Mr. Chairman and Members of the Committee:

At the outset I should like to emphasize that the Board of Governors believes that bank holding company legislation is desirable. The Board's general views on this subject have been stated several times in recent years. They were set forth in my letter to you, Mr. Chairman, in April 1952, and in a statement made by Governor Robertson before your Committee in June of that year. They were stated again when Governor Robertson and I appeared before the Senate Banking and Currency Committee in June 1953. The Board continues to adhere to these views, although, as indicated in my recent letter to the Committee, dated February 21, 1955, the Board has modified or refined its opinions in certain particulars which I shall mention later. Accordingly, the remarks I am about to make will in large measure be a restatement in substance of what we have said on previous occasions.

The essence of our position is that further regulation of bank holding companies should be kept to a minimum necessary to meet whatever problems may exist in this field which are not met by present law and cannot effectively be dealt with by the States alone.

There are now on the statute books certain provisions enacted in 1933, regulating affiliates and holding company affiliates of banks which are members of the Federal Reserve System. Affiliates of member
banks are made subject to reports and examinations. Limitations are placed upon the amount which a member bank may loan to any of its affiliates, including any holding company affiliate. Finally, any holding company affiliate which desires to vote stock owned by it in any member bank must first obtain from the Board of Governors a voting permit and, as a condition to the permit, the company must agree to submit itself and its controlled banks to examination, to establish certain reserve funds, to dispose of any interest in securities companies, and to declare dividends only out of actual net earnings.

These provisions of existing law regulate the activities of a bank holding company only if it happens to control a member bank and only if it desires to vote the stock of that bank. In effect, therefore, regulation is largely voluntary on the part of the holding company. Even if a voting permit is obtained, the regulation to which a holding company is subject is aimed mostly at protecting the soundness of the member banks in the group.

These provisions, therefore, do not deal at all with two apparent problems in the bank holding company field. In the first place, there is nothing in present law which restricts the ability of a bank holding company to add to the number of its controlled banks. Consequently, there can well be situations in which a large part of the commercial banking facilities in a large area of the country may be concentrated under the management and control of a single corporation.

In the second place, there is nothing in existing law which prevents the combination under the same control, through the holding
company device, of both banking and nonbanking enterprises. Obviously, this makes it possible for the credit facilities of a controlled bank to be used for the benefit of the nonbanking enterprises controlled by the holding company. Moreover, the ordinary nonbanking business requires a managerial attitude and involves business risks of a kind entirely different from those involved in the banking business. Banks operate largely on their depositors' funds. These funds should be used by banks to finance business enterprises within the limitations imposed by the banking laws and should not be used directly or indirectly for the purpose of engaging in other businesses which are not subject to the safeguards imposed by the banking laws.

These two existing problems in the bank holding company field could be met, we believe, by legislation which would need to cover only four essential features:

1. The term "bank holding company" should be defined in language generally adequate to cover all known bank holding company groups which need to be covered, without attempting at this time to cover all situations that might possibly arise.

2. Bank holding companies should be required to obtain the prior approval of a Federal agency before acquiring additional bank stocks; and in granting such approval the administering agency should give consideration to relevant standards stated in the law and to the views of the appropriate State and Federal authorities.

3. Bank holding companies should be required within a reasonable time to divest themselves of ownership of stock and similar equity interests in nonbanking enterprises with a minimum of specific
exceptions. The bill might give statutory exemption to bank holding companies operated principally for charitable, religious, and similar purposes. In addition, it should permit the administering agency to exempt bank holding companies from the divestment requirements in exceptional cases in which control of a bank may actually be necessary in the public interest. Furthermore, the administering agency should be given a limited authority to exempt shares of stock in businesses closely related to the business of banking.

Finally, there should be a few administrative provisions requiring the registration of bank holding companies, authorizing the administering agency to obtain information necessary to pass judgment on proposed acquisitions of bank stocks, and providing criminal penalties for violations of the statute.

It is with these four essential features in mind - coverage, expansion, nonbanking interests, and administration - that I should like to state briefly our principal comments with respect to the bill H. R. 2674.

1. **COVERAGE**

One of the most basic and at the same time most controversial aspects of bank holding company legislation has always been the matter of coverage or definition.

The present bill would define a "bank holding company" as any company which owns 25 per cent or more of the voting shares of two or more banks or any company which might be determined by the Board of Governors to exercise a controlling influence over two or more banks.
We believe that this definition goes further than necessary in certain respects. In the first place, we think it unnecessary and undesirable to vest the administering agency with discretionary power to bring under coverage of the bill companies not meeting the stated definition. In the second place, we think that a definition based primarily upon majority stock control of a bank is probably adequate to cover all companies which would need to be regulated in order to accomplish the objectives of the legislation. However, if in the judgment of Congress such a definition would not be adequate for this purpose, it would not appear objectionable to base the definition upon some lower percentage test, even down to 25 per cent as provided by the pending bill.

In one respect we believe that the definition in this bill would not be adequate to effectuate one of the two main objectives of the legislation. It would not apply to a company which controls only one bank and would not, therefore, require such a company to divest itself of its nonbanking interests. Yet, it seems clear that the potential abuses resulting from combination under single control of both banking and nonbanking interests could easily exist in a case in which only one bank is involved. In fact, if the one controlled bank were a large bank, the holding company's interests in extensive nonbanking businesses might very well lead to abuses even more serious than if the company controlled two or more very small banks. For these reasons, the Board would continue to urge that, whatever the percentage test may be, the definition should be related to control of a single bank.
The pending bill would exempt from the definition of "bank holding company" any mutual savings bank and any organization operated exclusively for charitable, religious, and similar purposes where the organization would otherwise be a bank holding company by reason of its ownership of bank stocks on the effective date of the Act.

In the Board's opinion, it is questionable whether any company which meets the stated definition of a "bank holding company" should be exempted from the necessity of obtaining the prior approval of the administering agency if it should decide to acquire additional banks. In this respect the Board has somewhat modified the views heretofore expressed by it. It would not now recommend the inclusion of even discretionary authority in the administering agency to exempt companies from the expansion requirements of the bill. We cannot believe that any hardship would result from requiring even a charitable institution to comply with these requirements.

On the other hand, it is recognized that there may well be cases in which the exemption of certain companies from the divestment requirements of the bill would be desirable in order to prevent hardship and to protect the public interest, as, for example, charitable, religious, and similar organizations. However, we question the necessity for exempting mutual savings banks from the divestment requirements.

In order to cover unforeseeable emergency situations, it might be desirable to give the administering agency a limited authority to exempt from the divestment requirements any bank holding company if the administering agency determines that the company's control of a
bank is necessary in order to provide needed banking facilities or to assure the sound financial condition of the bank involved, subject to revocation of the exemption when the need disappears.

Before leaving the matter of coverage, it should be noted that the provision of the pending bill defining the term "company" would include not only corporations and business trusts, but also any partnership and "any similar organized group of persons". The meaning of the phrase "organized group of persons" is not clear. In any event, however, the Board feels that such a broad definition goes beyond the necessities of the situation. By including partnerships and groups of individuals, the definition might be interpreted as being intended to cover chain banking, that is, control of banks by individuals or by testamentary or other personal trusts.

2. LIMITATIONS ON EXPANSION OF BANK HOLDING COMPANIES

The second requisite feature of the legislation - restrictions on the expansion of bank holding company groups - would be dealt with in the pending bill by provisions requiring the Board's prior approval for any action which would result in a company becoming a bank holding company or for any acquisition of bank stocks by a bank holding company or its subsidiary or for the acquisition of substantially all of the assets of a bank by a holding company which is not a bank or by a nonbanking subsidiary.

We think that these provisions should be expanded to require prior approval before any bank holding company may merge or consolidate with another bank holding company. On the other hand, it would seem unnecessary to include any provision with respect to acquisitions of bank assets by a holding company or subsidiary which is not itself a bank.
In the interest of minimum control, we suggest that it would be sufficient to require prior approval for the acquisition of bank stocks only if, after the acquisition of the stock of a bank, the holding company will own a substantial percentage of the outstanding stock of that bank, say 5 per cent. Such a modification of the requirements of the bill would permit properly diversified investments in bank stocks where control is not the motive.

Our principal comments, however, with respect to the expansion features of the bill relate to those provisions of section 5 which are apparently aimed at protecting the rights of the States in this field.

In the first place, the bill would make it impossible for a bank holding company to acquire any bank stocks if "any bank affected" is a State bank, unless the appropriate State banking authorities also approve the application within 30 days. Similarly, if "any bank affected" is a national bank, the application could not be approved unless also approved by the Comptroller of the Currency. These provisions would have the effect of diffusing responsibility for administration of the legislation. They would involve duplication of effort and give rise to administrative difficulties. We think it would be desirable to require the administering agency to give due regard to the views of the State authorities and the Comptroller of the Currency but that the final responsibility for approving or disapproving any application should rest with the administering agency alone.

The bill would further prohibit a bank holding company or any of its subsidiaries from acquiring the stock of a bank or substantially
all the assets of a bank outside of the State in which the holding company or the subsidiary involved has its principal office or conducts its principal operations. In addition, a bank holding company or any of its subsidiaries would be prohibited from acquiring bank stocks or assets in any State except within the geographical limitations applicable to the establishment of branches under the laws of such State, or unless the acquisition is specifically and affirmatively authorized by State statute.

These severe provisions would in effect "freeze" the existing status of most bank holding companies and would go beyond what we conceive to be the necessities of the situation.

As the Board has previously indicated, it believes that regulation of bank holding company groups should not be related to the branch banking laws of the States and that the States should be left free to deal differently, if they desire, with these two types of multiple-office banking. The pending bill includes a new provision which would permit expansion of bank holding companies in non-branch States if such expansion is affirmatively authorized by the statutes of the State in question. However, there are, of course, no States which have affirmative legislation of this kind.

This new provision of the bill follows almost literally a provision of the national banking laws which permits a national bank to establish out-of-town branches only if affirmatively authorized by State law with respect to State banks. However, before the enactment of that provision national banks had no authority at all for the
establishment of branches. The situation is quite different with respect to bank holding companies whose existence has been legislatively recognized for many years. We feel, therefore, that it is inappropriate to apply to bank holding companies exactly the same principles which were applied to branches of national banks. If any analogous provision is necessary here, it should make the expansion of bank holding companies dependent, not upon affirmative authorization by the States, but upon the absence of express prohibition by the States.

In our judgment the rights of the States in this field can be effectively protected by provisions which would require the administering agency to obtain and consider the views of the State authorities before passing upon any application for the acquisition by a bank holding company of control of additional banks. In any event, we think that provisions for this purpose should not go further than a prohibition against the acquisition of the stock of any State or national bank in any State in which the statutes of such State would prohibit such acquisition in the case of a State bank.

3. DIVESTMENT OF NONBANKING INTERESTS

In order to meet the third requisite of the legislation, the bill would require bank holding companies within two years to divest themselves of any shares or other securities or obligations of any company other than a bank and to cease engaging in any business other than that of banking.

To the extent that this requirement relates to obligations, as distinguished from shares of stock, of nonbanking enterprises, we
believe that it goes further than necessary. Single control of both a bank and a nonbanking business is usually made possible by control of stock rather than by ownership of obligations.

The bill would provide a number of specific exemptions from the divestment requirements. While some such specific exemptions may be appropriate, they should be kept to a minimum and be explicit. It may be desirable, for example, to exempt shares of a company engaged solely in holding or operating properties used by a subsidiary bank or engaged solely in conducting a safe deposit business. Also, it may be appropriate to include the exemption provided in paragraph (6) of section 6(c) of the bill with respect to the ownership of not more than 5 per cent of the outstanding voting securities of a nonbanking company. It is questionable, however, whether some of the exemptions provided are necessary or desirable. For example, exception (5) on page 9 of the bill would seem to permit a bank holding company which is itself a bank to own any shares of nonbanking companies which it would be permitted to own under State law. We see no logical reason for such an exemption. In fact, this exemption might operate to defeat the purposes of the legislation in some situations.

In any event, as against numerous specific exemptions, it would seem preferable to vest the administering agency with a limited authority to exempt ownership of shares of companies which are determined to be closely related to the business of banking or of managing or controlling banks. Such a provision should, we believe, be coupled
with the new provisions which I have already proposed for the exemption of certain bank holding companies from the divestment requirements in a very limited class of cases.

4. ADMINISTRATION

The administrative provisions of the bill are contained in sections 4, 9, and 10, which relate, respectively, to registration, reports and examinations of bank holding companies, hearings, and judicial review of administrative action, and criminal penalties for violations of the Act.

Our only comment on these provisions relates to section 9 which would give to any person in any way affected by the Board's action or omission to act under the bill a right to judicial review, with a trial of the facts de novo by the reviewing court. It is questionable whether any specific provisions for judicial review are necessary, since, even without such provisions, any arbitrary, capricious, or unlawful action on the part of the administering agency would be, and should be, subject to review by the courts. However, if any provisions on this subject are included in the bill, we feel that a provision for trial of the facts de novo would be at variance with the spirit and intent of the Administrative Procedure Act which exempts from judicial review any action committed to agency discretion. We also think that, instead of the vague provision for review at the instance of any person "affected", the right to review should be limited to the principals in the proceedings involved.
OTHER PROVISIONS OF THE BILL

Certain provisions of the pending bill have no direct connection with the two main objectives of the legislation.

Under section 7 of the bill, subsidiary banks would be absolutely prohibited from making loans to, or investing in the stock or securities of, their bank holding company or any other subsidiary of the bank holding company. We feel that these provisions are unnecessarily restrictive. Moreover, if any provisions on this subject are deemed to be necessary, we believe that they should be enacted in the form of amendments to section 23A of the Federal Reserve Act, which now places certain limitations upon loans by member banks to their holding company affiliates or other affiliates. As to nonmember banks, the States should be left free to determine what restrictions they may wish to impose upon loans by State banks to their affiliated organizations.

Section 11 of the bill would make a number of technical amendments to provisions of existing law. Insofar as these provisions would amend the Internal Revenue Code to afford appropriate tax relief to bank holding companies complying with the divestment requirements of the bill, we think that they are desirable, although we do not feel specially qualified to comment on their adequacy. However, the amendments proposed to be made to existing provisions of law relating to holding company affiliates of member banks have no apparent relation to the principal objectives of the bill. The existing provisions are aimed primarily at maintaining the soundness of member banks in holding
company groups. It may be that in some respects they should eventually be modified, but there appears to be no reason why they should not be continued in force for the present.

CONCLUSION

These comments on the pending bill have been made for the purpose of helping, as far as we can, in the working out of reasonable and effective legislation on this subject. By way of summary, we think that the principal objectives of the legislation could be accomplished by a bill which, in addition to certain administrative provisions, would include only—

(1) a definition of "bank holding company" as a company controlling a majority of the stock of any one bank, with no exceptions;

(2) a requirement that every bank holding company obtain prior approval before acquiring the stock of any bank if thereafter its holdings of the stock of that bank will exceed 5 per cent, with provision for obtaining the views of State and Federal authorities; and

(3) a requirement that bank holding companies divest themselves of their nonbanking interests, with a minimum of specific exemptions, but with administrative authority to make the limited exemptions which I have mentioned.