Statement of
Wm. McC. Martin, Jr., Chairman,
Board of Governors of the Federal Reserve System,
before
Subcommittee No. 1
of the
House Committee on Banking and Currency,
on S. 1771, H. R. 8874, and H. R. 7796
July 19, 1962

My appearance today is in response to the invitation of your Chairman to present the views of the Board of Governors on S. 1771, H. R. 8874, and H. R. 7796. These bills would amend the banking laws in response to developing needs in the fields of international finance, automation, and housing.

S. 1771, relating to foreign branches of national banks

S. 1771 would authorize the Board to permit foreign branches of national banks to exercise, in addition to powers that are otherwise authorized to national banks, such further powers "as may be usual in connection with the transaction of the business of banking in the places where such foreign branches shall transact business." The bill is consistent with legislative policy already expressed in the field of foreign banking operations in that it would extend to foreign branches of national banks the same kind of flexibility that is afforded to so-called "Edge Corporations" by section 25(a) of the Federal Reserve Act. With safeguards similar to those found in section 25(a) and the Board's Regulation K, the bill would make it possible for foreign branches to compete more effectively with foreign institutions.

The Board has become increasingly aware of the difficulties that foreign branches of American banks have encountered in competing abroad, and the problem has been the subject of extensive consideration for a period of years, both within the Federal Reserve System and by others, notably your Committee, who are concerned with the role of banking in the "furtherance of the foreign commerce of the United States"--the express statutory purpose for which national banks were originally authorized under section 25 to establish branches abroad.

Business methods and operating conditions in foreign countries often differ considerably from those in this country, and banks in foreign countries are often subject to few if any of the rules that apply to national banks in this country. It is apparent that in this situation American banks may often find their effectiveness materially handicapped. I would like to emphasize, however, that I would not interpret this bill as a carte blanche for the full equalization of foreign branch powers with those of foreign banks. Apart from the fundamental limitations in the bill itself, it would not allow foreign branches to exercise any additional powers except as expressly permitted by Board regulations that would be formulated after consideration of actual conditions and with due regard for the integrity and soundness of the American banking system.

It would be extremely difficult to anticipate in comprehensive detail the various kinds of powers that might suitably be authorized under this bill in the various circumstances that may now exist or that may develop in the future. To cite a few examples, however, it has been suggested that this legislation might appropriately be used to relax some existing restrictions on the issuance of certain types of guaranties, exchange of negotiable instruments with full recourse endorsements, and acceptance financing of foreign inland shipments. Powers granted would commonly relate to the forms in which banking business is transacted, and variations in substance from the practices now permitted to national banks would be authorized only with particular circumspection.

Various provisions of section 25 of the Federal Reserve Act in its present form would assist in supervising activities that might be authorized under this bill. Although separate accounting is not required of national banks with respect to their domestic branches, the eighth paragraph of section 25 requires that every national banking association "shall conduct the accounts of each foreign branch independently of the accounts of other foreign branches established by it and of its home office . . . ." In addition, under the sixth paragraph of section 25, "every national banking association operating foreign branches shall be required to furnish information concerning the condition of such branches to the Comptroller of the Currency upon demand . . . ."

I might point out that State member banks would share in the benefits of this legislation, to the extent permitted by State law, because the third paragraph of section 9 of the Federal Reserve Act provides that:

> ". . . nothing herein contained shall prevent any State member bank from establishing and operating branches in the United States or any dependency or insular possession thereof or in any foreign country, on the same terms and conditions and subject to the same limitations and restrictions as are applicable to the establishment of branches by national banks . . . ."

S. 1771 would be beneficial to American commercial activities abroad and to the national economic interest, and its enactment would not jeopardize the fundamental character of American banking. The Board of Governors, therefore, recommends its enactment.

H. R. 8874, relating to bank service corporations

Next, I will offer some observations and suggestions concerning the bill H. R. 8874, which would authorize member banks of the Federal Reserve System to invest in "bank service corporations". As set out in its report on H. R. 8874 to your Committee, the Board favors the objective of the bill, but suggests some changes in it. The bank service corporations established under the bill would serve as a means whereby banks--and especially small and medium-size banks--and their customers could benefit from the improved efficiency and economies possible today only through automation. The operations of a bank entail a tremendous volume of data processing, such as the various kinds described in section 2(a) of the bill. At one time much of this was associated with the high desk and quill pen. Today, high speed electronic and related mechanical equipment designed to handle this work is being used by banks with increasing frequency.

Notwithstanding the high initial cost of equipment of this kind, some banks--especially the larger banks--are purchasing or leasing this equipment. Other banks are gaining access to this equipment through various contractual arrangements with data processing centers operated by private commercial concerns, and some banks that have purchased or leased this equipment are doing data processing for other banks and business concerns.

Under the bill, two or more banks would be able to pool their resources through the corporate device in order to gain the benefits--for themselves and for their customers--of this expensive equipment. This approach to the problem is not now open to member banks, because they are quite limited by the Federal banking laws as to the stock or securities that they may acquire. Of course, even if this bill is enacted, State member banks will be able to invest in bank service corporations only if authorized to do so by State law, but I understand that at least six States have recently enacted laws that specifically authorize such investments by State banks.

The Committee may be interested in some of the findings of a survey conducted by the System in March of this year concerning automation accomplishments and plans of commercial banks. This survey covered nearly all of the 975 banks with deposits of $25 million or more. In Federal Reserve Districts where interest in automation was believed to be relatively high, several hundred smaller banks also were surveyed.

Nearly 500 banks indicate that they either are already using electronic computers or some other form of automation equipment or have firm plans for automation within three years. Nearly all large banks are in this group, but the ratio of automating banks to the total number of banks falls rapidly as one moves down the scale in bank size, particularly among banks with deposits of less than $50 million. Only about one-fifth of the banks with deposits of $25-50 million have automation plans, and at smaller banks the proportion is negligible.

About one-fifth of the automating banks indicate that they are using or plan to use outside facilities for their automation operations, mainly those of an independent service bureau or a correspondent bank. Twenty-four banks, according to the survey, are planning to use some form of cooperative arrangement, despite the difficulties of doing so under present law.

I will not take the Committee's time to discuss the details of H. R. 8874 or to elaborate on the suggestions for changes which the Board set out in its report on the bill. These changes do not affect the bill's essential purpose. The Board's staff will be glad to be of all possible help to the staff of your Committee, Mr. Chairman, with respect to any of these changes.

H. R. 7796, relating to real estate loans by national banks

The third bill before you today is H. R. 7796, relating to real estate loans by national banks.

Under existing law, national banks may make construction loans on residential and farm buildings provided the maturities of such loans do not exceed nine months. These loans are classified as ordinary commercial loans and are not subject to the various limitations which, under section 24, apply to loans secured by real estate. Section 2 of H. R. 7796 would increase the permissible maturities of such loans from 9 to 18 months. This change would be helpful in meeting situations where, for some reason beyond the control of the contractor, it is not possible to complete construction within a nine-month period or where there are other unavoidable delays. National banks would continue to be limited in the aggregate amount of construction loans which may be made to 100 per cent of unimpaired capital and surplus.

Under the first paragraph of section 24 of the Federal Reserve Act, a national bank may now make real estate loans in an aggregate amount not in excess of the amount of the capital stock of the national bank paid in and unimpaired plus the amount of its unimpaired surplus funds, or not in excess of 60 per cent of the amount of its time and savings deposits, whichever is greater. Section 1 of H. R. 7796 would increase the second alternative to 70 per cent. Last year the Board reported to your Committee that it had no objection to this increase. The Board adheres to that view, but desires to call your attention to the fact that in the interim there has been a considerable increase in time and savings deposits, which may well reduce the need for relief in this form.