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Statement of

William McChesney Martin, Jr.,

Chairman, Board of Governors of the Federal Reserve System,

before the

House Committee on Banking and Currency,

on

H. R. 5845, H. R. 7878, H. R. 8230, H. R. 8245, and H. R. 8247

September 24, 1963.

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You have asked for the comments of the Board of Governors of the Federal Reserve System on five bills proposing greater latitude for banks and for savings and loan associations in their financial activities.

Four out of the five bills relate to national banks, and the fifth to savings and loan associations. The bank bills propose:

1. To create another exception to the rule laid down in the National Bank Act that a national bank "shall not underwrite any issue of securities," a change that would apply as well under the Federal Reserve Act to all State banks that are members of the Federal Reserve System.

2. To authorize conventional loans by national banks on real estate--that is, loans not insured or guaranteed by Federal agencies--to run longer, and to run higher in relation to the value of the property.

3. To authorize loans by national banks to a single borrower in double the size now permitted by law.

4. To authorize larger and longer loans by national banks on forest tracts.

Of them all, one thing may be said in common: they would relax limitations that were adopted by the Congress to safeguard these

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institutions and the public they serve from dangers that may seem remote today but have been all too real at other periods of our history. Fortunately, conditions in the economy today are good. During a comparatively long period of relative prosperity, or at least one unbroken by an economic setback on the scale we suffered in the 1930's, we have made great progress in improving the techniques by which our financial institutions meet the public's needs. We know more than we formerly did about avoiding depressions, and I wish I could say with confidence that we will never see another. But I do not think we can afford to proceed on that premise. Particularly, I question whether at this time, when our economy is doing well, we should relax credit standards further.

H. R. 5845: Underwriting by Commercial Banks

H. R. 5845, dealing with a subject known in capsule form as "revenue bond underwriting by commercial banks," is the most controversial of the four bank bills, and I will begin my discussion with it.

State-backed obligations of public housing agencies. The bill would modify section 5136 of the Revised Statutes by means of two amendments. The first would confer upon national banks (and State banks that are members of the Federal Reserve System) special powers with respect to short-term obligations of public housing agencies that are secured by an agreement by the State to lend to the

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agency an amount sufficient to pay such obligations at their maturity. Investment in such obligations would not be subject to the ordinary limitations and requirements of section 5136 with respect to banks' securities investments, and banks could also underwrite and deal in such obligations.

R. S. 5136 presently exempts from its limitations and restrictions "general obligations of any State"--that is, obligations that are backed by the full faith and credit of a State. As amended by section 602(a) of the Housing Act of 1949, R. S. 5136 also exempts short-term obligations of public housing agencies secured by agreements of the kind contemplated by H. R. 5845 that are entered into by the United States Public Housing Administration. If the agreements contemplated by the proposed amendment would pledge the general credit of the State to the payment of the obligations involved, the conferring of "exempt" status on such obligations appears to be justified as a matter of principle. We have some suggestions for technical changes in this portion of the bill that are incorporated in the draft attached to my statement.

Revenue bonds. In its provisions dealing with the subject of revenue bond underwriting by commercial banks, H. R. 5845 proposes to grant to banks by process of law certain underwriting privileges that the Comptroller of the Currency recently undertook to grant by process of redefinition. The Comptroller's action, however, has

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created a situation in which national banks would seem to have even broader privileges than H. R. 5845 would grant either to national banks or to State banks that are members of the Federal Reserve System.

The National Bank act now provides that a national bank "shall not underwrite any issue of securities," and the Federal Reserve Act makes this prohibition applicable also to State member banks. However, the statutes further provide that the prohibition of underwriting (as well as "dealing" in securities) "shall not apply to obligations of the United States, or general obligations of any State or of any political subdivision thereof."

These provisions were enacted by Congress over 30 years ago, and until recent months they were consistently interpreted, by the Federal Reserve System and the Office of the Comptroller of the Currency, to permit national banks and member State banks to underwrite "municipal bonds" (a term used in the trade to include bonds of States as well as smaller governmental entities) only when those bonds were backed by the full faith and credit of a governmental body that possessed general powers of taxation, including property taxation. H. R. 5845, like similar bills introduced over the past decade, is based on that interpretation, which the Federal Reserve System continues to follow in applying the law to State member banks, and I shall discuss the bill on that basis.

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Besides issuing "general obligations," States, cities, school districts, and other governmental authorities of various kinds also issue securities that do not have the same "full faith and credit" backing. As examples, a State may issue bonds that are to be repaid solely from tolls paid for use of a bridge, tunnel, or turnpike, or from a particular tax source such as a gasoline sales tax or a severance tax. A city may issue bonds payable solely from the income of a municipal auditorium.

In many cases a State, instead of issuing in its own name bonds payable solely out of a designated revenue source, will create a Roads Commission or Turnpike Authority, with power to raise necessary funds by selling its own bonds to the public. Bonds of that kind ordinarily are not binding on, or backed by, the State itself. Such bonds may be general obligations of the Commission or Authority that issues them, but since that body does not possess general taxing power they have the same status as equivalent bonds issued by the State but payable only from a particular source of State income. In other words, all of these securities are in the category of "revenue bonds" and may not be underwritten or dealt in by commercial banks.

From the passage of the Banking Act of 1933 until recent weeks, banks have not underwritten or dealt in revenue bonds because of the statutory prohibition. On the other hand, a few large banks,

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both national and State, do have departments that actively participate as underwriters and dealers in bonds that are "general obligations" under section 5136. Either individually or as members of syndicates, they submit offers for new issues of municipal "G. O.'s," as they are called, and if the offer is accepted they distribute the securities by selling them to the investing public, including institutional investors. Such banks also act as dealers--that is, they buy and sell G. O.'s that are already outstanding and maintain inventories of such bonds for sale.

These underwriting and dealing functions must be distinguished, of course, from banks' investments in securities. Under section 5136 and the Investment Securities Regulation of the Comptroller of the Currency, a bank may purchase for investment (the statute uses the expression "purchase for its own account") securities of any kind, including corporate securities and revenue bonds, that meet prescribed standards of quality. The pending bill does not relate to such investments, but rather to the authority of banks to underwrite and deal in securities. (For brevity, I shall refer hereafter only to "underwriting," but "dealing" should also be understood.)

Under section 5136, banks may underwrite G. O.'s without any statutory restriction as to amount or specification as to quality. Questions respecting quality and amount are taken care of by the examination process.

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H. R. 5845, on the other hand, is intended to permit banks to underwrite only such revenue bonds as "are at the time eligible for purchase by a national bank for its own account" (page 2, lines 23-25)--that is, securities that are of "bank quality" and therefore already eligible for bank investment. The bill also is intended to forbid banks to "hold. . . [revenue] obligations [of any one issuer] * as a result of underwriting, dealing, or purchasing for its own account. . . in a total amount exceeding at any one time" 10 per cent of the bank's capital and surplus (page 3, lines 2-9). In other words, if a bank already held bonds of the X Turnpike Authority in its investment portfolio in an amount equal to 6 per cent of the bank's capital and surplus, it could not, as underwriter (or in any other capacity), buy bonds of a new issue of that Authority in an amount exceeding 4 per cent of capital and surplus.

In these respects, and others, the bill requires revision in order to effectuate its intent, and a suggested rewording is attached to this statement, for consideration in the event it is decided that legislation along these lines is advisable.

As I indicated, I have been discussing the bill on the basis of the long-standing interpretation of what R. S. 5136 means today.

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* The bill does not contain these bracketed words, but it seems clear that the omission was inadvertent.

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The situation is further complicated, however, by the fact that the Comptroller of the Currency has recently announced a new interpretation of the law. He has redefined the term "general obligation" to include an obligation that is backed by the full faith and credit of the obligor, even though the obligor is a special authority without taxing power. Since "general obligations" are exempt from all of the restrictions of R. S. 5136, the Comptroller's new interpretation goes much farther than H. R. 5845 would go. That is, if one considers revenue bonds to be "general obligations," it means banks may underwrite them without limitation as to amount and without reference to the quality standards H. R. 5845 would apply.

The Board of Governors believes this interpretation to be unwarranted by the statute. In applying the law to State member banks, we feel obliged to construe "general obligations" in its traditional sense. The result, at the moment, is that national banks are operating under new rules that allow them much broader authority than this bill is intended to grant, whereas State member banks are operating under the rules in force when the bill was introduced. Clearly, some way must be found to apply one rule for all member banks, State or national.

Accordingly, the proposed revision of H. R. 5845 that we are submitting includes, as a last sentence, an explicit definition of the statutory term "general obligations" which, it is hoped, would

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remedy this situation. In the Board's judgment, prompt enactment of such a definition is urgently needed; its importance far transcends that of either of the topics dealt with by H. R. 5845 in its present form.

I now return to consideration of the bill on the basis of its underlying assumption--that, contrary to the Comptroller's position, existing law does not permit banks to underwrite revenue bonds.

The chief benefit asserted by proponents of revenue bond underwriting by banks is that it would reduce the cost of long-term governmental financing. At present, revenue bonds are underwritten almost solely by investment banking concerns; the largest are in New York and other financial centers, but there are hundreds of others throughout the country. If commercial banks were permitted to engage in this activity, it is claimed, competition among bidders for new issues of revenue bonds would be broader and more intense, with the result that issuers of revenue bonds would receive higher bids and the costs of their financing would be correspondingly lower than would be the case if banks were not permitted to compete in this field.

Opponents of the pending bill, on the other hand, maintain that competition among revenue bond underwriters already is intense and effective, and that additional competition from a relatively small number of commercial banks would have little or no effect on the

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costs of municipal financing. They also assert that the quantitative importance of the revenue bond segment of public financing has been exaggerated, and that a number of recent issues, based on lease arrangements in many cases, actually are G. O.'s and consequently are already eligible for bank underwriting. They further contend that the main effect of permitting banks to underwrite revenue bonds would be to take a first step toward releasing upon the economy the evils that the Banking Act of 1933 sought to avert by separating commercial banking from investment banking.

Most of these evils can be grouped as undesirable conflicts of interest. It is said that many of the principal and unique functions of commercial banks inevitably would be less effectively performed if banks were permitted to expand their underwriting activities. Banks could underwrite securities that might not be appropriate investments for them for a variety of reasons. However, if a particular underwriting proved to be "sticky," a bank might take the securities into its investment portfolio rather than liquidate them at a loss. In this way, it is said, banks would not perform with optimum efficiency their vital job as investment intermediaries.

The trust departments of banks are one of the main fiduciary groups of the country. It is said that there would be conflict between their fiduciary and underwriting functions. Likewise, it has been asserted that the advice and guidance given to correspondent

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banks and other customers by large metropolitan banks would be affected adversely by wider participation of such banks in underwriting, since it would be difficult for a bank to maintain the position of an impartial adviser when deciding whether to recommend purchase of securities in which the advising bank itself held a position as underwriter or dealer. Another contra argument is that the credit-granting decisions of a commercial bank should be made solely on the merits of the bank-loan proposal, without being influenced by the bank's position as underwriter--or prospective underwriter--of the would-be borrower's securities.

A further argument made against the bill is that, in the long run, it would actually lessen, rather than intensify, investment banking competition. It is pointed out that industrialized countries in which investment and commercial banking are combined have not developed anything like our strong and extensive investment banking industry. From this it is argued that any immediate enhancement of competition resulting from entry of commercial banks into this area would be more than offset, in time, by a reduction in the number, the competitive power, and the vigor of investment banking concerns. At the same time, there would be a tendency to undue concentration of economic power in commercial banks.

Although these contentions are advanced against the limited proposal of the present bill, it is apparent that, assuming their

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validity, their force would be multiplied if there were a possibility that commercial banks' underwriting activities might be still further expanded hereafter. And that argument is emphatically advanced by opponents of the bill--that H. R. 5845 does not present the entire problem, but is only an entering wedge that would permit commercial banks gradually to infiltrate much wider areas of investment banking.

In this connection it is said that, regardless of the good faith of the sponsors of such bills and their protestations that no further steps are contemplated, the logic of the situation cannot be disregarded. The pending bill would permit banks to underwrite bonds issued, for example, by an Electric Power Authority that was owned by a municipality. It is argued that enactment of this bill would enable such an authority to borrow more cheaply the funds needed for generators and transmission lines, and that the benefits would flow to the public in the form of lower rates for electric power. Precisely the same argument could be made, however, in the case of a city in which electric power production and distribution were in the hands of a private corporation. The quality of the securities would be comparable in these two cases, and in each lower interest rates would lead to lower electricity rates for consumers.

This being the case, it is argued, is it not inevitable that the benefits of bank underwriting would be sought in the public utility field, as an example, after municipal revenue bonds had been made

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eligible? And is it reasonable to assume that the expansion would stop there? If homeowners who heat their houses with gas fuel are entitled to legislative action designed to reduce their costs, is there any sound reason for withholding similar benefits from those who use oil for that purpose? The argument goes somewhat along those lines.

I have outlined a number of points that have been considered by the Board of Governors in reaching a judgment. But enumeration of arguments is only a step in the clarification of issues. The essence of the decision-making process is determining the validity of each of those arguments and the weight to which it is entitled, balancing the arguments for and against, and then deciding which side outweighs the other, in the aggregate.

In one of the few areas in dispute that are subject to quantitative analysis, we have found it feasible to make an independent, although limited, study.

To test the extent to which interest costs differ between revenue bonds and general obligation bonds of comparable quality, data were tabulated on the terms of new bond offerings made in the first half of 1963. All issues in amounts of $2 million or more which carried a Moody's Investors Service quality rating of A, and for which public information on costs was available, were included in the tabulation--99 issues in all.

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The simple average of net interest costs incurred on these issues was 3.27 per cent for the revenue bonds and 3.00 per cent for the G. O.'s. But more than half of this 27 basis point difference was accounted for by factors other than disparities in the interest yields required by investors--largely differences in average maturities. Comparing reoffering yields to investors on identical 5, 10, and 20-year maturities, revenue bonds in the tabulation provided average yields only about 11 basis points higher than on G. O.'s. This unexplained difference--less than one eighth of 1 per cent--represents the major part of the differential which might be narrowed by permitting commercial banks to underwrite revenue bonds.

Other differences in the underwriting circumstances of these issues were not large. The average number of bids received on the G. O.'s was 7, as against 6 on the revenue offerings, and the difference between the lowest and next lowest bid was actually slightly less on the revenues than on the G. O.'s. Moreover, underwriting spreads (the gross compensation to the purchasing syndicates, in terms of interest cost differentials) appear to have been as low, or lower, for the revenue bonds as for the G. O.'s in this tabulation.

The experience of the Georgia Rural Roads Authority, whose bonds recently became eligible for bank underwriting in consequence of a constitutional change, is cited by proponents of this legislation as an example of the possible benefits to be received. Of

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the 3 latest bond offerings of that Authority, in August 1958, January 1962, and October 1962, only the last--in October 1962--was underwritten by banks. But analysis indicates that the differences in yields on these issues were mainly attributable to changes in the general market. Thus, if reoffering yields on these Georgia's and on all A-rated bonds issued in August 1958 and October 1962 are compared, we find that there was little difference in the relative movements. And underwriting spreads do not appear to have declined significantly over this period on the Georgia issues, despite inclusion of banks in the syndicates bidding for the last of these offerings.

Our conclusions from these observations are that there is not much latitude for competitive reductions in interest costs between revenue and G. O. bonds of similar quality, and that one recent instance of a change in classification--the Georgia case--does not indicate that inclusion of banks as underwriters brought a significant decline in interest costs to the issuer. Nor does the record cited suggest that the participation of banks in competition for G. O. bonds has produced underwriting spreads that are lower than those on revenue issues of similar size and quality.

It should be pointed out, moreover, that even if bank underwriting of revenue bonds were to result in some narrowing of the relatively small existing interest rate differential, the cost would tend to be borne by issuers of general obligation bonds. If banks

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were to broaden markets for revenue bonds through sales to regular clients, this might well bring an offsetting reduction in purchases of G. O.'s by these same clients. Some upward adjustments in yields on G. O. issues would be the probable result. All in all, the prospective interest cost benefits of commercial bank revenue bond underwriting do not appear to us to be of significant dimensions.

It appears, therefore, that the revenue-bond proposal before the Committee would not produce, to any substantial extent, the benefits that its proponents have advanced as its principal merit and justification. The Eoard believes, moreover, that the principle of separation of commercial banking from investment banking (including underwriting and dealing), which was recognized and adopted by Congress in the Banking Act of 1933, is a sound and significant one. It tends to minimize the possibility of banks being subjected to conflicts of interest that might affect adversely their ability to devote themselves single-mindedly to their primary function of serving their depositors, borrowers, correspondents, and trust accounts.

For these reasons it is our judgment that the benefits to be derived from maintaining the principle of separation of commercial banking from the securities business decidedly outweigh the limited benefits that might result from enactment of the second part of H. R. 5845. Accordingly, the Board recommends against enactment of that part of the bill.

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H. R. 7878: Mortgage Loans

Another of the bank bills on which you have asked for our comments, H. R. 7878, would raise the limits on conventional real estate loans by national banks in two respects: the maximum maturity would be increased by 50 per cent, from 20 to 30 years; the maximum loan-to-value ratio, which was raised from 66-2/3 to 75 per cent only 4 years ago, would be further raised to 80 per cent. Today, there is an ample supply of mortgage funds; total mortgage credit has been rising by record amounts; and commercial banks themselves have recently added larger amounts than ever before to their mortgage portfolios. National banks do not seem to be suffering from a competitive disadvantage as a consequence of the present loan limits. In the past year, the conventional real estate loan portfolios of national banks increased somewhat more, proportionately, than did those of State-chartered commercial banks. Nor are commercial banks as a whole pressing against the existing limits; their conventional home loans are currently made for an average term of about 16 years, well under the 20-year limit of existing law, and the average loan-to-price ratio is roughly 60 per cent, compared with the 75 per cent limit now in effect.

Already in the postwar period, mortgage credit standards have been progressively relaxed, partly in an effort to meet a pent-up demand for housing and partly in an effort to stimulate the economy. In the Board's judgment, this is not the time to relax standards still

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further. Even if the process of relaxation has been both safe and stimulative, it would seem preferable to reserve further steps in this direction for a time of greater need and surer effect.

H. R. 8247: Loans to Single Borrowers

You have also requested comment on H. R. 8247, which would raise the limit on loans by a national bank to a single borrower from 10 per cent to 20 per cent of the bank's capital and surplus. The present 10 per cent limit was established to make certain of diversification and thus avert the danger inherent in concentrating too large a portion of a bank's resources in a few large loans. There is little evidence of a need today to double this loan limit, especially since loan participations are available to meet the needs of large borrowers, and the present law contains numerous exceptions for loans that are regarded as particularly safe or are secured by specified types of collateral. The proposed change would permit banks to concentrate lending risks unduly, and could intensify pressures from large national accounts to increase their loan commitments, thereby diverting loanable funds away from local borrowers.

H. R. 8230: Loans on Forest Tracts

The fourth bank bill on which comments were requested is H. R. 8230, which would authorize national banks to lend more liberally on forest tracts. Present law limits such loans to 40 per cent

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of the "appraised value of the economically marketable timber offered as security" and the term must not exceed 2 years unless the loan is to be amortized, in which case the limit is 10 years. The bill would change the basis for evaluating the security to the "appraised fair market value of the growing timber lands, and improvements thereon." It would authorize loans up to 60 per cent of this value for a 3-year term or, if amortized, up to 75 per cent for a 15-year term. Relatively few loans on forest tracts are now being made by member banks, and reports from most of the Federal Reserve Banks indicate their members generally lack experience with such loans. The Board would not recommend favorable action on the proposal unless further study reveals greater evidence of a need for it.

H. R. 8245: Savings and Loan Associations

Finally, you have requested the Board's comments on H. R. 8245, relating to savings and loan associations. This bill would authorize Federal savings and loan associations to establish special savings accounts (that is, deposit accounts) for pension or retirement trust funds, and would authorize these associations and other members of the Federal Home Loan Bank System to act as trustees for stock bonus, pension, and profit-sharing plans. It would also broaden the investment authority of Federal savings and loan associations to include obligations of Federal agencies and of the States and local governmental entities, including special obligations as defined by the

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Federal Home Loan Bank Board. Federal savings and loan associations would also be authorized to make loans for "furnishing, equipping, or promoting the livability of a home," as well as for paying the expenses of a college education or acquiring a mobile dwelling. Other provisions of the bill would qualify institutions insured by the Federal Savings and Loan Insurance Corporation as depositaries for funds of the Federal Government, grant to savings and loan associations authority similar to that granted to banks last year to establish service corporations, and authorize small business investment companies to place idle funds in FSLIC-insured institutions.

Furthering the efficiency of operations of savings and loan associations, along with that of other financial institutions, is of course desirable, and we therefore recommend favorable consideration of an extension of the Bank Service Corporation Act to cover such associations. The Board believes, however, that before the question of granting additional powers to savings and loan associations is taken up, action should be taken to strengthen supervision, safety, and liquidity of these institutions, and to provide safeguards against conflicts of interest. This was the position taken by the Administration and the Board in connection with proposals to increase FDIC and FSLIC insurance coverage, and we believe it is applicable with at least equal force in this case.

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Now, in conclusion, a few general observations.

All of these proposals involve in one way or another the position of particular financial institutions in relation to that of their competitors. And all affect in some degree the ability of the institutions concerned to obtain a greater share of the profits available from the rendition of the services they commonly offer, or would like to offer.

In part these proposals raise questions of equity and justice: the right of each to compete with others on equal terms, insofar as the law--and in this instance the supervisory authorities, operating within the law--can make the terms equal; also the right of all to gain for themselves the greatest profits they can achieve in full and fair competition with others.

If that were all, the verdict would be easy and obvious. Equality of opportunity is the very cornerstone of our society, and the profit-motive the very foundation of the economy by which that society is sustained. But there is more here than that. For the fundamental issue of public policy involved in these proposals is not what these financial institutions are to be allowed to do, but what risks they are to be allowed to take with other people's money.

Because they operate with other people's money, it has been almost universally deemed in the public interest, and we so

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deem it now, that commercial banks and savings institutions be held to strict standards of prudence and care in their loan and investment operations. In the view of the Board, this is no time to relax those standards further.

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ATTACHMENT

Suggested revision of H. R. 5845, 88th Congress, with explanation

(Submitted by Board of Governors of Federal Reserve System)

A BILL

To assist cities and States by amending section 5136 of the Revised Statutes, as amended, with respect to the authority of national banks to underwrite and deal in securities issued by State and local governments, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That paragraph "Seventh" of section 5136 of the Revised Statutes of the United States, as amended (12 U.S.C. 24) is hereby amended--

(1) by striking out everything between "(1)" and the word "prior" in the sixth sentence thereof and inserting in lieu thereof the following:

"by an agreement between the public housing agency and the Public Housing Administration or the State wherein the agency is situated, in which the agency agrees to borrow from the Administration or State, and the Administration or State agrees unconditionally to lend to the agency,";

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(2) by striking out the last sentence thereof and inserting in lieu thereof the following:

"The limitations and restrictions herein contained as to dealing in and underwriting investment securities shall not apply to

(1) obligations issued by

(a) any State or any political subdivision thereof or any public agency of a State or political subdivision (except obligations payable solely from the proceeds of special benefit assessments) or

(b) the International Bank for Reconstruction and Development or

(c) the Inter-American Development Bank

which are at the time eligible for purchase by a national bank for its own account;

(2) obligations issued by the Tennessee Valley Authority:

Provided, that no national bank shall at any one time hold obligations issued by any one of such issuers, as a result of underwriting, dealing, and/or purchasing for its own account (and for this purpose obligations as to which it is under commitment shall be deemed to be held by it), in a total amount exceeding 10 per centum of its capital stock and surplus. The provisions of the preceding sentence shall not apply to general obligations of any State or of any political subdivision thereof, which are specifically

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covered by another provision of this paragraph. As used in this paragraph, the term 'general obligations of any State or of any political subdivision thereof' means only obligations that are supported by an unconditional promise to pay, directly or indirectly, an aggregate amount which (together with any other funds available for the purpose) will suffice to discharge, when due, all interest on and principal of such obligations, which promise (1) is made by a governmental entity that possesses general powers of taxation, including property taxation, and (2) pledges or otherwise commits the full faith and credit of said promisor; and said term does not include obligations that are to be repaid only from specified sources such as the income from designated facilities or the proceeds of designated taxes."

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Explanation of suggested revision of H. R. 5845, 88th Congress

1. The language of H. R. 5845 requires only that "the State agrees to lend to the public housing agency" (page 2, lines 3 and 4). To reduce the possibility of misinterpretation, it is suggested that this language be changed to read "the State agrees unconditionally to lend to the public housing agency", so as to make clear that the exemption is applicable only when the agreement by the State effectively pledges its full faith and credit.

H. R. 5845 would insert an additional lengthy provision in the sixth sentence of paragraph "Seventh" of R. S. 5136, which is already extremly long and complicated. The substitute amendment would achieve the same result, with at least equal clarity, by the insertion of relatively few words in an earlier clause of the sentence.

2. In lines 17 to 19 on page 2 of H. R. 5845, reference is made to "all other obligations issued by a State or political subdivision or agency of a State or political subdivision". The proposed statutory provision relates to so-called "revenue obligations", as distinguished from general obligations. An existing provision of section 5136 of the Revised Statutes completely exempts general obligations from the limitations and restrictions of R. S. 5136. Presumably, the reference to "all other obligations", etc., in the proposed new provision is intended to relate back to that complete exemption of general obligations, so that the new limited exemption applies only to "all other (municipal) obligations" than those--in other words, to revenue obligations.

This wording has both advantages and disadvantages. If the reference-back of the term "all other obligations" were clear, it would simplify the wording of the proposed new provision (compare language of S. 3131, 87th Congress). However, there are over 40 lines of statute between the reference to "all other obligations" and the prior language to which it must be related, and readers might have serious difficulty in making the necessary relation back. In addition, the language in question refers to "all other obligations issued by a[n] ... agency of a State or political subdivision"; however, since there is no earlier mention of obligations of such agencies, reference to all other obligations of such agencies might cause confusion and avoidable problems of interpretation.

3. The amendment of R. S. 5136 proposed by clause (2) of H. R. 5845 presumably is intended to permit underwriting of only such revenue bonds as are "eligible for purchase by a national bank for its own account". However, page 2, line 21, includes the words "to obligations of", which were not included in earlier bills such as S. 3131, 87th Congress. The inclusion of these words seemingly causes the words "eligible for purchase by a national bank for its own account" (page 2, line 24) to be applicable only to obligations of the IBRD and the IDB. Consequently, the amendment, if enacted in that form, might be interpreted to mean that municipal revenue obligations are eligible for bank

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underwriting regardless of whether they would be eligible as investments for national banks. This clearly is not intended or desirable.

4. The proviso to clause (2) of the bill prescribes a maximum limit on the amount of securities of the types previously described that a bank may hold "as a result of underwriting, dealing, or purchasing for its own account". H. R. 5845 departs from S. 3131, 87th Congress, by omitting after "amount" on page 3, line 6, the words "with respect to any one of such issuers". As a result of this omission, the proviso appears to forbid a national bank to hold municipal revenue bonds or obligations of the IBRD, IDB, and TVA in an aggregate amount, for all those issuers, exceeding 10 per cent of the bank's capital and surplus. It is presumed that this excessively narrow restriction is not intended, and the language of the bill should be amended to correct it.

5. It is believed that the best solution of the foregoing problems would be to modify clause (2) of the bill as indicated in the accompanying suggested revision. That revision also includes some other modifications intended to achieve greater clarity and to avoid possible ambiguities.

6. If, however, it is decided to retain the shorthand expression "all other obligations", etc. (see "2" of this Explanation), the suggested substitute should be changed by omitting the penultimate sentence and making appropriate changes elsewhere.

7. The purpose of the last sentence of the suggested substitute is to prevent misinterpretation of the statutory term "general obligations of any State or of any political subdivision thereof". The Comptroller of the Currency, in recent months, has interpreted that term in a way that would cover not only full faith and credit obligations of a government with general powers of taxation but also revenue bonds payable solely from the income of a toll bridge, tunnel, or turnpike, or from a specified limited tax source. The proposed definition of the term has been made extremely explicit, in order to prevent such misinterpretations hereafter.

8. The draft bill to which this Explanation is attached would revise H. R. 5845 with respect to both subjects covered by the bill. However, as indicated by Chairman Martin's Statement, the Board does not favor enactment of the second portion of the bill, which would authorize banks to underwrite revenue bonds. The revision of that portion has been submitted by the Board of Governors so that the bill, as reported by the House Banking Committee, will be free from certain existing technical defects, in the event that, contrary to the Board's recommendation, the revenue-bond-underwriting provision is enacted. Consequently, if the Board's recommendation is followed, all of the second proposed insertion in R. S. 5136 (beginning near the top of page 2 of the suggested revision) would be deleted with the exception of the last sentence (defining "general obligations"), which should be enacted in any event.

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