to interpolate here to say that Congress has provided specific authority for banks to acquire stocks in eight different cases—one of which was as recent as 1968. Those cases, if you are interested, include safe deposit companies, bank premises subsidiaries, small business investment companies, bank service corporations, and certain types of foreign banking corporations. And in 1968 title 9 of the Housing and Urban Development Act of 1968 created a housing corporation and authorized national banks to purchase its stock, which indicates that Congress thought it was necessary, in order to provide this authority, to specifically legislate. And in the case to which the chairman referred, safe deposit companies, Congress also felt that was necessary even though some banks had gone ahead and gone into that business previously.

Until August 14, 1968, the Board considered that the only purchases of stock comprised within such concept were those that became necessary in order for the bank to realize on a debt previously contracted.

Let me say that before the statute was amended in 1933, the incidental power clause was in the law and had been construed as authoriz-

ing only one kind of acquisition of stock, and that was DPC stock, where a bank had to take stock in order to protect itself on a debt previously contracted. And that was not repealed in the 1933 legislation.

I continue to believe that the incidental powers clause cannot properly be interpreted as authorizing member banks to purchase stock in any other circumstances unless specifically permitted to do so by the Federal banking statutes.

I agree with the Board that establishment by a bank of a wholly owned subsidiary corporation to engage in activities that the bank itself may perform can be a convenient alternative organizational arrangement. However, I disagree with the Board's current view that the incidental powers clause permits a bank to organize its operations under such an arrangement. Even if I agreed with the Board's current view of the incidental powers clause, I believe that the question of whether banks should be permitted to establish operations subsidiaries should have been resolved through legislation rather than by changing our interpretation of the law.

I am convinced, from a review of court decisions relating to the incidental powers of national banks, that such powers are limited to those that are necessary or required to enable such banks to perform their *authorized* functions, and that, in deciding whether this is the case, the general intent of the statutes under which the banks operate, as well as long continued administrative practices, may properly be considered.

When I say "long-continued administrative practice," I refer to the fact that all supervisory agencies of the Federal Government interpreted this statute, from the date it was enacted until the 1960's, as prohibiting the acquisition of stock.

In this connection, I am impressed by the reasoning of the Supreme Court in *First National Bank v. Missouri*, 263 U.S. 640. In holding in 1924 that national banks did not have incidental power to establish branches, the Court stated:

"The extent of the powers of national banks is to be measured by the terms of the Federal statutes relating to such associations, and they can rightfully exercise only such as are expressly granted or such incidental powers as are *necessary* to carry on the business for which they are established." (263 U.S. at 656; emphasis added.)

An alternative organizational arrangement of the sort we are discussing, although it may promote convenience, is not *necessary* in order for a bank to carry on its banking business. As the Supreme Court noted in its ruling that national banks do not have incidental power to pledge their assets as security for private deposits, "A practice is not within the incidental powers of a corporation merely because it is convenient in the performance of an express power." (*Texas & Pacific Railway Co. v. Pottorff*, 291 U.S. 245, 255 (1934).)

Even if the incidental powers clause, standing alone, were construed as permitting a national bank separately to incorporate its departments, I believe that the stock-purchase provision, which was enacted subsequent to the incidental powers clause, was intended to prohibit the exercise of that procedure.

As I said earlier, it didn't repeal the incidental powers-clause. It left it exactly as it was.

From time to time over the years since the stock-purchase prohibition was enacted in 1933, the contention has been advanced that such prohibition was intended by Congress only to prevent banks from *investing* in corporate stock from income and capital appreciation, in the way that banks invest in debt obligations of the Federal Government, municipalities, and private corporations. In my view, although the prevention of such investment in stocks undoubtedly was a major congressional purpose, the stock-purchase prohibition was intended *generally* to prevent the purchase of the stock of corporations, including those created to perform functions that could be performed by the bank itself. Until recently, the prohibition was so interpreted and applied by the Board (and by the Comptroller of the Currency until a little less recently) since its enactment. As you may remember, I was in the Office of the Comptroller of the Currency from the date of this legislation until I went to the Board.

One of the principal banking problems of the 1920's that led to the enactment of the Banking Acts of 1933 and 1935 was the "affiliate system," including member banks' ownership of other corporations. Among the objectives of the Banking Act of 1933, as expressed by the Senate Banking Committee, was "to separate as far as possible national and member banks from affiliates of all kinds." (S. Rept. 77, 73d Cong., p. 10.) Together with a number of other provisions of the Banking Act of 1933, the stock-purchase prohibition of Revised Statute 5136 served the purpose of confining the bank-affiliate system by preventing banks from purchasing the stock of other corporations, except to the limited extent that Congress specified.

My experience in the supervision of banks has revealed that the likelihood of unsafe and unsound practices, violations of law, and other developments contrary to the public interest is significantly greater when banks operate through subsidiary corporations. There appear to be an inevitable tendency for some banks, in time to regard their subsidiary corporations as separate enterprises and thereupon to conduct their operations in a way that is unsuitable for a part of a banking enterprise, to disregard pertinent restrictions and requirements, and, in particular, to venture through their subsidiaries into activities that are beyond the powers of the parent bank. It is reasonable to infer that Congress, having in mind the predepression affiliate system, concluded that the American banking system and the general welfare would be benefited by limiting the authority of member banks to conduct their operations through separately incorporated organizations.

I can readily understand how others might arrive at a different decision, but I find it difficult to believe that others would deny that there are sound legal principals supporting the Board's earlier position that the stock-purchase prohibition prevents the establishment or acquisition of operations subsidiaries except as specifically authorized or recognized by Federal law. In such circumstances, changing by administrative action the meaning of a provision of law should be avoided. Under our form of government, the appropriate body to change the law in those circumstances is the Congress.

The Board's authorization of operations subsidiaries is made more significant by the companion ruling on so-called loan production

offices. Such ruling actually expands the substantive powers of member banks. Taken in conjunction with the authorization of operations subsidiaries, its potential effect is so broad that it raises fundamental questions regarding the structure of banking in this country.

Just what is a loan production office? Essentially it is an office that is open to the public and staffed by employees of the bank regularly engaged in contacting potential borrowers soliciting applications for loans, negotiating terms, and processing loan applications. It does not formally approve loans, and it has no funds of its own to disburse to borrowers. Approval of loans and disbursement of funds take place only at the main office or a branch of the bank.

That is true under the Board's interpretation but it isn't necessarily true with respect to others.

I am informed, for example, that in at least two cases where subsidiaries are operating under the control of national banks, that they actually operate as principals and not as agents, and they do make loans with their own funds, not only in the State in which the bank is located, but in other States as well.

If loan production offices constitute branches, a member bank may establish them only with Federal supervisor approval and only to the extent permitted by the branch banking laws. If such offices are not branches, they may be established at any place in the United States by State member banks without such supervisory approval. Under the Comptroller's ruling, national banks have to get his approval before establishing such an office through a subsidiary.

A State may prohibit banks chartered by it from establishing such offices, and it may attempt to prevent other banks from establishing such offices within its boundaries. However, insofar as Federal law is concerned, there would be no impediment to the establishment of such offices or legal control over such establishments.

In 1967, the Board published an interpretation on loan production offices in which it reiterated a position that it had taken in 1964 with respect to the operation by a Missouri bank—at that time a member State bank—of certain subsidiary offices in an adjacent State.

Because of that ruling, that particular bank converted into a national bank and, therefore, was permitted to do it.

Section 5155(f) of the Revised Statutes, which is made applicable to member State banks by the third paragraph of section 9 of the Federal Reserve Act, provides that the term branch "shall be held to include any branch bank, branch office, branch agency, additional office, or any branch place of business \* \* \* at which deposits are received, or checks paid, or money lent."

Until August 14, 1968, the Board considered that loan production offices constitute places of business at which money is lent and therefore could be established or acquired by a member bank only at places where it might establish a branch and with the approval of the appropriate Federal bank supervisory agency—the Comptroller of the Currency in the case of national banks and the Board in the case of member State banks.

In reaching that conclusion, the Board expressed the view that the statutory enumeration of three specific functions—receipt of deposits, payment of checks, and lending of money—is not meant to be exclusive but to assure that offices at which any of these functions is performed

are regarded as branches by the bank regulatory authorities. In other words, the specification of these three functions, as a U.S. court of appeals recently pointed out, "was not intended to be exhaustive." (*Dickinson v. First National Bank in Plant City*, 5th Cir., No. 25173, opinion of Sept. 12, 1968, p. 16.) Stated still another way, Congress real purpose in enacting the branch statute was to prevent significant banking functions from being carried on except at governmentally authorized offices.

In view of a footnote in its August 14 ruling, the Board apparently still subscribes to that view. However, contrary to the implication in its 1967 ruling, last month's ruling implies that the operations of a loan production office do not constitute significant banking functions of the type Congress had in mind when it enacted the Federal branch banking law.

In my judgment, loan production offices constitute branches for the purpose of Federal law for two reasons: First, the operations of such offices constitute the lending of money at offices of the bank within the meaning of the specific language of the Federal branch statute; second, those operations constitute significant banking functions (even if not regarded as the lending of money) that Congress contemplated should be made available only at governmentally authorized offices.

In my view, the facts that final approval of loans arranged at production offices emanates from the home office or authorized branches and that credits to borrowers' accounts for the proceeds of loans are entered in the bank's books at such authorized offices should not be controlling. Otherwise, member banks can conduct their operations—receiving deposits as well as lending—at numerous locations anywhere in the country, without the approval of supervisory authorities, by the means of performing the final step in each transaction at an authorized office of the bank, thereby substantially nullifying the legislative purpose. Such final step could be performed at an authorized office almost instantaneously by telephone or other electronic device.

Let me just explain. A bank in New York City could establish a loan production office in my hometown, Broken Bow, Nebr. I could do everything with respect to setting up that loan. It could pick up the telephone and call the head office and get approval there and they could credit the account of that individual with the amount of the loan, and the man in Broken Bow would merely hand out a bunch of checks and say, "Write your checks."

And this, in my opinion, is a very important change in the banking structure of this country.

Lawmaking by administrative interpretation to fill gaps in statutory provisions is unavoidable. However, both as a lawyer and as a believer in the concept of separation of governmental powers, I am of the view that such lawmaking should be held within the limits of the language of the statute, its relationship to other provisions of law, and the purposes and intentions of the legislature in its enactment. Although Congress certainly intended that member State banks should not be treated more restrictively than national banks with respect to purchases of corporate stocks and establishment of branches, the law does not place upon the Board a duty to promote competitive equality. On the contrary, as the Court implied in the recent litigation on whether national banks may underwrite "revenue bonds," to do so

would constitute a failure on the part of the Board to perform its duty to interpret and enforce those laws with respect to member State banks. In other words, the Board should use its own judgment and come to its own interpretation of the law and apply it even though some other agency has erroneously construed the same law differently. (See *Baker Watts & Co. v. Saxon*, 261 F. Supp. 247 (1966), affirmed 392 F. 2d 497 (1968).)

An administrator may not like the result to which he is led by the law any more than the person whose conduct is affected. Nevertheless, his remedy is the same as the private person. He must direct his efforts toward getting the legislature—the Congress insofar as Federal law is concerned—to change the law. This point was made quite effectively by Judge Thornberry in concurring in the recent case relating to the power of national banks to engage in the insurance business when he stated that “From the economic standpoint, it may be unfortunate that this Court is interfering with the expansion of national banks into the area of credit-related insurance, but the banks should look to Congress, not the Comptroller.” (*Saxon v. Georgia Association of Independent Insurance Agents, Inc.*, 5th Cir., No. 25050, opinion of August 12, 1968, p. 29.)

The appropriate yardstick for an administrator to use in making his evaluation is the sound and tested principles of statutory interpretation. Only where the application of legal principles clearly indicates that an agency has adopted the poorer view as to the meaning of statutory language should it change an outstanding legal interpretation. In my judgment, a fair application of those principles indicates that the Board’s earlier rulings on both operations subsidiaries and loan production offices embodied the better view of the legal issues involved. Consequently, I had no choice but to express that judgment in the form of a dissent from the Board’s action.

I must say that Governor Brimmer has asked me to state that he shares the views expressed in this statement.

Chairman PATMAN. Thank you, Governor Robertson.

I would like to ask one question, and then I shall yield to the other members of the committee.

Mr. Martin, the rulings on loan production offices and purchase of shares by banks for their own account, put out by the Federal Reserve Board on August 14, have these rulings gone into effect, or are you contemplating that you will place them in the Federal Register so that comments will be invited and then the Board can make the final decision?

Or do I understand correctly that your rulings of August 14 are already in effect and that any bank under your jurisdiction can take advantage of the change in policy which the Board has authorized?

Mr. MARTIN. The rulings are in effect now.

Chairman PATMAN. They are in effect now?

Mr. MARTIN. Yes, sir.

Chairman PATMAN. You did not put them in the Federal Register?

Mr. MARTIN. No, we did not publish them for comment in advance, since they were interpretations.

Chairman PATMAN. If you put them in the Federal Register, it would be subject to some delay. To pass on them.

Mr. MARTIN. I think it is 30 days.

Chairman PATMAN. But you did not avail yourself of that opportunity?

Mr. MARTIN. We did not publish the original rulings in the Federal Register in advance, either.

Chairman PATMAN. Well, of course, we are just talking about the August 14 one.

Mr. MARTIN. I would like the record to show that the original rulings were not published in advance in the Federal Register for comment.

Chairman PATMAN. When were the original rulings?

Mr. MARTIN. 1966 and 1967.

Chairman PATMAN. Mr. Widnall.

Mr. WIDNALL. Thank you, Mr. Chairman.

Mr. Martin, Mr. Robertson, we certainly welcome you before the committee again. We are very pleased to have you here. We always know we are going to be enlightened in many ways—we hope as well from you as from the Congress—during the course of the hearings.

Isn't what we are talking about something that essentially has been going on for quite some time? Isn't this something that is pretty much along the same line? Hasn't this business been produced all through the country for so many years by outlying offices that are not branch offices, but actually are funneled into the Bank of America? What is the difference?

Mr. MARTIN. I haven't been able to determine the difference. That is one of the problems. Governor Robertson might have a different reaction to it.

Mr. WIDNALL. What is your reaction? I have one of those BankAmericards. This happens to be a Virginia BankAmericard that is mailed out unsolicited to a borrower or potential borrower.

Mr. ROBERTSON. We have seen over the past number of years now a stretching out by banks seeking business, not only in the area in which they are located, but all through the United States. They do send representatives out but that is a very different thing from establishing an office at which you are in a position to contact the public, in which you are able to do anything except get a final word of approval at the home office. The home office can set up a line of credit under which a loan is automatically approved and then you merely hand out the checks to the individual and he starts writing checks. I would say this is a long step beyond what has been done in the past, and fortunately this hasn't been done to any large extent, except in the case of mortgage offices, and that is what really gave rise to the problem.

Mr. WIDNALL. I believe you tried to point out that if it is followed through to its logical conclusion you would have almost instantaneous approval of an application.

Mr. ROBERTSON. That is my opinion.

Mr. WIDNALL. And it would be handled just as though it was in the office at which you were making your application?

Mr. ROBERTSON. That is my fear.

Mr. WIDNALL. Through an IBM machine or by telephone communication?

Mr. ROBERTSON. That is right.

Mr. WIDNALL. Mr. Martin, page 9 seems to express what I believe is the real emphasis of your remarks:

The question of whether a State member bank may establish such an office will now depend solely on State law. If the law of the State where the bank is chartered, as interpreted by State authorities, prohibits the bank from conducting its operations in this fashion, that will end the matter. If advance approval of the supervisor must be obtained in each case under State law, that requirement will continue to apply; if, on the other hand, the State law provides general authority for the bank to establish such offices without specific approval of the supervisor in each case, that law will apply, as to offices established in the home State.

Now, isn't this really the peak of the arguments against your action?

Mr. MARTIN. Yes, I think it is. And as I mentioned on page 10, another problem here is that if a State deliberately permits a loan production office, our ruling of 1967 overrode the State law on that. And at the same time the Comptroller said that this was all right. I am not trying to say that competitive equality is a goal that we ought to be always striving for, but, nevertheless, I don't think that a State member bank of the Federal Reserve System ought to be placed in a serious disadvantage to a national bank operating in the same State.

Mr. WIDNALL. But among any pressures that you may have received, or any consideration that you may have given to this, was not a prime controlling factor the expansion of business, the more expeditious handling of business, or the decrease in cost of handling that business, rather than whether or not that decrease in cost could be passed on to the ultimate consumer?

Mr. MARTIN. Yes, I think all three of those were factors in this, and we have to view it entirely from the standpoint of the public interest. I think it is an extremely difficult thing to—this is a lawyer's field day again. I am not a lawyer. I am not an economist. That has been one of my handicaps on the Board, or one of my assets. I don't know which. But I am neither a lawyer or economist.

But I am trying to put this in terms of what serves the public best, and in this instance, I wasn't persuaded, as time has gone on, that our original ruling necessarily serves the public best.

Mr. WIDNALL. Doesn't this new ruling more or less open up a can of worms as to extension of the banking business? I would say that this floats out in many directions and all you have to do to have your branch or branch production office is to follow it up with a charter later on and you are already in business.

Mr. MARTIN. I think it may. I don't believe it will. But this has been impressed upon me several times.

I was out not so long ago playing golf in a western city with two men from New York banks who were there only for the purpose of getting business. I see no way that we can prohibit them going out or that we can prohibit them from calling on the telephone to Broken Bow, as Governor Robertson says, to get this business. This has been going on for years.

I don't see how to draw a line between an office in the Statler-Hilton Hotel and an office in an office building. But I think it is time we face up to some of these problems realistically and not just hide our heads in the sand. There are forces at work that ought to be dealt with and we have no way of coping with them under present law.

Mr. WIDNALL. My time has expired. May I make an aside off the record?

(Discussion off the record.)

Chairman PATMAN. Mr. Barrett.

Mr. BARRETT. Mr. Chairman, I am very much interested in the statement Mr. Robertson made. I just can't altogether comprehend whether he is indicating that Chairman Martin should have his wrist smacked for allowing these regulations to be inaugurated and thereby circumvent the prerogative of the Congress, or whether the responsibility should fall on the counsel of the Federal Reserve Board. This doesn't seem clear to me. You talk about violating the Prohibition Act of 1933. I am almost coming to the conclusion that it is not necessary for Congress to enact laws because the Federal Reserve System can and does change the law at will.

Would you comment on this?

Mr. ROBERTSON. I would be very glad to comment.

Mr. BARRETT. I may say, too, I would like to commend you. I remember about 10 years ago you were one of the dissenters on the Board. I think it was at the time the economy was out of balance. And I believe you had taken a stand that had they done this, and shifted the economy, that the economy might have been brought back into balance.

You seem to be very observing on what is necessary to help the country, the economy, and the people who depend on the integrity of the Federal Reserve, and I would like to get your clarification in a way so we will know what the score is.

Mr. ROBERTSON. Like every other member of the Board, I think each of us has a job to call our shots as he sees them. I am sure that the Chairman and the other four members of the majority have acted in absolute good faith and in a way which they think is right. It doesn't happen to be the way which I think is right, and I do not think you should slap the wrist of the legal division, because it is on my side.

Chairman PATMAN. Governor Robertson, what was your last statement there?

Mr. ROBERTSON. That the legal division is in accord with my views.

Mr. BARRETT. Then could I close by asking you this question: Should we slap the wrist of Mr. Martin?

Mr. ROBERTSON. No. This is a matter of judgment on the part of the Chairman. And I think the Congress has the problem—and that is the whole purpose of this—to put the problem where I think it should be. The Congress should decide what the law should be in this area. That is the democratic process.

Mr. MARTIN. Let me interject here that Governor Robertson and I have been friends for many years and always will be. But we have never let our friendship interfere with our duty as we have seen it to administer the law.

Mr. BARRETT. My time has expired. But when I hear of these clandestine meetings, one seems to disapprove of them, and I am beginning to wonder—

Mr. MARTIN. Governor Robertson did not disagree with the holding of this meeting.

Mr. ROBERTSON. No; I think not at all. And it wasn't clandestine in any sense of the word. This was a meeting that was exactly as the Chairman stated it was, asked for by Mr. Frank Wille, the New York State superintendent of banks. He selected all the people who came to that meeting.

Mr. BARRETT. I ask unanimous consent that I be permitted to put into the record at this point the following article, entitled "The Heads of Top State Banks Held Secret Talks With the Federal Reserve Board."

Chairman PATMAN. Without objection, it is so ordered.

Mr. BROWN. I object, until it is identified.

What does he wish to put in the record?

Chairman PATMAN. Mr. Barrett asked unanimous consent to place into the record an article that was in the New York Times on August 20 about the heads of the top State banks held secret talks with the Federal Reserve. It is just an article.

Mr. BARRETT. Does the gentleman object?

Mr. BROWN. I withdraw the objection.

Chairman PATMAN. Without objection, it is so ordered. Any relevant article should go in, I think.

Mr. MARTIN. I would like the record to show that I deny the implications of that headline.

(The article referred to follows:)

[From the New York Times, Aug. 20, 1963]

#### HEADS OF TOP STATE BANKS HELD SECRET TALKS WITH THE RESERVE

(By H. Erich Heinemann)

The Federal Reserve Board held a secret meeting with the heads of some of the Nation's largest State-chartered banks last Tuesday, Aug. 13, the day before the Board issued a ruling significantly easing certain regulations governing these institutions. According to participants in the meeting—held at the Board's Washington headquarters—a broad range of complaints against the Reserve's regulations and regulatory procedures was aired at the session—including protests against its ban on operating through subsidiaries, and against its generally "tough" attitude toward mergers and holding-company acquisitions.

#### PARTICIPANTS LISTED

The Board, whose seven members all were at the meeting, made no commitments, it was said, and there was no hint that a new ruling—reversing the Board's stand on subsidiaries—would be issued the next day.

The meeting, which was organized at the initiative of the National Association of Supervisors of State Banks, was designed, participants said, to underscore the seriousness of State-bank complaints about the Reserve's regulation, complaints that have led to an increasing number of conversions from State to National charters.

The bankers who attended the session were R. E. McNeill, Jr., chairman of the Manufacturers Hanover Trust Company; John M. Mayer Jr., president of the Morgan Guaranty Trust Company; Howard W. McCall Jr., president of the Chemical Bank New York Trust Company; John R. Bunting Jr., president-elect of the First Pennsylvania Banking and Trust Company of Philadelphia; Kenneth V. Zweiner, chairman of the Harris Trust and Savings Bank of Chicago; Harry J. Volk, president of the Union Bank of Los Angeles; Douglas R. Fuller, president of the Northern Trust Company of Chicago; and Carl K. Dellmuth, president of the Fidelity Bank of Philadelphia.

On the supervisory side, the meeting was attended by Frank Wille, New York State Superintendent of Banks; James M. Hall, California Superintendent of Banks; G. Allen Patterson, Pennsylvania Secretary of Banking; Roland W. Blaha, Illinois Commissioner of Banks and Trust Companies; and Philip Hewes,

Connecticut Banking Commissioner and head this year of the National Association of Supervisors of State Banks.

The burden of the arguments that were presented to the Federal Reserve Board was that federally chartered national banks have considerably more operating freedom under the supervision of the Controller of the Currency than do their state-chartered competitors.

#### ADVOCATE OF MERGERS

Of the 50 largest banks in the country, only 18 have State charters, and of those 18, several, including some represented at the meeting last Tuesday, are considering conversion to national charters.

Among other things, the Controller has long allowed national banks to operate through subsidiaries. In addition, the incumbent Controller, William B. Camp, is an open advocate of bank expansion through merger, having denied only one merger application, while approving more than 125.

The Federal Reserve, by contrast, has placed heavy emphasis in several recent merger decisions—including one denying the Bankers Trust New York Corporation the right to acquire the Liberty National Bank and Trust Company in Buffalo—on its belief that mergers or acquisitions may destroy potential as well as actual competition.

Bankers generally were pleased by the Reserve Board's ruling last week that state banks may operate through subsidiaries, and in addition that they may set up "loan-production offices" anywhere in the United States.

Mr. Wille, the New York Superintendent of Banks, said that he was "delighted" with the Reserve's ruling, which, he added, "made a significant contribution to the competitive status of State-chartered banks."

Another banker said that "it was far more liberal than anybody could have hoped."

At the same time, bankers emphasized that serious problems remained. Large, State-chartered banks, which all are members of the Federal Reserve, are compelled to obtain two regulatory approvals—from state authorities and from the Reserve—every time they make a significant move, and this can be a time-consuming process.

A good part of the discussion at last Tuesday's meeting, it was said, concerned suggestions from the state supervisors about ways of streamlining the Reserve Board's regulatory procedures.

Chairman PATMAN. Mr. Clawson.

Mr. CLAWSON. Thank you very much.

Clandestine meetings are not necessarily peculiar to the Board. I have heard of other meetings sometimes being held. They may have been held in other areas, so this is not unusual, perhaps, today.

Mr. Martin, the loan production office activity concerns me to some extent. At what point they might convert to a branch? Under the examination power that you have in their activities, at what point would you decide whether it should be a branch rather than a loan production office, when they meet only one of these three activities, or would this be possible under the present ruling?

Mr. MARTIN. Well, the three activities that are enunciated here, I think, are fundamental to the operations of a branch.

A loan production office that is engaged in any one of these would be considered a branch by the Board.

Mr. CLAWSON. Loan production offices do, though, come under the examination and supervisory authority?

Mr. MARTIN. They come under our authority, and I am sure we would get a report at that juncture and we would probably rule it out of order.

Mr. CLAWSON. Do I understand your response to a question by Mr. Widnall that you believe that this expansion of powers, if that is how we want to define it, is in the public interest?

Mr. MARTIN. That is correct; that is my conclusion.

Mr. CLAWSON. Mr. Robertson, may I be permitted to ask you this question:

On page 2, you use the term "necessary," in the second paragraph of your statement. You believe that this rather narrow construction would be more in the public interest, or do you think that perhaps could be broadened in keeping with the reinterpretation?

Mr. ROBERTSON. I think that the word "necessary," was not put in accidentally by Congress. I think the Congress was trying to give an incidental power to do that which was necessary in order to carry out a function.

An example of a necessary power is the illustration which I gave relating to collection of previously contracted debts, and consequently I think if it is determined that the powers should be broadened, it should be done by Congress, which gave the powers in the first instance, rather than by an administrative agency.

Mr. CLAWSON. So it is really your opinion that it is a matter of congressional determination to change the law, rather than what the law contains?

Mr. ROBERTSON. That is exactly so.

Mr. CLAWSON. And it might possibly be that the public interest could well be served by this rather broad interpretation?

Mr. ROBERTSON. This is right.

There are lots of changes which I think should be made and could be made, but I think the changes should be made by Congress rather than an administrative agency.

Mr. CLAWSON. This is the real nut of the problem as far as you are concerned in the action that was taken by the Board in August?

Mr. ROBERTSON. That is exactly right.

Chairman PATMAN. Mrs. Sullivan.

Mrs. SULLIVAN. I am going to ask your permission to question Mr. Robertson about other responsibilities of the Federal Reserve.

Chairman PATMAN. You may proceed.

Mrs. SULLIVAN. Mr. Robertson, I would like to ask several questions about another responsibility of the Federal Reserve, which is a new one, and that is the drafting of regulations for carrying out the Truth-in-Lending Act. I believe there is an advisory committee helping you out on that, and I am wondering when the first working draft of the regulations might be available for public study.

Mr. ROBERTSON. We began work on proposed regulations sometime before the statute was enacted. We have a complete draft of the proposed regulation.

We have designated an advisory committee which, in my judgment, is topnotch. We have had that committee with us. We have gone over every single provision of the proposed regulation. We are now polishing it. We hope to put it out for public comment by October 15. My hope is that we will have the comments in, call our advisory committee back, and analyze those comments and revise, if necessary, and put out a final regulation by January 15, so that all of the institutions in this country which are on the lending or selling side, and all the consumers on the other side, can have as long as possible to get acquainted with it. Then we have the job of starting an educational program to see to it that this is understood by people throughout the country. That is our time schedule.

Mrs. SULLIVAN. The word I have is that the proposed regulations are presently being submitted to various credit industry groups. When do you think that we here in the Congress might get a look at them?

Mr. ROBERTSON. We have given a copy of the regulation to each member of the advisory group and to each one of our Federal Reserve banks. We have not made this available to any credit groups and we deliberately refrained from doing so, although we have had many requests. We simply thought everyone ought to be on an even basis with respect to the time of preparation, so that when it is made available it will be given to everyone who wants it.

I have heard these stories that copies have leaked out. I don't know how you account for that. But we have not put out any such copies. We will put them out for everyone on October 15.

Mrs. SULLIVAN. That is why I am asking you in the public hearing today.

Do you have a list that is available on the advisers—the names of the people?

Mr. ROBERTSON. Yes, we do, and we have published that. It is a matter of public information and I would be glad to send you a copy.

Mrs. SULLIVAN. I wish you would.

Curiously enough, no one, as far as I know, has consulted anyone on this committee about the legislative intent behind anything in the bill, insofar as drafting the regulations are concerned. I sincerely hope that in implementing this law you will attempt to interpret it primarily from the standpoint of the consumer and his right to have full information. I think that whenever a monetary consideration is involved in any kind of credit transaction, you should require that the consumer have something in writing to show what he is being charged for and how much.

The reason I say that is that I am pursuing a case of this kind with the Home Loan Bank Board now. A man paid a savings and loan company \$174 as a "something" on an application for a mortgage at 6 percent. But when Maryland raised its interest rate ceiling, the savings and loan then advised him that the rate on his proposed mortgage would be 7 percent. He then placed the mortgage somewhere else. Now he can't get his \$174 payment back. But they never gave him anything in writing about his deposit or down payment or fee, or whatever it was, and this is completely out of order, I believe, and I just wondered—don't you think that he should have been given something in writing to show what his payment to the savings and loan company was supposed to be for?

Mr. ROBERTSON. I wouldn't want to give an opinion off the cuff on a transaction like that, but I would say that I hope you will be very pleased with the way in which the regulation provides against this sort of thing, when you read it, and we will make it available to you just as soon as we can.

I would like to reiterate to this group that I think the people we have on this advisory committee have proven to be absolutely top-notch people, and they are equally divided between those who represent the public interest and those drawn from particular industries, who are not free to give this information to their industry. They were selected because of their particular competence.

I am sure in my own mind that you are going to be pleased with what comes out.

Mrs. SULLIVAN. Thank you very much.

Chairman PATMAN. Mr. Stanton.

Mr. STANTON. Thank you, Mr. Chariman.

Mr. Martin, near the end of your statement, with regard to the banks who are desirous of meeting their customers' constantly changing needs, you brought up the increase of the one-bank holding companies and said the Board was at this time reexamining the Bank Holding Company Act.

Do you anticipate or could you give us any idea of when you would have some recommendations for Congress in this regard?

Do you anticipate early next year?

Mr. MARTIN. I would hope that early next year we would. The phrase has been used here twice, "A can of worms." This is a real can of worms. I used the word "ramifications" in my statement. It requires a very careful study and it can affect the whole capitalistic system in the United States, in my judgment. It revolves around the matter of banking and nonbanking business. It revolves around conglomerates, congeneric activities, and I have used the phrase "consanguineous activities." We are studying this hard now; it is a very difficult problem. We have come to no conclusions and we are working with the Comptroller and with the FDIC and with the administration on it. It is a very, very real problem and this problem I consider to be a very serious one.

Mr. STANTON. It certainly has far-reaching ramifications in it, but I see the need for action. As you say, they are increasing and they are doing it presumably in good faith within the law.

Mr. MARTIN. I might say that the Board, you know, ever since the Bank Holding Company Act was enacted, has consistently opposed the one-bank exemption.

However, the Congress has not seen fit to eliminate that. And without taking a position on this particular issue, I might say that of that loophole had not been here maybe some of this problem wouldn't have arisen.

Mr. STANTON. Mr. Robertson, do you agree in principle with Mr. Martin that the larger banks in this country now and have for years been sending their traveling representative across the country soliciting business; and I gather from reading his statement that it is primarily a place to put this man's hat that Mr. Martin wants.

Mr. Widnall said something about saving money for the ultimate consumer and updating a system that certainly should be updated; and would you agree in principle that the banks of today want to do this?

Mr. ROBERTSON. This is the fact. There isn't any question about it.

Mr. STANTON. Do you disagree with that?

Mr. ROBERTSON. As a fact? Oh, no.

Mr. STANTON. You don't disagree with the principle that they should be allowed to go out and solicit business?

Mr. ROBERTSON. No; I raise no question with respect to the propriety of their sending representatives from New York to San Francisco, or San Francisco to New York. All I say is you don't set up an office to do that.

Mr. STANTON. Mr. Martin said that it is better to establish an office in downtown Los Angeles than in the Hilton Hotel.

Mr. ROBERTSON. From my point of view, you may decide that after a thorough investigation of this, we ought to have nationwide branch banking where each of these offices is an authorized office. You may decide this. And, if you do, I think it is a prerogative of the Congress, and then we as the administrative agency would merely execute the laws.

Mr. STANTON. Once again, since we don't know what the danger is or the shape they will take, why not wait for experience on this?

Mr. ROBERTSON. I think it is fine to wait just as long you want. In the meantime, while you are waiting, you shouldn't violate the law in order to authorize banks to set up these offices unless Congress says so, in my judgment.

Mr. STANTON. Mr. Martin, would the State laws that are involved, do you have any idea or could you tell the committee how many State laws consider these loan production offices to open branches?

Mr. MARTIN. We don't know. One of the difficulties is that in a number of States the law is unclear.

Mr. STANTON. I will yield.

Mr. BROWN. I thank the gentleman for yielding.

On the point of the traveling loan officer, may he establish a location and advertise his presence?

Mr. ROBERTSON. This is not a matter of practice. They do not do it this way.

Mr. BROWN. Well, could they?

Mr. ROBERTSON. This gets to the point now as to whether or not—

Mr. BROWN. I am asking about the interpretation presently applied to a loan officer from a bank in one State going some place else and setting up a room at say the Statler-Hilton, can he advertise in the newspaper that he is available, and is there as a loan production officer of X Bank?

Mr. ROBERTSON. I know of no bank which engages in this, which establishes an office and advertises that as a place of business for them, customers come in to contact that individual.

Mr. BROWN. What would be the posture of the Board if someone did this?

Presently they don't advertise. Presently you don't have complaints of this nature. But if a loan production officer, a traveling loan production officer did this, what would be the posture of the Board?

Mr. ROBERTSON. I would think this decision of the Board, which is the law of the Federal Reserve at the moment, would be controlling.

Mr. BROWN. I mean prior to this interpretation?

Mr. ROBERTSON. We would then have to come to a decision. If the Board ruled this way it would be OK, and if they ruled my way, it wouldn't.

Chairman PATMAN. Mr. Reuss.

Mr. REUSS. Chairman Martin, a hypothetical question:

Suppose this morning I go up to the Riggs Bank in Washington and sit down with their chief loan officer and tell him I need \$1,000 loan, after he has told me about the bank's facilities; and suppose he gets all my credit information and verifies it and then says, "Well,

Mr. Reuss, you look pretty good. We are going to prepare a loan application right now." And they do it, and I sign it, and he says, "This is in excellent order and I just want to tell you, Mr. Reuss, that as far as I am concerned, you are going to get this loan. I am going to have to speak to our president over the lunch hour, and why don't you come back at 1:30 and I think we can fix you up."

In your judgment, would that activity on the part of the chief loan officer of the bank, that I have described, constitute a significant banking function?

Mr. MARTIN. Why, yes, it is a banking function.

Mr. REUSS. I would think so.

How do you square the belief that what I have just described is a significant banking function, with the fact that in your opinion, on August 14, on page 2 footnote 1, you and your majority colleagues said, in applying the statute—and this is a branch banking statute—the emphasis should be to assure that significant banking functions are made available to the public only at governmental authorized offices.

In other words, weren't you right just now and weren't you wrong on August 14, and shouldn't you go back to your 1967 opinion, because what you seem to have done by setting up these loan production offices is to allow banks to carry on significant banking functions. I would agree they are significant.

Mr. MARTIN. I don't agree with you at all, Mr. Reuss. When I was on the golf course, to use my earlier phrase, when I was on the golf course, would you say the loan was a significant banking operation that was concluded there? Yes, in one sense, it was.

Mr. REUSS. Well, I was asking you, and your answer was, in the case I appeared, in which there was solicitation of a loan, the assembly of credit information, and the preparation of a loan application, did constitute a significant banking function. You admit in your opinion that anything that is a significant banking function is within the tenor of the banking prohibition.

Therefore, I suggest that you really ought to review your August 14 opinion, that you were right the first time the year before, and you are right today, and that is two out of three. The only time you were wrong was on August 14—which is a pretty good average.

Now, let me refer to your statement here this morning where, at the top page 9, I think you give the rationale of the Federal Reserve System for permitting the loan production offices. You say:

Many large banks have for years sent traveling representatives to all parts of the Nation to solicit loan business. The loan production office gives the traveling representative—who does not approve loans or disburse money, but merely engages in preliminary and servicing functions—a place to hang his hat.

Isn't it a fact that under the Federal Reserve ruling of August 14, 1968, which ruling permits loan production offices, a New York bank may erect whatever beautiful and majestic, Gothic or Athenian or Georgian banking structure it wants to and there conduct its loan production business? That is the effect, is it not?

Mr. MARTIN. Under this ruling instead of his using a room in the Hilton Hotel, which the bank is paying for, he can have an office where the bank pays rent directly to some landlord and it is marked as an office and he hangs his hat there instead of in the Hilton Hotel.

Mr. REUSS. Or under this ruling; if they prefer not to be a tenant, but prefer to be an owner, they can erect their own banking structure?

Mr. MARTIN. I think it is utterly out of the question that anybody is going to erect a building for the purpose of engaging in these activities. No deposits are being accepted, no money is being lent or disbursed, and if they are foolish enough to start that sort of thing, I think we ought to take a look at them.

But I can't conceive of anybody putting up a Greek temple.

Mr. REUSS. Your ruling does let them do that, does it not?

Mr. MARTIN. In theory.

But only with respect to—

Mr. REUSS. Please answer yes or no.

Does not your ruling permit a bank to erect such a banking structure for loan production purposes?

Mr. MARTIN. I would question very much whether our ruling would permit them to erect a building in St. Louis, for example, for a loan production office. I would have to take that up with the Board.

But I would question very much whether our ruling permits that. I don't think we are going to have any applications.

Mr. REUSS. There won't be any applications, since by your ruling you have said they can set up a loan production office without an application. They wouldn't have to apply if they wanted to build a new Parthenon in St. Louis?

Mr. MARTIN. Our banking examiners and community will let us know promptly whether any building is contemplated.

Mr. REUSS. There is no procedure whereby you have to say aye, yes, or no, if they do start to erect such a building. You have exempted them from coming to you on this ruling.

Mr. MARTIN. On the loan production office, within the confines of that interpretation we have specifically, yes.

But I am saying to you that the erection of an Athenian or Gothic building, as you suggest, for a loan production office, is really, to use your phrase, a hypothetical question that is most unlikely.

Mr. REUSS. Let me return to one other matter.

You have said, Chairman Martin, in your statement, one of the reasons for this August 14, 1968, ruling, of the Federal Reserve was that the Comptroller of the Currency has already for some time permitted national banks to establish loan production offices. That is a correct statement by me, is it not? That is one of the things you have mentioned?

Mr. MARTIN. That is not the reason. But this has certainly made it more difficult, because it has placed the State member banks at a disadvantage competitively with the national banks. And while I don't think uniformity is something we ought to be striving for per se, I don't really think in terms of equity or fairness this is something that is desirable.

Mr. REUSS. This brings up a point at which you will find me on your side, I think, that it really is a kind of bizarre banking system which leaves it to the Comptroller of the Currency, and in his uncontrolled discretion, to make his first decision—which he did a number of years ago—that a national bank may have a loan production office. That, I think, is where the snake entered the Garden of Eden in the first place. Then the State legislature and banking authorities in the nature of things feel that they have to liberalize their State banking and branching laws so their State bank can maintain loan production offices.

And then finally the third phase, the Fed looks at the situation and says, "Well, this is rather ridiculous, that we are keeping State member banks from doing what they can do under their own State laws."

Mr. MARTIN. Right.

Mr. REUSS. I now ask you, the example I have just described seems to me far short of an ideal system of bank regulation. Would you agree?

Mr. MARTIN. Governor Robertson will be glad to deliver his favorite speech on that subject.

Mr. REUSS. What about you?

Mr. MARTIN. I still have some questions about the solution of the problem by combining the regulatory agencies into one agency. I think that this comes back again to the earlier point of banking and nonbanking business. And we may want to get the Justice Department involved in this operation also, before we get through.

I think it is a real—I have used the words "can of worms," it is a real kettle of fish.

Mr. REUSS. Thank you.

Chairman PATMAN. Mr. Mize.

Mr. MIZE. Thank you, Mr. Chairman.

Under these regulations, for example, could the Chase Manhattan Bank rent space in a building across the street from the first National Bank of Dallas, or the Commerce Trust Co. in Kansas City, and put their standard Chase Manhattan Bank sign up over it and that is all, or do they have to put underneath this "Loan Production Office"?

Mr. MARTIN. They could put the sign up, as you suggest. But it would quickly be apparent to everybody, whether they put the sign up or not, that they couldn't accept deposits or lend money or close loans in this office.

Now, I think this hearing is useful, and I think it is very desirable that this thing has come out in the open.

But any bank can go out to Dallas or to San Francisco, or my home in St. Louis, and rent a room in the Statler Hotel—I don't mean to be advertising the Hilton Hotel here—and solicit loans business, but whether they put a sign on the door or not, I don't think it makes a whole lot of difference.

Mr. MIZE. Are the banks in favor of this new regulation of yours?

Mr. MARTIN. I think a lot of the banks are. I think some of them are not. We have made no poll of the banking community.

Mr. MIZE. Thank you.

Mr. Robertson, when did you say you feel the regulations regarding the implementation of the truth-in-lending law will be made available to the public?

Did you say the middle of October?

Mr. ROBERTSON. Yes, I did.

Mr. CLAWSON. I would like to ask Mr. Martin whether or not he believes it would be a good public relations policy for the bank to establish its own building with a big structure that might even look like a bank and still not provide these other three very definite banking services?

It seems to me that would have a negative effect on the public to do that and then not provide these other services.

Mr. MARTIN. That would be my judgment. And I can't conceive that any bank is going to do it.

Mr. CLAWSON. If I were to walk into a building like this and they didn't provide all the services, that is the last time I would want to do business with the bank; that is my own personal reaction.

Mr. MARTIN. And certainly mine.

Chairman PATMAN. Mr. Moorhead.

Mr. MOORHEAD. Thank you, Mr. Chairman.

When did the Comptroller of the Currency hold in favor of these operations subsidiaries and that the loan production offices were not branches?

Mr. MARTIN. 1964.

Mr. MOORHEAD. Was there a vote in the Federal Reserve Board in 1966 and 1967 on these regulations?

Mr. MARTIN. Yes, there was.

And we approved the position that was then taken.

Mr. MOORHEAD. Was that unanimous, then?

Mr. MARTIN. That was unanimous, yes.

There have been some changes in the Board since then, however.

Mr. MOORHEAD. I understand.

Now, if there were before this committee at this moment legislation which would return the situation to, let's call it the pre-1964 situation, for both national banks and State member banks, would you testify in favor of or in opposition to that legislation—just as an individual, not for the Board?

Mr. MARTIN. I see no reason why a bank that can do something directly should not organize the operation as a subsidiary, instead of running it as a department. I see no reason at all why those activities should be precluded to someone who wants to have a wholly owned subsidiary.

In other words, I would be in favor of changing the law, if the law precluded that.

Mr. MOORHEAD. And the same with respect to loan production offices and buildings in other States?

Mr. MARTIN. I am not quite so sure on that one, Mr. Moorhead, because we have had very little experience with this.

One of the things that I am pleased with in this hearing and in the course of events, is the fact that now this is being put out on the table to be looked at in terms of whether it is serving the public interest instead of just denying the authority for one class of banks, making it easier for one competitor versus another competitor. And I think the public interest should control. We have had very little experience with this on the table.

Now, I personally think that the likelihood of an Athenian or Gothic building or anything of that sort is very remote. And I think we want to see what the experience is.

But by and large, I can see some advantages, as I said in this statement, and the majority of the Board did also. I could see some advantages of having these loan production offices on the table in terms of public service.

Mr. MOORHEAD. With respect to other operations subsidiaries, specifically the safe deposit companies was that allowed by specific legislation or by a ruling of the Board?

Mr. ROBERTSON. Specific legislation.

Mr. MOORHEAD. Doesn't that lead one to the inference that if special legislation were involved in permitting safe deposit company subsidiaries, that other subsidiaries equally important should require special legislation?

Mr. MARTIN. Well, safe deposit companies don't accept deposits or make loans. This is a special service of a type that is incidental to the banking business. The big problem that we are wrestling with right now and the broad problem is the interpretation of the phrase, "financial, fiduciary, or insurance," which is in the law now, and directly related activities. This is where we are going to have the big problem in drawing the line between banking and nonbanking business.

Mr. MOORHEAD. Thank you.

Chairman PATMAN. Mr. Brown.

Mr. BROWN. Thank you, Mr. Chairman.

At the outset, I would like to concur with Governor Robertson on the general philosophy and principle of the issue here today. I think the Congress has been very derelict in its oversight and review function, especially when diametrically opposed rules or regulations or interpretations of the same rule or regulations are adopted or made by an administrative agency.

Another good example, a recent one, is the tax-exempt status of the income from industrial development bonds. I think when the Congress concurs in the interpretation or ruling for years by not taking action to change that ruling and nullify it, it certainly cannot be the congressional intent, as well as the administrative intent, when a diametrically opposed ruling is then adopted.

Therefore, it seems to me it is incumbent upon Congress to reverse that administrative rule or regulation, if it has concurred in the diametrically opposed interpretation for many years.

Mr. ROBERTSON. I thank you.

Mr. BROWN. As I understand it, the loan production office would not be able to enter into, or, better, no one in that office would be able to enter into a transaction which would be a legally binding transaction—is that correct—otherwise a loan could not be closed and the parties could not be committed. Is that correct, Mr. Chairman?

Mr. MARTIN. I think—

Mr. BROWN. Under your interpretation of the ruling?

Mr. MARTIN. I think that is the correct ruling, yes.

Chairman PATMAN. Mr. Brown, would you suspend temporarily, please, until we can have an understanding about another meeting of the committee.

I will have to be over there right after 12 and I will have to get another member to serve, and you could go on as long as you can to get through, if possible.

Would it be satisfactory to meet next Tuesday morning? What about you, Mr. Martin and Mr. Robertson? Could you be here next Tuesday morning?

Mr. MARTIN. I have some negotiations in connection with the meetings of the World Bank and IMF, so that I ought not to be committing time during that period.

Chairman PATMAN. This is pretty important, too, you know.

Mr. MARTIN. I am sure Governor Robertson can be available.

Chairman PATMAN. Could you have your counsel here—the one who passed on these points of law that you rely on?

Mr. ROBERTSON. Tuesday would not be very convenient for me. I do have an engagement in Chicago on Monday.

Chairman PATMAN. I don't want to dispute with you gentlemen, but we have had trouble in the past getting a date with you.

Mr. MARTIN. We changed things in order to push this up. I came back from New York in order to be here today.

Chairman PATMAN. That is very good, and I appreciate it. But you see, the Congress will not be in session much longer. That is, we hope it will not. The committee will have to take some action.

So I would suggest, since you gentlemen are protesting against next Tuesday, that we will just have a meeting of the committee next Tuesday morning.

Mr. MARTIN. That is fine.

Mr. CLAWSON. In the meantime, could the members, who haven't had an opportunity to question, submit questions to these gentlemen?

Chairman PATMAN. Yes; and have them answer them.

Mr. Stephens, will you come over here, please?

Mr. Brown's time has not expired. You go as long as you can.

The committee will meet next Tuesday.

Mr. BROWN. Thank you.

I would like to inquire, Governor Robertson and Chairman Martin, of the functions of this traveling loan production officer, if I may call him such. I'd like you to discuss the functions of that officer as contrasted with or compared with the functions of a loan production office.

When we are talking about the traveling officer, isn't he by and large dealing with a different clientele than a loan production office would be dealing with? In the loan production office aren't you having people off the street walking in for smaller loans, consumer loans, et cetera; whereas the traveling loan officer is by and large dealing with a much larger loan type of borrowing client?

Mr. MARTIN. Well, I think this is unquestionably true. I don't think it makes much sense economically, nor do I think they can necessarily compete too effectively with the local institutions on small \$100 loans or that type of thing in a given community.

But to say that that is done by a traveling representative today, insofar as solicitation of business is concerned, just isn't so.

The traveling representative who goes out to these places—the two gentlemen I was talking about playing golf with are trying to get all the business they can for their bank, of whatever sort is available.

Mr. BROWN. How can that gentleman possibly appeal to the normal consumer-type borrower, if he cannot advertise and does not advertise his availability?

Mr. MARTIN. I think that is true.

Mr. BROWN. Aren't we talking about a really significantly different function performed by a loan production office as compared with a traveling loan officer?

Mr. MARTIN. We are talking about it; but I don't think it exists today.

Mr. BROWN. Well, you don't have loan production offices today, do you?

Mr. MARTIN. Well, the Comptroller has authorized them. I don't know how many there are. But Governor Robertson is an expert in this area. He has had banking supervisory experience. I haven't. So he might like to talk about it.

Mr. BROWN. I would like to have his comments.

Mr. ROBERTSON. I think there is merit in the contrast you are making. I think by and large the large banks which send a representative to various cities are dealing only with the larger corporations. It isn't worth their while to deal with a consumer. In these particular loan production offices, you are dealing with an entirely different thing.

For example, one bank owns a mortgage company which has offices in a number of States, in three different States, and it is engaged in the mortgage-lending business.

Now, it has an office, it operates under a different name than the bank, but it does contact people all throughout that community to enter into residential mortgage loans.

This is a very different thing from the kind of traveling salesman of a bank that you are referring to in the first instance, which is general practice in this country.

Mr. BROWN. Thank you very much. My time has expired.

Mr. STEPHENS (presiding). Mr. Martin, I think that I am next in line here. This is the first time I have had the opportunity to interrogate you from this vantage point.

Mr. MARTIN. It becomes you very well.

Mr. STEPHENS. I am sorry that the chairman had to leave because I wanted to make one statement and I hope it will be called to his attention.

I agree with what was said by Governor Robertson about the fact that the trouble goes back to the rulings made by the Comptroller that have affected the banks setup not under his supervision and other agencies have had to come to their protection.

I also agree with what he said in respect to the fact that we had hearings on a whole gamut of more or less charges that were "preferred" against Mr. Saxon. But as you pointed out, we gave birth to no legislation as a result of that. And I wanted to go on record in this matter by saying I introduced legislation to correct at least the ruling that had been made in branch banking and we never had any hearings on that and it never resulted in any legislation.

But I firmly believe, and I won't repeat what I said yesterday, I firmly believe that we ought to take the responsibility ourselves. If we think that the interpretations should not be changed, then we should so indicate by legislation.

I will point out, too, that yesterday I had the privilege of hearing the testimony of Mr. Milner of Athens, Ga., who is my former law partner, and he made a very strong case, I think, for supporting Governor Robertson. I will also point out to you that I went to school with two of the lawyers who are here today for the Federal Reserve, Charlie Molony and Fred Solomon, and I respect their opinions, too.

But what I would like to ask you along this line of questioning about a branch bank, because this is what this boils down to here, in my opinion, do you think you can have a branch bank for only a specific purpose, which this is?

This can't be anything but a branch of the main bank.

But what it seems to me you are saying, you can have a branch, even though branches are prohibited.

I would like to get your feeling as to whether you think you can have a branch for a specific purpose. I guess you think so, since this has been the ruling.

Mr. MARTIN. Some States have said that a loan production office is all right. So they must have thought so. This depends on how you define a branch. And some States have said no.

Mr. STEPHENS. Heretofore we have defined a branch as doing any business. Actually the congressional intent is clear from the former opinion of the Federal Reserve, and talking with members of the committee and knowing the personnel of the Banking and Currency Committee over the years, that branching for any purpose was considered a violation of the statute. And that was the intent of the statute.

Mr. MARTIN. Well, this is not defined as a branch. We are using the phrase "loan production office" here, and some States permit state-wide branch banking and some States do not. And some States have ruled that these production offices are not branches as such and are permissible, and some have ruled the reverse.

This is why I say it is a legal problem and a legal decision has to be made on it. I personally haven't been able to see the difference—

Mr. STEPHENS. Wasn't the legal decision made, and that was that this would violate the branch banking laws of the Congress, and then the decision comes back around and is changed after many, many years? I won't repeat what I said, but I would like for counsel to look at what I said about the principle of *Stare decisis* which, as you know, holds that once something has been decided upon and becomes a pattern of law, and everybody goes along with it, then it ought to stand as the law. I agree with what you said, that the rulings that are made by the Federal Reserve should be guided by what serves the public best. I agree with that. Except that you can't go too far in that. Isn't it true that what you really should be guided by is what the law is, not what serves the public best? If the law does not serve best, then the legislative body ought to consider its change and not an agency.

And I think that has beclouded the situation here, that the Board majority think this is in the public interest. But I say the traveling representatives who have been making these contacts—and we all know they have been doing so—may find it hard, but Congress intended for it to be difficult for them to make these contacts in establishing the competitive advantage, because they were employed by big banks that could come in.

I think Congress intended for it to be difficult for them. And they make them operate in that fashion.

Generally speaking, isn't it true that these people who are making these traveling contacts are really making the traveling contacts primarily with local banks, hoping that they will become correspondent banks, or potentially as their correspondent, rather than contacting the individuals?

Mr. MARTIN. I think that is true. And as I say in my statement

here, if the Congress wants to make a ruling on this, I see no objection. I only make clear that I think that whatever the congressional conclusion comes to, the rules ought to apply to State member banks and national banks simultaneously.

Mr. STEPHENS. I think so. There is no question about that.

Mr. CLAWSON. Would the Chairman yield?

Mr. STEPHENS. Yes.

Mr. CLAWSON. In connection with this type of loan, both policies become a matter of law because of the different rulings of the Comptroller of the Currency and also the Federal Reserve Board. If we are going to use the interpretation the chairman just made, Congress has in effect approved both of these differing policies by not taking any action.

Mr. STEPHENS. That is right.

Mr. BROWN. If I may comment, it appears now under this procedure, instead of the administrative agency carrying out the congressional intent, we have turned this around so now the administrative agency adopts the rule and in effect establishes the congressional intent.

Mr. STEPHENS. Let me ask one other question.

How long can you gentlemen stay? Can you say for a while longer?

Mr. MARTIN. Yes, indeed.

Mr. STEPHENS. I don't want to cut anybody off.

Mr. MARTIN. I can stay until 1 o'clock.

Mr. STEPHENS. I would like to ask permission to submit some questions that I haven't gone into. One of them is a question that will deal with this.

Do you think that the various and sundry slipping away from banking at its main institution, where you have got off-premises banking, won't eventually create such a competitive disadvantage for the smaller banks that they will go out of business and that we will end up with a very few number of banks running the entire financial interest of the country? That worries me, because this has been called to my attention in a statement of 1956 by Senator Douglas dealing with the concentration of banking powers in England and Canada and Germany. I would like permission to put this in the record.

(The statement referred to follows:)

[Excerpt from Congressional Record, Apr. 24, 1956, p. 6857]

**DANGERS OF CONCENTRATED BANKING POWER SHOWN IN EXPERIENCE OF BRITAIN**

If we look abroad we see plenty of corroboration for our fears about the concentration of banking powers. A century and a quarter ago, England had large numbers of provincial bankers who helped to finance the relatively small industries of their localities. But gradually these private bankers were bought up by and merged with the bigger houses, so that for many years now there have been virtually only five banks which have mattered in England and Wales, namely, Barclays, Lloyds, Midland, Westminster, and National Provincial. These firms do more than three-quarters of the banking business of the entire United Kingdom, including Scotland and Northern Ireland.

Along with this concentration in banking, and partially caused by it, there has developed a concentration in manufacturing and in industry. There is but 1 chemical company in Great Britain, 2 flour concerns, 2 chocolate and cocoa

companies, only a handful of breweries and distilleries, not more than 2 tobacco companies, and tight cartels in steel, tin, machinery, and textiles. Professor Ben Lewis has shown how widespread this stifling of competition is in Great Britain. The Big Five have been important factors in promoting this concentration and in reducing competition.

BANKING CONCENTRATION IN CANADA AND GERMANY ALSO LEAD TO INDUSTRIAL  
MONOPOLY AND CARTELS

Canada, our neighbor to the north, is going through a similar experience. There are only 11 banks in all of Canada to serve 16 million people. The Bank of Montreal, for example, has absorbed at least 10 other banks and has 603 branches. The Royal Bank of Canada, a consolidation of another 10 banks, has 793 branches. Ten more banks have been absorbed into the Canadian Bank of Commerce, which now has 651 branches, while still another score of banks have been swallowed up in the Canadian Bank of Commerce. The Bank of Nova Scotia, a consolidation of half a dozen banks, has 415 branches, while 2 banks designed to serve primarily the French-Canadian population have 560 and 349 branches, respectively.

The two biggest banks in Canada, namely, the Bank of Montreal and the Royal Bank of Canada, have almost precisely half of the total bank deposits in the entire country. If we add the third largest bank, 67 percent or two-thirds of the countrywide total will be included. The top four have well over three-quarters of the total deposits.

As in Great Britain, monopoly and quasi-monopoly in industry have accompanied this concentration of banking. There is, I believe, only one tobacco company, for example, in all of Canada, and one private railroad; and a similar situation exists in a very large number of industries. Moreover, industry and banking are so intertwined in directing personnel and in financing as to prove how the concentration of banking power has helped to promote industrial monopoly and quasi-monopoly.

Incidentally, the power of the private monopolies led to the movement for nationalization which was carried out for about one-fifth of the British industry by the Labor Party from 1945 to 1951.

The example of Germany is notorious. Prior to Hitler, there were only three banks in Germany, namely, the Deutsche, the Dresdner, and the Commerz Banks. These played ball with and helped the cartels and monopolies. As all students of nazism know, it was the cartels and the big banks which financed Hitler's final drive to power. Thus, concentration of financial power helped on the concentration of economic power, and then the two forces joined hands to aid in creating a dictatorship of political power with all of the terrible consequences which ensued.

CONCENTRATION IN BANKING AND CREDIT ARE ALSO SERIOUS DANGERS IN THIS  
COUNTRY

All of these examples paint an image of what is likely to happen in this country if we permit the concentration of banking and credit, which has already gone far, to go farther. For here, as elsewhere, the control over credit is moving into fewer and fewer hands.

At the same time, industry has been moving out of competition into closer and closer concentration—monopoly and quasi-monopoly. This has been helped by the big banks. If we do not wish to travel the path of Canada, Great Britain, and Germany, we should do something effective to check and, if possible, to roll back the concentration of banking and credit. For he who controls the credit of a country controls the industry of that country and ultimately, the political life of the Nation as well.

Unfortunately, we have already traveled very far down the way of the concentration of credit and banking. This has been done by the growth of the original home offices of the big banks, such as the Continental and First National Banks of Chicago and the Chase and National City Banks of New York, but also by three other forms of accretion, namely, mergers, branch banking, and bank holding companies.

## BANK MERGERS HAVE INCREASED RAPIDLY

During the past 9 years, bank mergers have been growing apace. The following number of banks have been merged since 1947:

Year:	<i>Number of mergers</i>
1947 -----	82
1948 -----	77
1949 -----	76
1950 -----	89
1951 -----	79
1952 -----	99
1953 -----	115
1954 -----	207
1955 -----	231
Total -----	1, 076

Source: Federal Deposit Insurance Corporation.

Thus nearly 1,100 banks merged during these 9 years, with the numbers greatly increasing during the last 3 years. This, moreover, was during a period when the total number of banks in the country was decreasing by 475, from 14,759 to 14,284. This was a decrease of 3.2 percent.

Among the big mergers were those in New York City of the Chase National Bank and the Bank of Manhattan, of the National City and the First National, the Chemical Bank & Trust and the Corn exchange, and the Bankers Trust and Public National. These mergers alone involved \$19½ billion of assets and over 57 percent of the banking facilities of New York City. There have been a great many other mergers in other portions of the country.

Mr. STEPHENS. Along the lines of this question, I would like to get the reaction that you have as to why this wouldn't happen, if we continue competition with the people who can afford these things, getting down to destroying these small, independent banks.

Thank you.

Mr. Williams.

Mr. WILLIAMS. Thank you, Mr. Chairman.

I think the most startling and perhaps the most noteworthy statement made here this morning is Mr. Robertson's statement to the effect that the legal counsel or legal staff of the Federal Reserve agrees with Mr. Robertson's position. And when I read the news release dated August 14 put out by the Federal Reserve, in the fourth paragraph, I see the statement "The interpretations, determined following a re-examination of Federal statutes, reverse positions taken by the Board in 1966 and 1967."

It was always my understanding that the reason for having legal counsel was to have them interpret the laws and the statutes.

Now, if you reverse your position on August 14 on the position taken in 1966 and 1967, and if your legal counsel supports Mr. Robertson's position, just on what legal basis did you reverse your position?

Mr. MARTIN. Let me put this to you a little differently. Do you think the Board ought to be bound by what the economists tell them, in making decisions? Do you make a distinction between the legal department and economic and professional economists?

Mr. WILLIAMS. Absolutely.

Mr. MARTIN. The Board counsel did not say that this was illegal. And I might say to you that I don't want to get rid of the legal counsel on the Board simply because on occasion they don't happen to agree with me.

But the only lawyer on the Board was Governor Robertson, who is not necessarily the final arbiter on the law.

Mr. WILLIAMS. Let me say this to you: you have already stated you are not a lawyer, and neither am I. But if you are not going to take the advice of your legal counsel, why bother having them?

Mr. MARTIN. In this case I happen to disagree with the legal counsel.

Mr. WILLIAMS. Even though you are not a lawyer.

Mr. MARTIN. Even though I am not a lawyer. But they have not told me that it was specifically illegal. They think the better legal view is to uphold the position that we earlier took, and I happen to believe that you can get very competent counsel who would disagree with the position taken both by Governor Robertson and by the legal staff.

Mr. WILLIAMS. The fact that you believe you could get legal advice that would support your position, in my mind, makes your failure to do so most glaring, because most certainly if we are spending huge sums of money in every Federal department for legal counsel, it is up to the people in those departments to heed the advice of their legal counsel.

Mr. MARTIN. I will take to heart what you say and maybe we should employ some more lawyers.

Mr. WILLIAMS. Well, it certainly seems to me it would have been fine if you had an opinion from somebody saying what you are doing is legal under the statutes.

Because if you don't have that, then that lends substance to the charge that you are making a legislative decision.

Also, on page 10 of your statement, you say, "Since the establishment of loan production offices by banks a relatively new development, there is little evidence available to enable us to determine what, if any, effect it will have on competition. But it seems to me that the burden should be on those who are concerned about this form of competition to prove that further restrictions on issues are needed to protect the public, rather than simply to protect one competitor from another."

It certainly seems to me that with a responsible organization like the Federal Reserve, that it is incumbent upon you to make this determination, rather than to place the burden upon someone else. And it seems to me there is enough evidence available to give some indication of what effect this is going to have, when that evidence is carefully studied.

Mr. MARTIN. We are going to study it very carefully.

Mr. WILLIAMS. Due to the limitation of time, I have a number of other questions, but we did have some testimony yesterday from Thomas H. Milner, Jr., who is the president of the Independent Bankers Association of America. I believe he is also the president of the National Bank of Athens. And I would like to refer you to his testimony where he indicates very definitely that the establishment of these loan production offices is going to hurt the small local banks, even in areas where there is presently competitive banking.

But I notice in Mr. Robertson's testimony that he quoted a number of recent court rulings, some made just before your action, which was publicized on August 14, and some after.

Now, in view of these recent court rulings, is there any possibility that you are going to restudy your position taken on August 14?

Mr. MARTIN. We are always studying it, Mr. Williams. I think this is our duty and our responsibility.

Mr. WILLIAMS. In light of these court decisions which Mr. Robertson quoted, I would certainly like to suggest that you do carefully reexamine these court rulings with the idea of perhaps reversing your position.

Mr. MARTIN. We most certainly will.

Mr. WILLIAMS. Thank you.

Mr. STEPHENS. Mr. Gettys.

Mr. GETTYS. Thank you, Mr. Chairman.

Time is short, Mr. Chairman, and, of course, I always feel it a great honor to have these distinguished gentlemen before our committee.

There is one question that overrides the merits of the question of whether or not banks should be authorized to establish loan production offices—that disturbs me—and that is that for several years your Board has determined that the legislative authority on the subject here does not exist. Then all of a sudden you change.

And you followed the lead of interpreting the legislative intent of Congress as established by the Comptroller, rather than by consulting the constitutional body which is supposed to legislate.

Now, it is inconsistent in my mind with previous actions of your very distinguished Board in neglecting, it seems to me, to consult or to prepare proposals to change the law, rather than acting unilaterally. That is the point that disturbs me. It is in line with the trend of erosion of the proper functions of the three branches of Government. And the principle bothers me.

Of course, there are four branches of Government now—the executive, legislative, judicial, and bureaucracy. I was reading the Constitution the other day and I can't find the fourth branch, but it does exist, and I think it is running this country.

There is the point, Mr. Martin, and Mr. Robertson, that disturbs me, rather than the merits of the question, and I wonder if either one of you would comment.

Mr. MARTIN. I think that Governor Robertson has commented on it in his statement, and I concur in Governor Robertson's general approach to this.

I think we should be very cautious and lean over backward not to use administrative decisions to change the law.

I also think that we ought not to be running to Congress all the time to interpret laws, if we are clear in our own minds.

Mr. GETTYS. At that point, Mr. Martin, if there is a pretty substantial disagreement among the members of the Board as to what is the legislative intent, then it seems to me that the history of your Board has been to propose that Congress take appropriate action to correct—which you did not follow in this instance.

Mr. MARTIN. I think you are quite right in being disturbed about it, Mr. Gettys. I am disturbed by it also.

We had a clear majority of the Board here. This was not a case of four to three. But also we had a problem that this is a moving railroad.

Mr. GETTYS. You have some banks under the Comptroller who are actually operating under this rule. Correct?

Mr. MARTIN. It is a moving railroad, and on this broader problem of banking and nonbanking interests, we have had some question about a loophole, the exception for the one-bank holding company, which is now being used as a device to combine banking and other interests.

The Board has for years been trying to get this exemption repealed and the Congress has denied us this and in the meantime the railroad is rolling on.

Mr. GETTYS. I will cut short my time for Congressman Bingham. He asked a question yesterday which I hope he will pursue today on the banks' proceeding at their peril.

Mr. STEPHENS. Mr. Bingham.

Mr. BINGHAM. Thank you, Mr. Chairman.

Following the suggestion of Mr. Gettys, I will repeat what I said yesterday, Chairman Martin, and that is that I think there is sufficient question about the legality of this Board's new interpretations, so that I would be very cautious, if I were a lawyer advising a bank, to tell the bank to proceed on the basis of the interpretations now adopted by the Federal Reserve Board. And I think the banks will proceed at their peril on the basis of your interpretation.

I would call your attention particularly to the decision of the Fifth Circuit in the *Dickinson* case where the court overruled the interpretation apparently made by the Comptroller in that case as to a mobile office not being a branch, and held that it was a branch. And I think quite conceivably the courts are going to hold here that your interpretation of the law here was wrong and that a loan production office of this type is a branch within the meaning of the statute.

Mr. MARTIN. Are you distinguishing between operations subsidiaries and loan production offices?

Mr. BINGHAM. In this case I am referring particularly to the loan production office, because although I think the same might apply to the other ruling as well, I don't think this committee is quite as much concerned about the other ruling as it is about the loan production office ruling.

May I just say that I do concur with those members who have suggested, in view of the fact that you had adopted a previous position, which was known to this committee and which had never been criticized by the committee, presumably, therefore, it was acquiesced in by this committee, that it was very unwise to proceed to reverse those rulings without any consultation with this committee.

May I ask how common are the loan production offices now under the national banking system and as established by the State banks not members of the Federal Reserve Board?

Mr. MARTIN. There are not a great many. Mr. Solomon, who follows this, says he doesn't know how many. We are trying to find out.

Mr. BINGHAM. I think we ought to have that information because that bears on the question of how far the State banks were really under pressure of competition from the national banks in this regard.

Mr. ROBERTSON. I think that information can best be obtained from the Comptroller. We wouldn't have it ourselves. We would have to ask him for it.

Mr. BINGHAM. May I draw your attention, Chairman Martin, to your footnote on page 2 of the Federal Reserve announcement of August 14.

Do you have that in front of you?

If not, I have an extra copy. Mr. Reuss referred to this before.

And I must say it puzzles me very substantially too.

That footnote would seem to say that you don't want significant banking functions to be carried on at other than governmentally authorized offices. I assume you mean by that branch offices.

Chairman MARTIN. That is right.

Mr. BINGHAM. Are you then saying that the loan production function is not a significant banking function?

Mr. MARTIN. It is not significant in the sense that it requires a branch to do it.

Mr. BINGHAM. Well, isn't that begging the question?

Mr. MARTIN. I think it is a very, very difficult question, Mr. Bingham, and I think you will find among thoughtful and conscientious people a wide variety of views as to the significance or lack of significance of this. I have tried very hard. I have tried very hard. I have talked to a great many people about this, and I have tried very hard to get clear in my own mind the distinctions. But I am convinced this footnote is basically correct.

I think you have to be realistic about this thing as to the number of people that are traveling around the country today soliciting business for little as well as big banks in various areas. It is much larger than some of us realize.

Mr. BINGHAM. What did you mean by the second sentence of that footnote? Can you explain that to us?

Mr. MARTIN. What I said was that if we found this was a significant banking function, or that some other thing that they are doing was a significant banking function, we would want to review the interpretation. We don't see any indication of it at the moment.

Mr. BINGHAM. I think that is a helpful statement, and I hope that you will review the action in that light, because elsewhere in this statement and in your statement today, it seems to me that you have suggested that the words "deposits received," "checks paid," or "money lent," as being an exhaustive definition of what happens at a branch; and this footnote seems to go beyond that. Now I understand you to say you don't limit the concept in your mind to those three operations.

Mr. MARTIN. No, no, not at all. That is the purpose of this.

Mr. BINGHAM. Thank you very much.

Mr. MARTIN. I would just like to interject here, Mr. Bingham, that this matter of competition from the banks is something that is really very difficult. Unless you get right out in the field, it is very hard for us on the Board on our day-to-day activities to really know what the competitive forces are at times.

Mr. BINGHAM. Thank you.

Mr. STEPHENS. Mr. Griffin.

Mr. GRIFFIN. Thank you, Mr. Chairman.

I wish to compliment you gentlemen on your very frank testimony. I have only one brief question.

To get back to Mr. Widnall's credit card, when I go into a restaurant and use that credit card, when I sign the receipt, do I not in essence obtain then a loan from the bank?

Mr. MARTIN. Well, you have a deposit at the bank, perhaps. I wouldn't call it a loan if you have a deposit. You are just using the resources that are already available to you.

Mr. GRIFFIN. To obtain goods and services, though, I sign a contract where I have to repay it. Well, in that case, wouldn't the restaurant be a clandestine loan production office?

Mr. STEPHENS. To follow up on what Mr. Griffin had to say, technically, when the man sits down to discuss the details of his loan and the agent says, "I have to call up the home office to find out whether or not they will let you have the money." He will call and then is going to have to turn around to this fellow and say, "Now, you are going to have to go to the home office to find out whether they told me 'yes' or 'no.'" Otherwise he has closed the loan right there with him if he says what the home office says. And as it now happens, the agent does say it is all arranged and he goes out and draws checks. So the loan procurement office is closing the loan right there on the premises, isn't he?

Mr. MARTIN. It has to actually go back to the home office to be closed.

Mr. STEPHENS. Well, he can't tell him that then on the premises. But he does and the borrower relies on that. He goes out and transacts his business. The agent tells him, you go ahead and start drawing, the bank is going to give you credit.

Mr. BROWN. Mr. Chairman, I think we ought to clarify this point, because Governor Robertson has said that in effect it can be instant cash, instant deposit.

Could a legally enforceable obligation be consummated at the loan production office, papers signed and all those things, so that the loan officer could pick up the telephone and call the main office, the money would be deposited and checks would be furnished and the borrower would be able to in effect use the cash as of that moment.

Now, does your ruling limit the activities of the loan production officer so this couldn't be done?

Mr. MARTIN. According to our ruling this could not be done. Governor Robertson disagrees, but that is the ruling the way I look at it. He can call on the telephone to Broken Bow and do it right now—if you want to put it that way. A lot of this business is done over the telephone. But it is not legally signed.

Mr. BROWN. If you are making a loan, though, and before you are going to deposit that money to an account and let it be drawn on, you are going to have an enforceable agreement in your hands some place, unless it is a longstanding line of credit. We are talking about strangers doing business with each other. Before you are going to permit a drawing on the deposit that you have made from the proceeds of the loan, you are going to have an enforceable agreement. I have never seen a bank deposit money to an account without a mortgage or note signed.

Mr. MARTIN. Then it is going to have to go back to the home office.

Mr. BROWN. Does the ruling say that and, if so, what is the language of the ruling? I don't have it right here in front of me.

Mr. MARTIN. That is certainly the intent of the ruling.

Mr. BROWN. While Mr. Solomon is locking it up, may I pursue this one step further:

When the Comptroller made his decision or his ruling or interpretation, was it based on the same general language as is applicable to

State member banks, that is, the Comptroller's ruling with respect to national's?

Mr. ROBERTSON. The answer is "No."

There is a difference between the Board's ruling and the Comptroller's. In that the Comptroller's ruling originally—

Mr. BROWN. This is 1964?

Mr. ROBERTSON. It was in 1966.

But his original ruling was changed by a letter dated August 13, the day before our August 14 ruling, although it apparently was not published until 2 weeks thereafter.

Mr. BROWN. May I stop you right there? Let me get the picture. The chronology of this is that the Comptroller adopted a ruling or interpretation with respect to national banks prior to the time you adopted?

Mr. ROBERTSON. That is right.

Mr. BROWN. But his ruling did not come out, was not promulgated until subsequent to yours?

Mr. ROBERTSON. Let me make it clear. He did rule originally in 1966 to the effect that a national bank could acquire a subsidiary, a mortgage company, to engage in loan production activities, and the bank could acquire as little as 51 percent of the stock. Under our ruling a State member bank must have 100 percent of the stock.

One day before the Board ruled last month the Comptroller changed his interpretation to require that a national bank must have at least 80 percent of the stock of that subsidiary.

Under the Board's interpretation, a State member bank must still have 100 percent.

And the Comptroller changed his ruling so that a national bank couldn't do this without his specific approval.

That isn't true in our case. A State member bank can do it without approval because it isn't a branch.

Those are the two big differences between the two.

Mr. BROWN. The Comptroller's ruling did not specifically deal with the loan production office question?

Mr. ROBERTSON. Yes, that is what I am talking about. It covered a loan production office where they acquire another subsidiary which carries on the loan production activity. These were mortgage companies that were involved.

Mr. BROWN. Can a national bank acquire a loan production office or have a loan production office without having a subsidiary as such, that is, just have a loan production office as can be done by State member banks under the new ruling.

Mr. ROBERTSON. This was through a subsidiary. And in all these cases they have subsidiaries to do this.

And the intent of it was that they could acquire a mortgage company which was engaged in business in several different States and those offices would not be branch offices. They just are loan production offices and, therefore, the bank could have them.

Under our original ruling a loan production office was considered a branch. A State member bank couldn't have a branch unless under the law they were authorized to have a branch and the Board approved it. Under the Board's new ruling a loan production office, whether it is a subsidiary or otherwise, isn't considered to be a branch, and, there-

fore, we have no control over the establishment of it. They can do it at their own will.

Mr. BROWN. But the basic language involved is the same?

Mr. ROBERTSON. The general intent of the two current interpretations is the same, except for the differentiations that I have mentioned.

Mr. GETTYS. The Comptroller makes a distinction and you do not.

Mr. ROBERTSON. The Comptroller requires they must get his approval first, and we don't. The Comptroller also says you can do this through a subsidiary corporation of which you own now only 80 percent. Under ours you can't do it unless you own the whole thing.

Mr. BROWN. But the statutory law has been the same as it applies to the Comptroller and his rulings?

Mr. ROBERTSON. The statutory language is identical.

Mr. BROWN. That incidental power involves these three functions?

Mr. ROBERTSON. Identical. It is on the same legal basis, the same statutes.

Mr. STEPHENS. Part of the motivation behind the ruling of the Federal Reserve would be to give State banks that belong to the Federal Reserve System the same privilege that the national banks have under the ruling of the Comptroller of the Currency.

Is that part of it behind it?

Mr. ROBERTSON. If I may, I think the real issue here was one of competitive equality. And you didn't want to penalize State banks that were members of the System, when national banks which were also members of the System, weren't penalized.

Mr. BROWN. Even the ruling of the Federal Reserve Board does not establish equality on your subsidiary operations because the Comptroller requires 80 percent ownership and you require 100 percent.

Mr. ROBERTSON. Not complete.

Mr. BROWN. If you are going to establish equality, it seems to me you should do equality.

Mr. ROBERTSON. State banks are a little ahead of the national banks now in this.

Mr. BROWN. Did the gentleman find the language in the ruling?

Mr. SOLOMON. Yes.

Mr. MARTIN. I don't consider this a race of laxity. This is where the difference of judgment comes.

Mr. SOLOMON. Mr. Chairman, on page 4 of the interpretation, there is a listing of all the things that are permitted, and then in about the eighth line on page 4, it says, "When loans are approved and funds disbursed solely at the main office or a branch of the bank, an office at which only preliminary and servicing steps are taken is not a place where 'money [is] lent'. Because preliminary servicing steps of the kinds described do not constitute the performance of significant banking functions of the type that Congress contemplated should be performed only at governmentally approved offices, such office is accordingly not a branch."

Mr. BROWN. Mr. Chairman, I can concur completely with what you have said in your interpretation but you have started out with an assumption that such is the case "when loans are approved"—and where in the ruling does it say that no loans can be approved or funds disbursed except solely at the main office or branch of the bank?

Mr. SOLOMON. I should have perhaps read the earlier language which says what can be done. This language, which says, "When loans are approved and funds disbursed solely at the main office or branch," is saying what cannot be done at the loan production office. It is the contrast between what can be done and what cannot be done.

Mr. WIDNALL. Mr. Martin, at the end of your testimony, on page 12, you stated: "The recent trend toward the establishment of such companies by banks underscores the need for reexamination of the Bank Holding Company Act."

You are currently studying that question now. When do you think your study will be completed?

Mr. MARTIN. I would hope early in the next year.

I would hope the next Congress would get some results of this study. But I can't make a commitment as to time because this is a very difficult study.

Mr. WIDNALL. Once one is prepared and received, you will make it available as quickly as possible?

Mr. MARTIN. Yes, sir.

Mr. WIDNALL. May I make this comment at the end:

You admit you are not a lawyer, but you certainly follow the footsteps of the late Chief Justice John Marshall who moved in a broad construction where the public, in his opinion, would be benefited, would receive balanced benefit.

Thank you for being here today.

Mr. STEPHENS. We appreciate you all being with us today. I suppose we didn't agree on any further meeting and so we will adjourn subject to the call of the chairman.

Mr. MARTIN. We are glad to come up and we think it is a very useful thing to have this explored.

(Whereupon, at 12:40 p.m., the hearing in the above-entitled matter was adjourned, subject to the call of the Chair.)

(The following material was submitted for the record:)

THE AMERICAN BANKERS ASSOCIATION,  
Washington, D.C., September 27, 1968.

HON. WRIGHT PATMAN,  
Chairman, Committee on Banking and Currency,  
House of Representatives,  
Washington, D.C.

DEAR CHAIRMAN PATMAN: The American Bankers Association is pleased to have the opportunity afforded by the hearings before your committee to comment on the Federal Reserve Board Rulings entitled "Member Banks Purchase of Stock of Operations Subsidiaries."

As we understand it, the Board, after a reexamination of the relevant Federal statutes, ruled that member banks were not precluded by Federal law from owning stock in corporations performing bank-related functions. Accordingly, the revised interpretation stated that insofar as Federal law is concerned "State banks that are members of the Federal Reserve System as well as national banks, may purchase for their own account shares of corporations to perform at locations at which the banks are authorized to engage in business, functions that the banks are empowered to perform directly."

The Board's August 14 interpretation also holds that there is nothing in the Federal statutes which precludes banks from establishing "loan production offices" with certain limited powers. The activities of these offices would include: soliciting loans, assembling credit information, making property inspections and appraisals, securing title information, preparing applications for loans (including action recommendations), soliciting investor purchases of loans, arranging to contract for servicing such loans, and other similar agency activities.

The American Bankers Association endorses the Board's actions. With regard to the powers covered, the rulings generally accord to State member banks a position of competitive equality with national banks as far as Federal law is concerned. In States where existing statutes permit State-chartered banks to exercise such powers State member banks would not be precluded by Federal law from having such privileges. The rulings have the effect of resolving some fundamental differences in the interpretation of such laws between Federal regulatory agencies.

The American Bankers Association considers the Board's interpretation of Federal statutes concerning the ownership of operations subsidiaries to be reasonable and proper. This would not modify in any way the prohibition under existing law of purchasing stock in other types of business corporations for investment by banks for their own account. But, we are fully in agreement with the basic conclusion reached by the Federal Reserve that "a wholly-owned subsidiary corporation engaged in activities that the bank itself may perform is simply a convenient alternative organizational arrangement." The fact that under the Comptroller of the Currency's interpretation of the same statutes such arrangements have been available to national banks for several years without untoward consequences may well have prompted the Board to decide that as far as Federal law is concerned, State member banks should not be denied similar privileges.

In enabling the establishment of subsidiaries or loan production offices, one of the evident purposes of the rulings—both of the Comptroller of the Currency for national banks and the Federal Reserve for State member banks—is to permit banks to engage in mortgage servicing. Such activity would clearly be in the public interest in that it would provide lower cost loans to builders and home owners.

However, in its endorsement of the Board's actions, the A.B.A. recognizes that the laws of the States having jurisdiction over State member banks are controlling insofar as their right to use the powers affected by the rulings is concerned. Clearly a State bank can do nothing that its State charter does not authorize it to do and, accordingly, the ruling cannot and will not supersede State law in this respect.

It should be mentioned that the controlling jurisdiction of the States extends equally to both intrastate and interstate locations of loan production offices of all banks, as in the case of regularly established branches of State and national banks, so that under no circumstances would the door be opened to the introduction of branching across State lines or contrary to State law.

In summary, The American Bankers Association welcomes the Federal Reserve Board's rulings of August 14. As a result of the re-interpretation, State-chartered member banks are not precluded by Federal law from having the same competitive opportunities as national banks or as State nonmember banks. Furthermore, in and of itself, the resolution of fundamental differences in the interpretation of Federal law between regulatory agencies is an essential ingredient of sound bank supervision.

Very truly yours,

CHARLES R. MCNEILL

STATE OF MISSOURI,  
DEPARTMENT OF BUSINESS AND ADMINISTRATION,  
*Jefferson City, September 23, 1968.*

HON. WRIGHT PATMAN,  
*Chairman of House Banking & Currency Committee,*  
*Washington, D.C.*

DEAR CONGRESSMAN PATMAN: In reading a recent NASSB bulletin, I see that during the week of the 23rd of September, the House Banking Committee will hold hearings on the recent Federal Reserve Board rulings permitting banks to establish loan production offices and to purchase for their own accounts, shares of corporations, to perform at locations at which banks are authorized to engage in business, functions that the banks are empowered to perform directly.

There have been many questions presented to me since this ruling. As a State bank commissioner residing in a State that does not permit branch banking, I have made the commitment that no bank shall perform these functions in Missouri regardless of the Federal Reserve ruling. I feel that the Federal Reserve Board should not be empowered to over-rule State law in the jurisdiction of State chartered banks and I feel that only Congress should have the power to issue such laws.

While I am a member of the NASSB, and while the support of this ruling is upheld by that organization, I do not feel that they have the total support of all said State supervisors since at no time was I contacted concerning this matter. I would appreciate your consideration to this letter and certain if I may be of assistance to you, please feel free to contact this office.

Respectfully yours,

C. W. CULLEY, *Commissioner of Finance.*

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MORTGAGE BANKERS ASSOCIATION OF AMERICA,  
*Washington, D.C., September 27, 1968.*

HON. WRIGHT PATMAN,  
*Chairman, Banking and Currency Committee,*  
*House of Representatives,*  
*Washington, D.C.*

DEAR CONGRESSMAN PATMAN: The ruling of the Board of Governors of the Federal Reserve System of August 14, 1968 that loan production offices of banks do not constitute branches is a matter of deep concern to the members of this association. The ruling marks a significant and fundamental change in national banking policies, as did the ruling of the Comptroller of the Currency in November, 1966 that national banks may establish loan production offices.

As you know, Congress took steps in 1935 to separate financial functions from commercial functions in response to the serious financial disturbances of that era. Now, we find the way opened for a repetition of abuses that were flagrant in the thirties by far-reaching interpretations of Federal law without the benefit of public hearings or the advice of Congress.

You are to be commended for bringing this matter to the attention of the public. We urge that additional hearings be held and that the Congress give further consideration to the consequences that are likely to result. It is obvious from the differences of opinion among the members of the Federal Reserve Board itself and in the banking community that the definition of "branch" as it is stated in Section 5155(f) of the revised Statutes is in need of clarification. Because this matter is fundamentally so important to the continued viability of the nation's banking system as well as to business firms that rely upon banks to finance their commercial operations, we feel that the Congress, and not the Federal agencies, should make this clarification. We urge Congress to seek withdrawal of the August 14 ruling of the Federal Reserve Board until such time as appropriate clarifying legislation can be promulgated.

Sincerely,

OLIVER H. JONES, *Senior Director.*

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NATIONAL ASSOCIATION OF SUPERVISORS OF STATE BANKS,  
*Hartford, Conn., September 26, 1968.*

Re Rulings of the Board of Governors of the Federal Reserve System relating to "operations and subsidiaries" and "loan production offices," August 14, 1968.

HON. WRIGHT PATMAN,  
*Chairman, House Banking and Currency Committee,*  
*Washington, D.C.*

DEAR CHAIRMAN PATMAN: On behalf of the National Association of Supervisors of State Banks I am responding to the request of the Committee for comments upon the two rulings captioned above.

The National Association of Supervisors of State Banks has, in taking positions on proposed Federal legislation, consistently supported two principles which we consider essential to the preservation of a decentralized dual banking system in this country. The first is that on matters of basic competitive opportunity State-chartered banks should have the same rights and be subject only to the same restrictions under Federal law as national banks. The second is that on matters of bank structure (i.e., the opportunity to branch or merge in particular locations) State law rather than Federal law should govern the geographic rights of both State and national banks.

We view each of the rulings issued by the Board of Governors of the Federal Reserve System on August 14 as consistent with these two principles. In the case of the "loan production office" ruling, our view is based on the assumption that the September 12, 1968, decision of the United States Court of Appeals for the Fifth Circuit in *Dickinson v. First National Bank in Plant City, Florida* correctly interprets the meaning of Section 36(f) of the National Bank Act.

Each ruling promotes the concept of basic competitive equality between national and State member banks under Federal law, since the Comptroller of the Currency had previously ruled that national banks may have "operations subsidiaries" and "loan production offices" throughout the United States under the provisions of the National Bank Act. Each ruling, moreover, requires an affirmative grant of power in State law before either can be utilized effectively by State member banks. Thus, no State member bank may establish an "operations subsidiary" or a "loan production office" unless the law of the State in which it is chartered permits such action, and in the case of offices outside the charter State, State member banks may also have to comply with the laws of the State in which such offices are to be located. At least as to the geographic locations of subsidiary offices and loan production offices, it further appears from the *Dickinson* decision that national banks will be equally bound by the applicable provisions of State law.

Since each of the Board's rulings promotes equality between national and State banks on matters of basic competitive importance and since each defers to the primacy of State law, we support the new rulings without reservation. Individual States, as a result, may now shape their own laws on these matters according to the economic and political forces at work within their respective borders, and these laws will apparently govern the location of national bank, as well as State bank, offices.

We believe further that the Board of Governors has properly concerned itself with equalizing the competitive position of State member banks and national banks under Federal law, since the Federal Reserve Act expressly contemplates that State member banks will have the same rights and be subject to the same restrictions as national banks with regard to stock acquisitions and the location of branches and other offices.

It would also be unrealistic to ignore the grave threat faced by the dual banking system early this year. In May the Wachovia Bank & Trust Company of Winston-Salem, the largest State member bank in North Carolina, with \$1.8 billion in deposits, announced its intention to convert to national charter. Five weeks later, Wells Fargo Bank of San Francisco, the largest State member bank in California, with deposits of approximately \$4.2 billion, announced its intention to convert to national charter. In each case the banks involved held 30% or more of the total commercial bank assets subject to State supervision in their respective States.

Both of these banks assigned as one of their principal reasons for conversion the Board's prior position with regard to "operation subsidiaries" (12 CFR 208.119).

These two conversions were not isolated incidents. At the American Bankers Association's International Monetary Conference held at Dorado Beach, Puerto Rico, in late May, it was apparent that other large State member banks were also studying conversion to the national system, and for similar reasons.

No one can deny that such a development would have been extremely damaging to the dual banking system as we know it. A vast majority of the banking assets of the country would have ended up under the supervision and regulation of a single Federal administrator, the Comptroller of the Currency. With such power concentrated in his hands, he would be able to fashion the banking system of the country according to his personal views of what the law permits. The important contribution of State banking laws and regulation, reflecting, as they do, regional considerations not always possible in monolithic Federal regulation, would have been substantially weakened. And the whole result might well have been the product, not of any default upon the part of State banking laws or State banking departments, but rather the inability of two Federal agencies to agree upon the proper interpretation of the same statutory language.

For the reasons indicated, this Association welcomed the rulings issued by the Board of Governors on August 14.

Very truly yours,

PHILIP HEWES, *President.*

REPLY OF HON. WILLIAM MCC. MARTIN, JR., TO QUESTIONS SUBMITTED  
BY COMMITTEE

BOARD OF GOVERNORS  
OF THE FEDERAL RESERVE SYSTEM,  
Washington, D.C., October 8, 1968.

HON. WRIGHT PATMAN,  
Chairman, Committee on Banking and Currency,  
House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: At your hearing on September 25 your staff furnished us with certain questions, indicating your desire that I answer them for the record of the hearings. The questions and my answers follow:

*Question. Concerning the decision originally made by the Comptroller and now joined-in by the Federal Reserve to permit banks to purchase "operations subsidiaries," I'd like to know how you can reconcile this ruling with the relevant statute (12 U.S.C. 24). The so-called "incidental powers" clause of this statute permits subsidiary operations only where, and I quote the law, "necessary to carry on the business of banking." I repeat, only where "necessary." Isn't it true that the ruling by the Comptroller and now the Federal Reserve's ruling of August 14th stretches this clause to cover any subsidiary corporation that performs a function that the bank is legally empowered to perform directly? If this is not the case, tell us the functions you would not allow to be performed by operations subsidiaries of banks but require the bank itself perform.*

*To pursue the point, not all functions banks are empowered to perform are necessary to carry on the business of banking yet the ruling doesn't distinguish between necessary functions and those that are not essential, to the banking business. This flies in the face of the purpose of the law. The Federal Reserve Board itself just two years ago, in 1966, stated, and I quote from the Federal Reserve Bulletin of August, 1966, p. 1151, "that the stock-purchase prohibition was intended generally to prevent the purchase of the stock of corporations, including those created to perform functions that could be performed by the bank itself." And it also was noted in that Bulletin that the law had been so interpreted and applied since enactment in 1933. Now, however, the statutory requirement that subsidiary operations be necessary to the banking business is ignored, and I want to know why. Why have you decided to rewrite a law which has stood for 35 years?*

Answer: The Board's ruling in no way adds to the functions that a bank is authorized to perform. If a particular function is not expressly authorized by some other provision of law, and is not "necessary to carry on the business of banking" within the meaning of the incidental powers clause, then it is not a function the bank is authorized to perform, and our ruling would not authorize its performance through a subsidiary. So no "stretching" of the incidental powers clause is involved.

Our conclusion that the incidental powers clause authorizes a bank to perform its banking functions through a wholly-owned subsidiary is, of course, a reversal of a previous ruling by the Board. This is not, in my judgment, "rewriting the law." Rather, it is an exercise of our responsibility, as an administering agency, to interpret the law in accordance with the intent of Congress, as best we can judge that intent. One indication of the intent of Congress, as I indicated in my prepared statement, is that the House Banking and Currency Committee in 1927 interpreted the "incidental powers" clause as authorizing a particular kind of operations subsidiary. Other indications of the intent of Congress, as outlined in my statement, convinced the Board that its previous interpretation of the statute was in error, notwithstanding the fact that it was a long-standing interpretation. I believe that our responsibility to carry out a statute includes the responsibility to change our interpretation when we become convinced our previous interpretation was wrong.

*Question: In 1966, the Board, when it ruled on purchases of operations subsidiaries, was concerned with how the public interest would best be served. In prohibiting such purchases, except where necessary to carry out the banking business, the Board said that "Experience in the supervision of banks has revealed that the likelihood of unsafe and unsound practices, violations of law, and other developments contrary to the public interest is significantly greater when banks operate through subsidiary corporations." That statement can also be found in the Federal Reserve Bulletin of August, 1966. It's on page 1152. But now the public interest is forgotten and the question is settled solely on how*

*banks' interest would best be served. I want to know why. Why is it a good idea to now ignore the Federal Reserve's 1966 warning that operations subsidiaries are likely to produce developments contrary to the public interest—unsafe and unsound practices and the like?*

*To pursue this matter, have you made any studies which show that subsidiaries performing non-essential functions are likely to perform them as efficiently and safely as they would be performed by banks directly? If you haven't, on what ground can you justify that a wholly-owned subsidiary is simply a convenient organizational arrangement with no special potential for the production of developments contrary to the public interest, a potential the Federal Reserve Board thought existed just two years ago?*

Answer: Although in the 1920's and 1930's some banks engaged in undesirable practices when operating through subsidiaries, this was associated with lack of specifications to limit the subsidiary to functions permissible for the bank and lack of suitable authority for the bank supervisor to examine the subsidiary and require compliance. With the limited functions of the subsidiaries expressly specified, as in the Board's 1968 interpretation, and with the bank supervisory legislation passed since the 1930's, the earlier experience has become less relevant. It is not possible to demonstrate conclusively that banks would operate more efficiently, or less so, through subsidiaries; but this is the sort of purely internal, non-substantive question that should normally be left to the decision of management in the absence of some overriding public interest—and after careful deliberation the Board has concluded that the interpretation adequately safeguards the public interest.

*Question: Now about these loan production offices which banks are allowed, under the August 14th ruling and an earlier one by the Comptroller, to set-up at any location in the United States, I want to know, first, what effects they will have on the profitability and growth of banks in communities where they are opened. Accordingly, I ask you to describe in detail what you think these effects will be.*

*Second, I ask that you tell us what effects these loan offices will have on correspondent relations between banks.*

*Third, I want to know whether the door is now opened for setting-up a deposit-soliciting-office anywhere in the country? To put the matter otherwise, how long will it be before we have nationwide banking in these United States? And what far-reaching effects will this trend towards interstate banking by the back-door have on (1) the dual banking system, (2) on local banking, and (3) on the viability of local businesses in general?*

Answer: As I indicated in my statement before the committee on September 25, "Since the establishment of loan production offices by banks is a relatively new development, there is little evidence available to enable us to determine what, if any, effect it will have on competition." Similarly, there is little evidence as to what effect, if any, a loan production office may have on the profitability and growth of banks in a community where one may be established. It should be noted, however, as stated in the Board's interpretation, that only preliminary and servicing steps could be taken at the loan production office; loans would be approved and funds disbursed solely at the main office or a branch. In addition, deposits would not be received and checks would not be paid at the loan production office. It will be seen that the local banks are already subjected to direct competition from institutions that do considerably more than the loan production office would do—for example, savings and loan associations, local mortgage brokers, cash loan companies, and sales finance companies. In such a setting, the limited operations permitted to loan production office can hardly be expected to have any significant adverse effect on local banks. Similarly, a loan production office probably would have very little, if any, effect on correspondent relations between banks. The interpretation on loan production offices has no bearing on the setting up of a deposit-soliciting office.

*Question: It occurs to me that the structure of banking in our country is being changed and changed radically by capricious spur-of-the-moment decisions by the Comptroller, the Federal Reserve and the FDIC. To put my mind at ease on this, I want you to tell us what your conception is of the optimal structure of the U.S. banking business with respect to the following characteristics:*

- (a) the number of separately owned banks in the country.*
- (b) the number of banking offices and their location by population center.*
- (c) the range of services offered by banks.*
- (d) the state of correspondent banking relations.*
- (e) interbank competition for loans and deposits.*

*What laws, and new regulations, if any, are required to produce this optimal banking structure you conceive?*

*How do the Federal Reserve's rulings of August 14th and the earlier decisions of the Comptroller on these matters serve to bring about the optimal structure you conceive?*

Answer. This is a question to which I certainly would not want to give a spur-of-the-moment answer, let alone a capricious one. As I indicated in my prepared statement and in answers to questions by committee members, I think recent developments underscore the need to keep banking separate from commerce, which lies at the heart of your question. The Board is studying this problem carefully, and we hope to have proposals to submit to your Committee early next year.

*Question. Mr. Martin, you are aware of the so-called Williams Amendment to Public Law 90-364, the so-called surtax legislation which places a limitation on the number of civilian officers and employees in the Executive Branch of the Government. As you know, among other things, this amendment provides that no person shall be appointed to a permanent position in the Executive Branch during any month when the number of such employees is greater than the number of such employees on June 30, 1966, and that during any period when appointments are prohibited under this section of the Williams Amendment, the head of any department or agency may, with certain restrictions, appoint a number of persons as full-time civilian employees in permanent positions in their department or agency equal to 75% of the number of vacancies in such positions which have occurred during such period by reason of resignation, retirement, removal, or death.*

*Was the Federal Reserve Board and System contacted by the Director of the Bureau of the Budget upon enactment of this law? Has the Federal Reserve Board and System complied with the directive in the so-called Williams Amendment?*

Answer. I believe these questions were answered in a letter to the Director of the Bureau of the Budget, a copy of which is attached. (See p. 75.)

*Question. I am correct, am I not, Mr. Martin, that in August 1966 the Federal Reserve Board by administrative interpretation ruled and reaffirmed its previous position that member State banks of the Federal Reserve System cannot purchase for its own account any shares of stock of any corporation except as specifically permitted by provisions of Federal law or as comprised within the concepts of such incidental powers necessary to carry out the business of banking? Is this correct, Mr. Martin?*

Answer. Yes.

*Question. Is it also correct, Mr. Martin, that in August 1967 the Federal Reserve Board by administrative ruling again turned down requests for an interpretation of the Act which would have allowed the establishment of loan procurement offices?*

*Then, Mr. Martin, I believe I am correct, on August 14, 1968, the Federal Reserve Board did in fact reverse its long-standing position on these two subjects.*

Answer. The Board's 1967 interpretation neither allowed nor disallowed establishment of such offices in all cases. It did, however, treat such offices as branches for purposes of Federal law, thereby subjecting them to the limitations on branches imposed by Federal law, in addition to those imposed by State law. In 1968 the Board concluded that such offices are not branches within the meaning of Federal law.

*Question. In arriving at this new position, Mr. Martin, did you or other members of the Federal Reserve Board seek a legal opinion from your law department?*

*What was the conclusion of your legal counsel in both of these instances? Did the legal brief support the final decision taken by the Board as regards the matter of subsidiary operations and as regards the matter of loan production offices?*

*Please supply for the record a copy of your counsel's legal position on these two subjects.*

Answer: Analyses of various possible interpretations of the statutes involved, with views as to the most reasonable interpretations, were included in memoranda prepared by the Board's legal division. As I mentioned at the hearing, I hope that your committee will not press the Board to supply copies of internal staff memoranda prepared to assist the Board in making decisions. The Board takes the responsibility for these decisions and states the reasons for them,

as was done in this case. Internal memoranda prepared for the use of the Board in arriving at these decisions are not disclosed to the public, nor do I think they should be subject to review by Congressional committees. To follow such a procedure would inhibit the expression of views in such memoranda and impair the ability of the staff to assist the Board in the decision-making process.

Sincerely yours,

WM. MCC. MARTIN, JR.

BOARD OF GOVERNORS  
OF THE FEDERAL RESERVE SYSTEM,  
*Washington, D.C., August 27, 1968.*

HON. CHARLES J. ZWICK,  
*Director, Bureau of the Budget,*  
*Washington, D.C.*

DEAR CHARLIE: This is in reply to your letter of August 20, 1968, regarding your responsibility for reassigning vacancies among departments and agencies of the executive branch pursuant to section 201 of the Revenue and Expenditure Control Act of 1968.

As you know, the Board's expenses are met from earnings of the Federal Reserve Banks rather than from appropriated funds. In section 10, paragraph 4, of the Federal Reserve Act, the Congress provided that the employment of Board personnel "shall be governed solely by the provisions of this Act, [and] specific amendments thereof." This provision of the Federal Reserve Act makes it clear that general provisions of law applicable to Federal personnel are not to be interpreted as applying to Board employees, in the absence of some specific expression of Congressional intent to do so. It follows, therefore, that the provisions of section 201 of the 1968 Act do not apply with respect to Board personnel.

Even though the Board is not subject to the provisions of the 1968 Act, we recognize the pressing need for all agencies of Government to keep expenditures to a minimum, and accordingly have carefully reappraised our budget for calendar 1968, cancelling or deferring a number of proposed expenditures.

Sincerely yours,

WM. MCC. MARTIN, JR.

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