Minutes for July 21, 1959

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.

	A	B
Chm. Martin	x	
Gov. Szymczak	x	
Gov. Mills	x	
Gov. Robertson	x	
Gov. Balderston	x	
Gov. Shepardson	x	
Gov. King	x	

Minutes of the Board of Governors of the Federal Reserve System on Tuesday, July 21, 1959. The Board met in the Board Room at 9:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Balderston, Vice Chairman
Mr. Szymczak
Mr. Mills
Mr. Robertson
Mr. Shepardson
Mr. King

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Farrell, Director, Division of Bank Operations
Mr. Solomon, Assistant General Counsel
Mr. O'Connell, Assistant General Counsel
Mr. Nelson, Assistant Director, Division of Examinations
Mr. Benner, Assistant Director, Division of Examinations
Mr. Davis, Assistant Counsel
Miss Hart, Assistant Counsel
Mr. Thompson, Supervisory Review Examiner, Division of Examinations
Mr. McClintock, Review Examiner, Division of Examinations

Discount rates. The establishment without change by the Federal Reserve Bank of Kansas City on July 18, 1959, and by the Federal Reserve Bank of Atlanta on July 20, 1959, of the rates on discounts and advances in their existing schedules was approved unanimously, with the understanding that appropriate advice would be sent to those Banks.

Items circulated to the Board. The following items, which had been circulated to the members of the Board and copies of which are attached to these minutes under the respective item numbers indicated, were approved unanimously:

	Item No.
Letter to Parish Bank and Trust Company, Momence, Illinois, approving its request for permission to exercise fiduciary powers.	1
Letter to The First Citizens State Bank of Whitewater, Wisconsin, waiving the requirement of six months' notice prior to withdrawal from membership in the Federal Reserve System.	2
Letter to the Federal Deposit Insurance Corporation regarding continuation of deposit insurance following the proposed consolidation of The Mohawk State Bank, Mohawk, Indiana, and the Willow Branch State Bank, Willow Branch, Indiana.	3

Revision of examination report page (Item No. 4). There had been distributed to the members of the Board copies of a memorandum from the Division of Examinations dated July 17, 1959, submitting a proposed revision of page D(1) of the confidential section of the report of examination of State member banks. This page, which had not been changed since its adoption in August 1952, outlined the formulae for computation of deposit and risk asset ratios as an aid in determining the adequacy or inadequacy of capital of State member banks. As the result of discussion with representatives of the Office of the Comptroller of the Currency, agreement had been reached on the proposed revision of page D(1) and its counterpart found in the report of examination of national banks. Should the revised page D(1) be approved by the Board, it was contemplated that both agencies would continue to utilize identical pages, except for minor technical differences reflecting physical characteristics of the reports

of examination of State member and national banks, respectively. Submitted with the memorandum was a draft of letter to the Presidents of all Federal Reserve Banks which would transmit copies of the revised page and with which would be enclosed a memorandum of comments and suggestions for use in the preparation thereof.

Following explanatory comments by Mr. Benner, the proposed revision of page D(1) was approved unanimously. A copy of the letter sent to the Federal Reserve Banks pursuant to this action is attached as Item No. 4.

Messrs. Benner and McClintock then withdrew from the meeting.

Section 4(c)(6) cases (Items 5-8). In the light of hearing examiners' reports and recommended decisions as well as memoranda from the Legal Division, the Board on June 24, 1959, gave preliminary consideration to requests by Bank Shares, Inc., Otto Bremer Company, First Bank Stock Corporation, and Northwest Bancorporation for determinations under section 4(c)(6) of the Bank Holding Company Act with respect to certain nonbanking subsidiaries. There had now been distributed to the members of the Board, with a memorandum from Mr. Hackley dated July 17, 1959, drafts of statements and orders designed to carry out the Board's preliminary decisions in the respective cases. In substance, the drafts would (1) approve all of the requests relating to nonbanking organizations engaged in the insurance agency business, although, in the case of certain of the Otto

Bremer Company subsidiaries, subject to the condition that certain noninsurance activities be discontinued; (2) deny the request of First Bank Stock Corporation with respect to First Bancredit Corporation, with a special concurring opinion by Governor Mills (and such other Board members as might agree) placing denial solely on the basis of inconsistency with the purposes of the Bank Holding Company Act instead of on both that ground and violation of the "discount" provisions of section 6 of the Act; and (3) offer for the Board's consideration alternatives with respect to Northwestern Mortgage Company, a subsidiary of Northwest Bancorporation, one of which would deny the request and the other of which would approve it.

At the request of the Board, Mr. Hackley offered summary comments on the drafts of orders and statements that had been distributed. He added that the staff would like the privilege of making minor editorial changes in such of the orders and statements as might be approved by the Board and went on to say that, if agreeable to the Board, it would be intended to issue a press release on the cases this afternoon. Should it develop that the editorial revisions in the statements were not too extensive, the statements would be issued along with the press release and orders; if this could not be done, however, the statements would be released later. In accordance with the customary practice, the material released would include the reports and recommended decisions of the hearing examiners in the respective cases.

Discussion then turned to the request of Northwest Bancorporation for a determination with respect to Northwestern Mortgage Company, concerning which alternative drafts had been submitted to the Board.

Governor Mills said he had concluded that the operations of Northwestern Mortgage Company were of such nature that the retention of that company by Northwest Bancorporation would not be permissible under the provisions of the Bank Holding Company Act. Accordingly, he felt that the draft of statement denying the request of Northwest Bancorporation for a section 4(c)(6) determination with respect to Northwestern Mortgage Company should be approved.

Governor Robertson indicated that he considered the case a very close one. On balance, he favored denial of the request, on the ground that any other decision might lead to substantial difficulties. For example, if a holding company should make a request for retention of a trucking company, whose business was partially that of carrying cash for banks in the holding company system, the Board might feel obliged to determine the activities of the trucking company to be a proper incident to the business of banking if it approved the request with respect to Northwestern Mortgage Company. Also, Governor Robertson said, the operations of the mortgage company did not appear to him to be as nearly incidental to the business of banking as those of First Bancredit Corporation.

Governor Shepardson said that he also found this case difficult to decide. At first, his inclination was to vote for approval of the request, on the basis that the activities of the mortgage company appeared to him to be directly incidental to banking operations. What concerned him, however, was the percentage of the mortgage company's activities not related to the business of the holding company's banks and also the possible "monopolistic influence" involved in the type of services rendered by the mortgage company being available to the banks in the holding company system and not available to other banks.

The remaining members of the Board likewise stated that they favored denial of the request of Northwest Bancorporation with respect to Northwestern Mortgage Company. Accordingly, it was the unanimous decision that the request should be denied and that the alternative statement appropriate to that decision should be issued.

At the instance of Governor Mills, there followed clarifying comments by the staff regarding the proposed order and statement with respect to the requests of Otto Bremer Company, after which the Board approved unanimously the proposed orders with respect to the requests of Bank Shares, Inc., Otto Bremer Company, and First Bank Stock Corporation. In the case of Northwest Bancorporation, the requests for determinations with respect to South Side Insurance Agency, Inc. and Union Investment Company also were approved unanimously. It was

understood that in the First Bancredit Corporation case a concurring opinion would be issued by Governor Mills. In this connection, Governor Mills stated that he had advised the Legal Division of certain revisions that he desired to make in the draft of the concurring opinion.

It was also understood that a press release on the respective decisions would be issued this afternoon at an hour to be agreed upon after consultation by the Legal Division with Mr. Molony, Special Assistant to the Board.

Secretary's Note: The press statement and orders were released at 4:00 p.m. today, while the statements were released on July 31, 1959.

Attached under Item No. 5 are copies of the order and the statement with respect to the requests of Bank Shares, Inc.; attached under Item No. 6 are copies of the order and statement with respect to the requests of Otto Bremer Company; attached under Item No. 7 are copies of the order, the statement of the Board, and the concurring opinion of Governor Mills with respect to the requests of First Bank Stock Corporation; and attached under Item No. 8 are copies of the order and statement with respect to the requests of Northwest Bancorporation.

Insurance activities of St. Joseph Agency (Item No. 9). In July 1958, St. Joseph Bank and Trust Company and St. Joseph Agency, Inc., both of South Bend, Indiana, and both bank holding companies pursuant to the provisions of the Bank Holding Company Act, asked for interpretations

as to whether the casualty insurance business carried on by St. Joseph Agency could continue to be performed by the agency or, in the alternative, whether such activities could be transferred to and carried on by the bank.

Memoranda from the Legal Division dealing with these questions were distributed to the Board in November 1958 and in June 1959. However, consideration of the matter by the Board was deferred pending action on the section 4(c)(6) cases involving bank-related insurance agencies concerning which decisions were reached earlier at this meeting. In its memorandum of June 19, 1959, the Legal Division again concluded that (1) the insurance activities of St. Joseph Agency could not be regarded as "servicing" activities exempt under section 4(a)(2) of the Bank Holding Company Act, (2) such activities could not be exempted under section 4(c)(6), since that exemption applies only to shares of stock in a separately incorporated organization and not to a business directly engaged in by a bank holding company, and (3) such activities, if carried on by St. Joseph Bank and Trust Company, would not be prohibited by the Act because Indiana State law expressly authorizes banks to engage in such activities and they would not, therefore, cause the bank to engage in a business "other than banking".

Following explanatory comments by Mr. Hackley and discussion based thereon, unanimous agreement was expressed with the position taken by the Legal Division. Accordingly, approval was given to a letter to the Federal Reserve Bank of Chicago in the form attached as Item No. 9.

Messrs. Nelson, O'Connell, Davis, and Thompson then withdrew, as did Miss Hart, and Mr. Young, Assistant Counsel, entered the room.

Procedure for election of directors (Item No. 10). At the meeting of the Board on November 17, 1958, it was understood that the Legal Division would make a review of outstanding instructions relating to the procedure for election of Class A and Class B directors of Federal Reserve Banks. The fact that this study was being made was mentioned at the meeting of the Chairmen's Conference on December 5, 1958.

There had now been distributed to the members of the Board copies of a memorandum from the Legal Division dated July 17, 1959, which pointed out that in March 1927 a committee appointed at a conference between the Board and the Federal Reserve Agents submitted a report outlining the procedure for the nomination and election of Reserve Bank directors. The procedure outlined in that report, as modified and supplemented by a number of subsequent Board letters, had remained the basis for the procedure followed in the election of directors. Submitted with the memorandum was a draft of proposed instructions to the Reserve Banks which would (1) collect in one place all outstanding instructions and rulings regarding the election procedure, (2) simplify and clarify the existing instructions, and (3) incorporate a few changes in procedure that appeared to be desirable. It was

recommended that the draft of instructions be sent to the Chairmen and Presidents of the Federal Reserve Banks for comment prior to final adoption by the Board.

Following comments by Mr. Hackley, it was agreed unanimously to send the draft of instructions to the Chairmen and Presidents of the Federal Reserve Banks for comments, to be received not later than August 17, 1959. A copy of the letter sent to the Chairmen pursuant to this action is attached as Item No. 10.

The meeting then adjourned.

Secretary's Notes: Pursuant to recommendations contained in memoranda from appropriate individuals concerned, Governor Shepardson today approved on behalf of the Board increases in the basic annual salaries of the following persons on the Board's staff, effective July 26, 1959:

Phyllis H. Lockhart, from $3,590 to $3,755, with a change in title from Draftsman-Trainee to Draftsman, Division of Research and Statistics.

Harry W. Huning, Review Examiner, Division of Examinations, from $9,290 to $9,890.

John T. McClintock, Review Examiner, Division of Examinations, from $9,290 to $9,890.

On July 20, 1959, Governor Shepardson approved on behalf of the Board a letter to the Office of Alien Property, Department of Justice, requesting an extension of the detail to the Board of Harry R. Hinkes, Hearing Examiner. A copy of the letter is attached as Item No. 11.

Pursuant to the action taken at the meeting on July 14, 1959, regarding the collection of data on electric power sales, a letter in the form attached as Item No. 12 was sent to the Federal Reserve Banks on July 21, 1959.

Secretary

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

Item No. 1
7/21/59

July 21, 1959.

Board of Directors,
Parish Bank and Trust Company,
Momence, Illinois.

Gentlemen:

This refers to your request for permission, under applicable provisions of your condition of membership numbered 1, to exercise fiduciary powers.

Following consideration of the information submitted, the Board of Governors of the Federal Reserve System grants permission to Parish Bank and Trust Company to exercise the fiduciary powers now or hereafter authorized by its charter and the laws of the State of Illinois.

Very truly yours,

(Signed) Kenneth A. Kenyon

Kenneth A. Kenyon,
Assistant Secretary.

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

Item No. 2
7/21/59

July 21, 1959.

Board of Directors,
The First Citizens State Bank
of Whitewater, Wisconsin,
Whitewater, Wisconsin.

Gentlemen:

The Federal Reserve Bank of Chicago has forwarded to the Board of Governors your letter of July 2, 1959, and the accompanying copy of a resolution signifying your intention to withdraw from membership in the Federal Reserve System and requesting waiver of the six months' notice of such withdrawal.

In accordance with your request, the Board of Governors waives the requirement of six months' notice of withdrawal. Upon surrender, to the Federal Reserve Bank of Chicago, of the Federal Reserve Bank stock issued to your institution such stock will be cancelled and appropriate refund will be made thereon. Under the provisions of Section 10(c) of the Board's Regulation H, as amended effective September 1, 1952, your institution may accomplish termination of its membership at any time within eight months from the date the notice of intention to withdraw from membership was given.

It is requested that the certificate of membership be sent to the Federal Reserve Bank of Chicago.

Very truly yours,

(Signed) Kenneth A. Kenyon

Kenneth A. Kenyon,
Assistant Secretary.

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

Item No. 3
7/21/59

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

July 21, 1959.

The Honorable Jesse P. Wolcott,
Chairman,
Federal Deposit Insurance Corporation,
Washington 25, D. C.

Dear Mr. Wolcott:

Reference is made to your letter of July 2, 1959, concerning an application from The Mohawk State Bank, Mohawk, Indiana, a member bank of the Federal Reserve System, and the Willow Branch State Bank, Willow Branch, Indiana, a nonmember bank, to establish a branch at Mohawk, upon consolidation of the two banks with the result that the continuing bank will not be a member of the Federal Reserve System.

No corrective programs have been urged upon the member bank which, in the opinion of the Board of Governors, it would be desirable to incorporate as conditions to continuance of deposit insurance or the establishment of a branch.

Very truly yours,

(Signed) Kenneth A. Kenyon

Kenneth A. Kenyon,
Assistant Secretary.

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

S-1703
Item No. 4
7/21/59

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

July 29, 1959.

Dear Sir:

Enclosed are two copies of revised page D(1) which the Board has approved for use effective upon receipt, and a memorandum prepared by the Board's Division of Examinations, regarding suggestions for the preparation of the revised page. A supply of the new form sufficient to provide for examinations during the next several months is being forwarded to the Vice President in Charge of Examinations and additional copies may be obtained upon request.

The Comptroller of the Currency has adopted an identical revision which will be included in future reports of examination prepared by that office.

In accordance with current practices, banks with risk asset ratios in excess of $1 to $6 or with ratios of capital to deposits in excess of $1 to $25, as determined by the revised page D(1), are to be considered undercapitalized. However, in those instances where a bank has either a higher risk asset ratio or capital to deposits ratio than $1 to $6 or $1 to $25, but the institution is nevertheless believed to be adequately capitalized and merits the highest capital rating under the uniform rating system, such judgment should be indicated by the use of Roman Numeral I.

It will be noted that no provisions have been made on the revised page for the computation of a primary risk asset ratio. Until the present stock of Form F. R. 209, "Analysis of Report of Examination," has been exhausted, it is suggested that no figures be shown on that form for the "Primary computation" and that the single risk asset ratio, as determined by the revised page D(1), be shown as the "Secondary

computation." The "Adjusted Capital Structure" on Form 209 should continue to reflect the same amount as that used to compute the ratios on page D(1). In this connection, it will now be necessary to combine the unapplied valuation reserves on loans and securities and to extend the aggregate opposite the word "ADD" in the capital block.

Very truly yours,

Merritt Sherman,
Secretary.

Enclosures

TO THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS
(Page D(1) of Form F.R.410 with addressed copies only)

Suggestions for the Preparation of Revised Page D(1) of the Report of Examination Form F.R. 410 -- Enclosure with S-1703

In the interest of uniformity, the following comments and suggestions are offered with respect to certain details of the revised form:

ESTIMATED VALUE NON-LEDGER ASSETS

It will be noted that the several items pertaining to unallocated charge-offs and valuation reserves on loans and securities and previously included in the schedule have been omitted and that provision has been made for their inclusion in the computation of the deposit and risk asset ratios. "Net bond appreciation," if any, should agree with the amount shown in the appreciation column opposite the caption "Grand totals - all groups" on page 8(x). It is comtemplated that "Other" non-ledger assets would include, for example: excess of estimated realizable value of other real estate over book value; excess cash value of life insurance over book value; estimated collectible value of charged-off loans. All estimated values shown in the schedule are memorandum items only and are not to be included in the computation of deposit or risk asset ratios.

RATIOS OF CAPITAL TO RISK ASSETS AND DEPOSITS

Capital

In accordance with the definition of capital for purposes of page D(1), capital, as used in the computation of ratios, consists of the Adjusted Capital Account, as shown on page 3 of the report, plus unapplied valuation reserves on loans and securities.

Risk Asset Ratio

It will be noted that the formerly used primary computation has been omitted and that provisions have been made for only one risk asset ratio which must be computed and shown in all reports of examination. Contrary to previous practice, total Reserve for Bad Debts and unallocated charge-offs and valuation reserves on loans and securities are to be added to the total assets as shown on page 1 of the report. Concurrently, total estimated losses and 50 per cent of assets classified Doubtful are to be deducted from "Total Assets."

New Housing Authority bonds

Should include the total of such bonds issued under the provisions of the Housing Act of 1949.

Loans or portions of loans insured under Title I of the National Housing Act

The regulations of the Federal Housing Administration provide that loss claims on Title I loans which originated on or after October 1, 1954, are limited to 90 per cent of the loss of principal by the lender, but such claims in the aggregate are collectible only to the extent of the applicable insurance reserve. Therefore, a portion of Title I loans should be regarded as riskless assets, at least to the full extent of the applicable insurance reserve. In those instances where the bank's claims record is so favorable and the insurance reserve so substantial that there appears to be no possibility of loss on loans made on or subsequent to October 1, 1954, except on that portion of each such loan (10 per cent) for which the Federal Housing Administration assumes no liability, examiners may, in their discretion, include the equivalent of 90 per cent of all such loans as riskless assets for purposes of page D(1). Inasmuch as Title I loans made prior to October 1, 1954, are fully insured within the aggregate limitations of a bank's Title I insurance reserve, such loans may, in the discretion of the examiner, be considered riskless in their entirety in those cases as described above in which there appears to be no possibility of loss on such loans.

Loans or portions of loans guaranteed by the Small Business Administration

Include only those portions of loans, which, under agreement, the Small Business Administration pledges reimbursement upon request of the lending bank. Do not include the bank's portion of loans made with the Small Business Administration in which the Administration participated at the outset by disbursing its portion of the proceeds to the borrower.

The amount of outstanding loans guaranteed by the Reconstruction Finance Corporation has become relatively insignificant and for this reason no provisions are made for listing portions of loans so guaranteed. Until all such loans have been eliminated, the portions guaranteed by the Corporation should be included with those guaranteed by the Small Business Administration.

Loans or portions of loans secured by hypothecated deposits

Include (1) deposits accumulated for payment of personal loans which under contract between the bank and the borrower do not immediately reduce the unpaid balances of the loans, but are assigned or pledged to assure repayment of the loans at maturity, and (2) loans or portions of loans secured by assigned savings deposits for which the bank holds the savings passbooks or certificates of deposit.

Loans or portions of loans secured by dealers' reserves required by agreement

The amount shown should be the equivalent of the aggregate withheld from the proceeds of dealer paper, under agreement between the bank and dealer, which is held in dealer reserve accounts to provide for losses on such loans and is unavailable to the dealers until after the applicable loans have been repaid by the borrowers. That portion of dealers' reserves which is subject to immediate withdrawal should not be included as security to any loans or portions of loans.

Loans made under exceptions 10, 11, and 12 of Section 5200, Revised Statutes

It will be noted that two additional exceptions of Section 5200 have been included.

Income collected, not earned

Should represent the total of the same account as shown on page 1.

COMMENTS

In the computation of the risk asset ratio, it will be noted that there are no provisions for the deduction of riskless assets from total assets other than those listed. With the exception of loans or portions of loans guaranteed by the Reconstruction Finance Corporation, the deductions made in computing risk assets should be limited to those listed in the schedule. If the bank is considered to be undercapitalized, other highly liquid, minimum risk assets, if any, should be listed and described fully at the bottom of the page. It is contemplated that such assets would include, for example: brokers' call loans; loans secured by cash value of life insurance; "federal funds" sold; bankers' acceptances; Group 1 municipal obligations maturing in three years or less; short-term loans to municipalities in anticipation of the receipt of proceeds of an authorized bond issue.

UNITED STATES OF AMERICA

Item No. 5
7/21/59

BEFORE THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

WASHINGTON, D. C.

In the Matter of the Requests of	
BANK SHARES, INCORPORATED	DOCKET NOS.
	BHC-38
For Determinations under Section 4(c)(6)	BHC-39
of the Bank Holding Company Act of 1956	BHC-40
	BHC-41

ORDER

Bank Shares, Incorporated, Minneapolis, Minnesota, a bank holding company within the meaning of section 2(a) of the Bank Holding Company Act of 1956, has filed requests for determinations by the Board of Governors of the Federal Reserve System that the 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 U.S.C. § 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 section 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 corporations with respect to which the requests were filed, with the hearing docket number of each, are:

Chicago-Lake Agency, Incorporated	- BHC-38
Columbia Heights Agency, Incorporated	- BHC-39
Marquette Insurance Agency, Incorporated	- BHC-40
University National Agency, Incorporated	- BHC-41

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 the above requests be denied; Applicant having filed Exceptions and Brief with respect to each request; oral argument having been heard before the Board; the Board having given due consideration to all relevant aspects of the 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 ORDERED, for the reasons set forth in the Board's Statement of this date and on the basis of the record made at the hearing in this matter, that the activities of the four above-named corporations are 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 section 4 of the Bank Holding Company Act of 1956 to apply in order to carry out the purposes of that Act, and, therefore, Applicant's requests with respect to the said four corporations shall be, and hereby are, granted.

Dated at Washington, D. C., this 21st day of July, 1959.

By order of the Board of Governors.

Voting for this action: Chairman Martin, Vice Chairman Balderston and Governors Szymczak, Mills, Robertson, Shepardson and King.

(SEAL)

(signed) Merritt Sherman

Merritt Sherman,
Secretary.

UNITED STATES OF AMERICA

BEFORE THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

WASHINGTON, D. C.

In the Matter of the Requests of BANK SHARES, INCORPORATED for determinations under section 4(c)(6) of the Bank Holding Company Act of 1956	DOCKET NOS. BHC-38, 39, 40, and 41

STATEMENT

BACKGROUND OF THE CASE

On April 17, 1958, Bank Shares, Incorporated, Minneapolis, Minnesota, a bank holding company herein sometimes called "Applicant", filed with the Board of Governors requests for determinations that four of its nonbanking subsidiaries are of such a nature as to be exempt from the divestment requirements of the Bank Holding Company Act of 1956 (the "Act"), pursuant to section 4(c)(6) of the Act and section 5(b) of the Board's Regulation Y promulgated pursuant to the Act (12 CFR 222.5(b)). 1/

1/ 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

The subsidiaries involved consist of four insurance agencies:

Chicago-Lake Agency, Incorporated ("Chicago-Lake")
Columbia Heights Agency, Incorporated ("Columbia")
Marquette Insurance Agency, Incorporated ("Marquette")
University National Agency, Incorporated ("University")

The attached copy of the Hearing Examiner's Report and Recommended Decision describes the activities of Bank Shares, Incorporated, as well as of these subsidiaries.

As required by the statute, a formal hearing was held on all four of these requests on June 3, 4, and 5, 1958, pursuant to the regulations of the Board and the Administrative Procedure Act. The hearing in this matter was held after due notice before a duly selected and qualified hearing examiner at which opportunity was provided for presentation of evidence by the Applicant and others. Thereafter, Applicant submitted to the Hearing Examiner proposed findings of fact and conclusions of law.

1/ [cont'd.] prohibitions of this section to apply in order to carry out the purposes of this Act. . . . "

* * *

Section 5(b) of the Board's Regulation Y is as follows:

"(b) Shares of financial, fiduciary, or insurance companies. - Any bank holding company which is of the opinion that a company all the activities of which are of a financial, fiduciary, or insurance nature is so closely related to the business of banking or of managing or controlling banks, as conducted by such bank holding company or its banking subsidiaries, as to be a proper incident thereto and as to make it unnecessary for the prohibitions of section 4 of the Act to apply in order to carry out the purposes of the Act, may request the Board for such a determination pursuant to section 4(c)(6) of the Act. Any such request shall be filed in duplicate with the Federal Reserve Bank. After receipt of any such request, the Board will notify the bank holding company of the place and time fixed for a hearing on the requested determination; and, after the conclusion of such hearing and on the basis of the record made at the hearing, the Board will by order make or decline to make the requested determination."

The Hearing Examiner's Report and Recommended Decision was filed with the Board on December 19, 1958. The Hearing Examiner recommended that all four requests be denied. He concluded that, while the activities of the four subsidiaries are of an insurance nature, such activities are not 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(a)(2) of the Act to apply in order to carry out the purposes of the Act. Accordingly, he recommended denial of the Applicant's requests.

On March 10, 1959, Applicant filed with the Board exceptions and brief in support thereof to the Hearing Examiner's Report and Recommended Decision, and on May 11, 1959, counsel for Applicant presented before the Board an oral argument with respect to the pending requests and the Hearing Examiner's Report and Recommended Decision.

Since all of the organizations involved are insurance agencies, and since substantially the same considerations are applicable, they may conveniently be discussed together.

FACTUAL SUMMARY

Chicago-Lake, a Minnesota corporation, was organized in 1942. Its office is located at 823 East Lake Street, Minneapolis, Minnesota, on the premises of the Chicago-Lake State Bank. Prior to 1942 the bank operated an insurance business as a department of the bank; the insurance department was discontinued upon incorporation of the agency.

The activities of Chicago-Lake are confined to the writing of a general line of insurance, chiefly fire and extended coverage insurance, casualty insurance and credit life insurance.

Columbia, a Minnesota corporation organized in 1948, is located at 3982 Central Avenue, Columbia Heights (adjacent to Minneapolis), and on the banking floor of the Columbia Heights State Bank. In addition, Columbia owns real estate a substantial portion of which is used by Columbia Heights State Bank as part of its banking premises.

Columbia's insurance activities consist primarily of fire, extended coverage insurance, casualty insurance, credit life insurance, and accident and health insurance.

Marquette, a Minnesota corporation, was organized on October 9, 1923. Its office is on the banking floor of the Marquette National Bank at 7th Street and Marquette Avenue, Minneapolis, Minnesota.

Marquette's insurance activities consist principally of fire and extended coverage insurance, casualty insurance and credit life insurance.

University, a Minnesota corporation organized in 1942, maintains its office in the lobby of the University National Bank at 718 Washington Avenue, S. E., Minneapolis, Minnesota. The agency is engaged in writing insurance which consists primarily of fire and extended coverage, casualty insurance and credit life insurance.

In connection with their respective insurance activities, all of the four insurance agencies do a nominal amount of advertising.

DISCUSSION

Preliminary requirement as to nature of activities. - To qualify for exemption under section 4(c)(6) of the Act it is first necessary that all of the activities of a company be of a "financial, fiduciary, or insurance nature." Chicago-Lake, Marquette, and University clearly meet this preliminary requirement since all of their activities are of an insurance nature.

With respect to Columbia, that agency, as previously noted, owns real estate in addition to its primary activities which are clearly of an insurance nature. Since the connected bank's occupancy of the real estate owned by Columbia is substantial, the ownership of such real estate would be, in the Board's opinion, exempt under section 4(c)(1) if carried on by a company engaged solely in such activities. Therefore, for the reasons set forth in Part I of the Board's Statement of this date in the matter of the requests of First Bank Stock Corporation, the ownership by Columbia of the aforementioned real estate does not, in the Board's opinion, preclude exemption of its activities under section 4(c)(6).

Closeness of relationship. - Although meeting the statutory requirement as to the nature of their activities, the subsidiaries here involved must be found to be "so closely related" to the business of the Applicant's subsidiary banks as to be a proper incident thereto and as to make it unnecessary for the prohibitions of section 4 of the Act to apply in order to carry out the purposes of the Act.

Each of the insurance agencies operates on the banking floor of the related subsidiary bank. In two cases (Chicago-Lake and Columbia) all of the clerical work of the agency is performed by employees of the related bank. In the other two (Marquette and University) the agencies have a few full-time employees, but the related bank also provides clerical help. The operations of all four agencies are supervised by the manager of Marquette. While these facts do not necessarily establish a close integration with the banking functions of the banks, they suggest at least that the operations of the insurance agencies are intimately related to the operations of the respective banks.

The agencies do a general insurance business, dealing with the general public as well as the related banks. Nevertheless, the business of the agencies is primarily with customers of the related banks, that is, depositors, borrowers, box holders, trust department clients, and other persons having dealings with the banks.

In the aggregate, according to the Hearing Examiner, about 34.8 per cent of the net premiums of the four agencies are derived from insurance directly connected with bank transactions. The percentage of premiums of each agency related to transactions of its associated bank is indicated below:

Chicago-Lake	61.6%
Columbia	21.8%
Marquette	44.1%
University	16.1%

From the point of view of the subsidiary banks, it appears that, as of May 14, 1958, 25.8 per cent in dollar amount of their secured loans was covered by insurance obtained from the affiliated agencies. As to the individual banks, the percentages of <u>total</u> loans covered by insurance obtained from the respective agencies are as follows:

Chicago-Lake State Bank	14.5%
Columbia Heights State Bank	10.7%
Marquette National Bank	12.6%
University National Bank	22.1%

Since these percentages are based on <u>total</u> loans, the percentages of <u>loans covered by insurance</u> would be somewhat higher.

In connection with the percentages set forth above, it may be noted that Applicant asserts that the aggregate amount of the net premiums of the four agencies derived from insurance directly connected with transactions of related banks should be 37.3 per cent in lieu of 34.8 per cent; that the percentage of premiums for Marquette should be 49. per cent in lieu of 44.1 per cent; and that the percentage for Columbia should be 23.8 per cent in lieu of 21.8 per cent. (Exceptions to Certain Findings of Fact of Hearing Examiner, p. 1) For reasons hereafter indicated, these differences between the percentages used by the Hearing Examiner and those advanced by the Applicant are not significant in arriving at the decision herein reached.

The Hearing Examiner concluded in his Report (H. E. Rep., pp. 8-9) that the percentages listed above do not establish a substantial connection with bank transactions sufficient to warrant an exemption. Statements made by the Hearing Examiner seem to suggest that a substantial portion of an organization's activities must be directly connected with bank transactions in order to justify an exception and that anything less than a majority should not be considered "substantial". (H. E. Rep., pp. 4, 5, 8 & 9) It is the Board's view that section 4(c)(6) does not make it necessary as a prerequisite to an exemption that a majority of a company's activities be directly connected with bank transactions. At the same time, the Board believes that there must be some direct and significant connection between a company's activities and the business conducted by the related subsidiary banks in order to justify a conclusion that the requisite close relationship exists. What constitutes such a connection must, it is believed, depend upon all the facts of a particular case. Mere percentages alone should not be given controlling weight. They must be considered along with other pertinent factors suggesting a close relationship.

In the judgment of the Board the percentages (61.6 and 44.1) of the business of Chicago-Lake and Marquette directly connected with bank transactions are clearly substantial; and, as to Columbia and University, the comparable percentages, although lower (21.8 and 16.1), are sufficiently substantial to be entitled to weight along with other factors in determining whether the requisite close relationship exists. Similarly, the percentages of the loan transactions of the four subsidiary banks directly connected with insurance activities of the four agencies are relatively substantial and are entitled to some weight when considered along with the other factors bearing on the closeness of the relationship required by the statute.

The Applicant stresses not only the direct functional relation of the activities of the agencies but also their value to the related banks. Thus, the agencies review insurance policies for adequacy and compliance with requirements, see that they do not lapse, and provide interim coverage where necessary. The banks would need additional personnel if these services were not provided. (Brief in support of Findings of Fact and Conclusions of Law, p. 4) Moreover, it is asserted that most, although not all, banks in the area concerned provide such insurance services to customers and that the subsidiary banks would suffer competitively if they did not do so. (Brief, supra, p. 7)

The Hearing Examiner held that these qualitative aspects of the relationship could not be considered as substantially identifying the business of the agencies with that of the banks. (H. E. Rep., p. 8) In the Board's opinion, such qualitative factors, while not conclusive in themselves, may be given some cumulative weight along with all other factors in reaching an over-all judgment as to whether the necessary close relationship exists between the agencies and the banks.

Propriety of relationship. - In his Report the Hearing Examiner noted that, if the Federal statute (section 13 of the Federal Reserve Act) empowering national banks in places of less than 5,000 to act as insurance agents is regarded, as argued by the Applicant, as indicating general recognition that insurance is a proper incident to banking, this fact could imply that in places of over 5,000 - like Minneapolis - the insurance agency business is not a "proper" incident to banking. However, the Hearing Examiner did not pass on this question. (H. E. Rep., p. 7) For the reasons set forth in Part II of the Board's Statement of this date in the Matter of Requests by First Bank Stock Corporation, the Board believes that the national bank limitations should not be given decisive weight in the present case.

In the instant case, the Hearing Examiner apparently based his adverse recommendation primarily on a strict construction of certain statements by the Board in the Transamerica case regarding avoidance of "potential evils".2/ The Hearing Examiner interpreted the Board's statements in that case as meaning that potential evils are avoided only where an organization's activities are either:

2/ Transamerica Corporation, 43 Federal Reserve Bulletin 1014.

> "(1) . . . inherently so closely related to the business of banking or of managing or controlling banks as naturally to appertain thereto; or (2) so directly, appropriately and substantially related to bank transactions in the particular case as to be considered an aspect of the banking operation." (H. E. Rep., p. 6)

He concluded that the activities of the insurance agencies here involved are not "inherent" in the banking business; that they are not "substantially" related to banking transactions of the connected subsidiary banks; and that, therefore, they do not escape the so-called "potential evils" doctrine stated in the Transamerica case. He concluded also that "area practice" - the fact that about two-thirds of the banks in the area concerned have similar connections with insurance agencies - cannot be given weight "in the face of the supervening" Bank Holding Company Act. (H. E. Rep., p. 8)

The activities of an insurance agency may not, of course, be regarded as "inherent" in the banking business. It is not necessary, however, that the activities of a nonbanking organization have such an inherent relation to banking in order to warrant an exemption under section 4(c)(6). The law requires only a determination that they are "closely related" to the banking business in the manner there set forth. Similarly, the law does not expressly require a "substantial" connection between a company's activities and the business of banking. As previously indicated, however, the Board believes that a significant functional connection must exist in order to justify a finding of the requisite close relationship, and that in the present case the activities of the insurance agencies are "substantially" related to the business of the Applicant's subsidiary banks.

As explained in Part II of the Board's Statement of this date in the Matter of Requests by First Bank Stock Corporation, the statements in the Transamerica case referred to by the Hearing Examiner were intended to refer to those "potential evils" that may result from the existence of common control of banks and nonbanking organizations by bank holding companies, not to all evils that may arise from relationships between banks and other organizations. In the present case, the fact that non-holding company banks as well as holding company banks in the area involved have related insurance agencies indicates that, if there are any potential evils in such relationships, they are not evils peculiar to holding company groups.

While area practice alone may not be sufficient to justify finding that an organization's activities are such as to warrant an exemption under section 4(c)(6) of the Act, it may, in the Board's opinion, be given considerable weight as suggesting, not only that such activities are an "incident" to the banking business, but that they are a proper incident to such business, particularly where, as here, such relationships have apparently been known to the bank supervisory authorities and have not been objected to by them.

Giving such weight to area practice might, it is true, lead to exemption of a nonbanking subsidiary in one part of the country and to denial of exemption as to a similar organization in another part of the country. Such a result, however, would not seem contrary to the purposes of section 4(c)(6) or the Board's Regulation Y. The Regulation specifically refers to activities that are a "proper incident" to the business of banking as conducted by the subsidiary banks involved. This provision lends strong support to the right to consider the manner in which banks operate in a particular area, either because of local laws or because of banking practices carried on without objection by the bank supervisory authorities.

On the basis of the record in the present case, the Board concludes that the long-established practice by banks in the area - nonholding company as well as holding company banks - of maintaining connected insurance agencies, without objection by the bank supervisory authorities, may be considered as indicating that such connections are a "proper" incident to the banking business as conducted by the subsidiary banks involved.

CONCLUSIONS

In the light of all the circumstances and factors involved - particularly the substantial integration of their activities with the business of the subsidiary banks and the effect of area practice, it is the Board's view that the insurance activities of the four organizations here involved may properly be regarded as so closely related to the business of banking as conducted by the Applicant's subsidiary banks as to be a proper incident thereto and as not to be inconsistent with the purposes of the Act. To the extent that they are consistent with the foregoing statement, the Applicant's exceptions to the Hearing Examiner's Report and Recommended Decision are hereby sustained.

Accordingly, for the reasons stated above, it is the Board's judgment that the requests of Bank Shares, Incorporated, numbered BHC-38, 39, 40 and 41 for determinations under section 4(c)(6) of the Act should be approved; and it is so ordered.

As indicated in the Board's Order, its approval of these requests is based solely on the facts disclosed by the record; and if the facts should substantially change in the future in such manner as to make the reasons for the Board's conclusion no longer applicable, the statutory exemption resulting from the Board's present determinations would, of course, cease to obtain.

July 21, 1959.

UNITED STATES OF AMERICA

BEFORE THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Item No. 6
7/21/59

WASHINGTON, D. C.

In the Matter of the Requests of OTTO BREMER COMPANY for Determinations under Section 4(c)(6) of the Bank Holding Company Act of 1956	DOCKET NOS. BHC-29, BHC-31, BHC-32, BHC-33, BHC-35

ORDER

Otto Bremer Company, St. Paul, Minnesota, a bank holding company within the meaning of section 2(a) of the Bank Holding Company Act of 1956, has filed requests for determinations by the Board of Governors of the Federal Reserve System that the 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 U.S.C. § 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 section 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 corporations with respect to which the requests were filed with the hearing Docket Nos. of each are:

Citizens Agency, Inc.	BHC-29
Western State Agency, Inc.	BHC-31
New England Insurance Agency	BHC-32
Drovers Exchange Agency & Realty, Inc.	BHC-33
Willmar Investment Company	BHC-35

A hearing having been held pursuant to section 4(c)(6) of the Act 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 filed his Report and Recommended Decision wherein he recommended that Applicant's requests designated BHC Nos. 29, 31, 33 and 35 be approved, and that Applicant's request designated BHC No. 32 be denied unless Applicant, with the written consent of that subsidiary to which the request is related, gives proper assurance, as a condition of exemption, that the said subsidiary will cease to engage in the business of buying and selling real estate, and that, the foregoing assurance being given, such request be approved. Oral argument having been heard before the Board; the Board having given due consideration to all relevant aspects of the 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 ORDERED, for the reasons set forth in the Board's Statement of this date and on the basis of the record made at the hearing in this matter, that:

1. The activities of Western State Agency, Inc., with the exception of its lending activities, are 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 section 4 of the Bank Holding Company Act of 1956 to apply in order to carry out the purposes of that Act, and, therefore, Applicant's request with respect to Western State Agency, Inc. shall be, and hereby is, granted on the condition that Western State Agency, Inc. takes appropriate action to discontinue its lending activities within a reasonable period of time; and

2. The activities of Citizens Agency, Inc. are 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 section 4 of the Bank Holding Company Act of 1956 to apply in order to carry out the purposes of that Act, and, therefore, Applicant's request with respect to Citizens Agency, Inc. shall be, and hereby is, granted; and

3. The insurance activities of Willmar Investment Company are 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

section 4 of the Bank Holding Company Act of 1956 to apply in order to carry out the purposes of that Act; the remaining activities of Willmar Investment Company, with the exception of its real estate business activities, do not bar that Company from exemption under section 4(c)(6); and, therefore, Applicant's request with respect to Willmar Investment Company shall be, and hereby is, granted on the condition that within a reasonable period of time the real estate business activities of that Company be discontinued; and

4. The insurance activities of Drovers Exchange Agency & Realty, Inc. are 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 section 4 of the Bank Holding Company Act of 1956 to apply in order to carry out the purposes of that Act; the remaining activities of Drovers Exchange Agency & Realty, Inc. do not bar that Company from exemption under section 4(c)(6); and, therefore, Applicant's request with respect to Drovers Exchange Agency & Realty, Inc. shall be, and hereby is, granted; and

5. The activities of New England Insurance Agency, with the exception of its real estate business activities, are 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 section 4 of the

Bank Holding Company Act of 1956 to apply in order to carry out the purposes of that Act; and, therefore, Applicant's request with respect to New England Insurance Agency, shall be, and hereby is, granted on the condition that within a reasonable period of time, New England Insurance Agency ceases to engage in its real estate business activities.

Dated at Washington, D. C., this 21st day of July, 1959.

By order of the Board of Governors.

Voting for this action: Chairman Martin, Vice Chairman Balderston and Governors Szymczak, Mills, Robertson, Shepardson and King.

(Signed) Merritt Sherman

(SEAL)

Merritt Sherman,
Secretary.

UNITED STATES OF AMERICA

BEFORE THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

WASHINGTON, D. C.

In the Matter of the Requests of OTTO BREMER COMPANY for determinations under section 4(c)(6) of the Bank Holding Company Act of 1956	DOCKET NOS. BHC-29, 31, 32, 33, and 35

STATEMENT

BACKGROUND OF THE CASE

On June 17, 1957, Otto Bremer Company, herein the Applicant, a Minnesota corporation with its principal office and place of business in St. Paul, Minnesota, and a bank holding company as defined in section 2(a) of the Bank Holding Company Act of 1956 ("Act"), filed with the Board of Governors of the Federal Reserve System (the "Board") requests for determinations that the shares held by it in certain nonbanking subsidiaries are exempt under section 4(c)(6) of the Act from the prohibitions of section 4(a)(2) of the Act. The nonbanking subsidiaires involved are Western State Agency, Inc., Citizens Agency, Inc., Willmar Investment Company, Drovers Exchange Agency and Realty, Inc., and New England Insurance Agency.

On July 12, 1957, the Board ordered a consolidation of the aforesaid applications. Pursuant to order for and notice of hearing published in the Federal Register, a hearing on these applications was held in Minneapolis, Minnesota, on August 20 and 21, 1957, and on October 8 and 9, 1957, before a duly designated Hearing Examiner. On October 15, 1958, following the conclusion of this hearing, Applicant filed proposed findings of fact and conclusions of law, with a brief in support thereof. On November 25, 1959, the Hearing Examiner filed with the Board

his Report and Recommended Decision wherein, on the basis of findings of fact and conclusions of law set forth therein, he recommended that the requests of Applicant be granted as to four of its five nonbanking subsidiaries, but that Applicant's request as to New England Insurance Agency be denied. However, in reference to the New England Insurance Agency, the Hearing Examiner further recommended that if, prior to the expiration of the time for filing exceptions to his Report, the Applicant, with the written consent of New England Insurance Agency, should advise the Board that the Agency will discontinue its activities in buying and selling real estate, the Board should grant the Applicant's request for exemption as to that Agency.

By letter dated May 8, 1959, Applicant submitted to the Board a Memorandum Brief in Support of Hearing Examiner's Report and Recommended Decision and, on May 11, 1959, presented oral argument before the Board in support of the Recommended Decision of the Hearing Examiner.

The Board's findings and conclusions with respect to each of the nonbanking subsidiaries involved are set forth hereafter. Additional facts relating to the activities of such subsidiaries are contained in the Hearing Examiner's Report and Recommended Decision attached hereto; and to the extent not inconsistent with this statement, the findings of fact of the Hearing Examiner are hereby adopted.

I. WESTERN STATE AGENCY, INC.

Factual summary. - Western State Agency, Inc. ("Western Agency") is a Minnesota corporation, organized in 1956, and located in the premises of Western State Bank of Marshall, Minnesota, ("Western Bank"), a subsidiary of Applicant. The city of Marshall, with a population of approximately 7,000, has one other bank. In addition, there are approximately 15 other banks in the general area of Marshall.

Western Agency is engaged almost exclusively in the business of an insurance agency. With the exception of occasional loans made to customers of Western Bank resulting in interest income during the 19-month period preceding this hearing totaling $164, all of the Agency's income was derived from its insurance business.

Preliminary requirement as to nature of activities. - Since it appears from the record that Western Agency is engaged solely in insurance and lending activities, it is clear that it meets the initial requirement for exemption under section 4(c)(6) of the Act that all of the activities of a company must be of a "financial, fiduciary, or insurance nature".

Relationship of insurance activites to bank business. - Having met the preliminary requirement for exemption to which reference has just been made, Western Agency is entitled to exemption under the statute and section 5(b) of the Board's Regulation Y issued pursuant to the statute, only if its activities are so closely related to the business of banking or of managing or controlling banks, as conducted by the Applicant and its subsidiary banks, as to be a proper incident thereto and as to make it unnecessary for the prohibitions of section 4 of the Act to apply in order to carry out the purposes of the Act.

It appears from the record that prior to the incorporation of Western Agency, Western Bank itself conducted an insurance business through its President as licensed insurance agent. The present manner of conducting the insurance business is essentially identical with its operation prior to 1956, with the exception that net profits are now retained by the Agency for distribution to its shareholders (who are the same as Western Bank's shareholders), whereas formerly net profits were distributed directly to Western Bank.

The present offices of Western Agency are physically located in the premises of Western Bank. Western Bank's employees carry on the activities of Western Agency, all insurance policies being issued in the name of the Agency and countersigned by the president of Western Bank and Western Agency, the two offices being held by the same person. Applicant owns a majority of the outstanding shares of both Western Bank and Western Agency, the stock of both organizations being tied together by a shareholders' agreement precluding transfer of any shares of either Western Bank or Western Agency without simultaneous pro rata transfer of the stock of the other. Western Agency and Western Bank have common officers and directors. Western Bank is paid a fixed sum per year by Western Agency as compensation for administrative expenses connected with operation of the insurance agency, and the Agency's advertising is done in conjunction with that of the Bank, i.e., a joint ad, the cost of which is borne by the Bank.

In the six months preceding the hearing on this application, Western Agency derived about 93 per cent of its gross income from premiums on sale of hail insurance and of automobile, fire and casualty insurance, a majority of which was written for persons doing business with Western Bank, either as borrowers or depositors.

In the twelve months preceding July 1957, the date of notice of hearing, approximately 33 per cent of Western Agency's total premiums collected represented insurance written on collateral held by Western Bank; approximately 50 per cent of such total premiums represented insurance written for Western Bank borrowers on property not securing loans made by that Bank; approximately 16 per cent of such total premiums represented insurance written for nonborrowing customers of Western Bank; and approximately 2 per cent of such total premiums covered insurance written for persons not customers of Western Bank.

While the figures set forth above reflect that less than a major portion of the total premiums received by Western Agency represent insurance written on collateral securing loans made by Western Bank, that portion of the total insurance written which does represent insurance or collateral securing such loans by the Bank constitutes, in the Board's opinion, a substantial part of the Agency's total insurance writings. The significance of this connection is enhanced by the finding that in excess of 90 per cent of Western Agency's customers are also customers, in one form or another, of Western Bank. The fact of common customers, while not decisive, may be given weight as a cumulative factor where other circumstances indicate the existence of the statutorily required relationship. Similar cumulative weight may be given to the physical and personnel integration of the Agency with the Bank.

The presence of the requisite relationship is further supported by the fact that the relationship between Western Bank and the insurance agency conforms with long-settled area practice. As set forth in the Board's statement of this date in connection with First Bank Stock Corporation's application relating to First Service Agencies, Inc., the practice of operating insurance agencies in connection with banks has prevailed for many years in the area concerned, without evidence of objection on the part of the bank supervisory authorities.

In the State of Minnesota, it was shown that 87 per cent of all the banking offices have connected insurance agencies. In this case, the Hearing Examiner found this extensive area practice

to be decisively favorable to approval of Applicant's request. While the Board does not give conclusive weight to such area practice, it believes that it may be given strong weight as supporting a finding that the relationship shown is an "incident" to the banking business in that area. Thus, as to Western Agency, the Board finds that the existence of such area practice, when taken together with other facts found to exist and previously discussed, sufficiently supports a finding that the insurance activities of Western Agency are so closely related to the business of banking as conducted by Applicant's subsidiary bank as to be an "incident" thereto.

"Proper" incident. - As discussed at greater length in the Board's statement of this date relating to the application of First Bank Stock Corporation for exemption of First Services Agencies, Inc., the Board believes that section 4 of the Act was directed at those potential sources of evil found to be inherent only in bank holding company operations. If "potential evils" are found to exist that are prevalent among all banks, both holding company banks and non-holding company banks, then any such "potential evils" are not of the nature against which section 4 of the Act was directed. In this case, the practice of operating insurance agencies in connection with banks is sufficiently prevalent and accepted as to justify the conclusion that the particular relationship here involved is a "proper incident" to banking as conducted in the area concerned and is not inconsistent with the purposes of the Act.

Lending activities. - The single question remains as to whether the lending activities of Western Agency are such as to preclude the granting of an exemption to which Western Agency appears otherwise to be entitled. The record reflects that Western Agency on infrequent occasions has made loans for the purpose of accommodating Western Bank customers who, either because of loan limit restrictions or for other reasons, have not qualified for loans from that Bank. The Agency's interest income on such loans in the year and a half preceding the hearing on this application totaled $164. As to this activity, the Hearing Examiner concluded that it was "clearly related to the banking business conducted by its affiliate" and that "in any event this segment of the company's business is so small as to be considered de minimis". For these reasons, the Hearing Examiner concluded that the operations of Western Agency, "in their totality, satisfy the section 4(c)(6) requirements for exemption."

While the income from Western Agency's lending activities appears to be but a very minor portion of the Agency's total income, this fact alone cannot be the basis for a decision as to the nature of this activity and whether or not it is sufficiently closely related to the business of banking as to escape the divestiture requirement.

Moreover, the Board cannot agree, on the basis of the record, that the lending activities of Western Agency are clearly related to the banking business conducted by Western Bank. The record gives no evidence that the loans made had any direct connection with the Bank's business other than that they were made because the Bank did not make them. This does not constitute a transaction by or for the Bank. It differs in no respect, in the Board's view, from a loan that might be made by the Agency to a person having no connection or contact with the Agency's affiliated bank.

Apart from the fact that the loans made had no direct connection with the business of Western Bank, it should be noted that the record is void of any suggestion that the practice described is engaged in, to any extent, by other banks in the area. Clearly, the competitive advantage thus gained by Western Bank over other banks in the area might well be regarded as an evil intended to be precluded by the divestment provisions of the Bank Holding Company Act.

Conclusions. - On the basis of the facts established by the Applicant as to the substantial direct connection between the insurance activities of Western Agency and the business of banking as conducted by Western Bank, existence of common customers, other facts evidencing physical and personnel integration, and the showing that the operation of bank-connected insurance agencies is a prevalent practice in the area involved and has been sanctioned by bank supervisory authorities, the Board finds that such insurance activities of Western Agency are so closely related to the business of banking as conducted by Western Bank as to be a proper incident thereto and as to make unnecessary the application of the prohibition of section 4 in order to carry out the purposes of the Act. To the extent that the findings and conclusions and recommendations of the Hearing Examiner are consistent with the aforestated findings and conclusions, they are hereby adopted.

It is the judgment of the Board, for the reasons heretofore stated, that the lending activities of Western Agency are not sufficiently "closely related" to the business of banking as conducted by Western Bank so as to be qualified for exemption from divestiture, and further, that the nature of these activities precludes a finding that they are a "proper incident" to that business.

Accordingly, it is the Board's judgment that the requested exemption with respect to Western State Agency, Inc. should be granted on the condition that Western State Agency, Inc. take appropriate action to discontinue its lending activities within a reasonable period of time.

As indicated in the Board's Order, its approval of this request is based solely on the facts disclosed by the record; and if those facts should substantially change in the future in such manner as to make the reasons for the Board's conclusion no longer applicable, the statutory exemption resulting from the Board's present determination would, of course, cease to obtain.

II. CITIZENS AGENCY, INC.

Factual summary. - Citizens Agency, Inc. ("Citizens Agency") is a Minnesota corporation organized in 1955, and located in the premises of Citizens State Bank of Brainerd, Minnesota, ("Citizens Bank"), a subsidiary of Applicant. The city of Brainerd, with a population of approximately 14,000, has one other bank. It does not presently have a connected insurance agency. According to the testimony of record, except for that one bank, all the other banks in towns neighboring Brainerd operate insurance agency departments in one form or another.

Preliminary requirement as to nature of activities. - The activities of Citizens Agency are confined to the writing of various types of property and credit life insurance and fiduciary bonds. Accordingly, the preliminary requirement for exemption under section 4(c)(6) of the Act is satisfied.

Relationship of insurance activities to banking business. - As stated in connection with the Board's consideration of Applicant's request for exemption of Western Agency, the fact that an agency's activities are of a "financial, fiduciary, or insurance nature" is not alone sufficient to warrant exemption. In addition, it must be established, after a hearing, that the Agency's activities are so closely related to the business of banking or of managing banks, as to be a proper incident thereto and as to make it unnecessary for the prohibitions of section 4 of the Act to apply in order to carry out the purposes of the Act.

In essence, a similar degree of organizational, physical, and operational integration exists between Citizens Agency and Citizens Bank as was found to exist between Western State Agency, Inc. and Western State Bank of Marshall, hereinbefore described.

The facts supporting this finding as to Citizens Agency and Citizens Bank are set forth in detail in the Hearing Examiner's Report and are herein incorporated by reference.

Another factor, quantitative in nature, bearing on a determination of the closeness of relationship, is the proportion of the nonbanking organization's activities that are directly related to bank transactions and the extent to which the bank's business is dependent upon, or directly related to, the activities of the nonbanking organization. As to the proportion of Citizens Agency's total insurance activities that may be said to be directly or indirectly related to the business of Citizens Bank, the record reflects that in the 18-month period preceding the hearing on this application, Citizens Agency derived approximately 40 per cent of its total income from premiums on insurance written on collateral securing loans made by Citizens Bank.

In the same period, about 33 per cent of its total premiums represented insurance written for borrowers from Citizens Bank but not on property securing loans from that Bank. Approximately 16 per cent of the total premiums received in this period represented insurance written for nonborrowing customers of Citizens Bank and approximately 7 per cent thereof represented insurance written for noncustomers of that Bank. Five per cent of the Agency's total premiums received in this period represented insurance under which Citizens Bank was the named insured. Thus, approximately 45 per cent of the Agency's total premiums received from January 1956 to July 1957 represented insurance directly related to the business of banking as conducted by Citizens Bank.

The record does not contain a showing as to what proportion of the total insurance required by Citizens Bank on collateral securing loans made by it is or was written by Citizens Agency. Less significant in gauging the degree to which the business activities of each of these affiliates is related to the other, but nevertheless relevant, is the testimony of the President of Citizens Bank to the effect that he estimated that in excess of 75 per cent of the insurance customers of Citizens Agency were also customers of Citizens Bank. This estimate finds substantiation in the figures set forth in the Hearing Examiner's Report.

From the legislative history of section 4(c)(6) of the Act, it seems clear that Congress did not intend that the Board should make determinations under that provision on the basis of any set or all-inclusive standard or formula. Whether the activities of a particular nonbanking company are of such a nature and/or scope as to be considered sufficiently closely related to the business of banking as conducted by an affiliated bank, and thus exempt from the prohibitions of section 4, is a matter to be determined in the light of the facts surrounding each particular case, and in each instance must reflect consideration of multiple factors.

Thus, in the instant case, the fact that approximately 45 per cent of Citizens Agency's business is directly related to the banking transactions of Citizens Bank, while indicative of the requisite relationship, is not alone determinative. However, further evidence of satisfaction of this requirement is reflected in the finding of the manner in and extent to which organizational, physical, and operational integration exists between Citizens Bank and Citizens Agency.

The evidence of close relationship thus far established finds further support in the fact that in the period from January 3, 1956 to July 31, 1957, approximately 88 per cent of the total insurance writings of Citizens Agency were for customers of Citizens Bank, and that an additional 5 per cent of that total represented insurance written directly for that Bank.

The Hearing Examiner attached "no special significance" to the large proportion of Citizens Agency's insurance activities related to customers of Citizens Bank, other than to that proportion thereof directly related to insurance on property securing loans made by Citizens Bank. While no great significance should be attributed to the existence of common customers, the conclusion appears reasonable that a finding of a large number of common customers, when supported, as here, by other evidence indicating a close relationship, should be given appropriate cumulative weight.

The requisite close relationship is further evidenced in this case, as it was in the case of Western State Agency, Inc., supra, by the existence in the area involved, both in neighboring towns and in the State as a whole, of the practice among banks of offering to their banking customers various insurance services. Not only does such area practice

support a finding that the insurance activities of Citizens Agency are incidental to the business of Citizens Bank, but more, negatives the existence of the "potential sources of evil" at which section 4 of the Act appears to be directed.

Conclusion. - For the reasons heretofore given, the Board concurs in the conclusion reached by the Hearing Examiner that all of the activities of Citizens Agency are of an insurance nature and are so closely related to the business of banking, as conducted by Applicant's subsidiary bank, Citizens Bank, 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 Act.

III. WILLMAR INVESTMENT COMPANY

Factual summary. - Willmar Investment Company ("Willmar Co.") is a Minnesota corporation, organized in 1948, with its place of business at Willmar, Minnesota, a city with a population of about 12,000. Willmar Co. occupies rented offices on the same street as and about 200 feet from the Bank of Willmar, a subsidiary of Applicant. From 1948 until March 1957, Willmar Co. occupied an office at the Bank of Willmar.

The record reflects, and the Hearing Examiner found, that Willmar Co. is engaged principally in the writing of fire, general coverage, casualty, sickness, accident and life insurance. It also conducts noninsurance activities consisting of (1) the liquidation of assets acquired from the Bank of Willmar, (2) the holding of properties acquired for the future use of its related bank, and (3) the operation of a real estate agency.

The circumstances asserted to have given rise to Willmar Co.'s engagement in the above activities are set forth in the Hearing Examiner's Report. They are briefly hereafter summarized inasmuch as they appear to bear directly on the questions of the nature of those activities and their relation, if any, to the business of banking as conducted by Bank of Willmar.

During the course of a reorganization of the Bank of Willmar in 1933, certain bank assets were transferred to trustees for liquidation, the proceeds from which were to be paid to depositor-creditors who were

given certificates to evidence their interest in the trust property. A portion of these assets remained yet to be liquidated as of 1948. Willmar Co. was organized for the primary purpose of purchasing these assets from the trustees, the proceeds of the purchase to redeem the remaining certificates evidencing indebtedness. The funds used by Willmar to purchase these assets were supplied by subscription to Willmar Co. stock by stockholders of the Bank of Willmar and by a loan from that Bank to Willmar Co. At the same time, Bank of Willmar transferred to Willmar Co. an unincorporated insurance agency and real estate business formerly operated by the Bank. The transfer was allegedly made to provide Willmar Co. with a source of operating funds while in the course of liquidating the assets purchased from the trustees.

Insurance activities. - The record supports the finding of the Hearing Examiner that by far the greatest portion of Willmar Co.'s income results from its insurance agency activities. To this extent, Willmar Co. meets the preliminary requirement for exemption under section 4(c)(6) that all of a company's activities be of a "financial, fiduciary, or insurance nature".

Relative to the further requirement of that section that such activities be so closely related to the business of banking, as conducted by the Applicant and its subsidiary banks, so as to be a proper incident thereto and as to make unnecessary the application of the prohibitions of section 4 in order to carry out the purposes of the Act, the Board is of the opinion that the record supports a finding that such a relationship exists in this case. There are present in the case of Willmar Co. substantially identical facts with respect to physical and personnel relationship as have been found to exist in the cases of Western State Agency, Inc. and Citizens Agency, Inc. These facts are set forth in detail in the attached Hearing Examiner's Report and need not be recited here. In addition to this evidence of the existence of the required relationship, the record contains statistical evidence bearing on the volume and type of insurance written by Willmar Co. during a specified period.

From January 1, 1956 through August 31, 1957, 39 per cent of the total premium receipts of Willmar Co. represented insurance written on collateral securing loans made by Bank of Willmar. During the same period, approximately 29 per cent of such total premiums received represented insurance written for borrowers from Bank of Willmar but not on property then securing loans. About 31 per cent of the premiums received in the same period represented insurance written for customers of the Bank of Willmar other than borrowers, while approximately 1 per cent of such premiums were on insurance written for persons not customers of the connected bank.

While the Hearing Examiner accurately characterized as "a minor percentage" the portion of Willmar Co.'s total writings that represent insurance on collateral securing loans of its related bank, it should be noted that, as stated by the Board in its statement of this date regarding the application of First Bank Stock Corporation for exemption of First Service Agencies, Inc., the Bank Holding Company Act does not require that a majority or even a substantial part of the business of a company be directly connected with transactions of a related bank in order to qualify for exemption under section 4(c)(6). A determination by the Board as to whether a particular company is entitled to exemption must rest upon consideration of all facts and circumstances evidenced by the record of the hearing on the request. Thus, in the instant matter, in addition to the 39 per cent of its total premiums that represented insurance on property securing loans made by Bank of Willmar, an additional 59 per cent of the premiums represented insurance written for customers of Bank of Willmar, some of whom were former borrowers, others of whom were depositors and users of other bank services.

While a conclusion as to the existence or not of the requisite close relationship between the insurance activities of Willmar Co. and the business of banking as conducted by Bank of Willmar might not be justified by any one of the facts heretofore discussed, it is the judgment of the Board that these facts - the physical and personnel relationship, the significant portion of the insurance business directly and functionally related to the business of the Bank of Willmar, and the extent to which the remainder of the Agency's writings represents a service rendered to the Bank's customers - when taken together, sufficiently establish the requisite closeness of relationship.

Further, as in the case of the activities of Western State Agency, Inc. and Citizens Agency, Inc., the closeness of the relationship is confirmed by the existence in the area involved, on the part of most banks, of the practice of offering to their banking customers insurance services and advice as part of a well-rounded financial service. The fact that such a relationship between insurance agencies and banks has been sanctioned by the bank supervisory authorities and has become recognized as a legitimate competitive device, supports the Board's conclusion that the insurance activities under consideration are "closely related" to the business of banking. Such area practice also negatives existence of the "potential sources of evil" at which section 4 of the Act was apparently directed and supports the adoption of the Hearing Examiner's finding that the insurance activities of Willmar Co. are a proper incident to the banking business as conducted by the Bank of Willmar and are consistent with the purposes of the Act. The Board's statements on this subject as applied to Western State Agency, Inc. and Citizens Agency, Inc. are equally applicable here.

Other activities. - Willmar Co.'s noninsurance activities include liquidation of assets as hereinbefore described, the holding of properties for the future use of Bank of Willmar and for its own future use, and the operation of a real estate business. The statements of record concerning these activities make it clear that they are not of a "financial, fiduciary, or insurance nature" so as to fall within the exemption grant of section 4(c)(6). The question is then presented as to whether these other activities are such as to preclude exemption of Willmar Co. under section 4(c)(6).

Section 4(c)(1) of the Act exempts from the retention prohibitions of section 4, inter alia, shares of any subsidiary nonbanking company engaged solely in liquidating assets acquired from an affiliated holding company bank. Also exempt are shares of bank holding company subsidiaries that are "engaged solely in holding or operating properties used wholly or substantially by any [holding company] bank . . . or acquired for such future use."

Clearly, Willmar Co.'s activities in liquidating assets acquired from the Bank of Willmar and of acquiring and holding properties for the future use of that Bank are of a nature expressly exempt under section 4(c)(1). For reasons fully set forth in the Board's statement of this date in connection with the application of First Bank Stock Corporation with respect to First Bancredit Corporation, the Board is of the opinion that, by engaging in activities that are exempt under section 4(c)(1), a company is not disqualified from exemption consideration under section 4(c)(6). Thus, the Hearing Examiner's conclusion that neither Willmar Co.'s liquidation activities nor its activities in acquiring and holding properties for the future use of the Bank of Willmar barred it from exemption otherwise determined under section 4(c)(6), is hereby adopted.

Further, the Company's acquisition and retention of three other parcels of real estate similarly do not constitute a bar from exemption consideration. Two of these parcels of land were acquired for future use in connection with the business operations of the Bank of Willmar and thus are exempt under section 4(c)(1). The third parcel of real estate was acquired by Willmar Co. for its own use as a situs for the insurance agency's business and, as found by the Hearing Examiner, "must be viewed as an integrated part of the Company's insurance activities."

The real estate agency activities of Willmar Co. present a different problem. The record reflects that Willmar Co., from the date of its organization, has held itself out as being engaged in a general real estate agency business. Applicant asserts that this business is now being conducted for the primary purpose of providing a source of funds to help finance retirement payments made by the Company to a former employee-manager of the Company's insurance business who is now retired but continues to lend his services to Willmar Co. as a real estate agent. Under this arrangement, Willmar Co. allows this former employee to draw a monthly sum which the Company describes as a form of pension intended to supplement his Social Security benefits. Applicant states that the sum thus paid is not in any manner dependent upon the amount of commissions earned from the sale of real estate, all such commissions being paid to Willmar Co. The commissions earned have consistently exceeded the amount paid by the Company to the former employee, although Applicant asserts that such excesses of commissions over payments are in fact overstated when various business and administrative expenses are taken into consideration.

On the basis of these facts and others set forth in the Hearing Examiner's Report, Applicant asserts that the real estate agency operations must be regarded as an "insurance activity" since it is being conducted in order to provide a source of funds for the employee who formerly managed the Company's insurance business.

The Hearing Examiner concluded that the real estate activities of Willmar Co. could not be regarded as an "insurance activity". However, he concluded that this activity on the part of Willmar Co. was properly classifiable as "fiduciary" within the broad meaning of that term, thus satisfying the preliminary requirement of section 4(c)(6). As to whether this "fiduciary" activity was sufficiently "closely related" to the business of banking as conducted by the Bank of Willmar, the Hearing Examiner concluded that he did not read section 4(c)(6) as requiring, as a condition of exemption, that each particular activity of a particular company must satisfy the statutory requirement of close relationship. The requirement of "close relationship" should be "relaxed", he felt, "where special circumstances warrant a departure." It was his judgment that such special circumstances were here present in view of the insubstantial portion of Willmar Co.'s total income represented by the real estate agency business, the asserted temporary

nature of the business, together with the purpose for which it was being conducted, and the assurance given by Applicant that upon the death or full retirement of the former employee, the real estate business would be discontinued entirely. Thus, the Hearing Examiner concluded that the real estate activities were not of sufficient substantiality to make necessary the application of the prohibitions of section 4 in order to carry out the purposes of the Act.

As stated, the Board finds no relationship between the real estate activities of Willmar Co. and that Company's insurance activities or the banking operations of the Applicant's subsidiary banks. Further, despite Applicant's assertion of the de minimis character of the income produced by the real estate business and despite Applicant's assertion of eventual discontinuance of this business, it appears quite clear that at any time prior to cessation of the real estate activities, a major portion of Willmar Co.'s income could represent income from the sale of real estate. To the extent that this potentiality exists, there also exists the potentiality of evil found by Congress to be inherent in combinations of banking and nonbanking business, thus requiring divestiture. In the Board's judgment, Applicant has failed to establish any proper justification for the continuance of Willmar Co.'s real estate activities.

Conclusion. - For the reasons given, it is the judgment of the Board that, with the exception of the real estate sales and brokerage activities of Willmar Company, all of its activities are of such a nature as to qualify for exemption under section 4(c)(6) or as not to preclude such exemption; but that, for the reasons heretofore stated, the real estate sales and brokerage activities of Willmar Company do not satisfy the exemption requirements of section 4(c)(6) and that, if continued, they would make necessary the application of the prohibitions of section 4 to the Company as a whole in order to carry out the purposes of the Act. For this reason, exemption of Willmar Company, as requested, will be conditioned upon its disengagement, within a reasonable time, of all real estate sales and brokerage activities and cessation of such activities so long as Applicant is subject to the provisions of the Bank Holding Company Act or holds more than 5 per cent of the voting shares of Willmar Investment Company.

As indicated in the Board's Order, its approval of this request is based solely on the facts disclosed by the record; and if those facts should substantially change in the future in such manner as to make the reasons for the Board's conclusion no longer applicable, the statutory exemption resulting from the Board's present determination would, of course, cease to obtain.

IV. DROVERS EXCHANGE AGENCY AND REALTY, INC.

Factual summary. - Drovers Exchange Agency and Realty, Inc. ("Drovers Agency") is a Minnesota corporation, the offices of which are located in a section reserved for it in the lobby of Drovers Exchange State Bank ("Drovers Bank"), a subsidiary of Applicant, located in South St. Paul, Minnesota. That city has a population of approximately 20,000. Within the city there is one other bank on the premises of which there is also operated a bank-related agency.

The record reflects that Drovers Agency is engaged in the writing and selling of various types of insurance and indemnity bonds, and that it also engages in certain real estate activities as hereafter described.

As in the case of each of Applicant's nonbanking subsidiaries heretofore discussed, a substantial degree of organizational, physical, and operational integration has been established between Drovers Agency and Drovers Bank. Two distinguishing characteristics, of minor significance, relating to the ownership and operation of Drovers Agency, are the facts that all shares of the Agency's capital stock are held by trustees for the benefit of the stockholders of Drovers Bank and that the Agency has its own paid employees.

Insurance activities. - During the period from December 1, 1955, through July 31, 1957, Drovers Agency derived 14 per cent of its total income from premiums on insurance written on collateral held by Drovers Bank incident to loans made by it. In addition to this "directly related" business, approximately 37 per cent of the Agency's total premium receipts during the same period represented insurance written for borrowers from Drovers Bank, not covering property securing loans made by that Bank; approximately 31 per cent of its total premiums represented insurance written for customers of Drovers Bank other than the borrowers; and approximately 17 per cent of this total represented insurance written for noncustomers of that Bank.

While the percentage of Drovers Agency's business related to bank transactions is somewhat less than the comparable percentages with respect to other bank-related agency subsidiaries of Applicant, hereinbefore discussed, the former percentage cannot

be said to be insignificant. Further, and most significant, the 14 per cent of the Agency's premiums representing "directly related" insurance activities, simultaneously represented, according to the Hearing Examiner's finding, about 25 per cent of all insurance covering automobiles on which the Bank held a chattel mortgage, and about 10 per cent of all fire insurance written on other collateral held by the Bank.

The sum of the facts thus found - physical, personnel, and organizational connections between the two organizations, the large percentage of customers common to both Bank and Agency, and the portion of the Agency's total income that represents insurance "directly related" to the business of the bank, as well as the proportion of the insurance required by the Bank that is written by the Agency - warrants the Board's adoption of the Hearing Examiner's finding that the insurance activities of Drovers Agency are "closely related" to the business of Drovers Bank to a degree sufficient to justify exemption. The validity of this view is supported by the finding in the Hearing Examiner's Report that of approximately 26 banks located in the general area of St. Paul, South St. Paul and White Bear, Minnesota, 20 or more such banks have insurance agencies located on their premises, thus reflecting the prevalence of area practice in this regard previously found to exist.

The fact that the Board has found Drovers Agency's activities closely related to the business of its affiliated bank is not alone sufficient basis upon which to grant the Applicant's request for exemption as to that Agency. As in the Board's consideration of the activities of each of the Applicant's agencies here involved, it must be further established that the activities of the particular agency are "so closely related" as to be a "proper incident" to the business of banking as conducted by its affiliated bank and as to make it unnecessary for the prohibitions of section 4 to apply. This requirement is here satisfied as to the insurance business by the absence in this record of evidence indicating that the bank-agency relationship has been established for any other primary purpose than to immunize the bank from responsibility for agency conduct and to provide a broader scope of service to banking customers than could be provided by the bank itself. Moreover, the propriety of the relationship is strongly supported by the fact that area practice followed for many years sanctions such relationships between banks and insurance agencies. In this connection, the Minnesota Commissioner of Banking testified that his department preferred to have an insurance agency department separately incorporated so as to immunize its related bank from any liability resulting from the agency's operations.

For the above reasons, the Board finds that the insurance activities of Drovers Agency are so closely related to the business of banking, as conducted by Drovers Bank, as to be a proper incident thereto and as to make it unnecessary for the prohibitions of this section to apply in order to effectuate the purposes of this Act.

Other activities. - Testimony and financial data of record reveal that Drovers Agency's real estate and property dealings have been restricted to the acquisition of various properties from Drovers Bank or from customers of that Bank for the sole purpose of aiding Drovers Bank in liquidating those assets, their nature being such that the Bank itself could not retain them. The circumstances surrounding the Agency's dealings in real estate and other property, together with a description of the property involved, are set forth in the Hearing Examiner's Report. Suffice it to say that these details substantiate the finding that such dealings have been for the sole purpose of liquidation of those assets. In this light, what has been said previously relative to the noninsurance activities of Willmar Investment Company is equally applicable here. In brief, the Board concludes that sections 4(c)(1) and 4(c)(6) of the Act are to be read as mutually complementary. Thus, a company otherwise qualified for exemption consideration under section 4(c)(6) is not disqualified therefrom because it is also engaged in an added activity which, had it stood alone, would have entitled that company to exemption under section 4(c)(1).

The approval hereinafter given by the Board to Applicant's retention of its interest in Drovers Agency, will be given subject to the requirement that there be no substantial variance in the nature of the real estate transactions conducted by that Agency from that found to exist at the time of this hearing.

V. NEW ENGLAND INSURANCE AGENCY

Factual summary. - New England Insurance Agency ("New England Agency") is a North Dakota corporation organized in 1955, and located on the premises of the Citizens State Bank of New England, New England, North Dakota ("Citizens State Bank"), a subsidiary of Applicant. The town of New England has a population of approximately 1,200 and has no other banks. However, in southwestern North Dakota, the area in which Citizens State Bank and New England Agency are located, there are approximately 12 other banks, each of which, according to the testimony of record, has a related insurance agency operating on the bank premises.

Applicant owns a majority of the capital stock of New England Agency and Citizens State Bank. Both corporations have the same principal officers. In these respects, as well as other physical and operational arrangements, a similar degree of integration exists between the banking and nonbanking organizations here involved as was found to exist between Applicant's other banking and nonbanking subsidiaries hereinbefore discussed. The extent of this integration is reflected by the facts contained in the attached Hearing Examiner's Report.

Preliminary requirement as to nature of activities. - New England Agency is engaged primarily in the sale of insurance - fire, automobile, life, crop-hail, casualty and hospitalization - and indemnity bonds. According to the testimony, it also deals in the purchase of discounted conditional sales contracts and notes, and, on occasion, has made direct loans to individual borrowers. It has also engaged, to some extent, in the purchase and sale of real estate. The Hearing Examiner found that the insurance activities of New England Agency and its activities in buying conditional sales contracts and making loans are of a nature contemplated by the provisions of section 4(c)(6) of the Act, thus satisfying the preliminary requirement for exemption under that section; but that the Agency's real estate transactions are not of such a qualifying nature.

For the reasons hereinafter set forth, the Board agrees with this finding and accordingly so holds.

Relationship of insurance activities to bank business. - As in the cases of Applicant's other subsidiaries involved in these requests, the fact of a close relationship between the nonbanking organization and its related bank is suggested by the organizational, physical and personnel integration found to exist.

The existence of a close relationship is further confirmed by analysis of the insurance writings of New England Agency for the 19-month period from January 1, 1956 through July 31, 1957. During this period, the Agency received $145,500 in premiums on insurance written by it. In the same 19-month period, approximately 7 per cent of these premiums received represented insurance written on property securing loans made by Citizens State Bank; and approximately 85 per cent of the total premiums represented insurance covering property not securing bank loans but placed by persons who were borrowers from the Bank at one time or another. Normally, the former figure would be an indication that but a minor fraction of the Agency's insurance writings were directly related to the business of banking as conducted by its related bank.

However, not included as insurance written on bank collateral during the above-mentioned 19-month period, was that insurance written by the Agency insuring crops against hail damage. These writings represented premium receipts totaling $102,910. Under North Dakota law a bank may not take a mortgage on growing crops. However, as stated in the Report of the Hearing Examiner, the record shows that, in determining the creditworthiness of a farmer loan applicant, the bank considers, among other factors, whether or not the applicant's crop is protected by insurance against hail damage. North Dakota law allows hail insurance policies to carry a loss-payable clause running to the bank in an amount equal to the premium charges for the hail insurance. Thus, in reality, hail insurance is properly considered as insurance directly related to bank loans. So considered, the percentage of New England Agency's total premiums attributable to insurance written on collateral held by its related bank would be increased to a point where a great majority of its total insurance writings are directly related to loans made by its connected bank.

On the basis of the foregoing conclusion as to the high percentage of New England Agency's total premiums that, for all practical purposes, represent insurance written on property securing loans made by Citizens State Bank, in view of the extent to which the activities of the related organizations are integrated, and considering the area-wide practice found by the Hearing Examiner to exist as to other banks in having insurance agencies located in the bank premises, and, apparently, operated as departments of the banks, the Board finds that the insurance business, as conducted by New England Agency, is so closely related to the business of banking as conducted by Citizens State Bank 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.

Other activities. - Apart from its insurance activities, the Hearing Examiner found that New England Agency has engaged in the purchase of conditional sales contracts and other third-party paper and, on occasions, has made direct loans to individual borrowers. In addition, according to the testimony of its President, New England Agency regards itself as engaged in the business of buying and selling real estate. As to the activities other than the real estate transactions, the Hearing Examiner concluded that they were "clearly of a financial nature." The Board agrees and for this reason finds that they meet the preliminary exemption requirements of section 4(c)(6).

The Hearing Examiner found further that these "financial" transactions were related directly or indirectly to the business conducted by its affiliated bank. This finding was premised on the fact that the purchase of the conditional sales contracts and other paper was, for the most part, to accommodate the interests of Citizens State Bank, in that, the Bank was either precluded from directly purchasing the contracts or paper, or, for policy reasons, chose not to do so.

The Board concurs in the finding of the Hearing Examiner as to the nature of the activities above described and in the further finding that, on the basis of the testimony given concerning the circumstances surrounding these activities, they are sufficiently closely related to the business of the Agency's related Bank as to be a proper incident thereto. This finding is necessarily

premised on the nature and scope of the purchasing and lending activities as of this date. Any substantial increase or change therefrom rendering the reasons for the Board's conclusion no longer applicable would result in the inapplicability of the exemption granted.

As to the real estate dealings of New England Agency, the Hearing Examiner found that this activity "plainly does not meet the 'financial, fiduciary or insurance' preliminary requirement of section 4(c)(6), nor is it such as to be otherwise allowable under the statute." On review of the facts relating to the real estate operation of New England Agency as set forth in the Hearing Examiner's Report, the Board agrees that such operation fails in all respects to meet the requirements for exemption.

In view of this finding, the Hearing Examiner stated he was obliged to disqualify the Company's total activities from exemption consideration under section 4(c)(6) unless, prior to the expiration of the time for filing exceptions to his Report, the Applicant, with the written consent of the Agency, should advise the Board that "as a condition to exemption, it will not engage in the business of buying and selling real estate."

On December 2, 1958, Applicant submitted to the Board a written agreement providing that, in the event the Board shall grant Applicant's request for exemption of New England Insurance Agency from the prohibitions of section 4 of the Act, New England Agency will cease to engage in the business of buying and selling real estate and Applicant will so vote its shares in New England Agency as to prohibit that Agency from engaging in that business, so long as Applicant is subject to the provisions of the Act or is a stockholder in New England Insurance Agency.

Conclusion. - In view of the statement submitted by Applicant with reference to the discontinuance by New England Agency of its real estate business, and with the understanding that such business will be discontinued within a reasonable period of time, it is the judgment of the Board that the other activities of New England Agency are all of an insurance or financial nature and are so closely related to the business of banking as conducted by Citizens State Bank 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 Act, and that, therefore, Applicant's request for exemption of New England Agency should be approved.

As indicated in the Board's Order, its approval of this request is based solely on the facts disclosed by the record; and if those facts should substantially change in the future in such manner as to make the reasons for the Board's conclusion no longer applicable, the statutory exemption resulting from the Board's present determination would, of course, cease to obtain.

July 21, 1959.

Item No. 7
7/21/59

UNITED STATES OF AMERICA

BEFORE THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

WASHINGTON, D. C.

In the Matter of the Requests of FIRST BANK STOCK CORPORATION For Determinations under Section 4(c)(6) of the Bank Holding Company Act of 1956	DOCKET NOS. BHC-36 BHC-37

ORDER

First Bank Stock Corporation, having its principal office and place of business in Minneapolis, Minnesota, a bank holding company within the meaning of section 2(a) of the Bank Holding Company Act of 1956, has filed requests for determinations by the Board of Governors of the Federal Reserve System that First Bancredit Corporation and First Service Agencies, Inc., and their activities are of the kind described in section 4(c)(6) of the Bank Holding Company Act of 1956 (12 U.S.C. § 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 section 4 of the Act with respect to acquisition and retention of shares in nonbanking organizations to apply in order to carry out the purposes of the Act.

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 both of the above requests be denied; Applicant having filed Exceptions and Brief with respect thereto; oral argument having been heard before the Board; the Board having given due consideration to all relevant aspects of the 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 ORDERED, for the reasons set forth in the Board's Statement of this date and on the basis of the record made at the hearing in this matter, that:

1. The activities of First Bancredit Corporation are determined not 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 section 4 of the Bank Holding Company Act of 1956 to apply in order to carry out the purposes of that Act, and, therefore, Applicant's request with respect to First Bancredit Corporation shall be, and hereby is, denied; and

2. The activities of First Service Agencies, Inc., are 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 section 4 of the Bank Holding Company Act of 1956 to apply in order to carry out the purposes of that Act, and, therefore, Applicant's request with respect to First Service Agencies, Inc., shall be, and hereby is, granted.

Dated at Washington, D. C., this 21st day of July, 1959.

By order of the Board of Governors.

Voting for this action: Chairman Martin, Vice Chairman Balderston, and Governors Szymczak, Mills, Robertson, Shepardson, and King.

(Signed) Merritt Sherman

(SEAL)

Merritt Sherman,
Secretary.

UNITED STATES OF AMERICA

BEFORE THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

WASHINGTON, D. C.

In the Matter of the Requests of FIRST BANK STOCK CORPORATION For Determinations under Section 4(c)(6) of the Bank Holding Company Act of 1956	DOCKET NOS. BHC-36, 37

STATEMENT

BACKGROUND OF THE CASE

On December 5, 1957, First Bank Stock Corporation (hereafter sometimes called the "Applicant"), a Delaware corporation with its principal office and place of business in Minneapolis, Minnesota, and a bank holding company as defined in section 2(a) of the Bank Holding Company Act of 1956 (the "Act"), filed with the Board of Governors of the Federal Reserve System (the "Board") requests for determinations that two of its nonbanking subsidiaries are of such a nature as to be exempt under section 4(c)(6) of the Act from the prohibitions of section 4(a) of the Act. The nonbanking subsidiaries involved are First Bancredit Corporation ("Bancredit") and First Service Agencies, Inc. ("Agencies, Inc.")

Section 4(a) of the Act makes it unlawful, subject to certain exceptions, for a bank holding company (1) to acquire direct or indirect ownership or control of voting shares of any company that is not a bank, or (2) to retain direct or indirect ownership or control of voting shares of any such company after 2 years from the date of enactment (May 9, 1956) of the Act. Bancredit is a nonbanking company the stock of which was entirely owned by the Applicant on the date of the Act and is presently so owned. Pending determination of the present matter, the time allowed for divestment by the Applicant of its ownership of stock in Bancredit has been extended by the Board pursuant to

provisions of the Act allowing such extensions. Agencies, Inc. is a nonbanking company of which the Applicant has never owned and does not presently own any stock, but of which the Applicant proposes to acquire stock.

The Applicant's retention of stock of Bancredit and its proposed acquisition of stock of Agencies, Inc. escape the prohibitions of the Act only if they fall within one of the exceptions provided by the Act. Section 4(c)(6) of the Act excepts shares of a nonbanking company if two requirements are met: (1) if all the activities of the company are of a financial, fiduciary, or insurance nature, and (2) if the Board determines, on the basis of the record made at a hearing, that the activities of the company are 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 Act.[1] Section 5(b)

[1] The relevant language of the Act is as follows:

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

"(1) after the date of enactment of this Act acquire direct or indirect ownership or control of any voting shares of any company which is not a bank, or

"(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. . . ."

of the Board's Regulation Y, issued pursuant to the Act, paraphrases the provisions of the Act, but requires that the activities of a company must be closely related to the business of banking or of managing or controlling banks "as conducted by such bank holding company or its banking subsidiaries."

As required by the statute, the Board, on December 20, 1957, ordered that a hearing be held on the Applicant's requests; and such a hearing was held at Minneapolis, Minnesota, before a duly designated Hearing Examiner on January 14-22, 1958, and April 17-18, 1958. Following the conclusion of that hearing, the Applicant on May 26, 1958, submitted proposed findings with an accompanying brief. In his Report and Recommended Decision, filed with the Board on July 23, 1958, the Hearing Examiner recommended denial of both of the Applicant's requests. Subsequently, the Applicant filed with the Board exceptions to the Hearing Examiner's Report and Recommended Decision; and on May 11, 1959, the Applicant presented oral arguments before the Board.

The salient relevant facts with respect to Bancredit and Agencies, Inc., are set forth hereafter in this Statement. Additional facts with respect to their activities are contained in the Hearing Examiner's Report and Recommended Decision attached hereto; and, to the extent not inconsistent with this Statement, the findings of fact made by the Hearing Examiner are hereby adopted.

In determining whether or not the pending requests should be granted, the Board has considered solely the facts embraced in the record of the hearing held in this matter. In addition, however, the Board has considered arguments presented in the Applicant's proposed findings, the Hearing Examiner's Report and Recommended Decision, the Applicant's exceptions thereto, and the transcript of the record of the oral argument before the Board. The Board's findings and conclusions are hereafter set forth with respect to each of the companies involved.

I. FIRST BANCREDIT CORPORATION

Factual Summary

The Applicant's first request for a determination pursuant to section 4(c)(6) of the Act relates to First Bancredit Corporation (for convenience sometimes called "Bancredit"). Bancredit, a Delaware corporation that became a wholly owned subsidiary of FBSC in 1929, is principally engaged in the business of purchasing installment paper and reselling such paper to FBSC's affiliated banks.

Bancredit's principal office and place of business is located in the First National Bank Building, St. Paul, Minnesota. Bancredit maintains 10 branch offices in St. Paul, Chicago, Indianapolis, Dallas, Houston, Corpus Christie, Kansas City, Minneapolis, St. Louis and Tulsa. At one time Bancredit had as many as 20 offices in operation, and as recently as 1947 it had 17 offices.

About 80 per cent of the paper Bancredit has purchased has been repair and modernization paper insured under the provisions of Title I of the National Housing Act. The balance, at least in recent years, has consisted of appliance financing paper acquired from dealers through arrangements with public utility or other companies (known as "schedule" paper) and miscellaneous property improvement paper not insured under Title I of the National Housing Act. Dollar amounts for the year 1957 are set forth in the report (p. 5) of the Hearing Examiner, which is attached and made a part of this statement. Bancredit originates more Title I paper than any other single organization in the country.

Bancredit's methods of operation differ slightly as between the three different kinds of paper it handles, and are set forth in detail in the Hearing Examiner's report. Omitting certain details that do not alter the principles applicable to the case, the operation may be briefly outlined.

Bancredit handles all details in connection with the acquisition of the paper, including the investigation and approval of the credit of the obligors. The installment notes are drawn to the order of the dealer or contractor selling the appliance or making the home improvement, and are endorsed by him to the order of Bancredit. The dealer endorsements are, with minor exceptions, on a nonrecourse basis.

In purchasing the installment paper, Bancredit pays the dealer or contractor the cash price charged the customers for the appliance sold or the improvement made. This is less than the face amount of the installment note signed by the customer. In computing that face amount there is added on to the cash price the carrying or interest charges for the term of the loan.

Bancredit does not retain in its own portfolio any of the installment paper it acquires, but sells all of it shortly after acquisition to or for the account of FBSC affiliated banks. In fact, its acquisitions are geared to the investment needs of those banks. Bancredit sells all its paper directly to the affiliated First National Bank of St. Paul, which in turn sells participations or undivided interests in pools of acquired paper to other FBSC affiliated banks.

Sales made by Bancredit are on a nonrecourse basis and at a price equal to the cost of the paper to Bancredit (that is, the amount actually disbursed by Bancredit to the dealer or contractor from whom the paper was purchased). The price paid Bancredit is thus less than the face amount of the paper sold. As the Hearing Examiner stated (p. 9): "In other words, the paper is negotiated at a discount."

Bancredit continues to service all installment paper sold, and the affiliated banks have almost no work to do in connection with the paper. Their gross earnings on the paper thus represent the equivalent of a net yield. The Hearing Examiner's report describes the carefully worked out manner in which earnings on the paper are determined and distributed among the participating banks and Bancredit.

Bancredit paper has proved a desirable form of investment for FBSC banks in terms of both yield and safety. The yield has usually been at least 1 per cent above the gross rate on prime commercial loans, and has always been substantially higher than that on bonds, or other securities. The loss on all Bancredit paper has been only 1/55 of 1 per cent of cumulative total volume, and has been covered about five times over by the loss reserves.

In conjunction with its acquisitions of paper, Bancredit offers credit life insurance to obligors on the paper. The insurance is offered under group credit life insurance policies which Bancredit has with an insurance company. The obligors have the option to elect whether or not they will be covered by such insurance. In 1957 about 35 per cent of the items and 44 per cent of the face amount of the paper had this insurance coverage.

Bancredit's only other activity is to provide certain accounting, statistical and advisory services to affiliated banks. In conducting its business of purchasing, selling and servicing installment paper, Bancredit has acquired an extensive installation of IBM tabulating machines and has developed a staff trained in providing the services facilitated by the use of such equipment. Bancredit makes its equipment and trained personnel available to affiliated banks. More specifically, Bancredit handles the accounting for the installment loan departments and pension fund of the First National Bank of St. Paul and its St. Paul affiliates; supplies accounting services for the pension fund, school division and payrolls of such affiliated banks; acts as statistical consultant for all

affiliates where needed; and assists bank affiliates in the preparation of plans and contracts related to the installment loan field. All of these are services which the banks must either perform themselves or have performed by others in conducting their normal banking activities. For such services, Bancredit charges an amount substantially equal to its costs for the services rendered.

Preliminary Test

As indicated in Matter of Transamerica Corporation (September 1957, Federal Reserve Bulletin 1014, 1015), section 4(c)(6) of the Act exempts the ownership by a bank holding company of shares of a nonbanking company from the prohibitions of section 4 of the Act only if the following conditions are met:

(1) All of the company's activities must be of a financial, fiduciary, or insurance nature, and

(2) The company must be determined by the Board to be so closely related to the business of banking or of managing or controlling banks (a) as to be a proper incident thereto and (b) as to make it unnecessary for the prohibitions of section 4 of the Act to apply in order to carry out the purposes of the Act.

Bancredit's principal activities, which consist of the acquisition, sale and servicing of installment paper, clearly qualify as being of a financial nature. It is unnecessary to decide whether its credit life insurance activities should be considered to be "financial" on the one hand, or "insurance" on the other, since in either event they would meet the preliminary test of being "financial, fiduciary, or insurance". Bancredit's additional activity of rendering various accounting, statistical and advisory services to affiliated banks does not appear to be "financial, fiduciary, or insurance" in nature. However, the following analysis by the Hearing Examiner (pp. 17, 18) is adopted and approved on this point:

". . . If Bancredit were engaged solely in furnishing accounting, statistical and advisory services to FSBC affiliated banks, it would be exempted from the Act's divestiture requirements by virtue of Section 4(c)(1). 22/ To the extent that Bancredit's total activities spill over the 'financial, fiduciary or insurance' lines of Section 4(c)(6), the overflow is entirely contained within the borders of Section 4(c)(1). To hold in these circumstances that Bancredit

"22/ Section 4(c)(1) exempts nonbanking companies which are engaged, inter alia, 'solely in the business of furnishing services' for a parent bank holding company or its banking subsidiaries. For a general description of the type of services considered by Congress to be of a servicing character, see S. Rep. 1095, p. 12, 84th Cong.; S. Rep. 1095, part 2, p. 3, 84th Cong.

may not qualify for exemption consideration under Section 4(c)(6) because some of its activities are of a bank servicing rather than of a financial, fiduciary or insurance nature, would, in my view, both offend logic and be at odds with the legislative intent. Sections 4(c)(1) and 4(c)(6) are integrated parts of a single statutory scheme, and may not reasonably be read as if each were a separate enactment unrelated to the other. The two exemptions are in harmony, not in conflict. If full scope is to be given to both exemptions, each must be construed as supplementing the other so as to allow in an appropriate case for a combined application. I therefore find Bancredit preliminarily qualified under the first condition of Section 4(c)(6) for exemption consideration."

"Discount" Question

Examiner's views. - After thus finding that Bancredit met the preliminary test of section 4(c)(6), the Hearing Examiner concluded that Bancredit failed to meet the second test, and that it should not be granted exemption. He stated his reasons in part as follows (p. 18):

"The factual findings made above establish clearly enough that Bancredit's operations are not only substantially related to the business of banking, but are so closely integrated with FBSC banking activities as to be in effect an adjunct or incident thereto. But this alone is not sufficient to satisfy the second requirement of Section 4(c)(6), as outlined above. For, as the Board stated in the Transamerica case, supra, at pp. 1015-1016,

> 'The section requires that a nonbanking business, in order to be exempted under the provision, must be not merely an "incident", but a "proper incident" to banking or managing or controlling banks.'

It is in the respect just noted that Bancredit falls short of the statutory mark.

"The finding that Bancredit sustains a close relationship to FBSC banking operations is predicated mainly upon Bancredit's origination of various types of installment paper for resale to FBSC banking affiliates. In its business relations with FBSC affiliated banks, Bancredit acts as an independent contractor. It initially acquires the installment paper in its own name and then negotiates it with the FBSC affiliated First National Bank of St. Paul which acts for its own account and on behalf of other participating FBSC banking affiliates. The First National

Bank of St. Paul purchases the paper from Bancredit at a discount, and without recourse.

"The transactions which give rise to the present close relationship between Bancredit and FBSC banking affiliates are bottomed on a form of self-dealing the Act condemns. Section 6(a)(4) of the Act makes it unlawful for a bank

> '. . . 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.'

In the General Contract Corporation case, 23/ the Board construed the term 'discount' as used in Section 6(a)(4) to include within its compass transactions identical to those present here, involving the purchase without recourse of third-party paper by a banking subsidiary of a bank holding company from a nonbanking affiliate of the same holding company. In view of the statutory proscription against this form of self-dealing, it follows virtually as a matter of law, and it is found, that the relationship between Bancredit and the FBSC banking operations is not such as to constitute a 'proper incident' to the business of banking as conducted by FBSC and its banking subsidiaries.

"The General Contract case provides square authority for the finding just made. The Applicant does not dispute that the factual situation presented here is indistinguishable from that ruled upon by the Board in the cited case. It contends, however, that the Board was wrong in its statutory construction of the breadth of the term 'discount' as used in 6(a)(4). In effect, the Applicant asks for reconsideration and reversal of the Board's views on that subject as earlier declared. The arguments the Applicant advances to support its position, though perhaps more fully elaborated, are basically the same as those which were presented to the

"23/ Matter of General Contract Corporation, 44 Federal Reserve Bulletin 260, March 1958."

Board in the Applicant's and amicus curiae briefs filed in the General Contract case. It would serve no useful purpose to detail them here as they have already been noted and ruled upon by the Board in its carefully considered opinion in that case. 24/ I am persuaded that the Board's holding in the General Contract case rests on a solid foundation, but even if I thought otherwise, I would be obliged to follow the precedent there established. If the reasoning in that case is to be re-examined, it must be done at a higher level than mine.

"For the reasons stated, I shall recommend denial of the Applicant's exemption request relating to Bancredit."

"24/ The Board's opinion in that case as well as the relevant portions of the attached hearing examiner's report, to the extent approved by the Board, are here incorporated by reference. See, particularly, 44 Federal Reserve Bulletin 260, at pp. 262-269 and at pp. 282-285."

Exceptions and arguments of Applicant. - Applicant takes vigorous exception to a number of the findings and conclusions of the Examiner, particularly concerning the "discount" question, and to the failure of the Examiner to make certain findings and conclusions proposed by the Applicant.

An initial exception by the Applicant is to the Examiner's failure to accept Applicant's contention that all of the activities of Bancredit are exempt as "servicing" activities under section 4(c)(1) of the Act. In this connection, the Applicant refers to an opinion of the Board (April 1958, Federal Reserve Bulletin 431) concerning the solicitation of installment paper business by a nonbanking subsidiary (called "Corporation Y") of a holding company through offices located in several States. That opinion was to the effect that such activities constituted "servicing" activities exempted by section 4(c)(1). Applicant argues that the activities of Bancredit are in exactly the same category.

This contention by Applicant, however, is made in the face of another opinion of the Board which was published at the same time (April 1958, Federal Reserve Bulletin 431) and in which the Board expressly decided that the activities of Bancredit are not "servicing" activities under section 4(c)(1). Copies of both these interpretations, which were published concurrently by the Board, are attached. Although the published interpretation refers to Bancredit anonymously as "Corporation X", the opinion on which the published statement was based had previously been given directly to First Bank Stock Corporation with respect to Bancredit. The Board distinguished the Bancredit ("Corporation X") case from the other ("Corporation Y") case on the grounds

that in the latter, the activities of the offices of the nonbanking organization are confined to the soliciting and servicing of purchases and do not include the actual "purchasing" of the paper by such offices, whereas in the Bancredit case the branch offices themselves purchase the paper and resell it to subsidiary banks, an activity which involves essentially a financial relationship with the affiliated banks as distinguished from a mere "servicing" relationship.

Although the question was carefully considered at the time, it has been thoroughly re-examined in the light of Applicant's exceptions and arguments in the present case. The Board has again concluded that the distinction drawn is a sound one and that Bancredit is not exempt under section 4(c)(1) as a company engaged solely in furnishing "services" to affiliated banks.

Applicant has filed several exceptions with respect to the Hearing Examiner's conclusion that Bancredit's activities conflict with section 6(a)(4) of the Act. These contentions may be summarized substantially as follows:

1. That the facts in this case are different from those in the General Contract case.

2. That an interpretation published by the Board in the September 1958 Federal Reserve Bulletin, p. 1059, regarding acquisition of loan "participations" by subsidiary banks is applicable in the present case.

3. That in any event the Board's conclusion in the General Contract case that a nonrecourse purchase of paper is a discount was legally erroneous.

As to the first of these contentions Applicant argues that Bancredit sells paper to the affiliated banks at cost whereas the nonbanking subsidiaries in the General Contract case sold the paper to the banks at an amount greater than cost. It is believed that this is not a substantial distinction. In the General Contract case, the paper was sold to the banks at 1 per cent above cost, apparently for the purpose of compensating the nonbanking subsidiaries for their service; in the present case, although the paper is sold at cost, Bancredit is separately compensated by the affiliated banks for its services in connection with the paper. As stated in the General Contract case (March 1958, Federal Reserve Bulletin 260, 269):

". . . 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 a 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 . . . ."

Similarly, other alleged factual distinctions do not affect the question here at issue.

As to the second contention, the Board's September 1958 opinion considered four different factual situations involving participations by subsidiary banks in the making of loans and held that in all four instances the banks could be regarded as "joining at the outset" in the making of such loans and that, therefore, they did not involve a "purchase" or a "discount". The Applicant contends that in the present case there is a previous contractual arrangement under which the affiliated banks participate in the paper purchased by Bancredit. (Oral argument, p. 15) However, the Board's September 1958 opinion related only to transactions between banks in which the prior agreement for participation covered "a specific loan or line of credit and a specific borrower" and not "a mere block of unidentified paper". That opinion depended not only upon the specific commitments for specific loans but also upon non-interest-bearing deposits owing from one bank to another, which are expressly exempted by section 6. Both those aspects of the situations covered by the September 1958 opinion are missing in the present case. Their absence distinguishes the present case from those dealt with in the earlier opinion.

Finally, as to the basic validity of the Board's previous position on the "discount" question, Applicant urges that the Board give "de novo" consideration to this question solely on the basis of the record made in the present case. Applicant submitted a comprehensive brief amicus curiae in the General Contract case and the arguments it offers now are substantially those urged upon the Board in that case. Briefly, the principal arguments are as follows:

1. That the word "discount" has several meanings and, in construing this word in a penal statute, the Board should not adopt the meaning that it did in the General Contract case; and that the Board should instead give the word either its "narrowest" meaning as covering a two-party-paper discount transaction where interest is deducted from the face of the note, or at least its meaning as covering a purchase of paper with recourse.

2. That the language of the statute does not support the Board's view in the General Contract case that the "broader aim" of section 6(a) was to prevent a holding company from misusing the resources of a subsidiary, and that when section 6(a)(3) prohibits purchases of securities and assets only "under repurchase agreement" it shows an intention to permit other purchases.

3. That the word "discount" in section 6(a)(4) is used in conjunction with "loan" and "extension of credit" and, by such association, should be read as referring only to transactions in which reliance is placed on the credit or worth of the holding company or a fellow subsidiary--in other words, a "borrowing" as indicated by the heading of section 6.

4. That the Danforth case cited by the Board in the General Contract case was an 1891 decision under a different type of statute; and that other courts have held that "discount" does not include purchases without recourse.

5. That nonrecourse purchases and sales of paper are extremely common between banks and that section 6(a)(4) could not have been intended to interfere with such an established banking practice. Applicant places particular stress on this point.

Notwithstanding the careful consideration that was given to the "discount" question in the General Contract case, the question has been thoroughly reconsidered in the light of the arguments of Applicant in the present case. Each phase of Applicant's argument as well as all other relevant aspects of the question have been carefully weighed and re-examined.

As a result of that careful reconsideration and re-examination the Board has again reached the conclusion that the term "discount" as used in section 6(a)(4) includes nonrecourse purchases of paper. The reasons for the Board's conclusion are substantially as set forth in the portions of the Board's statement in the General Contract case at Federal Reserve Bulletin of March 1958, pp. 262-269, which are attached hereto and made a part of this statement. The conclusion follows from a careful analysis of applicable judicial utterances on the subject, from the context in which the term "discount" is used, and from the legislative history of the provision. Each of those three considerations separately, and all three together, lead to the same conclusion. As the Board stated in the General Contract case, supra, p. 266:

"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. 18, 25-26:

> "'. . . 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 nullification 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.'"

Applicant points out that after the Board's decision in the General Contract case, the Board, as required by section 5(d) of the Bank Holding Company Act, recommended to the Congress changes in the law which in the opinion of the Board would be desirable, and that, among others, the Board recommended that nonrecourse purchases of paper between banks be exempted from the prohibitions of section 6 of the Act. However, these views of the Board as to the desirability of such a change in the law do not alter the meaning of the law as it now stands. As pointed out in the Board's statement in the General Contract case (p. 268):

> "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 provisions that became Section 6 be omitted from the bill as 'unnecessarily restrictive'. . . .
>
> "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. . . ."

For the reasons outlined above and more fully explained in the attached excerpt from the Board's Statement in the General Contract case, the Board feels constrained to agree with the Examiner's conclusion that the term "discount" in section 6(a)(4) of the Bank Holding Company Act includes nonrecourse purchases of paper and that, accordingly, Bancredit cannot qualify for exemption under section 4(c)(6) of the Act.

Other Aspects of "Proper Incident" and "Purposes of the Act"

Examiner's Views. - After setting forth his conclusion that Bancredit should be denied exemption because its activities conflict with section 6(a)(4) of the Act, the Hearing Examiner stated that, in addition to the discount question under that section, there is a further question as to whether Bancredit's relationship to the banking business conducted by FBSC could otherwise meet the "proper incident" and "purposes of the Act" requirements of section 4(c)(6). On this point the Hearing Examiner stated (p.20) in part:

> "As more fully appears from the factual findings made above, the installment paper that Bancredit originates and funnels into FBSC banks is acquired by it mainly through branch offices it maintains in various metropolitan centers located outside the Ninth Federal Reserve District where all FBSC banking subsidiaries are situated. At present, Bancredit has 10 branch offices, all but two of which are located outside that district. At each of the cities where Bancredit maintains branches, it competes with independent banks for the acquisition of installment paper. At one time Bancredit had as many as 20 branch offices simultaneously in operation. If the exemption application for Bancredit is allowed, there is no assurance that Bancredit will not in the future again expand its operations to reach into additional areas in which FBSC affiliated banks are not themselves permitted to maintain branch offices; certainly, there is nothing in the law that would prevent this.
>
> "The circumstances mentioned above may raise a serious question as to whether FBSC's retention of Bancredit would accord with the purposes of the Act. The statute was pointed, inter alia, at preventing unfair competition and minimizing the danger of undue concentration of banking activities thought to be inherent in

uncontrolled expansions of bank holding company systems.[25] It was also incidentally aimed at curbing the use of the holding company device as a means of evading restrictions imposed on banks by Federal and State laws.[26] Congress implemented the aforesaid purposes in part by restricting bank holding companies from expanding their banking interests, except under controlled conditions as set out in section 3 of the Act. The regulatory provisions thus limiting a bank holding company's freedom to expand are, however, limited in their reach. They do not specifically apply to restrict a bank holding company from utilizing the medium of a nonbanking subsidiary, granted exemption under 4(c)(6), to enter additional areas where, in competition with independent banks serving such areas, offices may be maintained for the purpose of soliciting business to be funneled into the holding company's banking affiliates. It may be argued, I think with considerable reason, that for the Board to grant the nonbanking subsidiary a 4(c)(6) exemption under such circumstances, would be for the Board to sanction a device enabling a bank holding company to evade restrictions imposed upon it and upon its banking subsidiaries in contravention of the statutory purposes noted above. Evidence is not wanting that a bank holding company's utilization of a nonbanking subsidiary to compete for business against indepent banks in areas closed to its banking subsidiaries was looked upon as an evil to be guarded against, not only by proponents of the bank holding company legislation,[27] but also by at least one responsible national banking

"25/ See, e.g., S. Rep. 1095, 84th Cong., 1st Sess., p. 8; H.R. Rep. No. 609, 84th Cong., 1st Sess., pp. 6, 11; 101 Cong. Rec. 8020, 8030, 8032; 102 Cong. Rec. 6750, 6853.

"26/ See e.g., 101 Cong. Rec. 8032, 8035. See also 102 Cong. Rec. 6853, and particularly the following colloquy between Senators Capehart and Robertson:

"Mr. Capehart: Is the object of the bill not to make certain that bank holding companies do not expand, and that bank holding companies shall not be permitted to do that which banks cannot do? Broadly speaking, is not that what is sought to be done?

"Mr. Robertson: That is absolutely correct . . . . "

"27/ See, e.g., statement of Harry J. Harding, president of Independent Bankers Association, 12th Federal Reserve District, before the Senate Committee on Banking and Currency. Hearings on S. 880, S. 2350, and H.R. 6227, 84th Cong., 1st Sess., p. 122.

official and by the House Committee on Banking and Currency as well. 28/

"28/ See H. R. Rep't No. 609, p. 16, where the House Committee, explaining its opposition to a provision granting the Board unrestricted discretionary authority to exempt 'closely related' businesses, stated:

'Your committee finds itself in full accord with the views expressed by former Comptroller of the Currency Preston Delano, when he testified before the Senate Banking and Currency Committee in 1950 on the Board's proposal. He stated:

> "Under this provision, a holding company could engage through its subsidiaries in any other business which the Board, in its discretion, determines to be a 'proper incident' to the business of managing, operating and controlling banks.
>
> "By way of illustrating the possible effect of this sweeping discretionary power, it might be pointed out that if the Board of Governors considered the business of acquiring consumer paper by purchase or otherwise and the servicing and sale of that paper to be a 'proper incident' to the business of . . . banking, a large bank holding company would be in a position to organize and control subsidiary companies in every city of the nation to engage in this business in competition with independent banks operating in their respective business areas, and such subsidiary companies could funnel this business into the banks of the holding company system.
>
> "Freedom to engage in such activities would give the bank holding company systems a tremendous competitive advantage over independent banks, which cannot engage in similar activities away from their home offices except through duly authorized branches, which in no case can be established beyond State lines."'

"It is to be noted that the House ultimately acquiesced in the 'closely related' exemption that was added by the Senate. But, that is a matter which goes to the power of the Board to grant the exemption, not to the question of whether the exemption ought to be granted by the Board in the exercise of its allowable discretion."

The Examiner indicated that a possible argument on the other side might be made on the basis of the opinion of the Board in April 1958 (Federal Reserve Bulletin, p. 431) mentioned above at p. 9. As already indicated, that opinion was to the effect that the solicitation of installment paper business (as distinguished from the actual purchase of such paper) by a nonbanking subsidiary of a holding company through offices located in several States constituted an exempted "servicing" activity under section 4(c)(1) of the Act.

The Examiner then stated that on the general discretionary question he had discussed he would "express no judgment and make no recommendation" and that he had "raised the question only to indicate that more may be involved in the Bancredit case than just the 'discount' question."

Exceptions and arguments of Applicant. - Applicant takes strong exception to the above views of the Examiner that, even aside from the "discount" question, the "proper incident" and "purposes of the Act" requirements of section 4(c)(6) may bar exemption of Bancredit.

Applicant's principal arguments can be summarized substantially as follows:

1. That stockholders of any nonholding company bank are legally free to organize and own a company like Bancredit, "have it operate just like Bancredit anywhere they may choose, and funnel the acquired paper into such nonholding company bank."

2. That any bank could establish offices, and purchase paper at them, over several States as Bancredit does.

3. That Bancredit's activities affirmatively serve the "purposes of the Act" by contributing to competition in the various places where it buys paper.

4. That Bancredit's activities are limited to meeting the investment needs of its affiliated banks, and therefore could not be inconsistent with the "purposes of the Act".

5. That any bank "could lawfully purchase ... paper directly from the dealers and contractors at Chicago, Tulsa or anywhere else in the United States, and could lawfully send its agents to any and all such locations to effect such purchases directly by the bank."

6. That Bancredit's activities are essentially the same as those of the company in the "Company Y" case mentioned above (April 1958, Federal Reserve Bulletin 413) in which the Board held that a nonbanking affiliate that solicits installment paper business is exempt under section 4(c)(1) as a "servicing" company.

After carefully considering the question of whether, aside from the "discount" question, Bancredit's activities satisfy the "proper incident" and "purposes of the Act" requirements of section 4(c)(6), the Board has concluded that they fail to meet the test, and that Bancredit should be denied exemption under section 4(c)(6) even if the "discount" provision of section 6(a)(4) were not contained in the Act. In reaching this conclusion the Board has carefully weighed all aspects of the question, including all arguments offered by Applicant.

There are discussed below the reasons which led to the Board's conclusion and persuaded the Board that Applicant's arguments could not be accepted.

As stated before, section 4(c)(6) requires the Board to determine whether or not all the activities of Bancredit are "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." The section does not permit the Board to limit its inquiry to the narrow question of whether the activities at issue are directly forbidden by law or would be an evasion of law. Rather, the section requires the Board to reach a considered judgment on the question of whether in the particular circumstance, viewed in the light of the purposes of the Act, Bancredit should be granted exemption from the general prohibition of section 4 against the ownership of nonbank assets by a bank holding company.

The extensive geographic spread of Bancredit's operations at the present time, as well as the even broader scope of those operations in the past and their possible extension in the future, appear in practice to be largely unavailable to banks which are outside a holding company group. Although there appears to be no

legal prohibition against the stockholders of a nonholding company bank establishing an affiliate operation like that of Bancredit, the record discloses no instance of such an operation or relationship of a nonholding company bank. This contrasts sharply with the record in FBSC's companion case of First Service Agencies, Inc., discussed below on p. 23, which shows that the insurance agency activities there in question are widely prevalent among nonholding company banks in the area. The difference probably is not accidental. Only negligible funds are needed to establish an insurance agency operation; but sizable amounts of capital, such as are more readily marshaled through a holding company, are needed for an operation like that of Bancredit.

Bancredit argues that any bank could establish its own offices in several States and purchase paper at those offices as Bancredit does. However, this contention appears to be based on a misreading of the branch banking laws.

The statute applicable to branches of national banks (R.S. 5155; 12 USC 36) states in part:

> "The term 'branch' as used in this section shall be held to include any branch bank, branch office, branch agency, additional office, or any branch place of business located in any State or Territory of the United States or in the District of Columbia at which deposits are received, or checks paid, or money lent." (Underscoring supplied.)

Applicant quotes this provision and then asserts (Ap. Ex. and Br. p. 33): "Thus, under the national banking laws, a bank may lawfully maintain additional offices anywhere for any purpose other than (1) receiving deposits, (2) paying checks, or (3) lending money. Purchase and servicing of third-party paper is not one of those three activities . . ."

Putting to one side Applicant's questionable contention that operations by a bank like those at Bancredit's offices would not be one of the three activities specifically enumerated in the provision, Applicant's argument is subject to the even more basic defect that it misreads the word "include" as if it were "mean". As the Supreme Court said in American Surety Co. of New York v. Marotta, 287 U.S. 513, 516 (1933):

> "In definitive provisions of statutes and other writings, 'include' is frequently, if not generally, used as a word of extension or enlargement rather than as one of limitation or enumeration."

Thus, the Office of the Comptroller of the Currency, which charters and supervises national banks, treats as a branch an office where a national bank only exercises trust powers, a function clearly not one of the three stated in the branch provision quoted above. To the same effect is Boatmen's National Bank of St. Louis v. Hughes (Ill., 1944) 53 N.E. 2d 403. Applicant's argument that establishment by a bank of offices like those of Bancredit would not amount to the establishment of branches cannot be accepted.

Through its wide geographic coverage Bancredit and its affiliated banks can actively acquire installment paper over much wider areas than would be feasible for nonholding company banks. This can give FBSC banks a competitive advantage and tend toward a concentration of banking activities in a manner which is not readily attainable by nonholding company banks. There can be undesirable effects not only on banks that compete with FBSC banks, but also upon FBSC banks.

Bancredit as a part of its operation necessarily has a substantial investment in equipment, a body of highly competent personnel, and considerable "overhead" expense. The natural momentum of such an organization cannot fail to afford significant attractions for the funds of its affiliated banks. Without deviating in the slightest from the highest business standards, affiliation of such a company with a group of banks is likely to have subtle but important effects on the banks' credit judgment and policies. There is inevitably some tendency for affiliated banks to invest their funds through the established far-flung organization, and a somewhat lessened tendency to seek outlets for their funds in and around their respective communities.

Banking is of necessity heavily dependent on the judgment exercised by individual bankers and bank officers in passing upon particular loans and in allocating the funds entrusted to their care. Factors which tend even indirectly, and perhaps almost imperceptibly, to influence that judgment in one direction or another can be of vital importance over a period of time in the functioning of particular banks and the banking system.

The primary credit function of a bank has traditionally been to serve the credit needs of its local community, with outside investments playing a definitely secondary role. The Bank Holding Company Act was intended, among other things, to prevent undue dilution of this traditional emphasis on the meeting of local credit needs, and to prevent bank holding companies from having nonbank affiliations that might undesirably influence the credit judgment of bank officers in the holding company group. As the Board said in Matter of Transamerica Corporation (Fed. Res. Bulletin, September 1957, pp. 1014, 1016):

> "To put the matter another way, Congress has recognized that banking is a unique business, with unique economic power and responsibilities. Banks hold the current funds of the economy and the demand deposits that serve as the nation's principal medium of exchange. The public interest requires that decisions as to whether or not a bank extends credit in a particular case should be based, as far as possible, solely on creditworthiness. Congress apparently felt that this objective could be furthered by laying down a general

rule, subject to only limited exceptions, that no company should own or control both banks and nonbanking enterprises."

The record in the present case indicates that the operations of Bancredit have tended to adjust to the investment needs of affiliated banks, and there is no evidence that the affiliated banks have in fact altered their lending policies in order to invest funds through Bancredit. But the kinds of influences upon judgment that are here at issue are intangible, psychological, and often not clearly recognized even by the persons directly concerned. Moreover, they may become of great importance in a particular situation or at a particular time even though they may be of considerably less significance in other circumstances.

It was doubtless with such considerations in mind that the Congress in ordering the divestment of nonbanking assets did not make the requirement depend upon whether or not a particular nonbanking business had resulted in actual evils. As the Board said in Matter of Transamerica, supra, p. 1016:

> ". . . The language and history of the Act make it clear that Congress intended to eliminate potential evils by correcting what it considered to be unsound corporate structures in bank holding company systems, and that it did not wish to require proof of the existence of actual evil in each particular situation. . . ."

For the reasons outlined above, "potential evils" of the kind against which the Act was directed are present here, in view of such aspects as the incentives inherent in the arrangement, the lack of arm's length dealing and the multi-State operation.

Finance companies and other nonbanking organizations unaffiliated with banks or bank holding companies operate over even wider areas than does Bancredit. However, as the Hearing Examiner pointed out (p. 6), banks predominate in the field of repair and modernization loans in which Bancredit specializes. Moreover, unaffiliated nonbanking organizations are not investing depositors' funds, and the fact that they are not affiliated with banks tends to prevent any effect on the investment judgment of banks.

Nonholding company banks may acquire paper over wide geographic areas through arrangements with dealers and

contractors, correspondent banks, or through agents. However, such operations are not the same as those through an affiliated company. Common control is absent; the operations are less centralized, more subject to change, more nearly at arm's length, and less likely to influence the credit judgment or policies of the bank supplying the funds. Likewise, the operations of a nonbanking company which confines its activities to "servicing", as discussed in the April 1958 Federal Reserve Bulletin at p. 431, are different from those of a company like Bancredit which actually purchases paper and resells it to affiliated banks. Among other differences, the purely "servicing" operation is apt to be less elaborate, have less "overhead" expense, and involve less marshalling of funds; it is less likely to develop the kind of organization or relationship that can influence the credit judgment or policies of affiliated banks.

Accordingly, the Board is convinced that none of Applicant's arguments based on operations bearing some resemblance to those of Bancredit are sufficient to alter the fact that the activities conducted by Bancredit fail to meet the "proper incident" and "purposes of the Act" requirements of section 4(c)(6).

Conclusions

For the reasons outlined above, the Board has reached the conclusions that:

1. The activities of Bancredit meet the preliminary test under section 4(c)(6) of being entirely "of a financial, fiduciary, or insurance nature".

2. However, those activities fail to meet the further test under the section of being a "proper incident" to the business of banking or of managing or controlling banks and of being consistent with the "purposes of the Act". They fail to meet the test both (a) because they conflict with the "discount" provisions of section 6(a)(4) of the Act, and (b) because they represent a type of corporate structure, readily available to a holding company and relatively inaccessible to nonholding company banks, which is likely to have effects of a kind which the Bank Holding Company Act was intended to prevent.

3. Applicant's exceptions to the Hearing Examiner's Report and Recommended Decision are hereby sustained to the extent that they are consistent with the foregoing Statement and rejected to the extent that they are inconsistent therewith.

4. The request of FBSC for exemption of Bancredit under section 4(c)(6) should be denied, and it is so ordered.

II. FIRST SERVICE AGENCIES, INC.

Factual summary. - Agencies, Inc. was organized on August 7, 1957, under the laws of Minnesota. It presently exists only on a standby basis and engages in no business; none of its stock is owned by the Applicant. However, if the present request is granted, it is contemplated that Agencies, Inc. would take over the business now carried on by 19 unincorporated insurance agencies and also the insurance activities of First Service Corporation ("First Service"), a wholly owned subsidiary of the Applicant. At that time all of the stock of Agencies, Inc. would be acquired by the Applicant.

While the language of section 4(c)(6) is couched in the present tense, it does not, in the Board's opinion, preclude consideration of a request for exemption with respect to a corporation in which the Applicant proposes to acquire stock where, as here, the nature of the activities to be carried on by that corporation is susceptible of determination. In the present case those activities will comprise substantially the same activities as those now carried on by the 19 unincorporated insurance agencies, along with the insurance activities of First Service. Accordingly, it is appropriate to consider the present request as though all such activities were presently being carried on by Agencies, Inc. Thus, the activities of the 19 insurance agencies must be considered, not as they relate to the business of each of the banks with which they are connected, but as they relate in the aggregate to the business of banking as conducted by the Applicant and its subsidiary banks.

Turning first to the insurance activities of First Service, those activities are confined to group life and hospitalization insurance written for the Applicant and its affiliates; blanket policies for dealers and affiliated banks covering automobiles and other merchandise financed on a "floor plan" basis; and miscellaneous fire and automobile policies written for employees of the Applicant and its affiliates. The blanket policies are obtained from a non-affiliated insurance company; commissions are paid to a countersigning insurance agent who may or may not be connected with a lending subsidiary bank; but such commissions find their way back to the lending banks in the form of compensation for services rendered. All of these insurance activities would be transferred to Agencies, Inc. if this request is granted. First Service would continue to perform certain advisory and administrative services for the

Applicant's banking subsidiaries - services which would be of a type that would render the Applicant's ownership of shares of that corporation exempt under section 4(c)(1) of the Act.

The nature of the activities of the 19 unincorporated insurance agencies which would be taken over by Agencies, Inc. requires more detailed consideration, since those activities, unlike the insurance business of First Service, include dealings with the general public unrelated to the business of the Applicant's subsidiary banks.

Within the holding company group there are 52 unincorporated insurance agencies associated with 51 banking subsidiaries of the Applicant. Of these agencies, 33 are connected with national banks in places of less than 5,000 population which, under provisions of Federal law to be mentioned later, may directly act as insurance agents, or with State banks in Minnesota, North Dakota, and South Dakota where the banking authorities interpose no objection to the operation of such agencies for the direct benefit and in effect as departments of State banks. These 33 agencies are not involved in this proceeding. The remaining 19 - those involved in this proceeding - are connected with 17 national banks in places of over 5,000, and with 2 State banks in Montana where the State banking authorities apparently disapprove of the operation of such agencies directly for the benefit of State banks.

Each of the 19 insurance agencies here involved is a partnership with one or more of the principal officers of the "connected" bank among its membership. Each operates under the direct supervision of the principal officer of the connected bank; and personnel of the bank are utilized in the operations of the agency. Sixteen of the agencies occupy space in the banking premises of the connected banks; the other 3 are located in the building that houses the bank or in an adjoining building.

By virtue of outstanding agreements, the business of 16 of the agencies is in effect owned by First Service; in one instance the business is owned by the Applicant directly; and in the remaining 2 cases, the business is carried on for the benefit of the stockholders of the respective connected banks, both of which are majority-owned by the Applicant.

The 19 agencies are engaged in a general insurance agency business and actively solicit business from the public at large. However, 76.8 per cent of their customers are also customers of

the connected banks, i.e., borrowers, depositors, or safe deposit box renters; and, in dollar volume, about 75 per cent of the premiums are on insurance written for such bank customers.

As of December 31, 1956, about 26.4 per cent of the aggregate premiums received by the agencies were from policies covering property securing loans made, or paper purchased, by the connected subsidiary banks, and an additional .014 per cent represented premiums on life insurance securing loans by such banks.

As of August 31, 1957, about 80 per cent of the outstanding loans of the subsidiary banks with which the 19 insurance agencies are connected were secured loans; and of these secured loans 25.4 per cent in dollar amount ($11,604,728) were insured through the connected agencies. Of those loans as to which security was required, about 35 per cent carried insurance placed through such agencies.

A final fact of special significance is that the operation of insurance agencies in connection with banks is a practice that has prevailed for many years in the 4-State area here involved, without evidence of objection on the part of the bank supervisory authorities. From a survey made by the Applicant and relied upon by the Hearing Examiner, it appears that a very large majority of all banking offices in this area have bank-connected insurance agencies, as indicated by the following:

State	Percentage of banking offices with connected insurance agencies
Minnesota	87%
North Dakota	84%
South Dakota	89%
Montana	65%

For offices of State banks, the percentages in places of less than and over 5,000 are as follows:

State	Places under 5,000	Places over 5,000
Minnesota	97%	70%
North Dakota	88%	50%
South Dakota	93%	67%
Montana	87%	20%

Comparable percentages for national bank offices that have connected insurance agencies are as follows:

State	Places under 5,000	Places over 5,000
Minnesota	92%	48%
North Dakota	94%	64%
South Dakota	95%	57%
Montana	79%	11%

Thus, it seems clear that the practice of maintaining insurance agencies in close connection with banks is fairly widespread in the area involved. That it is more common in small towns than in large cities is not surprising; but even in larger cities and even among national banks in such cities the practice is not unusual.

While the practice varies, it appears that in many instances the net income of a bank-connected insurance agency is paid over directly to the connected bank, and that in other instances the insurance agency pays the connected bank for rent and services and turns over the remainder of its income to stockholders of the bank or to a nonbanking corporation owned by the bank's stockholders. The latter practice appears to prevail in the present case; after payments to the connected banks for rent and services, the income of the agencies is distributed to First Service or, in two instances, to stockholders of such banks.

Compliance with preliminary requirement as to nature of activities. - Since all of the activities of Agencies, Inc. would be related to the conduct of an insurance agency business, it is clear that they meet the preliminary requirement for exemption under section 4(c)(6) of the Act - that all the activities of the company involved be "of a financial, fiduciary, or insurance nature."

Relation to banking business. - Although of an insurance nature, the activities of Agencies, Inc. do not warrant exemption under the statute and the Board's Regulation Y unless they are determined by the Board to be "so closely related" to the business of banking or of managing or controlling banks, as conducted by the Applicant and its banking subsidiaries, as to be a "proper incident" to such business and as to make it unnecessary for the prohibitions of section 4 of the Act to apply in order to carry out the purposes of the Act.

The law prescribes no specific standards to guide the Board in making such determinations; it does not, for example, require that a majority or even a substantial part of the business of the company involved be directly connected with transactions of subsidiary banks. In effect, it leaves the determination to be made by the Board on the basis of the record of the hearing held in each case. As stated by the Senate Banking and Currency Committee's Report on the Holding Company Act, it was deemed advisable "to provide a forum before an appropriate Federal authority in which decisions concerning the relationship of such activities to banking can be determined in each case on its merits."

For the reasons just indicated, the Board regards the statute as imposing upon it a responsibility to consider all of the relevant facts and circumstances disclosed by the record of the hearing in determining whether, in its judgment, the activities of Agencies, Inc. have a relationship to the business of the Applicant's subsidiary banks sufficient to justify granting an exemption in this case.

In general, it may be said that both Federal and State laws implicitly recognize that insurance has some general relation to the business of banking. Thus, section 13 of the Federal Reserve Act, as amended in 1916, specifically authorizes national banks located in places of a population of not more than 5,000 to act directly as insurance agents. A number of States similarly authorize State banks to act as insurance agents; and in many other States, although there is no specific statutory language on the subject, State banks either engage directly in the insurance business or are associated with insurance agencies in a manner similar to that involved in the present case.

The fact that insurance may be considered as generally related to the banking business and in many respects similar to that business would not alone be sufficient to justify an exemption under section 4(c)(6) of the Holding Company Act. In view of the language of the statute and of the Board's Regulation Y, it is essential that the activities of the company involved - the contemplated insurance activities of Agencies, Inc. in the present case - must have some direct and significant connection with the business of banking or of managing and controlling banks as conducted by the Applicant or its banking subsidiaries.

The close physical and personnel connection between the 19 insurance agencies here involved and the respectively connected subsidiary banks cannot be regarded as decisive, since obviously

the statute was not designed to provide exemption for nonbanking organizations that may happen to be located in or near the premises of subsidiary banks or that may happen to have personnel connections with such banks. The Board agrees with the Hearing Examiner that "such organizational and physical integration, while a factor to be considered, does not itself satisfy the 'closely related' requirements of section 4(c)(6)." (H. E. Rep., p. 45) At the same time, such physical and personnel relationships may be regarded as giving rise to a presumption that the activities of the insurance agencies are "related" or incidental to the business of the subsidiary banks.

As has been indicated, approximately one quarter of the business of the insurance agencies is directly connected with the business of the subsidiary banks, and also approximately one quarter of the secured loans made by the banks are covered by insurance obtained through such agencies. The Hearing Examiner conceded that it is not necessary for all of the activities of a nonbanking company to be "closely related" to the business of banking, but felt that the statute carries an implication that there should be "a predominant measure of substantiality" in the relationship. (H. E. Rep., pp. 47-48) He concluded that, in the absence of special circumstances, the requirement of "substantiality" is not met where, as here, the insurance agencies are engaged in the general business of selling all kinds of insurance to the public with only a "minor part" of their activities directly related to banking operations of the affiliate banks.

While the Hearing Examiner's views have been given careful consideration, the Board believes that, on the basis of the percentages above indicated, there is reasonable ground for concluding that a substantial and not merely a minor part of the activities of the insurance agencies have a direct functional connection with the business of the subsidiary banks. Standing alone, the degree of direct and functional connection found to exist in the present case might not be sufficient in all cases to warrant the conclusion that a company's activities are so closely related to the business of subsidiary banks as to be a "proper incident" thereto and as to be consistent with the purposes of the Act. Nevertheless, it is the Board's judgment that the direct connection in the present case is sufficiently great to be given strong weight, along with other pertinent factors, as suggesting the close relationship required by the statute.

The Hearing Examiner concluded that no significance should be attached to the fact that a substantial portion of the customers of the insurance agencies are also bank customers in one form or another. (H. E. Rep., p. 46) He properly pointed out that, where an insurance agency operates in the premises of a bank, it may be expected to attract a large proportion of its customers from persons doing business with that bank. Again, as in the case of physical and personnel integration, the Board agrees that the existence of common customers cannot be given decisive weight as suggesting the requisite close relationship between the activities of a nonbanking company and the business of a bank. Again, however, the Board feels that the existence of such common customers should not be completely ignored, but may be given significance as a cumulative factor if other circumstances suggest the existence of the required relationship.

In this connection, it appears from the record that, except in two places in which there are no competing banks, each of the subsidiary banks with which the 19 agencies are connected is in competition with one or more other banks in its trade area which have connected insurance agencies of their own. The Applicant urges that, with the possible exception of the larger communities, it has become a recognized competitive factor in the 4-State area for banks to be in a position to offer their customers insurance services and advice as a part of a well-rounded financial service. This contention finds support in the practice heretofore mentioned that sanctions the relationship of insurance agencies with a great majority of banks in the area concerned. In other words, area practice may properly be regarded in the present case as an important factor suggesting that the activities of the insurance agencies in question are a proper incident to the business of banking in that area.

Effect of authority of national banks to act as insurance agents. - In his Report, the Hearing Examiner concluded, as previously indicated, that, without regard to area practice, the over-all business that would be conducted by Agencies, Inc. would fall short of meeting the requirements of section 4(c)(6). He conceded that it may be proper in certain circumstances to give weight to established customs and practices to which the supervisory authorities have not objected; but in the present case he felt that, even if the relationship here involved might be viewed as an "incident" to the business of the subsidiary banks, it should not be regarded as a "proper" incident. (H. E. Rep., p. 51)

The consideration which the Hearing Examiner felt must "control decision" in this case is the fact that Federal law empowers national banks to act as insurance agents only if located in places having a population of less than 5,000. Since 17 of the 19 banks involved in the present case are national banks located in places of over 5,000, the Hearing Examiner expressed the view that granting of the request for exemption of Agencies, Inc. would have the effect of perpetuating a "subterfuge" and of placing the Board's stamp of approval upon a clear evasion of the law.

If the activities of a nonbanking company or their relation to the business of subsidiary banks would involve a violation of the Holding Company Act or of some other law, they could not, of course, be regarded as a "proper" incident to the business of banking. The Board is not persuaded, however, that the relationship between the insurance agencies and national banks in places of over 5,000 that exists in the present case involves either a violation of law or a subterfuge to evade the law.

None of the Applicant's subsidiary national banks acts as an insurance agent. Indeed, it appears that in Minnesota, North Dakota, and South Dakota no corporation may be licensed as an insurance agent. Nor does it appear that any of the insurance agencies here involved operate directly for the benefit of connected national banks in the sense that net income of such agencies is included in the income of such banks. Consequently, it seems clear that the relationships in question do not violate the language of the provision of Federal law regarding national banks acting as insurance agents.

That provision of Federal law does not prohibit the operation of insurance agencies in connection with national banks in the manner in which they operate in this case. If such operation involves a subterfuge or evasion of Federal law, it is one that has existed for many years and one that, according to the record, has been known to the Comptroller of the Currency. In these circumstances, it would be inappropriate for the Board to rest its determination in the present case upon the assumption that the operation of the insurance agencies in conjunction with national banks constitutes an evasion of statutory provisions administered by the Comptroller of the Currency.

It may be noted that adoption of the Hearing Examiner's position on this point could mean that a national bank in a holding

company group, if located in a city of more than 5,000, could not avail itself of the services of a connected insurance agency, while a competing State bank in the same place or even a non-holding company national bank could have such a connected agency without objection by the bank supervisory authorities. It could also mean that a holding company controlling only State banks could make use of bank-connected insurance agencies, while a competing holding company controlling national banks could not do likewise.

Avoidance of "potential evils". - In reaching his conclusion - with which the Board disagrees for the reasons just indicated - that the business of connected insurance agencies is not a "proper" incident to the business of the Applicant's banks, the Hearing Examiner stated that he had not relied upon certain dicta in the Board's decision in the Transamerica case (Matter of Transamerica Corporation, September 1947 Federal Reserve Bulletin, p. 1014) to the effect that the words "proper incident" and "purposes of this Act," as used in section 4(c)(6), "limit the exemption of the statute to situations which substantially escape the 'potential sources of evil against which the general prohibition was directed.'" He expressed doubt as to his interpretation of this language in a previous case, apparently with the feeling that, if rigidly applied, the so-called "potential evils" principle would make it virtually impossible for any company to qualify for a section 4(c)(6) exemption. He suggested that the Board might wish "to clarify its views on this subject for the guidance of interested persons in future cases." (H. E. Rep., p. 54)

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As stated by the Board in its decision in the Transamerica case, the purpose of section 4 of the Act, namely, "to remove * * * potential * * * sources of evil," provides "a helpful guide in applying the requirements of section 4(c)(6)." However, section 4 was clearly not intended to remove all potential sources of evil in the banking field; it was directed at those that may be said to arise from, or be accentuated by, the operation of bank holding companies. Accordingly, it is important to determine whether a particular type of relationship is peculiar to banks in holding company groups, or, on the other hand, is prevalent among both holding company and non-holding company banks. If the latter circumstance prevails, it suggests that any "potential evils" that may be inherent in the relationship are not of the kind against which section 4 of the Holding Company Act was directed.

In the present case, the record indicates that the operation of insurance agencies in connection with banks - unlike the operation of an affiliated insurance company as in the

1/ Reference should have been to September 1957 Federal Reserve Bulletin.

Transamerica case - is widely prevalent in the area involved, not only among banks in holding company groups but among non-holding company banks as well. The existence of such an "area practice" tends to negative the potentiality of evils of the type contemplated by the Act or by the dicta contained in the Board's statement in the Transamerica case.

Conclusion. - After careful consideration of all the circumstances - physical and personnel integration, the degree of direct connection between the activities of the insurance agencies and the Applicant's subsidiary banks, the existence of common customers, and particularly the fact that the operation of bank-connected insurance agencies is sanctioned by long-established practice in the area here involved - the Board has determined that the activities of Agencies, Inc. would be so closely related to the business of banking, as conducted by the Applicant's subsidiary banks, as to be a proper incident thereto and as to make it unnecessary for the prohibitions of section 4 of the Act to apply in order to carry out the purposes of the Act. To the extent that they are consistent with the foregoing statement, the Applicant's exceptions to the Hearing Examiner's Report and Recommended Decision are hereby sustained.

Accordingly, for the reasons herein set forth, it is the Board's judgment that the requested exemption with respect to Agencies, Inc. should be granted; and it is so ordered.

As indicated in the Board's Order, its approval of this request is based solely on the facts disclosed by the record; and if the facts should substantially change in the future in such manner as to make the reasons for the Board's conclusion no longer applicable, the statutory exemption resulting from the Board's present determination would, of course, cease to obtain.

Attachments
July 21, 1959.

SEPARATE STATEMENT BY GOVERNOR MILLS

The conclusions of the Board that the request relating to First Bancredit Corporation should be denied and the one relating to First Service Agencies, Inc. should be granted are concurred in.

However, for the reasons set forth in the dissenting statement in the General Contract case (March 1958, Federal Reserve Bulletin 270) the prohibition in section 6(a)(4) of the Act against a bank making a "discount" for a fellow subsidiary is not believed to apply to a nonrecourse purchase of paper. Accordingly, that portion of the Board's statement dealing with the "discount" question is not concurred in. On the other hand, the conclusion that Bancredit fails in other respects to meet the exemption requirements of section 4(c)(6) seems entirely correct.

Section 4(c)(6) of the Bank Holding Company Act exempts a company from the nonbank divestment requirements of the Act only if the company meets several tests. One test, which Bancredit clearly meets, is that all activities be "of a financial, fiduciary, or insurance nature".

Another test is that all the activities must be determined by this Board "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." Bancredit fails to meet this latter test of being a "proper incident" and of being consistent with "the purposes of this Act."

As indicated by its name, a "bank holding company" is a form of holding company organization whose principal activity is to engage in the banking business through the vehicle of subsidiary banks. The spirit and letter of the Bank Holding Company Act of 1956 must be construed as limiting a bank holding company's operations to the sphere of strictly banking activities, subject to only limited exceptions.

A bank holding company subsidiary such as Bancredit that engages in a form of interstate financial business (that is of itself suspect in view of the prohibitions that exist against interstate branch banking), and by way of credit arrangements that are capable of putting a non-holding company bank competing in the same trade area at a disadvantage in developing comparable types of earning assets, is not entitled to the divestment exemptions of an

Act that is intended in part to preserve competition between non-holding company and holding company banks. Beyond a belief that the character of the operations engaged in by Bancredit are contrary to the purposes of the Act because of being too far outside of the purview of the closely related supervisory and service functions that are the principal ones permissible to a nonbanking subsidiary under the terms of the Act, looms the shadow of the principle of "potential evil". Objection as a "potential evil" must be raised to practices like those followed by Bancredit in originating loans and farming them out to subsidiary banks of its parent bank holding company that under unscrupulous sponsorship conceivably could expose the subsidiary banks to a kind of exploitation that might eventually threaten their financial stability. All circumstances considered, a section 4(c)(6) divestment exemption of Bancredit is not consistent with the provisions of the Bank Holding Company Act of 1956. The application for exemption must therefore be denied.

July 21, 1959.

Item No. 8
7/21/59

UNITED STATES OF AMERICA

BEFORE THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

WASHINGTON, D. C.

In the Matter of the Requests of NORTHWEST BANCORPORATION For Determinations under Section 4(c)(6) of the Bank Holding Company Act of 1956	DOCKET NOS. BHC-42 BHC-43 BHC-44

ORDER

Northwest Bancorporation, Minneapolis, Minnesota, a bank holding company within the meaning of section 2(a) of the Bank Holding Company Act of 1956 (12 U.S.C. § 1843), has filed requests for determinations by the Board of Governors of the Federal Reserve System that the corporations hereinafter named and their activities are of the kind described in section 4(c)(6) of the Act 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 section 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 corporations with respect to which the requests were filed, with the hearing docket number of each, are:

NORTHWESTERN MORTGAGE COMPANY - BHC-42
SOUTH SIDE INSURANCE AGENCY, INC. - BHC-43
UNION INVESTMENT COMPANY - BHC-44

A hearing having been held pursuant to section 4(c)(6) of the Act 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 three of the above requests be denied; Applicant having filed Exceptions and Brief with respect to all of the said requests; oral argument having been heard before the Board; the Board having given due consideration to all relevant aspects of the 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 ORDERED, for the reasons set forth in the Board's Statement of this date and on the basis of the record made at the hearing in this matter, that:

1. The activities of Northwestern Mortgage Company are determined not 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 section 4 of the Bank Holding Company Act of 1956 to apply in order to carry out the purposes of that Act, and, therefore, Applicant's request with respect to Northwestern Mortgage Company shall be, and hereby is, denied; and

2. The activities of South Side Insurance Agency, Inc., and of Union Investment Company are 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 section 4 of the Bank Holding Company Act of 1956 to apply in order to carry out the purposes of that Act, and, therefore, Applicant's requests with respect to South Side Insurance Agency, Inc., and Union Investment Company shall be, and hereby are, granted.

Dated at Washington, D. C., this 21st day of July, 1959.

By order of the Board of Governors.

Voting for this action: Chairman Martin, Vice Chairman Balderston and Governors Szymczak, Mills, Robertson, Shepardson and King.

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

(SEAL)

UNITED STATES OF AMERICA

BEFORE THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

WASHINGTON, D. C.

In the Matter of the Requests of NORTHWEST BANCORPORATION For Determinations under Section 4(c)(6) of the Bank Holding Company Act of 1956	DOCKET NOS. BHC-42, 43 and 44.

STATEMENT

BACKGROUND OF THE CASE

On March 14, 1958, Northwest Bancorporation, (hereafter sometimes called the "Applicant"), a Delaware Corporation with its principal office and place of business in Minneapolis, Minnesota, and a bank holding company as defined in section 2(a) of the Bank Holding Company of 1956 (the "Act"), filed with the Board of Governors of the Federal Reserve System (the "Board") requests for determinations that three of its nonbanking subsidiaries are of such a nature as to be exempt under section 4(c)(6) of the Act from the prohibitions of section 4(a) of the Act. The nonbanking subsidiaries involved are Northwestern Mortgage Company ("Mortgage"), South Side Insurance Agency, Inc. ("South Side") and Union Investment Company ("Union").

Section 4(a) of the Act makes it unlawful, subject to certain exceptions, for a bank holding company (1) to acquire direct or indirect ownership or control of voting shares of any company that is not a bank, or (2) to retain direct or indirect ownership or control of voting shares of any such company after two years from the date of enactment (May 9, 1956) of the Act. All three of the nonbanking subsidiaries are companies a majority of all of the voting shares of which were owned by the Applicant on the date of the Act and are presently so owned pending determination of the present matter. The time allowed for divestment by the Applicant of its ownership of such stock has been extended by the Board pursuant to the provisions of the Act allowing such extensions.

The Applicant's retention of stock of Mortgage, South Side, and Union escapes the prohibitions of the Act only if it falls within one of the exceptions provided by the Act. Section 4(c)(6) of the Act excepts shares of a nonbanking company if two requirements are met: (1) if all the activities of the company are of a financial, fiduciary or insurance nature, and (2) if the Board determines, on the basis of the record made at a hearing, that the activities of the company are 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 Act. Section 5(b) of the Board's Regulation Y, issued pursuant to the Act, paraphrases the language of the Act, but requires that the activities of a company must be closely related to the business of banking or of managing or controlling banks "as conducted by such bank holding company or by its banking subsidiaries."1/

1/ The relevant language of the Act and the regulation is as follows:

"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

As required by the statute, the Board, on May 8, 1958, ordered that a hearing be held on the Applicant's requests; and such a hearing was held at Minneapolis, Minnesota, before a duly designated Hearing Examiner on July 14, 15, 16 and 17, 1958. Following the conclusion of that hearing, the Applicant on September 15, 1958, submitted proposed findings with an accompanying brief. In his Report and Recommended Decision, filed with the Board on November 18, 1958, the Hearing Examiner recommended denial of all three of the Applicant's requests. Subsequently the Applicant filed with the Board exceptions to the Hearing Examiner's Report and Recommended Decision; and on May 11, 1959, the Applicant presented oral arguments before the Board.

1/ [cont'd.] 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. . . ."

* * *

"Section 5(b) of the Board's Regulation Y is as follows:

"(b) Shares of financial, fiduciary, or insurance companies. - Any bank holding company which is of the opinion that a company all of the activities of which are of a financial, fiduciary, or insurance nature is so closely related to the business of banking or of managing or controlling banks, as conducted by such bank holding company or its banking subsidiaries, as to be a proper incident thereto and as to make it unnecessary for the prohibitions of section 4 of the Act to apply in order to carry out the purposes of the Act, may request the Board for such a determination pursuant to section 4(c)(6) of the Act. Any such request shall be filed in duplicate with the Federal Reserve Bank. After receipt of any such request, the Board will notify the bank holding company of the place and time fixed for a hearing on the requested determination; and, after the conclusion of such hearing and on the basis of the record made at the hearing, the Board will by order make or decline to make the requested determination."

The salient relevant facts with respect to Mortgage, South Side and Union are set forth hereafter in this Statement. Additional facts with respect to their activities are contained in the Hearing Examiner's Report and Recommended Decision attached hereto; and, to the extent not inconsistent with this Statement, the findings of fact made by the Hearing Examiner are hereby adopted.

In determining whether or not the pending requests should be granted, the Board has considered solely the facts embraced in the record of the hearing held in this matter. In addition, however, the Board has considered arguments presented in the Applicant's proposed findings, the Hearing Examiner's Report and Recommended Decision, the Applicant's exceptions thereto, and the transcript of the record of the oral argument before the Board. The Board's findings and conclusions are hereafter set forth with respect to each of the companies involved.

I. NORTHWESTERN MORTGAGE COMPANY (BHC-42)

Factual summary. - Northwestern Mortgage Company ("Mortgage") was incorporated under the laws of Minnesota on June 27, 1927, under the name of the Central Company, to take over the insurance agency business of the insurance department of the Minnesota Loan and Trust Company. In 1934, when the Minnesota Loan and Trust Company was merged with the Northwestern National Bank under the name of Northwestern National Bank & Trust Company ("Bank"), the property management department which had been built up by the former was transferred to the renamed insurance agency. There are 250 shares of common stock of Mortgage outstanding, all of which are owned or controlled by the Applicant. Mortgage is authorized to do business in a six-state area also served by the Applicant.

Mortgage has offices in the Northwestern Bank Building in Minneapolis, the building which also houses Bank, the largest banking subsidiary in the Northwest system, as well as the home offices of the Applicant. Mortgage and the Applicant have several directors in common, and several officers of the Applicant are directors of Mortgage. Mortgage is more closely related to Bank than to any of the other banking subsidiaries of the Applicant, although it performs miscellaneous services for many of them. However, it is financially independent of Bank and has its own highly specialized personnel.

Activities of Mortgage may be classified generally under three headings. The first, insurance, is the least important, producing only 1.9 per cent of Mortgage's gross income, and falls into two entirely

separate parts. One part represents commissions on policies written as part of the mortgage loan and real estate management and sales activities of Mortgage. The other part represents blanket coverage under the so-called "Stuyvesant plan". Affiliated banks of Northwest can and do obtain automobile insurance policies under this plan in connection with automobile loans, and can thus compete with finance companies specializing in loans of this type.

The second activity of Mortgage, producing 71.6 per cent of its gross income, comprises the management, rental and sale of city and farm properties and farm livestock as agent or broker for private individuals - almost all customers of Northwest banks - and for the trust department of Bank and other Northwest banking affiliates.

The third activity, brokerage and servicing of city real estate loans, produces 23 per cent of the gross income of Mortgage. When various Northwest banking affiliates are approached by customers for mortgage loans which they do not wish to make because money is generally tight, or because the term of the loan is too long or the amount is outside the bank's lending limit, or for any other reason, they refer these customers to Mortgage which arranges the loan with any one of a number of insurance companies. Mortgage also arranges loans of this kind for banks in the Northwest system that have excess loanable funds.

In the aggregate, 17.7 per cent of the gross income of Mortgage derives from transactions on behalf of Northwest banking subsidiaries, particularly of Bank. The proportion varies among the three categories of business listed above. Brokering mortgage loans for the affiliated banks accounts for only 8.6 per cent of the portion of the gross income deriving from this activity. Since this type of loan is made only upon request by an affiliated bank (or by the borrower), volume varies with the amount of excess loanable funds which the banks have on hand. In periods when credit was easier, the total amount of these loans, and presumably income from them, bulked much larger than at present. When money is tight, business done for the banks diminishes.

A more significant connection appears in the property management area. Forty-five per cent of gross income of Mortgage derives from city real estate and property management and 15.3 per cent of this is attributable to banking subsidiaries of the Applicant. The proportion of gross income deriving from farm loans, management and sales is 26.6 per cent, and 33 per cent of this is similarly attributable to banking subsidiaries of Applicant. Taking farm management alone, the Applicant's figures show that 14.5 per cent 2/ of the farm

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2/ The figure found by the Hearing Examiner, to which the Applicant took exception, was 8.7 per cent.

properties managed by Mortgage in 1957 were managed for the affiliated banks and that 11 per cent of its income from farm management derived from fees for managing farm properties for these banks. Looking at the relationship from the side of the Bank, it appears from the Hearing Examiner's Report (although he made no direct finding on this point) and from the record of the hearing that Mortgage handles almost all of the property management business generated by the trust department of Bank, although very little of that arising with the other affiliated banks.

In order to have these services available to Bank at all times, wherever needed, Mortgage has further built up the staff of experts which it took over from the Minnesota Loan and Trust Company. These experts are trained in farm management and specialize in the diverse types of farming practiced over the large area served by Bank. Similarly, Mortgage has a staff of city real estate management experts. It has not been possible to maintain an organization on this scale for the benefit of trust business generated by the Northwest banks alone. In order to keep the organization functioning on an economical basis, it has been found necessary to accept business from outside sources. However, outside business in respect to property management is done almost without exception for customers of Bank and of the other banking affiliates of the Applicant. In addition, it appears that these banking affiliates frequently make use of advisory services which Mortgage is in a position to render, in connection with properties they handle in their trust departments.

Only a small fraction of the insurance income of Mortgage, 3.2 per cent, is attributable to business done for the banking affiliates. The Stuyvesant plan aspect of the insurance activity is entirely related to the business of these affiliates, but because little or no testimony was offered tending to prove the amount of business done under the plan, the Hearing Examiner was unable to make a finding on the proportionate importance of that segment of the insurance business.

No evidence was adduced at the hearing, and no finding was made by the Hearing Examiner, as to whether other banks in the area served by banking affiliates of the Applicant have similar relationships to separately incorporated agencies of the kind represented by Mortgage. The Applicant did lay considerable stress upon the high quality of the services rendered by Mortgage, and the Hearing Examiner found that it would cost Bank many times the amount paid Mortgage in fees annually to establish a comparable property management division within its own trust department. Testimony in the record tends to prove that the Minnesota Loan and Trust Company had unsatisfactory experiences with independent agents which it employed to manage its properties, and that the department whose functions were transferred to Mortgage was founded because independent agents did not provide satisfactory service.

Preliminary requirement as to nature of activities. - The Hearing Examiner found, and the Board agrees, that "the business of managing, renting and selling property as an agent is fiduciary in nature" and that "the brokerage and servicing of real estate loans . . . are financial in character". Accordingly, since its remaining activities are of an insurance nature, Mortgage meets the preliminary requirement of section 4(c)(6) of the Act that all of a company's activities must be "of a financial, fiduciary, or insurance nature".

Relation to banking business. - Even though Mortgage complies with this preliminary requirement of the law, the statute and the Board's Regulation Y further require that an exemption shall be granted only if the Board determines, after a hearing, that the activities of Mortgage are "so closely related" to the business of banking or of managing or controlling banks, as conducted by the Applicant and its banking subsidiaries, as to be a "proper incident" to such business and as to make it unnecessary for the prohibitions of section 4 of the Act to apply in order to carry out the purposes of the Act. As the Board pointed out in its Statement of this date with reference to the application of First Bank Stock Corporation for exemption of First Service Agencies, Inc., this determination is to be made on the basis of all the relevant facts and circumstances disclosed by the record of the hearing.

The Hearing Examiner in the present case expressed the view that the propriety of the incident may be established in either of two ways: (1) by a showing that it is "inherently" so closely related to the business of banking in general as naturally to appertain thereto; or (2) by a showing that the activities are so "directly, appropriately, and substantially related to banking transactions in the particular case as to be considered an aspect of the banking operation". Thus, his first test is qualitative, relating to the nature of the activity; and his second test is quantitative, relating to the proportion of total transactions of the subsidiary banks and of Mortgage that are directly connected with each other.

Having laid down these tests, the Hearing Examiner found that property managing and loan brokering, "though activities of a kind sometimes performed by a bank in connection with its operations, are not thereby inherently related to banking". As to the substantial nature of the connection, he believed that "at least the word [substantial] embraces 'major part'". He felt that such a substantial relationship must exist both as to the proportion of the nonbanking subsidiary's business that is related to the affiliated banks or bank holding company and as to the proportion of the relevant business of the bank or banks (or bank holding company) that is related to the nonbanking subsidiary. Since less than one-fifth of the business of Mortgage is done for the affiliated banks (or for the Applicant), he concluded that exemption should be denied.

While not necessarily adopting these tests, the Board agrees with the Hearing Examiner that the decision on the present application is governed by the Board's decision in the case of Transamerica Corporation, 43 Federal Reserve Bulletin 1014 (1957). In that decision, the Board stated that

> ". . . it seems evident that Congress was of the view that, in general and subject to only limited exceptions, bank holding company systems should be restricted to banking activities and should not engage in other types of business for the reason that common control of banks and nonbanking organizations could give rise to evils of several kinds." Id. at 1016.

These limited exceptions are available only where the relationship between the banking and the nonbanking organizations is sufficiently close to establish the propriety of the connection, and to avoid the possibility that evils of the kind foreseen by Congress might arise.

The Transamerica decision dealt with a case in which the relationship was qualitative only, being limited to a mere similarity of function between banking and the business of an insurance company which was a holding company subsidiary. The Board held that this was not sufficient to justify granting an exception under the statute. On the other hand, in its Statement of the present date with respect to the application of First Bank Stock Corporation, the Board held that, where insurance agencies are commonly operated in connection with banks in the area involved, and where there is a significant quantitative connection between the business of agencies owned by a holding company subsidiary and the business of individual banking subsidiaries related to those agencies, shares of the nonbanking subsidiary may be exempted from the divestment requirements of section 4. In that case, the area practice served to establish a proper qualitative relationship, i.e., that independent organizations of a particular kind are commonly operated in connection with banks in the area in question and that such operation is a proper incident of the banking business.

The area practice in that case also tended to overcome the presumption of a potentiality for evil envisaged by the statute where there is common control of banking and nonbanking organizations. The potential evils against which the Act is directed are evils which may be said to arise from, or be accentuated by, the operation of bank holding companies. Since area practice, acquiesced in by the Comptroller of the Currency and by State supervisory

authorities, sanctions the operation of insurance agencies in connection with both nonholding company and holding company banks, the evils, if any, incident to such relationships cannot be said to be causally connected with the operation of bank holding companies.

While stronger than the mere similarity between banking and the business of the insurance subsidiary in the Transamerica case, the qualitative relationship in the case of Mortgage is limited to the fact that property management and mortgage loan brokering are functions that are frequently performed by banks. The Applicant made no showing that it is common for banks in the area in question to have related or affiliated corporations which carry on a business of this kind.

Nor is the relationship between the business of Mortgage and the business of the Applicant's subsidiary banks of a kind that would tend to negate the potential sources of evil with which Congress was concerned. On the contrary, on the Applicant's own showing, the business of Mortgage was developed to its present size and efficiency largely because of the ample resources, the volume of business to be tapped, and the planning and managerial talent made available through the holding company form of organization. In addition, the extensive geographic spread of Mortgage's operations appears in practice to be largely unavailable to banks which are outside a holding company group. Thus, any potentiality for evil in that relationship would appear to be peculiar to holding company operation. This is not to say that such evils exist at present, or that they are imminent. Congress did not, as the Hearing Examiner pointed out, "condition its prohibitions upon the occurrence of abuses. Congressional purpose . . . was to eliminate any possibility of such occurrence."

While a substantial quantitative connection may be regarded as existing between Mortgage and the Applicant's subsidiary banks, nevertheless, for the reasons heretofore indicated, it is the Board's judgment that the activities of Mortgage are not related to the business of such banks in such a manner as clearly to be a "proper" incident thereto or as to be consistent with the purposes of the Act.

Conclusion. - After carefully considering all the relevant facts and circumstances developed at the hearing and discussed at the oral argument before the Board, as well as the Report and Recommended Decision of the Hearing Examiner, and the Applicant's exceptions and brief in support thereof, the Board has determined,

for the reasons set forth above, that the activities of Northwestern Mortgage Company are not so closely related to the business of banking, as conducted by the Applicant's subsidiary banks, as to be a proper incident thereto and as to make it unnecessary for the prohibitions of section 4 of the Act to apply in order to carry out the purposes of the Act.

Accordingly, for the reasons set forth herein, it is the Board's judgment that the requested exemption with respect to Mortgage should be denied; and it is so ordered.

II. SOUTH SIDE INSURANCE AGENCY, INC. (BHC-43)

Factual summary. - South Side Insurance Agency, Inc. ("South Side") was organized in 1922 under the laws of Minnesota to take over the insurance business formerly conducted by an unincorporated agency related to the bank which in 1927 became the Fourth Northwestern National Bank of Minneapolis ("Fourth"). The Applicant acquired stock in both South Side and Fourth in 1929, and now owns all but two of the 50 outstanding shares of the first, and 92.5 per cent of the stock of the second.

Since the bank was founded in 1899, there has always been an insurance agency operated in conjunction with Fourth and its predecessors. Despite separate incorporation, the manner of operating the agency remains substantially similar and the Hearing Examiner found that because of the historical connection "many Bank customers associate the Agency with the Bank, expect insurance as a part of bank services, and place insurance with the Agency". South Side has offices on the second floor of the building which houses Fourth, and one of the two entrances to the agency is through the bank lobby. While personnel of the two are separate, they have some common directors and officers, including the president and vice-president of each.

South Side is engaged in a general insurance business but sells no life or credit life insurance. A relatively small proportion of the insurance sold by the agency is related directly to banking transactions of Fourth. Of the premiums written in 1957, only 5.9 per cent represented insurance on real estate or personal property involved in loans by Fourth, and .8 per cent policies in which the bank was the named insured. An analysis from the side of the bank gives a more significant result. Of the $4,039,236 of loans outstanding on June 21, 1958 on which Fourth required insurance of security, 20.3 per cent

was insured through South Side. Of this figure, $2,145,812 represented real estate mortgages purchased by the bank, on which the agency presumably had no prior opportunity to write the insurance. Accordingly, the proportion of secured loans on which insurance was required which were insured through South Side, to the total of such loans which could have been so insured, was substantially in excess of 20 per cent.

Defining "customers" to include depositors, borrowers, deposit box renters, or persons whose obligations are held by the bank, about 50 per cent of the customers of the agency were also customers of the bank in 1957. Premiums on insurance written for customers of Fourth, however, represented 87.7 per cent of total premiums written by the agency in that year.

Finally, as pointed out in the Board's statement accompanying its order of this date with reference to the application of First Bank Stock Corporation for exemption of First Service Agencies, Inc., it is a fact of special significance that the operation of insurance agencies in connection with banks is a practice that has prevailed for many years in Minnesota, without evidence of objection on the part of the bank supervisory authorities. From a survey made by the Applicant and relied on by the Hearing Examiner, 48 per cent of the Minnesota banks in the classification to which Fourth belongs, i.e., national banks in places of over 5,000 population, have connected insurance agencies.

Preliminary requirement as to nature of activities. - Since South Side confines itself to selling insurance (other than life insurance) there is no question but that it meets the preliminary requirement for exemption under section 4(c)(6) of the Act - that all the activities of the company involved be of a "financial, fiduciary, or insurance nature".

Relation to banking business. - The statute and the Board's Regulation Y require that, after passing the preliminary test, the company's activities must be determined by the Board to be "so closely related" to the business of banking or of managing or controlling banks, as conducted by the Applicant and its banking subsidiaries, as to be a "proper incident" to such business and as to make it unnecessary for the prohibitions of section 4 of the Act to apply in order to carry out the purposes of the Act. This determination is to be made on the basis of all of the relevant facts and circumstances disclosed at a hearing held in the case.

The weight which the Board believes should be given these factors and circumstances is discussed at length in its Statement in the First Bank Stock Corporation matter referred to above. For the reasons there set forth, it is the Board's judgment that the direct connection between the activities of South Side and the activities of Fourth, considered in the light of the historical, physical, and personnel connection between the two, is sufficiently great as to be given strong weight, along with other pertinent factors, as suggesting the requisite close relationship required by the statute. The degree to which common customers make use of facilities offered by both is a cumulative factor entitled to be considered in this respect. Area practice, prevalent in Minneapolis as elsewhere throughout the region in which the Applicant operates, under which banks in these localities participate in insurance arrangements of the kind described in this Statement, as the Hearing Examiner points out, is a weighty circumstance when considered apart from the enactment of the Bank Holding Company Act. In the opinion of the Board, the enactment of that statute does not diminish the weight to be accorded such area practice.

Propriety of the relationship and the avoidance of potential evil. - In the language of the Hearing Examiner,

> "In general, and subject to limited exceptions, engagement by bank holding companies in nonbanking businesses presents possibility of potential harm or evil. Such possibility is avoided only where - and Congress so provided - the activities of a financial, fiduciary, or insurance subsidiary of a bank holding company are reasonably required for and appropriate to the discharge of an associated banking function. . . . . If there remains potential for evil [after the activities of such a subsidiary are shown to be so reasonably required and appropriate] it is a potential inherent in the business of banking, and - unless prohibited by section 6 of the Act [citation omitted] - not within the reach of this statute."

It was the belief of the Hearing Examiner that the propriety of the incident might be established either by showing that it is "inherently so closely related to the business of banking in general as naturally to appertain thereto" or "by a showing that the activities are so directly, appropriately, and substantially related to banking transactions in the particular case as to be considered an aspect of the banking operation". Applying these tests to the case before him, he concluded that the prevalent area practice of having insurance

agencies operated in connection with banks does not, because of the supervening policy expressed by the Bank Holding Company Act, support the propriety of the relationship. As to the substantiality of the direct connection between the two, he felt that the word "substantial" embraces at least "major part". Since connected transactions formed only 6.7 per cent of the business of the agency and less than a half, although more than a fifth, of the relevant business of the bank, he found that South Side failed to meet this test as well.

The applicant took exception to the use of both tests. While not necessarily adopting these as excluding alternative analyses, the Board differs with the Hearing Examiner as to their application. For the reasons set forth in its statement previously cited, the Board believes that the Act was directed at potential sources of evil that may be said to arise from, or be accentuated by, the operation of bank holding companies. If there is a potential for evil in the association between individual banks and related insurance agencies, this is "a potential inherent in the business of banking and . . . not within the reach of" the statute. Accordingly, the area practice may be viewed as supporting the conclusion that there is an inherent relationship between the insurance agency business and the business of banking as conducted in this area by this Applicant and its subsidiary banks, and that the business of South Side is a proper incident to the banking business of Fourth.

Turning to the Hearing Examiner's second test, after carefully considering his recommendation, the Board nevertheless believes that the percentages and other factors mentioned above are sufficiently significant to warrant the conclusion, in the light of the area practice just discussed, that the close relationship required by the statute may properly be regarded as existing in the present case.

Conclusion. - On the basis of all the circumstances - historical, physical, and personnel relationship, the extent of direct connection between the activities of the agency and the Applicant's related subsidiary bank, the degree to which common customers are enjoyed by both, and particularly the sanction given by long-established practice in the area concerned to the operation of bank-connected insurance agencies - the Board has determined that the activities of South Side Insurance Agency are so closely related to the business of banking as conducted by Fourth Northwestern National Bank of Minneapolis as to be a proper incident thereto, and as to make it unnecessary for the prohibitions of section 4 of the Act to apply in order to carry out the purposes of the Act. To the extent that they are consistent with the foregoing statement, the Applicant's exceptions to the Hearing Examiner's Report and Recommended Decision are hereby sustained.

Accordingly, for the reasons herein set forth, it is the Board's judgment that the requested exemption with respect to South Side should be granted; and it is so ordered.

As indicated in the Board's Order, its approval of this request is based solely on the facts disclosed by the record; and if the facts should substantially change in the future in such manner as to make the reasons for the Board's conclusion no longer applicable, the statutory exemption resulting from the Board's present determination would, of course, cease to obtain.

III. UNION INVESTMENT COMPANY (BHC-44)

Factual summary. - Union Investment Company ("Union") owns seven insurance agencies, each of which is operated in connection with a banking subsidiary of the Applicant. It has offices in the Northwestern Bank Building in Minneapolis. All the outstanding voting stock in Union is owned by the Applicant.

Union was organized under the laws of Delaware on October 29, 1903 and existed for many years as an independent bank holding company. In 1929, when it was acquired by the Applicant, Union owned stock in 31 banks in Minnesota, North Dakota, and Wisconsin. These stocks were gradually transferred to the Applicant in exchange for stocks in non-banking subsidiaries of banks brought into the system, so that Union could liquidate these subsidiaries, or, if thought suitable for holding company ownership, retain and manage them. The seven agencies involved in the present application comprise all of those which were finally retained. In recent years Union's liquidation activities have been of minor importance and confined to the disposition of assets of questionable banking value or character. The Company is in a position to participate at any time in the liquidation of assets, however; and it now holds $58,000 in government securities available for such purpose.

As in the case of the application by First Bank Stock Corporation with respect to First Service Agencies, Inc., decided by the Board as of this date, the issue here must depend, not upon the relationship of the business of each insurance agency to that of the bank with which it is connected, but upon the relationship of the activities of all of the insurance agencies in the aggregate to the business of banking as conducted by the Applicant and its subsidiary banks.

Each of the seven insurance agencies has been operated for a long time in connection with its related bank. Some, at least, were originally insurance departments of their banks, and became separate agencies, or were incorporated, at a later date. All the agencies are located on, or close to, bank premises. Five are directly accessible from the banking room during regular banking hours. The other two, both associated with stockyard banks and specializing in livestock transit insurance, must be reached by a public corridor or general building entrance and stairway.

Financial and organizational arrangements between the agencies and the connected banks vary; some agencies have their own employees, some use bank employees. In some cases, the licensed agents are bank officers, in others they are not. Two of the agencies, including one of the stockyard agencies, are self-sufficient financially. Others have varying arrangements under which a stated small percentage (one-half to one per cent) of net premium income goes to Union, while the balance is paid out to the bank in the form of rent and charges for personnel and supervision.

The agencies do a general insurance business, except that they write little or no life insurance. Two of the seven write a substantial amount of credit life insurance. Taking aggregate figures, 15.5 per cent of the agencies' premium income in 1957 derived from insurance related to transactions connected with the related banks (including 1.1 per cent derived from insurance where the bank was the named insured), while 21.2 per cent of their gross commissions derived from insurance so related. Viewing the related transaction in the same year from the side of the related banks, 37.5 per cent of the secured loans made by the banks on which insurance was required were insured through the related agencies.

Defining "customers" to include depositors, borrowers, deposit box renters, or persons whose obligations are held by the related banks, more than 60 per cent of the customers of the agencies were also customers of the related banks. The services offered by the two stock-yard agencies are particularly valuable to their related banks since the banks finance the livestock and packing industries, and this financing requires several highly specialized types of insurance which the agencies are peculiarly qualified to supply.

Finally, as was pointed out in the Board's Statement accompanying its order of this date with reference to the application of First Bank Stock Corporation for exemption of First Service Agencies,

it is a fact of special significance that the operation of insurance agencies in connection with banks is a practice that has prevailed for many years in the area concerned, without evidence of objection on the part of the bank supervisory authorities. Each of the seven agencies is connected with a national bank which is located in a town of over 5,000 population. According to a survey made by the Applicant and relied on by the Hearing Examiner, 48 per cent, 64 per cent and 31 per cent, respectively, of banks falling into this classification in the States of Minnesota, North Dakota and Iowa, where the seven banks are located, have related insurance agencies.

Preliminary requirements as to nature of activities. - Except for its liquidating activities, all of the functions of Union are clearly of an insurance nature and therefore meet the preliminary requirement of section 4(c)(6). The liquidating activities of Union would be exempted under another subsection of the statute. For the reasons set forth in the Statements accompanying the Board's decisions of this date with respect to requests by First Bank Stock Corporation, Bank Shares, Inc., and Otto Bremer Company, the Board agrees with the Hearing Examiner that the fact that part of Union's activities may be entitled to exemption under one section of the Act and part under another creates no barrier to a favorable decision on the application. The Board agrees with the finding of the Hearing Examiner that the liquidating activities of Union would not bar exemption under section 4(c)(6).

Closeness and propriety of relationship. - On the basis of the record and particularly the facts heretofore stated, it is the Board's view that the activities of Union bear a direct and substantial relationship to the business of the Applicant's subsidiary banks. For reasons set forth in the Board's Statement of this date with respect to the request of First Bank Stock Corporation for exemption as to First Service Agencies, Inc., the Board believes that the activities of Union should not be regarded as an "improper" incident to the business of such subsidiary banks merely because those banks are national banks which may not themselves act as insurance agents. Also for reasons set forth in that Statement, the Board concludes that the prevalence in the area concerned of bank-connected insurance agencies with respect to nonholding company as well as holding company banks negatives the existence of the potential sources of evil contemplated by the Bank Holding Company Act, and that, therefore, the relation of Union's activities to the business of the Applicant's banks is not inconsistent with the purposes of the Act.

Conclusion. - After carefully considering all the circumstances - historical, physical, and personnel relationship, the extent of direct connection between the activities of Union's insurance agencies and the Applicant's related subsidiary banks, the degree to which common customers are enjoyed by both, the peculiar importance of the two stockyard agencies to their respective related banks, and particularly the sanction given by long-established practice in Minnesota, North Dakota and Iowa to the operation of bank-connected insurance agencies - the Board has determined that the activities of Union Investment Company are so closely related to the business of banking as conducted by the seven related banking subsidiaries of the Applicant as to be a proper incident thereto and as to make it unnecessary for the prohibitions of section 4 of the Act to apply in order to carry out the purposes of the Act. To the extent that they are consistent with the foregoing statement, the Applicant's exceptions to the Hearing Examiner's Report and Recommended Decision are hereby sustained.

Accordingly, for the reasons herein set forth, it is the Board's judgment that the requested exemption with respect to Union Investment Company should be granted; and it is so ordered.

As indicated in the Board's Order, its approval of this request is based solely on the facts disclosed by the record; and if the facts should substantially change in the future in such manner as to make the reasons for the Board's conclusion no longer applicable, the statutory exemption resulting from the Board's present determination would, of course, cease to obtain.

July 21, 1959.

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

Item No. 9
7/21/59

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

July 22, 1959

Mr. W. R. Diercks, Vice President,
Federal Reserve Bank of Chicago,
Chicago 90, Illinois.

Dear Mr. Diercks:

This refers to the request of St. Joseph Agency, Inc. ("Agency") and St. Joseph Bank and Trust Company ("Bank"), both of South Bend, Indiana and both registered bank holding companies, for interpretations by the Board regarding the following questions in connection with the insurance activities presently engaged in by Agency:

A. Whether the general casualty insurance business of Agency is exempt from the divestment requirements of section 4(a) of the Bank Holding Company Act by virtue of either (1) the provision of 4(a)(2) relating to furnishing or performing services by a holding company for a subsidiary bank or (2) the provision of 4(c)(6) which exempts ownership by a holding company of shares in certain "closely-related" organizations;

B. Whether, if the Board should hold that the general casualty insurance business of Agency is subject to the divestment requirements of the Act, then, as an alternative, Bank (the parent of Agency) may establish, operate and maintain a general casualty insurance business as a department of the bank.

As you will recall, the Board has extended to November 9, 1959 the period within which Agency could retain its insurance business.

Relations between Agency and Bank. - Bank as trustee holds all of the outstanding voting shares of Agency for the benefit of the bank's shareholders. Agency owns a majority of the outstanding voting shares of two insured nonmember Indiana State banks: Hamlet State Bank and Central State Bank of Lakeville. In addition, Agency conducts a general casualty insurance business which, it contends, is maintained for the purpose of furnishing services to or performing services for Bank, the two banks owned by Agency, and customers of those three banks.

It is also understood that Agency handles the Bankers' Blanket Bonds, fire and extended coverage insurance, public liability and property damage insurance of the three banks; that the board of directors of Bank is the same as board of directors of Agency; that a vice president of Bank is also president of Agency as well as a director of one of the two banks owned by Agency; that employees of Agency and Bank are covered under the same pension plan and group insurance plan; that employees of Agency make calls upon customers of Bank and customers of the two banks Agency owns, representing both banking and insurance services; that the physical location of Agency is on the first floor of the "St. Joseph Bank Building" and is designated in that building as "Insurance Department".

It is further understood that under Indiana law, a State bank is allowed to operate and maintain an insurance department. In this connection it is noted that Agency is considered and treated by the Indiana Department of Financial Institutions as part of the banking operations of Bank and that both that Department and the Federal Deposit Insurance Corporation require examinations of Agency as a part of the regular examination of Bank.

Insurance operations of Agency. - The primary question presented is whether Agency's engaging in a general casualty insurance business would be engaging, as provided by the exceptive language of section 4(a)(2), in "furnishing services to or performing services for" a subsidiary bank. If the servicing provision applies, Agency could retain its insurance business.

As you know, section 4(c)(1) provides a parallel exemption relating to ownership by a holding company of shares of a servicing company. In this connection the Board has ruled that a company which writes comprehensive automobile insurance and life insurance for subsidiary banks of a holding company could not be regarded under section 4(c)(1) as a company engaged "solely in the business of furnishing services to or performing services for" a holding company or its subsidiary banks (44 Federal Reserve Bulletin 1280). While section 4(c)(1) relates to ownership of shares, it would seem to follow, a fortiori, that the principle underlying the Board's ruling would be applicable to the direct engaging by a bank holding company in an insurance activity. Such an interpretation would also be in accord with the legislative intent of the Act and general principles of statutory construction. Accordingly, in the opinion of the Board, the insurance activities of Agency cannot be regarded as "furnishing services to or performing services for" its banking subsidiaries within the purview of section 4(a)(2) so as to be exempt from the prohibitions of that section.

Agency raises alternatively the question of the possible applicability of section 4(c)(6) which provides for exemption of shares of corporations engaged in certain closely-related activities. In the opinion of the Board, section 4(c)(6) is not here applicable and affords no relief to Agency, since it refers only to ownership of shares of an organization whose activities are of a "financial, fiduciary, or insurance" nature and which are determined to be "so closely related to the business of banking or of managing or controlling banks as to be a proper incident thereto". No such ownership of shares exists in this case. Accordingly, in the opinion of the Board, section 4(c)(6) is not applicable to the question of Agency's retention of its insurance activities.

(Of course, if the insurance business of Agency were carried on by a corporate subsidiary of Agency, it would then be appropriate to consider a request for a determination under section 4(c)(6)).

Insurance operations of Bank. - In view of the Board's opinion regarding the foregoing questions, it is necessary to consider the question whether Bank may take over and operate the insurance business presently conducted by Agency. This involves the fundamental question of whether a holding company which is also a bank may engage in a business which is permitted to a bank under State law but which would ordinarily be considered to be nonbanking business if engaged in by a corporation other than a bank.

In the Board's opinion, section 4 of the Act was not intended to limit the business of banks where they are authorized by the applicable banking laws to engage in activities usually engaged in by other types of corporations. Consequently, while the prohibitions of section 4(a)(2) apply to nonbanking activities - as that term is generally understood - of a holding company that is not a bank (as hereinabove ruled with respect to Agency), they do not, in the Board's opinion, apply to such activities on the part of a holding company that is a bank if those activities are authorized for banks by the applicable banking laws. In such a case, the holding company would not, for this purpose, be engaging in an activity "other than that of banking". To state the matter differently, as far as section 4 is concerned, an activity which is permissible for a bank under State law is equally permissible for a bank which is a bank holding company under the Bank Holding Company Act.

It is the Board's view, therefore, that if St. Joseph Bank and Trust Company, a banking institution, is authorized by Indiana State law to engage in an insurance business such as that

presently operated by St. Joseph Agency, it could engage in such a business without violating section 4(a)(2) of the Bank Holding Company Act.

It would be appreciated if you would transmit the substance of this letter to St. Joseph Agency, Inc., St. Joseph Bank and Trust Company, and Mr. Charles M. Boynton of the law firm of Doran and Manion, counsel for both bank holding companies.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

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

Item No. 10
7/21/59

July 21, 1959.

Dear Sir:

At the Conference of Chairmen and Deputy Chairmen of the Federal Reserve Banks on December 5, 1958, reference was made to the fact that the Board's staff had under review the procedure for nomination and election of Class A and Class B directors of Federal Reserve Banks. As you know, the current procedure is based upon a committee report approved by the Board in 1927, as modified and supplemented in a number of respects by subsequent letters and interpretations of the Board. For the most part, these letters and rulings are set forth in the Federal Reserve Loose-Leaf Service #3110-#3121.

In recent months several questions with respect to the election procedure have suggested the desirability of a complete review of that procedure, particularly in the light of the time that has elapsed since it was originally adopted.

Enclosed is a draft of a proposed revision of the election procedure that would collect into one place and supersede all outstanding instructions and, at the same time, seek to simplify and clarify certain aspects of the procedure. The bracketed references are to outstanding letters now contained in the Loose-Leaf Service and to old Exhibits corresponding to the proposed new Exhibits. These are included in the draft for your convenience and would, of course, be omitted from the finally revised instructions.

The principal changes of substance would be the inclusion of express authorization for delegation of functions of the Chairman of the board of directors in the conduct of an election, and the elimination of spaces for specimen signatures on the form of resolution for designation by member banks of officers authorized to cast their votes. The latter change is based on the assumption that each Federal Reserve Bank has a current file of signatures of all member bank officers that is available to the Chairman.

Since the experience of your Bank in connection with elections may have suggested other changes in the procedure, it will be appreciated if you will review the enclosed draft. With the hope that the procedure may be revised in time for use in the next election of directors, the Board would like to receive your comments not later than August 17, 1959.

Very truly yours,

Merritt Sherman,
Secretary.

Enclosure.

TO THE CHAIRMEN OF ALL FEDERAL RESERVE BANKS

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

Item No. 11
7/21/59

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

BY MESSENGER

Mr. Paul Myron, Deputy Director,
Office of Alien Property,
Department of Justice,
Washington 25, D. C.

Dear Mr. Myron:

Reference is made to the detail to the Board of Governors of your Mr. Harry R. Hinkes, Hearing Examiner, GS-14, previously agreed to by you under letter dated March 31, 1959.

Under the terms of Mr. Hinkes' detail, he was made available to this Board for a three-month period beginning April 15, 1959, to preside at a hearing ordered by the Board of Governors pursuant to the Bank Holding Company Act of 1956. It was agreed that the Office of Alien Property would be reimbursed for Mr. Hinkes' salary on the basis described in the Board's letter of March 30, 1959, and for any travel expenses involved in his detail to the Board.

It now appears that Mr. Hinkes' services will be required for an additional time in order that he may complete his work on the hearing over which he is now presiding. It is difficult at this time to predict the exact additional time which will be required to complete this work. However, it is believed that an additional period of 60 days would reasonably cover any remaining services which will be required.

Therefore, the Board of Governors requests that the Office of Alien Property extend Mr. Hinkes' detail for an additional period of 60 days beginning July 15, 1959, on the same basis as the original detail as set forth in the Board's letter dated March 30, 1959.

It will be appreciated if you will confirm this extension of the reimbursable detail in order that the necessary arrangements can be made with the Civil Service Commission in connection with the confirmation of extension of Mr. Hinkes' services.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Secretary.

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

Item No. 12
7/21/59

July 21, 1959.

Dear Sir:

The Board has reviewed recent progress in the development of monthly data on electric power sales by industry and is considering the incorporation of this project as a regular part of the System's statistical program. In considering the project, the Board had before it Mr. Ralph A. Young's memorandum of June 26, 1959, a copy of which is enclosed, to which is attached a copy of the June 16, 1959 interim report of the Research Advisory Committee's Ad Hoc Subcommittee on the Electric Power Project.

Underlying the recommendation of the Subcommittee was the agreement on (a) the importance of the power data for improving the Board's industrial production index; (b) the progress achieved in obtaining agreements to cooperate from leading utilities companies located in 10 Federal Reserve Districts; (c) the usefulness of the power figures for studying regional developments; and (d) the importance of Systemwide participation to obtain the requisite coverage and coordination for a national statistical program of this kind.

The Board was favorably inclined toward the recommendation that the development of electric power data be made a Systemwide undertaking, such recommendation having been made by the Subcommittee at its meeting on May 27, 1959. To assist in reaching a final conclusion, the Board would appreciate receiving views and suggestions that your Bank may have regarding the formal adoption of this project as a part of the System's statistical program.

Very truly yours,

Merritt Sherman,
Secretary.

Enclosure

TO THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS