BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON 25, D. C.

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

April 14, 1952.

~~CONFIDENTIAL~~

Dear Sir:

For your information, there is enclosed a copy of a letter, with its enclosures, addressed by Chairman Martin on April 11, 1952, to Chairman Spence of the House Banking and Currency Committee, in response to that Committee's request for an expression of the Board's views with respect to a bill, H. R. 6504, introduced by Mr. Spence on February 7, 1952, relating to the regulation of bank holding companies. For convenient reference, a copy of the Spence bill is also enclosed.

Very truly yours,

S. R. Carpenter,
Secretary.

TO THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Honorable Brent Spence, Chairman,
Committee on Banking and Currency,
House of Representatives,
Washington 25, D. C.

April 11, 1952.

Dear Mr. Spence:

This is in response to Mr. Hallahan's letters of February 8 and February 11, 1952, requesting the Board's views with respect to the bill H. R. 6504, introduced by you on February 7, 1952, to provide for the control and regulation of bank holding companies.

Briefly stated, and without reference to details, this bill would define a "bank holding company" as any company which owns 15 per cent or more of the voting shares of two or more banks or which is determined by the Board of Governors to exercise a controlling influence over two or more banks; require registration of such companies and provide for reports and examinations; require the Board's consent, or, in certain cases, the consent of the Comptroller of the Currency or the Federal Deposit Insurance Corporation, for the acquisition of bank shares and assets by a holding company or for the acquisition of bank assets by its subsidiary banks; require such companies to divest themselves of nonbanking interests with certain exceptions; prohibit borrowings by such companies from their subsidiary banks; and contain provisions for investigations, injunctions, judicial review, criminal penalties, and necessary technical amendments to existing law.

As you know, over a long period of years Congress has from time to time considered bills of various types relating to the regulation of bank holding companies, some of which have been recommended or endorsed by the Board of Governors of the Federal Reserve System. The Board has taken the occasion of your Committee's request for a report on the present bill to make a careful re-examination of this subject in order to determine the basic nature of the actual or potential problems relating to bank holding companies, the principles which should govern legislation designed to meet these problems, and the extent to which existing law is inadequate for this purpose.

The conclusions reached by the Board as the result of its review of this matter, in the light of the desirability of keeping new legislation on this subject to a minimum, are set forth in the enclosed memorandum entitled "Extent of Need for Legislation for the Regulation of Bank Holding Companies." Also enclosed is a table showing information regarding 28 groups of banks in the United States which are generally considered as being bank holding company groups.

As indicated in the enclosed memorandum, the Board believes that the principal problems in the bank holding company field arise from two circumstances: (1) the unrestricted ability of a bank holding company group to add to the number of its banking units, thus making possible the concentration of a large portion of the commercial banking facilities in a particular area under single control and management; and (2) the combination under single control of both banks and nonbanking enterprises, thus permitting departure from the principle that banking institutions should not engage in businesses

wholly unrelated to banking because of the incompatibility between the business of banking which involves the lending of other people's money and other types of business enterprises.

In order to meet these basic problems, the Board feels that there are certain general principles which should be applied in considering any legislation on this subject. These principles, which are more completely stated in the enclosed memorandum, are briefly as follows:

1. The definition of "bank holding company" should cover such companies as need to be covered in order to accomplish the desired objectives, including companies which control nonmember as well as member banks.

2. There should be authority for regulation and restriction of acquisitions of bank stocks by bank holding companies leading to control or domination of additional banks, leaving to the respective States authority further to restrict expansion of bank holding companies within their borders.

3. Bank holding companies should be required to divest themselves of their interests in nonbanking enterprises, with certain appropriate exceptions.

4. Supervision of bank holding companies should be provided by requirement for their registration and by authority in the administering agency to obtain necessary information through reports and examinations.

5. The only essential enforcement measure is provision for criminal penalties.

6. Administration of such legislation should be vested in a single agency of the Federal Government to be determined by Congress.

In the light of these general principles, it is the Board's view that existing provisions of law on this subject originally enacted in the Banking Act of 1933 are inadequate in two major respects. They do not contain adequate provisions for the purpose of regulating and restricting the acquisition of additional bank offices by bank holding companies; and they do not provide for the divestment of nonbanking interests by such companies. In connection with any legislation designed to correct these inadequacies, it would be sufficient to provide a definition of "bank holding company" similar to the definition of "holding company affiliate" contained in present law, which is based primarily on majority ownership of stock, except that (1) the definition should not be limited to companies controlling only member banks, as is the present definition, but should cover companies owning nonmember as well as member banks, and (2) a company falling within the definition should continue to be regarded as a bank holding company as long as it continues to own any bank stocks.

It is the considered opinion of the Board that the major problems in the bank holding company field would be satisfactorily met by legislation

limited to provisions necessary to correct the deficiencies of present law which have just been mentioned and to carry out the principles outlined above. It is believed that legislation of this kind would not necessitate a revision of existing law on this subject, which relates principally to requirements aimed at maintaining the soundness of member banks in holding company groups.

The Board wishes to emphasize that it makes no recommendation as to what agency should administer legislation of the kind here proposed. It feels that the selection of an appropriate agency for this purpose is a matter which should be left to the judgment of Congress.

It will be appreciated if you and your Committee will give consideration to the statement of the Board's views as above outlined and as more fully stated in the enclosed memorandum. The Board will, of course, be glad to render all assistance possible in an effort to work out specific proposals for legislation of this kind.

As you will observe, the approach to bank holding company legislation here suggested does not accord in certain respects with the approach represented by the bill H. R. 6504, or with the approach heretofore taken by the Board with respect to previously considered bills on this subject. As the result of its re-examination of this matter, the Board believes that it would be preferable to limit legislation to the accomplishment of the objectives and principles above outlined. Nevertheless, if your Committee should wish to proceed on the basis of the approach of H. R. 6504, the Board would like to mention for your consideration certain respects in which it believes that this bill should be changed or modified.

The definition of "bank holding company" in section 3 of the bill is much broader than would seem to be necessary to accomplish the purposes of the legislation. It would cover an unknown number of companies which would not need to be subjected to regulation. As heretofore indicated, it is believed that a definition similar to that contained in present law, if expanded to cover nonmember as well as member banks, would be adequate, as a minimum, to achieve the objectives of legislation on this subject. On the basis of presently available facts, such a definition would include all companies which are normally considered to be bank holding companies.

Section 3 of the bill excludes from the definition of the term "bank holding company" certain organizations of a religious, charitable, scientific, literary, or educational nature. We doubt the desirability of such specific exclusions. Instead, we suggest that the administering agency should be vested with a limited authority to exclude from the definition companies which need not be covered in order to accomplish the basic purposes of the legislation and that appropriate standards for making such exclusions should be prescribed in the law.

Section 5(d) in effect would prohibit any bank holding company or any of its subsidiaries from acquiring bank shares or bank assets beyond State lines or in any State in which the operation of branches by banks is not authorized by State law. The Board feels that bank holding company legislation should not be made to depend upon laws of the various States enacted with a different type of banking in mind. The States should be free to deal with bank

holding company operations on a different basis from branch banking operations if they see fit to do so. In our opinion, the administering agency should be authorized to permit or deny the expansion of bank holding companies in accordance with standards provided in the law; and, in addition, the legislation should specifically reserve to the States the right to impose further restrictions upon the expansion of bank holding companies within their borders. In any event, if the prohibition is retained, it is believed that some exception should be made in order to permit emergency take-overs of banks where necessary in the public interest. In addition, the provisions of the bill on this subject would need clarification with respect to those States in which the prohibition is applicable.

In order to guide the administering agency in giving its consent to acquisitions of bank shares and assets by bank holding companies under section 5 of the bill, it would be desirable to require that the agency consider certain standards or factors, such as the financial history and condition of the applicant and the banks concerned, the character of their management, the needs of the community, and whether such acquisitions would expand the size of the holding company group in a manner inconsistent with sound banking or with the maintenance of local ownership and control of banks and of competition in the banking field.

Section 6 of the bill, requiring divestment of interests in nonbanking organizations, contains an exception as to ownership of shares or obligations of investment companies. Although the administering agency would be given authority to require divestment in such cases in order to prevent evasions, it is believed that this authorization for unlimited ownership of shares or obligations of investment companies should at least be restricted.

To the extent that section 7 of the bill would completely prohibit any loans by a subsidiary bank to its bank holding company, the bill would seem to be unnecessarily restrictive. If any provisions on this subject are deemed necessary, it would be preferable to include provisions, similar to those contained in existing law (section 23A of the Federal Reserve Act), which impose certain limitations as to amount and collateral security upon loans which may be made by member banks to holding company affiliates or other affiliates of such banks.

There are a number of other detailed respects in which it is believed it would be desirable for the bill to be changed or modified but which it does not seem necessary to cover specifically in this letter. However, if you should so desire, the Board will be glad to submit a memorandum with respect to details of this kind or to have its staff work with the staff of your Committee in this connection.

The Board believes that enactment of legislation for the more effective regulation of bank holding companies is important and it appreciates this opportunity to express its views regarding this matter.

Sincerely yours,

(signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.,
Chairman.

Enclosures

April 11, 1952

EXTENT OF NEED FOR LEGISLATION FOR THE REGULATION OF BANK HOLDING COMPANIES

Since the enactment of the Banking Act of 1933, which provided for the first time certain authority for the regulation of holding companies of banks, a number of bills have been introduced in Congress to provide more effective regulation of such companies. These bills have varied widely in many respects and have occasioned considerable discussion. The most recent is a bill (H.R. 6504) introduced by Chairman Spence of the House Banking and Currency Committee on February 7, 1952.

In the light of the long history of this matter, it appears desirable to re-examine the whole problem of bank holding company regulation. For this purpose, it is appropriate to consider the present factual situation as to bank holding companies, the special problems presented in this field, the principles which should guide minimum regulation of bank holding companies, and the extent to which present law is inadequate to carry out these principles.

FORMS OF MUTLIPLE-OFFICE BANKING

There are three forms of multiple-office banking; namely, branch banking, holding company banking (also commonly called group banking), and chain banking. The nature of the organizational structure of branch banking is well understood and needs no definition. The term "holding company banking" indicates a type of multiple-office banking in which independently incorporated banks are controlled by a corporation or similar organization. The term "chain banking" indicates a type of multiple-office banking in which independently incorporated banks are controlled by the same individual or individuals.

Under existing law, branch banking is the only form of multiple-office banking which is under regulation insofar as expansion of banking offices is concerned. However, restrictions upon branch banking can be evaded by turning to one of the other forms of multiple-office banking.

No logical distinction can be made between holding company banking and chain banking as means of making possible unrestricted expansion of banking offices under single control and management. However, in the case of holding company banking, involving as it does the use of a corporate or similar organization, great financial power toward expansion may be exercised through control of the management and policies of the holding company. On the other hand, the financial power involved in chain banking is limited to the personal means of one individual or a small group of individuals, and this places a degree of limitation upon the extent to which a chain banking system may expand; and therefore the problem of expansion in that field is not as serious as in the field of bank holding companies.

FACTS REGARDING BANK HOLDING COMPANIES

Banks in Holding Company Groups. - There are 28 groups of banks in the United States which are generally considered as being bank holding company

groups. At December 31, 1950, these 28 groups included 367 banks located in 28 States and the District of Columbia. The banks had 1,019 branches and deposits aggregating $18.5 billion.

The deposits of the 367 banks represented 12 per cent of the deposits of all commercial banks in the United States and 16.3 per cent of the deposits of all commercial banks in the 28 States, and the District of Columbia, in which the banks were located. The total of 1,386 banking offices operated by the banks represented 7.4 per cent of the banking offices of all commercial banks in the United States and 11 per cent of the banking offices of all commercial banks in the 28 States and the District of Columbia.

The above data include not only banks controlled by the holding companies but also banks which dominate certain of the respective groups or are closely associated with them. Some of the latter banks are comparitively large institutions.

In addition to the 28 groups, there are a number of cases in which banks are controlled by other banks, and some cases in which one or more banks are controlled by nonbanking organizations, but these cases are not generally regarded as involving holding company banking of a type which requires regulation because they are not engaged as a business in managing or controlling banks.

Expansion of Banking Offices. - The table below shows, for the period 1934-1950, inclusive, information regarding expansion in the number of banking offices operated by the banks in 20 of the 28 groups:

	20 groups
Banking offices December 31, 1933	1,001
Add:	
Independent banks and branches acquired	282
De novo banks established	11
De novo branches established	190
Key bank of group organized in 1945	1
Total additions	484
Deduct:	
Independent banks and branches discontinued upon acquisition	42
Group banks and branches absorbed by other group banks and the offices discontinued	41
Banks and branches sold or liquidated	81
Branches discontinued	42
Total deductions	206
Banking offices at December 31, 1950	1,279
Net increase 1934-1950, inclusive	278

The above figures reflect the net expansion of the 20 groups combined. Several of these groups underwent some contraction rather than expansion in number of banking offices during the 17-year period.

The above table includes information with respect to 20 of the 28 groups. Information is readily available regarding the 20 groups because they are subject to a degree of regulation under present law whereas the other eight are not.

Nonbanking Interests. - At December 31, 1950, there were, in the same 20 groups mentioned above, 79 nonbanking organizations with aggregate resources of about $500 million. These nonbanking enterprises covered a wide range as to size and included some which were not wholly unrelated to the banking business. Among the nonbanking enterprises included in these 20 groups were companies engaged in the following types of business: life insurance; home financing; automobile financing; instalment financing; automobile insurance; fire, auto, and marine insurance; real estate; fish catching and processing; manufacturing; investment; safe deposit; ownership of bank premises; liquidation of assets; and insurance agencies. The extent to which the 20 groups have nonbanking interests varies from none at all to rather extensive interests of this kind.

PROBLEMS REGARDING BANK HOLDING COMPANIES

In the light of the facts set forth above, the problems and potential problems which arise as the result of the use of the holding company device in the banking field may be summarized as follows:

(A) Unrestricted Power of Expansion. - The ability of a corporation or similar organization to acquire control of independently incorporated banks makes it possible to concentrate under unified control a large portion of the commercial banking facilities in a particular area. Control of banks may be acquired either by using funds derived from the sale of the share capital of the holding company to the public, or by exchanging the shares of the holding company for the shares of the individual banks.

(B) Combination of Banking and Nonbanking Interests under the Same Management. - The holding company device makes it possible to combine under the same management control both of banks and of enterprises unrelated to banking. Through this means, a bank holding company is in a position to expand in the nonbanking field. Through this means also, the management of a bank may be enabled to obtain control over the management of nonbanking enterprises and thereby evade provisions of the banking laws which restrict banks from engaging in businesses not related to banking. In addition, such situations give rise to a potential problem resulting from the possibility of undue use of the credit facilities of banks in the group for the benefit of nonbanking enterprises in the group.

PRINCIPLES WHICH SHOULD GOVERN BANK HOLDING COMPANY LEGISLATION

In order to meet the special problems presented by the facts regarding bank holding companies as outlined above, it is believed that regulation of such companies should be guided by the principles set forth below,

bearing in mind that, in order to avoid undue extension of Federal control over private interests, legislation should be limited to the minimum extent necessary to meet these special problems.

1. Coverage. - In defining "bank holding companies" for the purposes of minimum regulation of such companies, the definition should be no broader than is required to include the holding companies which need to be covered in order to accomplish the objectives of such regulation. The definition, however, should not be confined to companies controlling only member banks but should cover companies controlling any banks, since there are bank holding companies which control only nonmember banks, and since the problem of concentration of economic power exists whether the banks in the group are members or nonmembers. In addition, the definition should be so phrased as to provide continued coverage of companies included within the definition at the time of the enactment of legislation so that such companies would continue to be considered as bank holding companies even though they might reduce their stock ownership in the banks controlled by them, at least until such time as they might divest themselves of ownership of all bank stocks. At the same time, there should be a limited authority in the administering agency to exempt, in accordance with prescribed standards, companies which fall within the definition but which need not be subject to regulation in order to accomplish the desired objectives.

2. Expansion. - There should be authority for the regulation and restriction of the acquisition of additional banks by bank holding companies. To this end, the acquisitions of bank stocks by a bank holding company, directly or indirectly, should be subject to the prior consent of an appropriate Government agency which, in giving its consent, should be required to consider certain factors, including the financial history and condition of the applicant and the banks concerned, the character of their management, the needs of the community, and whether the proposed acquisition would have the effect of expanding the size of the holding company group beyond limits consistent with the policy of Congress in favor of local ownership and control of banks and competition in the field of banking or with adequate and sound banking and the public interest. In granting its consent, the Government agency should be authorized to prescribe such conditions as it may deem necessary in the light of its consideration of the above factors to assure maintenance of the relative financial status of the holding company and its banks and the character of their managements, on the basis of which the agency was enabled to act favorably on the application to expand. The right of the respective States to impose further restrictions upon the expansion of bank holding companies should be clearly reserved.

3. Nonbanking Interests. - There should be provision for the divorcement of the banking interests of bank holding companies from interests in nonbanking enterprises, with such exceptions as may be appropriate, together with provisions for appropriate tax relief where divestment of such nonbanking interests is required. The need for separating banking from nonbanking interests has long been recognized; and, as previously indicated, divestment of nonbanking interests of bank holding companies is necessary to prevent abuses of the credit facilities of banks resulting from the combination of banking and nonbanking interests under the same management.

4. Supervision. - Supervision of bank holding companies should go no further than is necessary to accomplish the main objectives of regulation of such companies and as incidentally may be appropriate to protect the soundness of banks in the holding company groups. However, provision should be made for registration of all bank holding companies and for authority in the administering agency to obtain such information by reports or examinations, if necessary, as may be necessary to enable it to pass judgment on proposed acquisitions, to determine compliance, and to keep Congress informed.

5. Sanctions. - The only essential sanction is provision for criminal penalties to be enforced through the Department of Justice.

6. Administering Agency. - Since the principal function of the administering agency, as here proposed, would be limited to approving or restraining expansion of bank holding companies as heretofore defined, it is believed that possible arguments for distribution of authority between the various bank supervisory agencies would be overwhelmingly outweighed by the desirability of uniformity of policies and procedure and the economy and efficiency resulting from centralization of information upon which such decisions can be made. Accordingly, it is believed that any legislation to carry out the above principles should provide for administration by a single agency of the Federal Government. The Board of Governors of the Federal Reserve System makes no suggestion as to which agency should have that responsibility but feels that this is a matter for determination by Congress.

PRESENT LAW

Under present law, a "holding company affiliate" is defined as any company which owns a majority of the stock of a member bank, or which owns more than 50 per cent of the number of shares voted in the last election of the directors of such bank, or controls in any manner the election of a majority of the bank's directors, or for the benefit of whose shareholders the stock of the member bank is held by trustees; but provision is made for exclusion by the Board of Governors from the definition of any company determined not to be engaged as a business in holding the stock of, or managing or controlling, banks.

The law provides generally that a holding company affiliate may not vote stock owned by it in member banks unless it first obtains a voting permit from the Board of Governors, and no such permit may be granted unless the holding company affiliate agrees to comply with certain conditions, including requirements as to examinations and reports, maintenance of a reserve of readily marketable assets, divestment of ownership or control of securities companies, and restrictions on dividends by the holding company. The Board is authorized to revoke any such voting permit upon violation of provisions of the law or of the conditions of such agreements, and in the event of any such revocation, national banks controlled by the holding company are prohibited from receiving deposits of public moneys of the United States and from paying dividends to the holding company and controlled State member banks are subject to forfeiture of their membership in the System. Other provisions of the law limit member banks in making loans to their holding company affiliates and to other affiliates as defined in the statute.

INADEQUACIES OF PRESENT LAW

The major inadequacies of the present law, as measured by the general principles heretofore discussed, are three:

1. Coverage. - The definition of "holding company affiliate" in present law is not broad enough to cover companies controlling only nonmember banks. In the light of the purposes of regulation of bank holding companies, the definition should cover companies which control any banks, whether member or nonmember. In other respects, the definition contained in the present law seems adequate in the light of the facts to meet the minimum requirements of bank holding company legislation except that, as previously suggested, it should be phrased to provide continued coverage of all companies meeting the definition as of the date of enactment of the legislation, even though such companies may subsequently reduce their holdings of bank stocks. Moreover, since the present definition has been in the statute for such a long period of time, it should not be changed unless necessary.

2. Lack of Restriction on Expansion. - While the establishment of branches by banks requires the consent of some supervisory agency, there is no similar requirement as to the acquisition of additional offices by bank holding companies other than banks. Expansion of bank holding company groups is not adequately restricted by the present voting permit procedure, since under that procedure it is optional with bank holding companies whether they obtain voting permits and, in any event, such permits need not be obtained until after additional banks have been acquired. Moreover, as indicated in paragraph 1 above, present law does not cover companies controlling only nonmember banks.

3. Nonbanking Interests. - There is no provision in existing law which prevents bank holding companies from acquiring control of varied kinds of enterprises unrelated to banking or from engaging in businesses in which banks may not themselves engage.

Legislation which would satisfactorily take care of the above inadequacies in present law in accordance with the general principles heretofore stated would meet the basic needs for regulation of bank holding companies. It is believed that enactment of such legislation would not necessitate any revision of present law on this subject. However, if, in the course of administration of the new legislation, it should be found that provisions of now existing law should be changed in certain respects or perhaps that they might properly be repealed, recommendations to that effect could be made at that time.