Minutes for February 10, 1958

To: Members of the Board
From: Office of the Secretary

Attached is a copy of the minutes of the Board of Governors of the Federal Reserve System on the above date.

It is not proposed to include a statement with respect to any of the entries in this set of minutes in the record of policy actions required to be maintained pursuant to section 10 of the Federal Reserve Act.

Should you have any question with regard to the minutes, it will be appreciated if you will advise the Secretary's Office. Otherwise, if you were present at the meeting, please initial in column A below to indicate that you approve the minutes. If you were not present, please initial in column B below to indicate that you have seen the minutes.

Chm. Martin
Gov. Szymczak
Gov. Vardaman 1/
Gov. Mills
Gov. Robertson
Gov. Balderston
Gov. Shepardson

1/ In accordance with Governor Shepardson's memorandum of March 8, 1957, these minutes are not being sent to Governor Vardaman for initial.
Minutes of the Board of Governors of the Federal Reserve System

on Monday, February 10, 1958. The Board met in the Board Room at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Balderston, Vice Chairman
Mr. Szymczak
Mr. Mills
Mr. Robertson
Mr. Shepardson
Mr. Carpenter, Secretary
Mr. Sherman, Assistant Secretary
Mr. Kenyon, Assistant Secretary
Mr. Riefler, Assistant to the Chairman
Mr. Thomas, Economic Adviser to the Board

Messrs. Young, Garfield, Noyes, and Robinson, Miss Burr, and Messrs. Williams, Dembitz, Brill, Eckert, Gehman, Miller, T. Smith, Trueblood, Wernick, Wood, and Yager of the Division of Research and Statistics

Messrs. Marget, Furth, Hersey, Sammons, Bangs, Reynolds, and Wood of the Division of International Finance

Economic review. The review by the Division of International Finance, which concentrated primarily on recent and prospective developments in United States exports and imports, indicated that the level of exports declined substantially near the end of 1957 and might be expected to fall somewhat further due to weakness in the economic situation of certain foreign countries, particularly in Latin America and the Far East. On the other hand, the level of this country's imports had held up well, contrary to the expectations of those who had foreseen a sharp decline which would contribute to an international dollar crisis. There had also been a continued steadiness of the European industrial level and
there were in prospect some welcome monetary reforms in certain foreign areas. On balance, the foreign situation thus far had been holding up better than many had anticipated and represented more of a constructive influence in relation to the domestic economy than had been expected in some quarters.

The report by the Division of Research and Statistics revealed a continuation of the downward trend of most important indices of economic activity, with the latest estimates holding little prospect for a reversal of that trend in the near future. At the same time, prices showed steadiness or some tendency to advance in sectors affected by factors of a seasonal nature. The demand for long-term funds continued strong, being stimulated by lower interest rates.

The members of the staff other than Messrs. Carpenter, Sherman, Kenyon, Riefler, Thomas, Young, and Dembitz then withdrew from the meeting. Messrs. Hackley, General Counsel, Molony, Special Assistant to the Board, Shay, Legislative Counsel, Horbett, Associate Director, Division of Bank Operations, Hostrup and Benner, Assistant Directors, Division of Examinations, and Solomon, Assistant General Counsel, joined the meeting at this point.

Discount rates. Unanimous approval was given to a telegram to the Federal Reserve Bank of Atlanta approving the establishment without change by that Bank on February 7, 1958, of the rates on discounts and advances in its existing schedule.
Contemplated call report. Advice having been received from the Comptroller of the Currency of his intention to make a call this spring for reports of condition of national banks, a telegram was sent to the Federal Reserve Banks on February 7, 1958, in accordance with the usual procedure, stating that a call upon State member banks also was contemplated.

The action taken in sending the telegram was ratified by unanimous vote.

General Contract Corporation matter (Items 1 and 2). At the meeting on February 6, 1958, it was decided to defer until today, with Chairman Martin present, action on the following documents prepared by the Legal Division pursuant to the discussion at the meeting on January 22, 1958, concerning the applications of General Contract Corporation, St. Louis, Missouri, for determinations with respect to certain non-banking subsidiaries under section 4(c)(6) of the Bank Holding Company Act: (1) order of the Board, (2) statement in support of the majority decision, and (3) statement by Governor Mills.

Following a brief discussion, the order and supporting statement were approved in the form attached hereto under Item No. 1, Messrs. Martin, Balderston, Szymczak, Robertson, and Shepardson voting "aye" and Mr. Mills voting "no". A copy of the separate statement of Governor Mills is attached under the same item number. This action was taken with the understanding that the order, the majority statement, and Governor Mills' statement would be released to the press this afternoon at 4:30 p.m. EST.
advice of the Board's decision would be transmitted through the Federal Reserve Bank of St. Louis to reach the applicant simultaneously with the release of the press statement, copies of the statements and order would be sent to the appropriate parties, the order would be published in the Federal Register, and the letter to First Bank Stock Corporation of which a copy is attached as Item No. 2 would be sent upon release of the press statement.

Messrs. Conkling, Assistant Director, Division of Bank Operations, Koch, Associate Adviser, Division of Research and Statistics, and Hald, Economist in that Division, entered the room at this point.

Reserve requirements. As requested at the meeting on February 7, 1958, there had been distributed to the members of the Board under that date copies of a memorandum from Mr. Hackley submitting a revised draft of possible legislation on reserve requirements. To improve the wording and take into account the discussion at the February 7 meeting, the revised draft contained changes in the standard to be followed in permitting individual banks to maintain lower reserves. In this respect, two alternatives were again submitted, the first of which would provide that a member bank in a reserve city might hold and maintain the reserve balances now specified in section 19(a) of the Federal Reserve Act for country banks, and that a member bank in a central reserve city might hold and maintain the reserve balances specified for either a reserve city bank or a country bank, if such permission was granted by the Board
of Governors either in individual cases or under regulations of the Board, on such basis as the Board might deem reasonable and appropriate in view of the character of business transacted by the member banks. It would further provide that "for this purpose the Board may take into account the velocity, composition or activity of deposits of a bank, its location, or other relevant factors." The alternative draft would provide that a member bank might hold and maintain, in lieu of the reserve balances required under other provisions of section 19, such lower reserve balances, but in no event less than those specified for country banks, as the Board of Governors might permit, either in individual cases or under regulations of the Board. The standard to be applied would be the same as in connection with the first alternative draft.

Governor Mills stated that he was very much impressed by the outcome of the Board's discussions regarding reserve requirements and the draft legislation prepared by the Legal Division. He then expressed a preference for legislation along the lines of the first alternative, stating that such difficulties as might be encountered in getting acceptance of legislation probably would focus around the complaint that the Board would have complete freedom to classify member banks in any area. Such being the case, it seemed to him that it would be wiser for the Board not to ask for authority going any farther than necessary beyond the classification provisions already in the law. Although it might be helpful to do away with the central reserve city classification, he felt that even those who were the strongest advocates of flexibility based on
velocity, size, and deposit activity criteria might veer from that point of view. In any event, if either of the alternatives were followed it appeared that a burden would fall upon the Board by way of requests for exemptions. He was inclined to feel, however, that these requests could be handled in an increasingly routine fashion with the passage of time.

Governor Robertson agreed that, whichever alternative was followed, the Board would be faced with an administrative burden in the form of requests for exemptions. His preference, he said, ran to the second alternative because he thought that it was more equitable and because personally he would have less difficulty in changing a reserve city bank to an intermediate reserve requirement level than in moving the bank direct to the level of requirements prevailing for country banks.

Governor Shepardson stated that he had the same feeling. If it seemed that a choice between the two alternatives would be crucial in obtaining legislation, he would be willing to take the course which would make legislation possible. Putting aside that consideration, however, he would favor the second alternative because it seemed to afford an opportunity to approach more nearly what he understood to be the basic concept of a desirable change in reserve requirement standards.

Governor Szymczak requested of Mr. Hackley a summarization of the essential differences between the two alternatives and then stated that he would lean toward the second alternative.
Governor Balderston said he had a feeling that during the initial phases of working under legislation of this kind the Board might have an easier administrative situation if the Congress should pass legislation phrased along the lines of the first alternative. Moreover, it appeared that the differential between reserve requirements for reserve city banks and country banks, which now seemed rather disturbing, would narrow in the course of time. Another reason for favoring the first alternative was that he thought it might enhance the prospect of favorable Congressional action.

Governor Shepardson commented that, although the Board might conceivably wind up with the first alternative, discussion with the Presidents of the Federal Reserve Banks and representatives of the American Bankers Association was contemplated. In the circumstances, he would rather start from the second alternative and then retreat somewhat if necessary.

After Chairman Martin stated that Governor Shepardson's comment was in line with his own thinking on the matter, Governor Robertson suggested that Congressional reaction might in fact be more favorable toward the second alternative. He supposed that there might be some members of the Congress who would not look favorably on a procedure whereby member banks would be reduced in one step from the level of reserve city banks to the level of country banks. Therefore, it seemed to him that there might actually be a better chance of obtaining legislation which would not involve such drastic reductions.
Governor Shepardson added the comment that it would not be necessary under the second alternative to set up multiple reserve requirement levels except as the Board considered this to be desirable.

At the instance of the Chairman, there ensued a discussion of the desirability of recommending legislation which would provide authority for different reserve requirements as between savings deposits and other time deposits.

Mr. Thomas expressed the view that other time deposits ought to be subject to the same reserve requirements as demand deposits, or at least larger reserve requirements than those prescribed for savings deposits. At present, he pointed out, commercial banks - particularly in New York City - are attracting foreign time deposits which are not really savings funds but shift back and forth according to the rate of interest available under alternative possibilities for their investment. Moreover, if commercial banks attracted such foreign funds at a rate of 3 or 2-3/4 per cent and hesitated to reduce the rate, there would be a temptation to shift into long-term loans in order to produce income. Then, with a change in the rate structure, these deposits might be shifted into Treasury bills or other forms of investment and the banks would find themselves in a difficult situation from the standpoint of liquidity. This all pointed toward the conclusion that other time deposits should be regarded as demand deposits from the standpoint of bank liquidity and from the standpoint that they represent readily shiftable funds.
Mr. Thomas suggested that the Board might want to discuss this point with the Federal Reserve Banks for it had a relationship to the whole problem of regulating interest rates on time deposits. In the light of possible developments, the New York City banks that wanted a higher maximum permissible rate of interest when it was profitable for them to hold time deposits might seek a reduction of the maximum rate.

In response to a request for his views regarding the draft legislation, Mr. Riefler expressed some concern about the second alternative, for he felt that it would be a "large blank check", one which might contain elements of danger in the field of bank reserves. As he read the first alternative, it would limit the Board to actions more along traditional lines and would therefore be less of a "blank check." While he would like to see a reform in reserve requirements in the direction of placing them on an "activity" basis, he would also like to be specific about what was being requested.

Governor Robertson said that he had no difficulty seeing Mr. Riefler's point. However, as he understood it, the intent of the second alternative was not to suggest that the Board would necessarily prescribe a number of different reserve requirement ratios for individual banks in reserve cities. Theoretically, that might be possible but in practice it would be difficult for the Board to refine its thinking so closely. The second alternative, it seemed to him, would permit coming closer to the "activity" approach.
Governor Robertson then suggested the possibility of changing the language of the draft legislation to say that the Board shall, rather than may, take into account the volume, composition, or activity of the deposits of a bank, its location, and other relevant factors in granting permission for the bank to hold lower reserves than would be otherwise prescribed.

Mr. Riefler agreed that this might come closer to basing action on some kind of a principle, particularly if the Board should act pursuant to regulations rather than on a case-by-case basis.

Mr. Hackley commented that the Legal Division had deliberately phrased permissively the provision referred to by Governor Robertson because, if it were mandatory, a member bank which had been refused permission to carry lower reserves might argue, for example, that the Board had not taken into account its location. In such a case, the Board might have felt on the basis of other factors that it would not be desirable to permit the bank to carry lower reserves, but the bank might complain that the Board had not complied with the statute.

Mr. Solomon expressed the view that it would be very difficult to formulate regulations if the provision contained mandatory language because the regulations would have to make some reference to each one of the factors. Therefore, it would almost be necessary to work on a case-by-case basis unless it were possible to develop some formula which would include each factor in some way.
Governor Robertson agreed that if the aspect of individual treatment for individual banks could be removed, that would be all to the good, but he did not see how it could be done. He concurred in Governor Balderston's observation that the first alternative would come closer to permitting actions according to a general classification basis; on the other hand, that alternative would compel the Board to go the full distance from one classification to another when it permitted banks to carry lower reserves.

Following a comment by Governor Balderston that, as he had mentioned earlier, the differentiations between classes of banks would tend to become narrower over the course of time, Chairman Martin suggested discussion of the pros and cons with the Reserve Bank Presidents.

There being agreement with this suggestion, it was understood that before the joint meeting the Presidents would be sent copies of the draft legislation prepared by the Legal Division along with copies of the memorandum, amended in certain respects, which was distributed by Mr. Thomas at the Board meeting on Friday, February 7.

For the Board's consideration and in order to obtain the reaction of the Presidents, it was suggested that the Legal Division also submit draft legislation which would permit a distinction between the reserve requirements applicable to savings and to other time deposits.

In a discussion of the form which such a draft might take, Mr. Hackley commented that a principal problem involved in any differentiation
between savings and other time deposits for reserve requirement purposes would be the problem of definition, similar to the one that had plagued the Board in connection with Regulation Q; that is, whether, because of form, a deposit is a time or a demand deposit.

Governor Balderston commented that he was in complete sympathy with the theoretical reasons for differentiating between savings and other time deposits but wondered whether, for the sake of simplicity, it might not be advisable merely to ask for authority to differentiate within the present range of reserve requirements applicable to time deposits.

Mr. Hackley suggested the kind of language that might be used for this purpose, and it was understood that the draft legislation would be prepared along such lines.

Chairman Martin then referred to the new five-man special committee on legal reserve requirements created by the American Bankers Association and said that the chairman of the committee, Mr. Daniel Bell, had indicated a desire to have the group meet with the Board after the 19th of this month.

At the Chairman's suggestion, it was agreed to extend to Mr. Bell an invitation to have his committee meet with the Board on Friday, February 21.

In a further comment, Chairman Martin said that, as his thinking had developed over the past weekend, it appeared to him that the Board
could easily accede, if it seemed necessary, to a proposal that the existing rates of reserve requirements be the maximum statutory rates. No disagreement from this position was expressed, although Governor Robertson suggested that this might be a point held aside for bargaining.

Reserve Bank expenditures. Governor Shepardson referred to remarks made by Congressman Patman of Texas at a hearing on the Financial Institutions Act before the House Banking and Currency Committee on February 7, 1958, in which Mr. Patman commented critically on certain types of Federal Reserve Bank expenditures.

Some of the Reserve Bank Presidents having expressed interest in reading those remarks, it was agreed that copies of Mr. Patman's statement would be distributed to the Presidents today and that at tomorrow's Joint meeting with the Board the Presidents would be handed copies of the Board's letter dated February 6, 1958, to the Chairmen and Presidents of all Federal Reserve Banks on the subject of membership dues and contributions.

The meeting then adjourned.

Secretary's Note: Pursuant to the procedure authorized by the Board on December 7, 1956, Governor Robertson today approved the designation of Robert Ritchie, Assistant Examiner for the Federal Reserve Bank of New York, as a Federal Reserve Examiner for the purpose of participating in forthcoming examinations of the Tokyo, Osaka, and Beirut branches of The Chase Manhattan Bank and the Beirut branch of Bank of America, New York.
UNITED STATES OF AMERICA

BEFORE THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

In the Matter of the
Applications of
GENERAL CONTRACT CORPORATION
Under Section 4(c)(6) of the
Bank Holding Company Act of 1956

ORDER DENYING APPLICATIONS FOR
EXEMPTION OF SUBSIDIARIES FROM SECTION 4(a)

General Contract Corporation, a Missouri corporation, and a
bank holding company within the meaning of section 2(a) of the Bank
Holding Company Act of 1956, has filed applications for determinations
by the Board of Governors of the Federal Reserve System that certain
subsidiary corporations, hereinafter named, and their activities are of
the kind described in section 4(c)(6) of the Bank Holding Company Act of
1956 (12 USC 1843) and section 5(b) of the Board’s Regulation Y (12 CFR
222.5(b)), so as to make it unnecessary for the prohibitions of sec-
tion 4 of the Act with respect to retention of shares in nonbanking
organizations to apply in order to carry out the purposes of the Act.
The subsidiary corporations of General Contract Corporation on behalf
of which the applications were filed, with the hearing docket number of
each, are:

Washington Fire and Marine Insurance Company (BHC-4)
Insurance Company of St. Louis (BHC-5)
Midwestern Fire and Marine Insurance Company (BHC-6)
Securities Investment Company of St. Louis and its subsidiaries:
  Securities Credit Company (Mo.)
  Securities Loan Company
  Securities Credit Company (Fla.)
  Broadway Insurance Agency, Inc.
  Securities Insurance Agency, Inc.
  Davidson Insurance Agency, Inc.
  Investment Insurance Agency, Inc.
  Craighead Insurance Agency, Inc.
  Palafax Insurance Agency, Inc.
  Industrial Loan Company
  Industrial Finance Company of Wellston
  Springfield Union Finance Company
  Quincy Union Finance Company
  Baden Loan Company
  General Contract Loan Company
  SIC Loan Company
  General Loan Company
  General Contract Loan Company, Inc.
  General Contract Loan Brokers, Inc.
  Apex Insurance Agency, Inc.
  Jefferson-Gravois Insurance Agency, Inc.
  Reid-Kruse, Inc.
  St. Louis-Washington Insurance Agency, Inc.
  Northwestern Insurance Agency, Inc.
  Springfield Insurance Agency, Inc.
  Quincy Insurance Agency, Inc.
  Sterick Insurance Agency, Inc.
  Texarkana Agency, Inc.

A hearing having been held pursuant to section 4(c)(6) of the Bank Holding Company Act of 1956 and in accordance with sections 5(b) and 7(a) of the Board's Regulation Y (12 CFR 222.5(b) and 222.7(a)); the Hearing Examiner having filed his Report and Recommended Decision wherein he recommended that all the above requests be denied; Applicant having filed Exceptions and Brief with respect only to requests numbered BHC-8 and BHC-12; the Board having given due consideration to all relevant aspects of the matter, including briefs amicus curiae on a legal question involved in requests numbered BHC-8 and BHC-12, submitted
through the Applicant by three bank holding companies not parties to this matter; and all such steps having been in accordance with the Board's Rules of Practice for Formal Hearings (12 CFR 263):

IT IS HEREBY ORDER, for the reasons set out in the Board's Statement of this date, that the requests of General Contract Corporation under section 4(c)(6) of the Bank Holding Company Act of 1956 for determinations exempting its shares in the above-named subsidiaries from application of the prohibitions of section 4(a)(2) of the said Act shall be, and hereby are, denied.

This 10th day of February 1958.

By order of the Board of Governors.

Voting for this action: Chairman Martin, Vice Chairman Balderston, and Governors Szymczak, Robertson and Shepardson; voting against this action: Governor Mills; absent and not voting: Governor Vardaman.

(Signed) S. R. Carpenter

S. R. Carpenter, Secretary.
UNITED STATES OF AMERICA

BEFORE THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

In the Matter of the
Applications of
GENERAL CONTRACT CORPORATION
Under Section 4(c)(6) of the
Bank Holding Company Act of 1956

Docket No.

BHC 4-17,
19-27.

STATEMENT

BACKGROUND OF THE CASE

On December 14, 1956, General Contract Corporation of St. Louis, Missouri, a bank holding company sometimes called herein "Applicant" or "GCC", filed with the Board of Governors requests for determinations that twenty-four of its nonbanking subsidiaries (one of which itself has nine subsidiaries) are of such a nature as to be exempt under section 4(c)(6) of the Bank Holding Company Act of 1956 from the divestment requirements of that Act.

The particular sections of the Act here applicable are:

"Sec. 4(a) Except as otherwise provided in this Act, no bank holding company shall -

* * *

"(2) after two years from the date of enactment of this Act . . . retain direct or indirect ownership or control of any voting shares of any company which is not a bank or a bank holding company . . . .

* * *

"(c) The prohibitions of this section shall not apply -

* * *

"(6) to shares of any company all the activities of which are of a financial, fiduciary, or insurance nature and which the Board after due notice and hearing, and on the basis of the record made at such hearing, by order has determined to be so closely related to the business of banking or of managing or controlling banks as to be a proper incident thereto and as to make it unnecessary for the prohibitions of this section to apply in order to carry out the purposes of this Act . . . ."
statute, a formal hearing was held on 23 of these requests, one of
the requests having been withdrawn during the course of the hearing
after the Board had expressed the opinion that the subsidiary involved
was exempt under other provisions of the Act. The Hearing Examiner's
Report and Recommended Decision was filed with the Board September 12,
1957.

The subsidiaries involved consist of an investment company,
ten loan companies, three insurance companies, and nine insurance
agencies. The attached copy of the Hearing Examiner's Report and
Recommended Decision describes the activities of GCC as well as of
these subsidiaries.

The Hearing Examiner recommended that all 23 requests be
denied. He concluded that, following the principles enunciated in
the Board's opinion in the Transamerica-Occidental case (Docket
No. BHC-28), the request as to the investment company should be denied
because, while its activities are similar in kind to some of the
activities of banks, it has no direct functional or operational
connection with the bank holding company's subsidiary banks. The
Examiner further concluded that the three insurance companies and
nine insurance agencies, while also engaged in activities somewhat
similar to banking, could not be considered to be a "proper incident"
to the banking business carried on by the subsidiary banks. The
Examiner found that five of the ten loan companies were not directly
integrated with the functions of the subsidiary banks, and that three
of them were only partially related to the business of the banks.

As to the remaining two loan companies, the Examiner concluded
that, although functionally integrated and operated much as though they
were departments of the banks, they could not be regarded as a "proper
incident" to the business of the banks or consistent with "the purposes
of this Act" because the very types of transactions that make the
companies "closely related" to the banks are unlawful under section 6
of the Bank Holding Company Act. These transactions are the sale by
the loan companies to the subsidiary banks, at a discount and without
recourse, of notes representing personal loans made by the loan companies.

GCC did not file exceptions or brief as to 21 of the 23
companies involved, and under Rule VII of the Board's Rules of Practice
for Formal Hearings (12 CFR 263.7) GCC is deemed to have abandoned any
objections to the Examiner's recommended decision as to those 21 companies
(Docket No. BHC 1-7, BHC 9-11, BHC 13-17, BHC 19-27). Therefore, without
passing upon the correctness or incorrectness of the Examiner's recommended
decision regarding those companies, Applicant's requests as to those
companies are denied.
GCC's exceptions and brief, dated October 14, 1957, and filed with the Board October 15, 1957, related only to the Hearing Examiner's recommended decision with respect to the two loan companies mentioned above, namely, Industrial Loan Company (Docket No. BHC 8) and Baden Loan Company (Docket No. BHC 12). Accordingly, further discussion will deal only with those two companies.

THE DISCOUNT QUESTION

As indicated before, the Examiner concluded that exemption should be denied the two loan companies in question because the transactions by which a subsidiary bank purchases personal loan paper from the loan company at a discount and without recourse involve violations of section 6(a)(4) of the Act, which makes it unlawful for a subsidiary bank to make any "loan, discount or extension of credit" to its bank holding company or to any fellow subsidiary. The exceptions and brief of GCC disagree with this interpretation of section 6(a)(4), as do also amicus curiae briefs filed with the Board by three other bank holding companies: First Bank Stock Corporation, Marine Midland Corporation and Northwest Bancorporation. The arguments in the different briefs are largely similar and for convenience all will usually be referred to as those of Applicant.

The facts as to the operations of the two loan companies are fully set forth in the Examiner's Report and are not challenged by Applicant. The key fact for present purposes is that Bank of St. Louis, a GCC subsidiary, purchases personal loan paper at a discount, and without recourse, from Industrial Loan Company (and that Baden Bank of St. Louis, another GCC subsidiary, makes such purchases from Baden Loan Company). In each case, the loan company is operated in effect as though it were the personal loan department of the bank; it sells substantially all its loans to the bank on the days when made, services such loans, and serves as the bank's chief source of such paper. All functions of the loan company are performed on the premises of the bank and by bank personnel. The loan company has no separate place of business or paid personnel of its own.

The question turns upon whether the word "discount", as used in section 6(a)(4), includes a purchase of paper at a discount but without recourse against the seller. It is conceded by all that the term "discount" may have several meanings. Thus it is sometimes used in a restricted sense as applying only to a loan transaction in which the borrower receives a sum of money less than the stated amount of the note given by him. However, it is also used in a broader sense as including a purchase of paper with recourse against the seller; and, in a still broader sense, as including a purchase of paper even though without recourse against the seller. The problem here is to determine which of these meanings should be applied in the present situation, in the light of the language and purposes of the law.
Judicial Interpretations

In seeking the meaning that Congress intended for the word "discount" in section 6(a)(4) it seems appropriate to see what the courts, particularly the Federal courts, have said about the meaning of the word. On this point the Examiner stated in his Report (p. 28):

"Ample judicial authority supports the conclusion—in the words of the Third Circuit Court of Appeals—that, 'in the business of banking, "discount" in the ordinary acceptance of the term, includes what is called "purchase"'. Moreover, the Federal Courts have interpreted other sections of the national banking laws where the term 'discount' is used as including within its scope, not only loans or advances by way of discount of commercial paper, but also the outright purchase by banks of such paper for an amount less than their face value. Thus it has been held that the authority of national banks to acquire title to commercial paper—authority that must stem from an express grant of power or impliedly be deemed prohibited—is derived from the statutory corporate power given national banking associations under U.S.R.S. § 5136, 12 U.S.C. § 24, to engage in the 'discounting' of 'promissory notes, drafts, bills of exchange and other evidences of indebtedness.' Thus, too, the term 'discount' as used in U.S.R.S. § 5197, 12 U.S.C. § 85, which prohibits usury by national banking associations on loans or discounts made by them, has been held to include within its scope, not only transactions involving bank loans to the person for whom paper is discounted, but also transactions involving bank purchases of third party paper—and this regardless of whether such paper is purchased with or without any right of recourse upon the seller.

[References to cases]


The Danforth case and some others cited by the Examiner relate to the usury provision of the National Bank Act (R.S. 5197; 12 U.S.C. 85). As the Examiner indicates, however, the cases holding the word "discount" to include a nonrecourse purchase of paper are not confined to those construing that provision. The case of Morris v. Third National Bank of Springfield, supra, held that the corporate authority for national banks to purchase paper derives from their authority to engage in the "discounting" of paper.

The provisions construed in these Federal cases are, of course, not identical in language or purpose with section 6(a) of the Bank Holding Company Act; but they have in common the fact that they are all Federal statutes that deal with banking operations and practices. Moreover, these cases do not turn upon any unusual use of the word "discount" in the statutes being construed; on the contrary, as indicated in the Danforth case, 48 F. 271, 274, they constitute judicial findings as to "the ordinary acceptance of the term" and "its usual commercial sense" -- findings which are highly relevant to the present question.

In view of these cases holding that the word "discount" in "its usual commercial sense" and in its "ordinary acceptance" includes nonrecourse purchases of paper, it would seem that the word should be similarly interpreted in section 6(a)(4) unless some persuasive reason to the contrary can be shown. Applicant attempts to make such a contrary showing, relying largely on arguments based upon the context in which the word "discount" appears.

Context in Which Word "Discount" Appears

Since Applicant's arguments relate chiefly to the context in which the word "discount" appears in section 6 of the Bank Holding Company Act, all of that section is quoted below for convenient reference.

"BORROWING BY BANK HOLDING COMPANY OR ITS SUBSIDIARIES

"Sec. 6. (a) From and after the date of enactment of this Act, it shall be unlawful for a bank -

"(1) to invest any of its funds in the capital stock, bonds, debentures, or other obligations of a bank holding company of which it is a subsidiary, or of any other subsidiary of such bank holding company;

"(2) to accept the capital stock, bonds, debentures, or other obligations of a bank holding company of which it is a subsidiary or any other subsidiary of such bank holding company, as collateral security for advances made to any person or company: Provided, however, That any bank may accept such capital stock, bonds, debentures, or other
obligations as security for debts previously contracted, but such collateral shall not be held for a period of over two years;

"(3) to purchase securities, other assets or obligations under repurchase agreement from a bank holding company of which it is a subsidiary or any other subsidiary of such bank holding company; and

"(4) to make any loan, discount or extension of credit to a bank holding company of which it is a subsidiary or to any other subsidiary of such bank holding company.

"Non-interest-bearing deposits to the credit of a bank shall not be deemed to be a loan or advance to the bank of deposit, nor shall the giving of immediate credit to a bank upon uncollected items received in the ordinary course of business be deemed to be a loan or advance to the depositing bank.

"(b) The provisions of this section shall not apply (1) to the capital stock, bonds, debentures, or other obligations of any company described in section 4(c)(1) of this Act, or (2) to any company whose subsidiary status has arisen out of a bona fide debt to the bank contracted prior to the date of the creation of such status, or (3) to any company whose subsidiary status exists by reason of the ownership or control of voting shares thereof by the bank as executor, administrator, trustee, receiver, agent, or depositary, or in any other fiduciary capacity, except where such shares are held for the benefit of all or a majority of the stockholders of such bank."

The Examiner summarized Applicant's arguments as follows (p. 29):

"The Applicant argues earnestly, however, that notwithstanding the broad commercial usage of the term 'discount', Congress in drafting Section 6(a)(4) intended to draw a distinction between, on the one hand, a discount involving a direct loan to an affiliated company, or on an advance to such affiliate on discounted third party paper for the payment of which the affiliate assumes liability as an endorser or guarantor, and, on the other hand, a transaction involving a bank's purchase of third party paper at a discount from an affiliate without any right of recourse upon the affiliate. The Applicant concedes that Congress intended the prohibitions of Section 6(a)(4) to apply to transactions of the first two types, but not, it contends, to those of the third type.

"The arguments upon which the Applicant would support that position are ably marshalled in its brief. The main points stressed are, in broad outline, as follows: (1) It is urged that Section 6(a)(4) may not be read in isolation, but must be read in context with the other
subdivisions of Section 6(a). It is claimed that 6(a)(1), prohibiting investments in capital stock, bonds, debentures or other obligation of an affiliated company; 6(a)(2), prohibiting the acceptance of such capital stock, bonds, debentures or other obligations as collateral for advances made to any borrower; and 6(a)(3), prohibiting the purchase of securities, other assets or obligations from an affiliate under a repurchase agreement—all disclose a Congressional concern over a bank relying on the worth or credit of its parent or fellow subsidiaries in its investment or lending activities. According to the Applicant, consistency and harmony with the pattern shaped by the earlier subdivisions demand that Section 6(a)(4) also be construed as applying only to situations where a transaction calls for bank reliance on the credit or worth of an affiliate. And such reliance, it says, is not involved in the case of an outright purchase of paper where there is no residue of liability on the part of the transferor. (2) It is claimed that Section 6(a)(3) allows by implication the purchase from an affiliate 'of securities, other assets or obligations' where there is no repurchase agreement, and it is asserted that the terms 'securities' and 'obligations' as therein used are broad enough to cover the purchase of consumer credit paper, thereby in effect limiting the breadth of 'discount' as used in Section 6(a)(4). (3) It is urged that the coupling in Section 6(a)(4) of the word 'discount' with the words 'loans' and 'extensions of credit' denotes an intention to have them all understood in the same general sense, as covering only such transactions as involve the lending or advance of money to an affiliate for which the affiliate assumes responsibility for repayment."

The Examiner concluded that these arguments of Applicant were not sufficient to overcome the weight of the cases already mentioned (p.32,33) and the legislative history which will be discussed later). He stated:

"... I am not persuaded that to interpret 'discount' in Section 6(a)(4) as including a purchase of commercial paper by way of discount would inject a discordant note in the provisions of Section 6(a)(3) read as a whole. It seems to me too narrow a view to say that Section 6(a) was only designed to prevent a bank from relying on the worth or credit of an affiliated company in the conduct of its banking activities. I think the broader aim of Section 6(a), as revealed by all its subdivisions, was to remove the danger that a bank holding company might misuse the resources of a bank it controls to gain an advantage for itself or other subsidiaries it also controls. This a holding company might otherwise do by causing a controlled bank to provide equity or working capital, directly or indirectly, to the holding company or another subsidiary, or by otherwise financing the business operations of such an affiliate. To interpret 'discount' as used in Section 6(a)(4) in the full sense of that term as established by commercial usage is entirely consistent with that aim. For,
Obviously, a bank's resources might be used to finance the operations of a parent or other affiliated company just as much through purchase of commercial paper without recourse, as through purchase with recourse, or by means of a loan against the pledge of such paper. 32/

Further, I am not persuaded that a broad construction of 'discount' in Section 6(a)(4) would create perforce an inconsistency with Section 6(a)(3). Section 6(a)(3) was evidently designed to cover a transaction which is in reality a loan transaction, but which takes the form of a purchase and repurchase agreement. By its terms it spells out a prohibition against a specific type of transaction, and goes no further. It confers no affirmative right with which the 'discount' prohibition, no matter how broadly construed, may be found inconsistent. And even if Section 6(a)(3) may read as reserving by implication whatever rights a holding company bank might otherwise have under the law to make purchases without repurchase agreements, this does not preclude the 'discount' provision of Section 6(a)(4) from being construed as imposing a limitation or restriction on such rights. Indeed, such a construction is not only permissible, it is entirely reasonable. It would both give full meaning to 'discount' in its accepted usage and at the same time comport with the ends that Congress sought to achieve, as revealed by the legislative history. . . . Nor would it otherwise negate the implication said to be contained in Section 6(a)(3). This is so because bank discounts, as commonly understood, apply to financial transactions involving notes, bills of exchange and the like, and not to a bank's acquisition through purchase of other assets, securities or obligations, such as, for example, corporate stocks, bonds or debentures.

The Applicant's argument, that the coupling of the word 'discount' with the words 'loan' and 'extension of credit' denotes an intent to have 'discount' apply only to transactions that involve loans made by a bank to an affiliate, is even less persuasive. The words 'loan' and 'extension of credit' do not have synonymous meanings, . . . and it seems unlikely that Congress would have inserted the word 'discount', which, in ordinary usage has a broader meaning than 'loan', had it merely intended that word to cover the same ground and no more. . . ."

"32/ This is aptly illustrated in the case of Industrial Finance Co. of Wellston. Before passage of the Act, that company obtained working capital for its dealer finance activities by borrowing against such paper from the Bank of St. Louis. After such borrowing was outlawed by the Act, the company continued to obtain its working capital from the Bank of St. Louis, except that now it sold the paper instead of borrowing against it. The procedure was changed, but the net result remained the same, except for diminution in the protection to the Bank."
In challenging these views and conclusions of the Examiner, Applicant earnestly and ably re-emphasizes the arguments previously made before the Examiner and also stresses the fact that Federal banking laws sometimes draw a distinction between recourse and nonrecourse purchases of paper. For example, R.S. 5200 (12 U.S.C. 84), which limits the total loans that a national bank may make to one borrower, does not count paper purchased without recourse as part of loans made to the seller. Applicant argues that the absence of a claim against the seller of the paper tends to cause the purchaser to be more cautious in considering the merits of the paper, and thus provides an additional safeguard. Applicant argues that this not only explains the exemption of nonrecourse purchases from R.S. 5200, but also indicates a Congressional intent to exempt them from section 6.

However, for the reasons outlined below, the Board is forced to the conclusion that the Examiner's analysis is sound and well reasoned, and that Applicant's arguments fail to give due weight to certain facts that are evident from the record and basic to operations of banks and bank holding companies.

It is of fundamental importance that section 6 deals with a situation in which there is a lack of the usual arm’s-length dealing between a bank and its customer. It is the nature of a holding company system, and of the problems at which the Bank Holding Company Act was directed, that the various units of the group are ordinarily under common control or susceptible to such control. While such control sometimes may not be exercised or may not even exist, it is abundantly clear that sections 4 and 6 of the Act are based upon an assumption that it usually is, or can be, exercised. It clearly exists in the present case.

It is also important that, as a practical matter, a bank can be used to finance an affiliate as effectively through discounting (purchasing) paper, either with or without recourse, as through making ordinary loans. In fact, as will be seen later, it is actually easier to use -- or misuse -- the resources of a bank through nonrecourse discounts than through ordinary loans.

In view of these facts, it is difficult to see how it can be of any significance that transactions described in clauses (1), (2) and (3) of section 6(a), or a "loan" or "extension of credit" described in clause (4), would involve a claim against the credit or worth of the affiliate while a nonrecourse purchase of paper from the affiliate would not. If there is arm's-length dealing, the absence of a claim against the seller of the paper may have the effect, as Applicant contends, of causing the purchaser to be more cautious in considering the merits of the paper itself, and may thus provide a basis for exempting nonrecourse paper from some limitations that apply to recourse paper, as for example, the National Bank Act limitations...
(R.S: 5200) on loans to one borrower. However, a fundamental purpose of section 6(a) is to prevent abuses where arm's-length dealing is lacking. Hence arguments based on arm's-length situations would not seem to be helpful in construing it. The Board is convinced that all of section 6(a) should be viewed as relating to the financing of an affiliate, with the existence or nonexistence of a claim against the affiliate being essentially irrelevant; and the Board cannot accept Applicant's arguments based on context.

It is also to be noted that Applicant's arguments based on context rely heavily on the doctrines of implied exclusion (expressio unius est exclusio alterius) and meaning by association (noscitur a sociis). These doctrines can be of use in some circumstances in interpreting statutes or other writings. However, it is well recognized that they are subject to serious limitations, require great caution in their application, and are not applied where, as here, they would lead to conclusions in conflict with the purposes of the statute. See, for example, authorities gathered at 50 Am. Jur. 240-241, 243-244; 82 C.J.S. 668-670, 655-656.

The irrelevance of these doctrines to the present question is evident from the fact, as indicated above, that if the doctrines were applied here they would result in conclusions in conflict with the realities of holding company operations. Analysis of the reference to "purchase under re-purchase agreement" in section 6(a)(3) indicates that the term usually refers to a specialized transaction which is generally regarded as a form of loan; that the term probably was used in 6(a)(3) out of an abundance of caution to be certain that such transactions were covered; that the phrase is a composite term for which there is no convenient single word; that the word "purchase" in that phrase has significance only as part of that composite term; and that it would be unrealistic to lift the word out of the composite term and attempt to read into it any further significance through the doctrine of implied exclusion.

The Board is mindful of the facts stressed by Applicant, that violations of section 6 are misdemeanors; that criminal statutes are to be strictly construed in favor of the defendant; and that, therefore, their language cannot be enlarged to encompass prohibitions beyond its ordinary meaning. As indicated above, however, the usual meaning of the word "discount" appears to include nonrecourse purchases of paper. As the Supreme Court of the United States said in United States v. Brown, 333 U.S. 26:

"... The canon in favor of strict construction is not an inexorable command to override common sense and evident statutory purpose. It does not require magnified emphasis upon a single ambiguous word in order to give it a meaning contradictory to the fair import of the whole remaining language. As was said in United States v. Gaskin, 320 U.S. 527, 530, the canon 'does not require distortion or multiplication of the evident meaning and purpose of the legislation.' Nor does it demand that a statute be given the 'narrowest meaning'; it is satisfied if the words are given their fair meaning in accord with the manifest intent of the lawmakers."
It seems desirable to review the legislative history of section 6 and of the addition of the word "discount" in section 6(a)(4). It will be seen that this legislative history, like the considerations already discussed, strongly indicates that the word "discount" in section 6(a)(4) was intended by Congress to include nonrecourse purchases of paper.

The Examiner was impressed, and we believe properly so, by the fact that during the Committee hearings leading to the enactment of the Bank Holding Company Act, frequent reference was made to the Bankers Discount Corp. situation as a flagrant example of the danger of abuse flowing from self-dealings between bank holding companies and their subsidiary banks. That situation involved a Texas finance company that acquired control of two Chicago banks and then, among other things, caused the acquired banks to purchase from it at a discount and without recourse notes of questionable value that it held, resulting in a forced temporary closing of the Chicago banks.

The word "discount" did not appear in the self-dealing provisions of the drafts of the Bank Holding Company Act that were introduced in Congress before the Bankers Discount situation engaged the attention of Congress. Those earlier bills (for example S. 1118, and H.R. 12, 83rd Cong., 1st Sess.) merely referred to "loan or extension of credit". After the Bankers Discount disclosures the word "discount" was added, so that the phrase read "loan, discount or extension of credit", as in section 6(a)(4) of the final Act. (H.R. 2674, H.R. 6227, S. 880, S. 2577, 84th Cong., 1st Sess.)

In reporting out the bill in 1955, the House Banking and Currency Committee described the Bankers Discount situation at length and stated (H.R. Report No. 609, 84th Cong., 1st Sess., pp. 18-19) as a reason for including the self-dealing provisions that:

"... to fail to prohibit self-dealing between bank holding companies and their subsidiary banks would be to invite a repetition of the [Bankers Discount] situation . . . ."

The Report of the Senate Banking and Currency Committee did not specifically mention the Bankers Discount situation. However, the Senate Committee appeared to share the House's concern, as shown by the following passage from its Report (S. Report No. 1095, 84th Cong., 1st Sess., p. 4):

"... fear has been expressed that, improperly but within the present law, a bank holding company may take undue advantage of one or more banks in its system. This it might do by discounting commercial paper at the bank with resulting profit
the bank holding company but at an unwarranted risk to the bank or its shareholders. No widespread abuse of this nature has been brought to the attention of your committee, but the provision in the bill prohibiting upstream lending should adequately prevent the possibility of any such abuse."

(emphasis supplied)

This legislative history of section 6(a) and of the addition of the word "discount" shows, in the words of the Committee Reports, that the section was intended to "prohibit self-dealing between bank holding companies and their subsidiary banks", that it reflected a fear that "a bank holding company may take undue advantage of one or more banks in its system", and that it was intended to "prevent the possibility" that "by discounting commercial paper at the bank" the holding company may cause "unwarranted risk to the bank". In other words, the legislative history indicates that in section 6(a) Congress was interested only indirectly, if at all, in the question of whether or not a transaction results in a bank's receiving a claim against an affiliate, and that the direct and immediate Congressional purpose in enacting section 6(a) was to forbid transactions in which there is a substantial possibility of a bank's resources being misused by an affiliate.

Applicant points out that the Bankers Discount situation involved both direct loans to affiliates and nonrecourse purchases of paper from them. Applicant argues from this that the statements in the Committee Reports related to the prohibitions in section 6 against direct loans. However, it is clear that in the Bankers Discount situation nonrecourse purchases were by far the more important of the two abuses of the banks' resources. The House Committee Report on the Bank Holding Company Act, in discussing the Bankers Discount situation, indicated (supra, p. 18) that the finance company obtained from the two banks $135,000 in the form of loans -- "the amount of the banks' legal lending limit", compared with more than $3,000,000 obtained from them by selling them consumer paper without recourse.

It is not surprising that such an overwhelming proportion of the banks' financing of the parent finance company in that situation took the form of nonrecourse purchases of paper. As indicated above, a national bank is subject to a general limitation, with some exceptions, against lending more than 10 per cent of the bank's capital and surplus to one person. (R.S. 5200; 12 U.S.C. 84) Most State banks are subject to similar "legal lending limits", even though the percentages vary. These limitations substantially curb the ability of an affiliate to abuse the resources of a bank through direct loans -- as indicated above, the House Committee Report stated that $135,000 was the banks' "legal lending limit". However, since a nonrecourse sale of paper does not involve a debt from the seller to the bank, the statutes limiting the aggregate liability of one person to the bank are ineffective to prevent an affiliate from using --
and misusing -- a huge proportion of a bank's resources through such nonrecourse sales. (As previously indicated, if there is arm's-length dealing between bank and customer, the absence of a claim against the seller may act as a safeguard by forcing the bank to give greater attention to the safety of the paper itself; but in a holding company situation, lack of arm's-length dealing removes that safeguard.)

In the circumstances, it is clear that nonrecourse purchases were far more important than direct loans as a source of abuse in the Bankers Discount situation. It is reasonable to believe that Congress, in following up its expressed concern over the kinds of abuses possible in such situations, would most likely have been at least as much interested in preventing the major abuse as in preventing the relatively less serious ones.

In this connection it is to be noted that the provisions in the House and Senate bills relating to the present question were substantially identical.

As a practical matter, recourse and nonrecourse purchases of paper, which the Board concludes to be covered in section 6(a)(4), and purchase of various assets under repurchase agreement, which are covered by section 6(a)(3), are virtually the only forms of purchases in which there would be substantial opportunity for an affiliate to abuse the assets of a bank. Banks can and do make other purchases, but they are relatively infrequent (such as bank premises), or relatively small in amount (such as office supplies), or already subject to substantial safeguards against abuse (such as investment securities).

It seems significant that in actual practice, if nonrecourse purchases of paper are included in section 6(a)(4), then all major methods by which a holding company can misuse a subsidiary bank's resources are covered, and the expressed Congressional purpose to prevent such misuse would be substantially accomplished. On the other hand, an interpretation which would exclude nonrecourse purchases would leave open a large and important area of possible abuse, and would mean that in practical effect Congress had failed to carry out its stated purpose.

Applicant points out that the Chairman of the Federal Deposit Insurance Corporation stated before the Subcommittee of the Senate Banking and Currency Committee (Hearings before Subcommittee of Senate Banking and Currency Committee, 84th Cong., 1st Sess., on S. 880, S. 2350, and H.R. 6227, p. 100) that:

"... there is no restriction in either of the bills against the purchase or sale of assets among the units of a holding company..."
However, there is nothing to indicate that the Committee agreed with his view, and it appears, as explained above, that the Committee disagreed. He urged that restrictions on purchases by banks from their managements should apply to all banks and not merely those in holding company groups, and also that they should apply to downstream as well as upstream dealing. After his testimony, the Senate Banking and Currency Committee, in reporting out the bill, not only made the statement quoted above on pp. 11 and 12 that "...the provision in the bill prohibiting upstream lending should adequately prevent the possibility of any such abuse [of a bank by its holding company]," but also continued with the statement that:

"This provision, in part at least, is in accordance with the recommendations of Mr. H. Earl Cook, Chairman of the Federal Deposit Insurance Corporation who testified against permitting either upstream or downstream dealing."

Possible Interference with Usual Banking Operations

Applicant, and particularly the holding companies who filed amicus curiae briefs, stress the fact that if section 6(a)(4) is construed as applying to nonrecourse purchases of paper it will interfere with a large volume of transactions between banks in the same holding company system.

It certainly can be argued that such a prohibition, particularly as between banks, is unnecessary or undesirable as a matter of policy. When the Bank Holding Company Act was being considered by Congress, the Board of Governors of the Federal Reserve System recommended that all of the provision that became section 6 be omitted from the bill as "unnecessarily restrictive". (Hearings before Subcommittee of Senate Banking and Currency Committee, 84th Cong., 1st Sess., on S. 880, S. 2350, and H.R. 6227, p. 79) The Comptroller of the Currency expressed similar objections to the section. (Hearings, supra, p. 86) On the other hand, the Chairman of the Federal Deposit Insurance Corporation endorsed the "purpose of the provisions" (Hearings, supra, p. 100), stating that "we would urge that the provisions concerning restrictions on self-dealing be extended either in this or in other legislation to banks whether independently owned or part of a holding company."

Such considerations of policy relate more to the advisability or inadvisability of legislation than to its interpretation. Having weighed these considerations, Congress included section 6 in the Act; and even under the narrow interpretation of "discount" urged by Applicant, the section clearly imposes substantial prohibitions on the movement of funds within bank holding company groups. These prohibitions in section 6 are considerably more stringent than the limitations in section 23A of the Federal Reserve Act on dealings between member banks of the Federal Reserve System and their affiliates. (12 U.S.C. 373c)
For example, section 6 exempts non-interest-bearing deposits but expressly prohibits all direct loans between banks in the same holding company group, even though such loans are frequently made between banks. Such being the case, it would not seem reasonable to assume that Congress was unwilling to prevent other transactions which, as indicated before, are even more susceptible to the kinds of abuses that Congress, for reasons that it deemed sufficient, was seeking to prevent.

Applicant has directed the Board's attention to the statement in the House Committee Report (Report No. 609, 84th Cong., 1st Sess., p. 25) that:

"Routine banking transactions between subsidiary banks are not treated as extensions of credit and do not fall within the prohibitions of this section."

However, this statement cannot affect the present question, since it plainly refers only to the specific exemption in the last paragraph of section 6(a) (quoted above on p. 6) and could not be extended beyond that exemption without a direct conflict with several portions of section 6. In fact, the limited exemptions contained in this last paragraph of section 6(a) and in section 6(b) tend to emphasize the fact that other transactions are not exempt if they fall within the usual meaning of the other provisions of section 6(a).

It may be noted, however, that when one bank seeks participation by another bank to aid in meeting the credit needs of a borrower, there would seem to be no conflict with section 6 if the second bank joined at the outset in making its portion of the loan, since this would not involve the second bank in either a direct loan to the first bank or a purchase of paper from it. This would seem to permit at least a partial solution of the problems involved in participations.

C. Certain Other Considerations

Applicant offered certain other arguments that have not been discussed above. They were carefully considered, and although they do not alter the Board's conclusion in this matter some of them are outlined below, together with certain related considerations.

Applicant argues that the term "discount" could not include purchases unless they are "at a discount"; that this means it could not include purchases unless they are for less than the principal amount of the paper; that by simply making notes interest-bearing in form instead of noninterest-bearing (for example, a promise to pay $100 plus 6 percent interest at the end of a year, instead of a promise to pay $106 at
at end of a year), transactions could readily be arranged so that purchases would not be "at a discount"; that this would easily permit nonrecourse purchases to evade section 6 even if the term "discount" were held to include nonrecourse purchases; and that, therefore, the term should not be construed to include nonrecourse purchases.

The transactions in the present case are clearly "at a discount" and the Examiner's Report naturally noted the fact. However, Applicant's argument based on this fact, and on the Examiner's references to it, contains several defects. Without attempting to discuss all of them, it may be noted that Applicant's major premise -- namely, that the term "discount" is limited to purchases of paper at an amount less than the principal amount of the paper -- appears to be untenable. As indicated above on pp. 4-5, the judicial interpretations of the word "discount" show that the term is used very broadly. In practice the term "bank discount" is applied broadly to transactions by which a bank computes interest in advance so that there is the possibility of compound interest, and it seems that any purchase of paper is a "discount" in that sense since it permits such advance computation and compounding. Prentice-Hall Encyclopedic Dictionary of Business (1952) defines "Bank discount" (p. 79) as:

"The interest charge made by a bank for converting commercial paper into cash before maturity. Bank discount is computed as simple INTEREST on the amount due at maturity on a note or draft and is deducted in advance...."

After giving this definition, the article explains how bank discount is computed on noninterest-bearing paper and also how it is computed on interest-bearing paper, indicating that bank discount can apply to both.

It is to be understood, of course, that the purchases referred to here are purchases of paper -- promissory notes, bills of exchange and the like. As the Examiner indicated (p. 5) bank discounts as commonly understood do not apply "to a bank's acquisition through purchase of other assets, securities or obligations, such as, for example, corporate stocks, bonds or debentures."

Another argument made by Applicant is to the effect that Federal legislation since about 1900 has not used the term "discount" to include the nonrecourse purchase of negotiable paper and that this indicates the word was not intended to include such purchases in section 6. However, the contention does not appear to be sound. Even if the examples cited by Applicant were so extensive as to preclude the possibility of any different usage in Congressional legislation since 1900, which they do not appear to be, there is the further fact that the legislation Applicant quotes merely uses the word "purchase" or "sell" in addition to the word "discount" in some connections, and this was true even in the legislation considered in the Danforth case and other cases discussed above on pp. 4-5.
CONCLUSIONS

For the reasons discussed above, the Board concludes as follows:

(1) The Hearing Examiner having recommended denial of Applicant's requests numbered BHC 4-17 and BHC 19-27, and Applicant having filed exceptions and brief only to the recommended denial of requests numbered BHC-8 and BHC-12, Applicant is deemed to have waived objections, if any, to the Hearing Examiner's recommended denial of the remaining 21 requests.

(2) The transactions by which Bank of St. Louis purchases paper from Industrial Loan Company (BHC-8), and by which Baden Bank of St. Louis makes such purchases from Baden Loan Company (BHC-12), violate the prohibition in section 6(a)(4) of the Bank Holding Company Act against a bank's making any "loan, discount or extension of credit" to its parent or fellow subsidiary. In view of this conflict with section 6(a)(4), these loan companies cannot be considered to qualify for exemption under section 4(c)(6). This being dispositive of the question, the Board does not pass upon whether or not these companies could otherwise qualify for such exemption.

(3) The requests of General Contract Corporation numbered BHC 4-17 and BHC 19-27 for exemption under section 4(c)(6) from the prohibitions of section 4(a)(2) of the Bank Holding Company Act should be denied, and it is so ordered.

February 10, 1958.
DISSENTING STATEMENT OF GOVERNOR MILLS

Under section 4(c)(6) of the Bank Holding Company Act and section 5(b) of Federal Reserve Regulation Y, the Board of Governors may not make the determination requested by Applicant unless each company involved is "a proper incident" to the banking activities of the GCC holding company system. I agree, of course, that if the relationship of these companies to GCC's banking activities consists of transactions that are prohibited by the Holding Company Act, such companies cannot be "proper incidents" to the system. Accordingly, the crucial question is whether the transactions described in the majority Statement--purchases of personal loan paper by GCC banks from affiliated loan companies at a discount, without recourse against the seller--are within the coverage of section 6(a)(4) of the Act, which forbids a holding company

"to make any loan, discount or extension of credit to a bank holding company of which it is a subsidiary or to any other subsidiary of such bank holding company."

I am compelled to dissent from the Board's decision on applications BHC 8 and BHC 12 for the reason that, in my view, the term "discount", as used in section 6(a)(4) of the Bank Holding Company Act, relates to transactions in which the seller of obligations (notes, conditional sale contracts, and the like) assumes liability thereon--as ordinarily stated, "sells with recourse"--and does not cover transactions that do not give the purchaser of paper any such rights against the seller.

The majority Statement relies principally on certain judicial decisions that have interpreted "discount" in other connections, on the so-called "legislative history" of the Bank Holding Company Act, and on arguments that the interpretation they adopt will more effectively guard against the dangers of "self-dealing" within a bank holding company system.

If section 6 itself were neutral on this question, I agree that such considerations would be entitled to considerable weight. However, it is my understanding that the meaning of a statutory provision is to be drawn, if possible, from the language of the provision itself. If the statute, on its face, clearly supports one meaning and refutes its opposite, the latter may not properly be adopted simply because, in the opinion of an administrative agency, it might have been wise for the legislature to have so provided and because the legislative committee heard testimony that might have supported such a provision.
However, even if the factors relied upon by the majority were entitled to primary weight, I question whether those factors, as they apply to this case, strongly support their decision. I am not satisfied that the judicial interpretations of "discount" in other connections, referred to in the majority Statement, are particularly persuasive in this matter. In the first place, it is my understanding that "discount" has been interpreted more often than not as referring to purchase with recourse against the seller and excluding purchase without recourse. Furthermore, interpretations of a word in quite different contexts—in statutes dealing with different problems and aimed at different objectives—are entitled to relatively little weight.

Likewise, I am not satisfied that the history of the Act discloses a clear legislative intention to include purchases without recourse in the purview of section 6(a)(4). That problem, admittedly, was present in the Bankers Discount case, which was mentioned at a Committee hearing in 1953, but there is no affirmative evidence that any committee, or Congress itself, acted to prohibit purchases without recourse. On the contrary, as the majority Statement indicates, the Senate Banking Committee was specifically informed by H. Earl Cook, Chairman of the Federal Deposit Insurance Corporation, that the proposed law, with the word "discount" therein, would not prohibit such transactions. *

Provisions and purposes of section 6(a)

"discount" is usually interpreted to include purchases without recourse, (2) that the legislative history reveals a committee intent to cover such transactions, and (3) that such coverage would be advisable as a matter of policy, I should still feel compelled to interpret "discount" in section 6(a)(4) to exclude purchases without recourse, in view of the Congressional intent that is disclosed by the terms of section 6 itself.

(p. 7) The majority Statement meets this crucial issue by adopting the following statement from the Hearing Examiner's Report:

"...the broader aim of Section 6(a), as revealed by all its subdivisions, was to remove the danger that a bank holding company might misuse the resources of a bank it controls to gain an advantage for itself or other subsidiaries it also controls."

* It is significant that Mr. Cook, who pointed this out in his prepared Statement to the Committee, was the sole witness cited in this connection by both the Senate and House Committees. See House Report 609, 84th Cong., P. 18; Senate Report 1095, 84th Cong., Part 1, p. 4.
If it were true that "all...subdivisions" of section 6(a) did reveal
the alleged "broader aim", I agree that the Board would be justified
in interpreting "discount" to include the purchase of paper on a non-
recourse basis. However, if the provisions of section 6(a) do not
reveal such a Congressional aim, the Board may not interpret "discount"
in that manner simply because it considers that this would have been a
wise Congressional aim in enacting section 6(a). For the reasons
hereinafter set forth, it appears to me that Congress did not reveal
the alleged broad aim in section 6(a), but on the contrary revealed
affirmatively a narrower objective, regard for which requires that
"discount" be interpreted to exclude the purchase of paper on a non-
recourse basis.

Section 6(a)(3) forbids a holding company bank

"...to purchase securities, other assets or obligations
under repurchase agreement from a bank holding company of
which it is a subsidiary or any other subsidiary of such
bank holding company."

Obviously this provision has to do with situations in which a holding
company bank might purchase real property, tangible personal property,
bonds, debentures, other securities, or other obligations from other
corporations in the holding company system. In section 6(a)(3)
Congress has forbidden a holding company bank to make such purchases
from related corporations "under repurchase agreement" and by clear
implication has not forbidden such purchases where there is no
repurchase agreement—that is, where the bank simply pays a certain
amount for the asset, with no further claim upon the seller. I under-
stand that the majority of the Board does not dispute this.

But if Congress had intended, by section 6(a), "generally to
remove the danger that a bank holding company might misuse the resources
of a bank it controls to gain an advantage for itself or other
subsidaries" (as the majority contend), this "broader aim" could have
been effectuated very simply by a general prohibition against holding
company banks' purchasing assets from other corporations in the system.
If a holding company owned a building, or office machinery, or secur-
ities lacking a ready market, presumably it could "misuse the resources
of a bank it controls" by selling such assets to the bank at excessive
prices. However, despite this possible argument for a more restrictive
prohibition, Congress did not generally forbid a holding company bank
to purchase assets from its affiliates; it prohibited such purchases
only when they were made "under repurchase agreement".

It is particularly significant that this distinction was drawn
in section 6(a)(3) not by an omission that failed to cover the nonrecourse
area, but by the affirmative inclusion of specific words ("under repurchase agreement"). If Congress had merely failed to include words covering the area in question, it could now be argued plausibly that there was a legislative oversight that should not control the interpretation of a cognate provision—namely, section 6(a)(4). But Congress did not simply fail to deal with the nonrecourse area; it enacted specific words—which otherwise would have been entirely unnecessary—to make clear that purchases in which the seller assumed no continuing liability were not prohibited.

It appears to me that this unquestionable expression of Congressional intent in section 6(a)(3) must control the interpretation of "discount" in section 6(a)(4), unless we are prepared to take the position that Congress explicitly adopted one position in section 6(a)(3) and then in the next subparagraph tacitly adopted a conflicting and inconsistent position. In section 6(a)(3), Congress has deliberately drawn a distinction between recourse purchases and nonrecourse purchases—the former are prohibited; the latter are not prohibited. It seems unreasonable, and contrary to the principle of statutory construction that provisions of a law should be interpreted in a harmonious manner, to interpret "discount" in section 6(a)(4) as prohibiting nonrecourse purchases of a certain type, when Congress took pains to indicate in section 6(a)(3), with definite language directed at the point, that nonrecourse purchases of a comparable type are not prohibited.

Wording of section 6(a)(4)

The briefs submitted by the holding companies in this matter present several additional reasons, some of considerable force, for construing "discount" in section 6(a)(4) to exclude purchases of paper on a nonrecourse basis. I shall not attempt to marshal all of these arguments. However, I wish to mention particularly the circumstance that "discount" was placed between "loan" and "extension of credit". The majority statement disposes of this point by the following sentence (on page 8):

"The words 'loan' and 'extension of credit' do not have synonymous meanings, and it seems unlikely that Congress would have inserted the word 'discount', which, in ordinary usage has a broader meaning than 'loan', had it merely intended that word to cover the same ground and no more."

It is my understanding that, in the interpretation of statutes, the meaning of an ambiguous word may be clarified by the meaning of other words with which it is associated in series; if the word in question has several meanings, one of which accords with the meanings of the associated words, that meaning is preferred to an alternative meaning that markedly differs from the associated words. Applying this principle to the instant case, it is clear that "loan" and "extension of credit"
are words that import reliance upon the credit of, and obtaining a contractual claim against, the person to whom the loan or extension of credit is made. The use of "discount" in this context suggests that it was meant in a similar sense.

The above-quoted sentence seems to say that a broad interpretation of "discount" is called for because otherwise that word would "cover the same ground and no more" than does the adjacent word "loan". But I have two difficulties with this approach. In the first place, the Bank Holding Company Act is not a statute in which Congress carefully avoided the inclusion of any words that might be unnecessary. Some redundancy appears at various places in the Act; two examples may suffice. In section 2(a)(A) reference is made to "ownership or control of shares in a fiduciary capacity" and in section 3(a)(A) the reference is to "shares acquired by a bank...in good faith in a fiduciary capacity"; but in section 6(b)(3) the wording is "ownership or control of voting shares...by the bank as executor, administrator, trustee, receiver, agent, or depositary, or in any other fiduciary capacity". It is clear that Congress had in mind the same coverage in all three provisions but in one—perhaps unnecessarily—it enumerated the more important fiduciary activities.

Even more in point is the fact that in section 6(a)(4)--the provision directly involved in this matter--Congress referred to "any loan...or extension of credit". The term "extension of credit" is very broad and unquestionably covers every "loan" in addition to extensions of credit by other means. Therefore, since section 6(a)(4) is patently redundant in its inclusion of "loan" (and the majority does not attempt to give that word a special meaning to avoid the redundancy), there is no justification for specially shaping the interpretation of the next-following word ("discount") for the purpose of avoiding redundancy.

In addition, however, I do not concede that interpreting "discount" to exclude purchases without recourse would give that word the same meaning as "loan". The latter term usually means a direct advance to the maker of a promissory note (or other primary obligor). A transaction in which a bank purchases outstanding instruments from a finance company ordinarily would not be described as a "loan", so that—even if redundancy had to be avoided at all cost in our interpretation of the Act—it cannot correctly be said that "discount" adds nothing to "loan" unless the former is construed to cover purchases on a nonrecourse basis.

The approach of the preceding paragraph suggests what is to me the most reasonable explanation of the insertion of "discount" in section 6(a)(4). It is conceded by all that, before that word was inserted, all provisions of section 6(a) were directed at advances by
holding company banks that involved reliance on the credit or worth of an affiliated corporation. With the Bankers Discount incident in mind, the draftsman might well have inserted "discount", perhaps with excessive caution, in order to guard against the possibility that "loan" and "extension of credit" might be interpreted to mean only advances to a primary obligor and not to include situations in which a holding company bank extended credit to an affiliate by purchasing from it the paper of third persons supported by its endorsement or guarantee. In this connection, I think we should hesitate to conclude that, by the mere insertion of the word "discount" with no special comment whatsoever, Congress intended to change the basic theory of section 6(a) from a provision aimed at intra-holding-company-group borrowing (and similar transactions) to one which covered not only that field but also the field of purchases involving no reliance on the credit or worth of the affiliate from which the purchase was made. Here we encounter again the force of the argument that Congress made very clear in section 6(a)(3) that it intended not to cover outright purchases where the seller did not assume responsibility.

**Role of supervisory authorities**

As previously mentioned, the wisdom of Congressional action is not the concern of an agency in its administration and interpretation of Federal legislation. However, the decision of the majority in this case apparently rests in part on the idea that Congress would have been acting in an unreasonable manner if it had not intended section 6(a) of the Holding Company Act to prohibit outright purchases (that is non-recourse purchases).

In my opinion, Congress sensibly could have decided that purchases in that category did not call for outright prohibition. Such purchases are a matter for close scrutiny under sound principles of bank supervision and examination, and consequently Congress could have decided that the dangers of misuse were not so great as to justify an absolute prohibition of a widely-used and recognized banking practice. I do not believe Congress contemplated that the Holding Company Act would be interpreted as interfering with normal banking relationships and operations, except to the extent clearly required by its provisions.

Elsewhere in the Act Congress exempted various matters from specific coverage because they came within the scope of bank chartering, branch authorization, supervision and examination, and therefore did not need to be covered also by holding company legislation. For example, section 3 forbids a bank holding company (1) to acquire the assets of a bank outside of its own State, or (2) to do so within its own State without the approval of the Federal Reserve Board. A specific exemption is provided, however, with respect to such acquisitions by a bank subsidiary of a holding
company, for the reason that such absorptions generally are subject to control by the bank chartering and examining authorities, and Congress considered it unnecessary to impose additional prohibitions and requirements under the Holding Company Act. Likewise, despite the fact that section 4 generally prohibits holding companies from acquiring shares of nonbanking corporations, section 4(c)(3) permits such acquisitions from a subsidiary that "has been requested to dispose of such shares by any Federal or State authority having statutory power to examine such subsidiary"; here again Congress recognized the responsibility of bank supervisory authorities by providing a specific exemption to enable them more freely and effectively to exercise their authority with respect to the soundness of the commercial banking system.

In the same way, it appears to me entirely proper to infer from section 6(a) a legislative intent to prohibit actual extensions of credit between the units of a bank holding company system, but to continue to leave to the judgment and decision of the supervising and examining agencies the matter of outright purchases of personal-loan and other paper. When Congress dealt with the same subject in the Banking Act of 1933, it left this area of banking activity to the ordinary processes of bank supervision (see section 23A of the Federal Reserve Act), and there is no convincing evidence that Congress did not adhere to that philosophy in the Bank Holding Company Act of 1956.

* * * * *

In his Report the Hearing Examiner indicated (p. 35) that, except for his adverse conclusion on the crucial "discount" question, he would have found that the two loan companies involved in applications BHC 8 and BHC 12 were "so closely related to the business of banking or of managing or controlling banks as to be a proper incident thereto and as to make it unnecessary for the prohibitions of [section 4] to apply in order to carry out the purposes of" the Bank Holding Company Act.

I agree with the Hearing Examiner's views on this point and I do not regard the "discount" provision of section 6(a)(4) as a bar. Consequently I conclude that the Applicant is entitled to favorable determinations by this Board, pursuant to section 4(c)(6), with respect to the two enumerated applications.

February 10, 1958.
Mr. Joseph H. Colman,
President,
First Bank Stock Corporation,
First National-Soo Line Building,
Minneapolis 2, Minnesota.

Dear Mr. Colman:

In your letter of January 10, 1958, you suggested that study of your applications under section 4(c)(6) of the Bank Holding Company Act might assist the Board in its determination of similar applications by General Contract Corporation. You made a similar suggestion in a later meeting with Governor Robertson.

The Board has issued a statement and an Order in the General Contract Corporation matter, and a copy of each is enclosed for your information, together with a separate statement in the matter by Governor Mills.

In connection with the legal question in the General Contract Corporation matter as to the meaning of the word "discount" in section 6(a)(4) of the Bank Holding Company Act, the Board gave careful consideration to the facts set forth in your First Bancredit Corporation application, and also to your brief amicus curiae filed with the Board in the General Contract Corporation matter. Both these documents were helpful to the Board in its consideration of the General Contract Corporation matter, and the Board appreciates having the benefit of them.

Sincerely yours,

Wm. McC. Martin, Jr.

Enclosures