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# BANK AFFILIATES AND THEIR REGULATION: PART III

*Parts I and II of this series discussed the events that led to the bank affiliate legislation of 1933 and described the bank affiliate provisions adopted in that year, including the first statutes designed to regulate bank holding companies. The 1933 bank holding company legislation proved to be inadequate; and bills designed to limit and control the growth of such companies, especially Transamerica Corporation, were introduced in Congress throughout the 1940's. When these bills failed to pass, an antitrust proceeding was begun against Transamerica in 1948. The case was lost, but the defeat spurred new legislative efforts that resulted in comprehensive Federal regulation of bank holding companies. In this concluding article, current regulatory provisions applicable to affiliation by means of bank holding company ownership are discussed.*

Efforts to obtain bank holding company legislation intensified after the antitrust case against Transamerica failed in 1953. At least five bank holding company bills were introduced in 1955, and extensive hearings were held before committees of both the House and the Senate. Again, as in prior years, the Independent Bankers Association took the lead in demanding legislation. Indeed, the primary reason for existence of this organization was to lead the fight against bank holding companies, and it was supported by many small banks across the nation, who were convinced that bank holding companies were being used as a device to evade Federal and state laws restricting branch banking and to bring about concentration in banking.[1]

In reality, however, there had been little if any growth of bank holding companies, in the aggregate, since enactment of the holding company affiliate legislation of 1933. As of December 31, 1954, only 391 banks were owned by the 46 known multi-bank holding companies, i.e., companies that owned or controlled 25 percent or more of the stock of each of two or more banks. Total deposits of these banks amounted to $14.3 billion, or just 7.7 percent of total commercial bank deposits in the United States;[2] and 18 of these companies with 254 banks and aggregate deposits of $10.8 billion were already regulated under the 1933 holding company affilate legislation. Moreover, of the 18 regulated companies, only Transamerica combined banking and nonbanking activities to any significant extent. Five of the 18 companies had no nonbanking subsidiaries at all. Although the remaining 13 had 82 nonbanking subsidiaries with total assets of $687 million, Transamerica and its 23 nonbanking subsidiaries alone accounted for $654 million, or almost 96 percent.[3]

The lengthy, extensive hearings in 1954 and 1955 not only established that bank holding companies as a group did not grow appreciably between 1933 and 1955—they also failed to produce any significant evidence of abuse of power or improper use of bank resources by such companies in the years following the 1933 holding company affiliate legislation. On the contrary, all three Federal bank supervisory agencies concurred in the view that, on balance, experience with bank holding companies and their operations had been favorable since that time. The Comptroller of the Currency reported that all of the 179 national banks controlled by bank holding companies were well-rated and were being operated successfully.[4] Similarly, the Chairman of the Fed-

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[1] Hearings on S. 76 and S. 118, 83rd Cong., 1st Sess. (1953), p. 58.

[2] "Control of Bank Holding Companies," Hearings on S. 880, S. 2350, and H.R. 6227, 84th Cong., 1st Sess. (1955), p. 54.

[3] *Ibid.*, pp. 62-3.

[4] Hearings on H.R. 2674, 84th Cong., 1st Sess. (1955), p. 131. During the 1953 hearings the Deputy Comptroller of the Currency discussed one situation in which a finance company based in Dallas, Texas, had purchased control of three small state banks located in Chicago, then proceeded to sell large amounts of doubtful finance paper to the banks on a "without recourse" basis, and to borrow from the banks. Initially, the Deputy Comptroller took the position that the improper use of bank resources could have been prevented by the pending bank holding company bills. Later, however, he revised his opinion to acknowledge that the root of the problem lay in the fact that existing affiliate provisions in Section 23A of the Federal Reserve Act limiting financial dealings between banks and their affiliates did not, at that time, apply to insured state banks that were not members of the Federal Reserve System. This situation was remedied in 1966 by making Section 23A of the Federal Reserve Act applicable to insured nonmember banks. *Supra*, note 1, p. 103. Section 18(J) of the Federal Deposit Insurance Act now provides as follows:

> (J) The provisions of Section 23A of the Federal Reserve Act, as amended, relating to loans and other dealings between member banks and their affiliates, shall be applicable to every nonmember insured bank in the same manner and to the same extent as if such nonmember insured bank were a member bank; and for this purpose any company which would be an affiliate of a nonmember insured bank, within the meaning of Section 2 of the Banking Act of 1933, as amended, and for the purposes of Section 23A of the Federal Reserve Act, if such bank were a member bank shall be deemed to be an affiliate of such nonmember bank. 80 Stat. 242 (1966).

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eral Deposit Insurance Corporation filed a statement indicating that banks owned by bank holding companies presented fewer problems with regard to asset control and management than independently-owned banks.[5]

Yet Transamerica's uncontrolled growth and expansion over the years demonstrated the inadequacy of the 1933 holding company affiliate provisions in certain respects. Commenting on its experience administering the 1933 provisions, the Board of Governors advised Congress:

> These provisions of existing law regulate the activities of a bank holding company only if it happens to control a member bank and only if it desires to vote the stock of that bank. In effect, therefore, regulation is largely voluntary on the part of the holding company. Even if a voting permit is obtained, the regulation to which a holding company is subject is aimed mostly at protecting the soundness of the member banks in the group.
>
> These provisions, therefore, do not deal at all with two apparent problems in the bank holding company field. In the first place, there is nothing in present law which restricts the ability of a bank holding company to add to the number of its controlled banks. Consequently, there can well be situations in which a large part of the commercial banking facilities in a large area of the country may be concentrated under the management and control of a single corporation.
>
> In the second place, there is nothing in existing law which prevents the combination under the same control, through the holding company device, of both banking and nonbanking enterprises. Obviously, this makes it possible for the credit facilities of a controlled bank to be used for the benefit of the nonbanking enterprises controlled by the holding company. Moreover, the ordinary nonbanking business requires a managerial attitude and involves business risks of a kind entirely different from those involved in the banking business. Banks operate largely on their depositors' funds. These funds should be used by banks to finance business enterprises within the limitations imposed by the banking laws and should not be used directly or indirectly for the purpose of engaging in other businesses which are not subject to the safeguards imposed by the banking laws.[6]

## THE BANK HOLDING COMPANY ACT OF 1956

The Bank Holding Company Act of 1956 was designed to remedy the two "apparent problems" described by the Board of Governors. Bank holding companies were prohibited from acquiring additional banks or from engaging in nonbanking activities except to the extent authorized by the Act or by the Board of Governors acting pursuant to statutory authority. To guide the Board in exercising its discretion, antitrust principles were incorporated into the pattern of affiliate regulation. As stated in a Senate Committee Report:

> The Bank Holding Company Act of 1956 was the result of many years of effort. It was intended to apply in the field of banking and bank holding companies the several purposes of the antitrust laws—to promote competition and to prevent monopoly, and the general purposes of the Glass-Steagall (Banking) Act of 1933—to prevent unduly extensive connections between banking and other businesses. . . .[7]

**Coverage of the Statute** At the outset, the decision was made to exclude ownership or control by individuals, *acting on their own behalf and in their individual capacity,* from the special restrictions on permissible affiliation imposed by the Bank Holding Company Act. The rationale for this decision was explained by Governor Robertson in the course of the hearings:

> (Control by individuals) is subject to an inherent limitation, in that the stock is dispersed either through sales while the individuals are alive, or through disposition of their estates after they die. There is very little you can do about that, in my opinion, and I do not believe that it is especially dangerous. In the first place, the number of banks which can be controlled in that manner is limited by the amount of funds which the individual or individuals have, as contrasted with a situation where, in holding company banking, you have a corporation which has the facilities for gathering large quantities of money with which to buy new banks or, by exchanging stock of the holding company for the stock of the bank. . . .[8]

Another decision at the heart of the 1956 legislation—but one that was reversed in 1970—was to exclude bank holding companies that controlled only one bank. As pointed out by the Board on numerous occasions during the hearings prior to 1956, abuses that result from combining both banking and nonbanking businesses can exist regardless of whether one bank or more than one bank is controlled.[9] Nevertheless, Congress excluded one-bank holding

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[5] "Control of Bank Holding Companies," Hearings on S. 880, S. 2350 and H.R. 6227, 84th Cong., 1st Sess. (1955), p. 99.

[6] *Supra,* note 4, pp. 13-14.

[7] S. Rep. No. 1179, 89th Cong., 2nd Sess. (1966), 2 *U. S. Code Congressional and Administrative News* (1966) at p. 2386.

[8] *Supra,* note 4, p. 84. Affiliation by means of individual ownership or control is, of course, subject to the affiliate provisions imposed in 1933, involving restrictions on financial dealings with affiliates, examinations by and reports to Federal supervisory authorities, and the separation of ownership and control of securities dealers and member banks. Except as prohibited by the 1933 affiliate legislation, therefore, Congress in 1956 decided not to prohibit affiliation of banks and nonbank businesses where ownership is by individuals on their own behalf and in their individual capacity instead of by bank holding companies.

[9] See, *e.g.,* "Hearings on H.R. 2674," 84th Cong., 1st Sess. (1955), p. 15.



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companies from regulation in 1956.[10] Because of the phenomenal growth of one-bank holding companies after 1966, however, these companies were brought under regulation effective December 31, 1970.

At present, therefore, the term "bank holding company" is defined to include any corporation, partnership, business trust, association, or similar organization, or any long-term trust that owns, controls, or holds with power to vote 25 percent or more of the voting shares of any one bank, or controls in any manner the election of a majority of the directors or trustees of a bank, or which exercises a controlling influence over the management or policies of a bank.[11]

Every organization coming within the definition of a "bank holding company" must register with the Board of Governors, and the Board's prior approval must be obtained for the formation of any new bank holding company. All bank holding companies must obtain the Board's prior approval for the acquisition of ownership or control of more than 5 percent of the voting shares of any bank, or for the acquisition of substantially all of the assets of a bank, or for any merger or consolidation with any other bank holding company.

**Supervision of Bank Holding Companies** Federal supervision and examination of banks is divided among three agencies: the Comptroller of the Currency for national banks, the Federal Deposit Insurance Corporation for insured state banks that do not belong to the Federal Reserve System, and the Board of Governors for insured state banks that are members of the Federal Reserve.[12] On top of this cumbersome machinery, the Bank Holding Company Act lodges additional supervisory authority in the Board of Governors over all holding companies and all of their subsidiaries, including banks as well as nonbanking companies. The Board is authorized to issue such regulations and orders as may be necessary to enable it to administer and carry out the purposes of the Bank Holding Company Act and prevent evasions of it. In addition, the Board may require reports under oath to keep it informed of compliance with the Act and the Board's regulations and orders issued pursuant thereto. The Board may also examine all bank holding companies and their bank and nonbank subsidiaries but is directed "as far as possible" to use reports of examination made by other agencies.[13]

**Restrictions on Financial Relationships** Every subsidiary bank of a holding company is required to be an insured bank and is therefore subject to Section 23A of the Federal Reserve Act in lending to, extending credit to, or investing in any other subsidiary or the parent holding company itself, or in accepting the capital stock, bonds, debentures, or other such obligations of any other subsidiary or of the parent company as collateral security for advances made to any person, partnership, association, or corporation. These provisions effectively limit the amount of a subsidiary bank's funds that may be used for the benefit of an affiliate in the holding company system to 10 percent of the bank's capital and surplus, in the case of any one such affiliate, and to a maximum of 20 percent of the bank's capital and surplus in the case of all such affiliates in the aggregate. Further protection is afforded by the requirement of Section 23A that even the limited permissible amount of loans to, extensions of credit to, and investments in other subsidiaries in the holding company system be well secured by stocks, bonds, debentures, or other such obligations.[14]

## REGULATING EXPANSION OF BANK HOLDING COMPANIES

The power of bank holding companies to expand by acquiring banks and nonbank businesses was brought under Federal regulation with the Bank Holding Company Act of 1956. A fundamentally different approach, however, was used to control bank holding company growth by acquisitions of

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[10] In 1956, the Senate Report gave this reason for its decision not to cover one-bank holding companies:

> Your committee did not deem it necessary to include within the scope of this bill any company which manages or controls no more than a single bank. It is possible to conjure up visions of monopolistic control of banking in a given area through ownership of a single bank with many and widespread branches. However, in the opinion of your committee, no present danger of such control through the bank holding company device threatens to a degree to warrant inclusion of such a company within the scope of this bill. Should legislation of that nature prove desirable in the future, the Congress is free to act upon a showing of need for such a law. S. Rep. No. 1095, 84th Cong., 1st Sess. (1955), p. 7.

Ten years later Congress again declined to accept the Board's recommendation that one-bank holding companies be brought under regulation, but for a different reason. On that occasion the Senate Committee report stated:

> After considering all of this testimony, the committee came to the conclusion that there was no substantial evidence of abuses occurring in one-bank holding companies. Furthermore, the committee received much testimony to the effect that repeal of the exemption would make it more difficult for individuals to continue to hold or to form small independent banks . . . However, in order to minimize the danger that conflicts of interest might occur in this field, the committee amended the Federal Deposit Insurance Act so as to make the provisions of Section 23A of the Federal Reserve Act relating to transactions between a bank and its affiliates applicable to all banks. S. Rep. No. 1179, 89th Cong., 2nd Sess. (1966), *U. S. Code Congressional and Administrative News*, Vol. 2, p. 2389 (1966).

As has been shown, there was no evidence of substantial abuses occurring in multi-bank holding companies from 1933 to 1956, when the Bank Holding Company Act was enacted.

[11] 12 U.S.C. §1841. Certain exceptions from coverage of the statute are provided in Section 2(a)(5) thereof. Probably the most important of these permits banks to own shares of other banks in a fiduciary capacity without becoming regulated bank holding companies, except to the extent that this class of ownership is specifically covered in Sections 2(g)(2) and (3) of the Act.

[12] See, *e.g.*, 12 U.S.C. §1818.

[13] 12 U.S.C. §1844.

[14] The relevant paragraphs of Section 23A are quoted in full in footnote 7 of Part II.

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banks from the method adopted to regulate nonbanking expansion.

**Bank Acquisitions and the Formation of Bank Holding Companies** Under Section 3 of the Bank Holding Company Act, prior approval by the Board of Governors is required for the formation of a bank holding company, for the acquisition by such a company of more than 5 percent of the voting shares of a bank, for the merger or consolidation of two or more bank holding companies, or for the acquisition of substantially all of the assets of a bank by a bank holding company.[15]

In every case, the Board is required to take into consideration the financial and managerial resources and future prospects of the applicant and the banks concerned, as well as the convenience and needs of the community to be served. The Board, however, has considerable discretion in applying these standards. Approval of an application is absolutely prohibited only where very serious antitrust consequences would result. Thus, Section 3(c) of the Act provides that the Board "shall not approve" any such transaction if it will result in a monopoly, or be in furtherance of any combination or conspiracy to monopolize or to attempt to monopolize the business of banking in any part of the United States. In addition, the Board is not permitted to approve any other application under Section 3 if the effect of the transaction may be substantially to lessen competition, or to tend to create a monopoly, or which in any other manner would be in restraint of trade, unless the Board finds that the anticompetitive effects of the proposed transaction are clearly outweighed by its probable effect in meeting the convenience and needs of the community to be served.[16]

[15] Mergers of banks are not included within the Board's jurisdiction under the Bank Holding Company Act. However, prior approval of all bank mergers, where the surviving bank is an insured bank, is required under Section 18(c) of the Federal Deposit Insurance Act, and the same statutory standards must be applied by the Federal banking agency acting on the merger application that govern applications to acquire a bank by a bank holding company. Under the Bank Holding Company Act, the requirement of prior approval does not apply where shares are acquired by a bank in a fiduciary capacity, with certain exceptions specified in Section 3(a) of the Act; to shares acquired in the regular course of securing or collecting a debt previously contracted in good faith, provided the shares are disposed of within two years from the date they are acquired; and to additional shares acquired by a bank holding company in a bank in which such holding company owned or controlled a majority of the voting shares prior to such acquisition.

[16] 12 U.S.C. §1842. Before 1966, substantially different criteria governed the approval of Section 3 applications. From 1956 until the Act was amended in 1966, the Board was required to take into consideration the following factors in acting on Section 3 applications: (1) the company or companies and the banks concerned; (2) their prospects; (3) the character of their management; (4) the convenience, needs, and welfare of the communities and the areas concerned; and (5) whether or not the effect of the acquisition or merger or consolidation would be to expand the size or extent of the bank holding company system involved beyond limits consistent with adequate and sound banking, the public interest, and the preservation of competition in the field of banking. (70 Stat. 135.) Between 1957 and 1966 the Board repeatedly advised Congress of its difficulties in attempting to balance the "convenience and needs" test of the fourth statutory factor with the "size or extent" test in the fifth factor. In 1966, Congress responded by substituting the antitrust and banking considerations described in the text for the five criteria of the original 1956 Act.

**The Geographic Restriction on Expansion** Apart from the restriction on approval of Section 3 applications that would produce significantly adverse antitrust effects, the Act in effect confines the growth of bank holding companies by means of bank acquisitions to a single state for each company. Section 3(d) prohibits the Board of Governors from approving any application to acquire any voting shares of, interest in, or substantially all of the assets of a bank located outside of the state in which the operations of the applicant holding company's banking subsidiaries were principally conducted on July 1, 1966, or the dated the applicant became a bank holding company, whichever is later, unless such an acquisition ". . . is specifically authorized by the statute laws of the State in which such bank is located, by language to that effect, and not merely by implication."[17] As of the end of 1972, Iowa was believed to be the only state that had affirmative legislation of this kind, but even this legislation is said to authorize acquisitions by out-of-state holding companies to a limited extent only.[18]

**Growth of Bank Holding Companies** Very little growth of regulated bank holding companies occurred from 1956 through 1965, as shown by data in Table I. In the earlier year there were 53 such companies with 428 banks and total deposits of $14.8 billion, or just 7.5 percent of total commercial bank deposits in the United States. Nine years later there were still only 53 registered multi-bank companies, and the aggregate deposits of their 468 banks amounted to $27.5 billion, or 8.3 percent of total commercial bank deposits in the nation.

From 1965 through 1970, however, substantial growth of multi-bank companies occurred. By the end of the latter year, 121 companies were registered with the Board of Governors, with 895 banks and deposits of $78.0 billion. This represented 16.2 percent of total deposits, almost double the percentage just five years earlier.

Even more dramatic growth occurred among unregulated one-bank holding companies after 1965, however. In that year there were 550 of these concerns, but most of them were relatively small organizations that controlled rather small banks.[19] Their deposits amounted to only $15.1 billion, or 4.5 percent of total deposits, approximately half the size of the deposits controlled by regulated multi-bank companies.

[17] 70 Stat. 134 (1956), as amended 80 Stat. 237 (1966).

[18] Speech, Jerome W. Shay, January, 1973.

[19] *Federal Reserve Bulletin*, December, 1972, pp. 999-1000.



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Table I

**COMPARISON OF OFFICES AND DEPOSITS OF BANKS AFFILIATED WITH REGISTERED BANK HOLDING COMPANIES**

| | 1956 | 1960 | 1965 | 1968 | 1969 | 1970 | 1971* |
|---|---|---|---|---|---|---|---|
| Number of companies | 53 | 47 | 53 | 80 | 97 | 121 | 1,567 |
| Banks | 428 | 426 | 468 | 629 | 723 | 895 | 2,420 |
| Branches | 783 | 1,037 | 1,486 | 2,262 | 2,674 | 3,260 | 10,832 |
| Total offices | 1,211 | 1,463 | 1,954 | 2,891 | 3,397 | 4,155 | 13,252 |
| Offices as a percentage of all bank offices | 5.7 | 6.1 | 6.7 | 8.9 | 10.1 | 11.8 | 36.1 |
| Deposits (In billions of dollars) | 14.8 | 18.2 | 27.5 | 57.6 | 62.5 | 78.0 | 297.0 |
| Deposits as a percentage of all bank deposits | 7.5 | 7.9 | 8.3 | 13.2 | 14.3 | 16.2 | 55.1 |

*The 1971 figure includes one-bank holding companies, brought under regulation by the Bank Holding Company Act for the first time on December 31, 1970. As of December 31, 1965, however, a total of 550 one-bank holding companies accounted for only 4.5 percent of total United States bank deposits, and multi-bank companies for 8.3 percent, or a total of 12.8 percent.

Source: Board of Governors of the Federal Reserve System.

Then, between 1966 and 1968, 201 new one-bank holding companies were formed, and between June 1968 and December 1970, an additional 690 such companies were created. Many of the new companies owned very large banks. By the end of 1968 there were 28 companies whose banks had $1 billion or more of deposits, and by this time most of the nation's largest banks had been absorbed into one-bank holding companies. As of June 1971, one-bank holding companies had aggregate deposits of $191 billion, or over 33 percent of total bank deposits in the country, compared with only about 20 percent for multi-bank companies.[20] Combined, by the end of 1971 there were 1,567 multi-bank and one-bank holding companies, accounting for $297.0 billion in deposits, or 55.1 percent of total deposits; and both classes of companies were regulated by the Board of Governors on the same basis as a consequence of the 1970 amendments to the Bank Holding Company Act.

## Nonbank Activities of Bank Holding Companies

Both multi-bank and one-bank holding companies have been subject to the same provisions of law regulating the extent of permissible nonbank activities since the amendments to the Bank Holding Company Act became effective on December 31, 1970.[21] Section 4 of the Act prohibits bank holding companies from (1) owning any voting shares of any company that is not a bank, or (2) engaging in any activities other than banking or managing and controlling banks, or (3) furnishing services to or performing services for their subsidiaries, except as specifically authorized by the Act itself or by the Board of Governors under authority of Section 4 (c)(8) of the Act.

Under Section 4(c)(8), bank holding companies are authorized to acquire shares of any company the activities of which have been determined by the Board of Governors, after notice and opportunity for hearing, to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. In making these determinations, the Board is required to consider whether the performance of a particular activity by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased

[20] *Ibid.*, pp. 999-1003; Table I.

[21] A "grandfather" clause of the 1970 amendments provides that one-bank holding companies brought under regulation as a result of such amendments may continue to engage in activities that they were engaged in on June 30, 1968, and have been continuously engaged in since that time. The Board, however, is authorized to terminate this authority if it determines that such action is necessary to prevent undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices. In the case of any company with "grandfather" privileges that controls a bank having assets in excess of $60 million, the Board is required to make a determination regarding continuation of "grandfather" authority within two years after December 31, 1970, or two years after the date on which the bank assets first exceed $60 million.



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competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices. In issuing orders or regulations pertaining to 4(c)(8) activities, the Board is authorized to differentiate between proposals to acquire going concerns and proposals to commence activities *de novo* (that is, by organizing a new company instead of by acquiring an existing company with an established market position). The Board has, in fact, adopted procedures that favor expansion by *de novo* entry as compared with acquisitions of established companies.

Table II

**NONBANKING ACTIVITIES UNDER SECTION 4(c)(8)**

**AUTHORIZED**

1. Issuing letters of credit and accepting drafts
2. Making mortgage loans
3. Consumer finance activities
4. Operating credit card company
5. Factoring
6. Operating an industrial bank
7. Servicing loans
8. Providing trust services
9. Acting as investment and financial adviser as specifically authorized
10. Furnishing general economic information and advice
11. Providing portfolio investment advice
12. Leasing of personal property on a full-payout basis
13. Making investments in community welfare projects
14. Providing bookkeeping or data processing services
15. Acting as insurance agent or broker where insurance is connected with an extension of credit
16. Underwriting of credit life insurance and credit accident and health insurance that is directly related to extensions of credit by the bank holding company system

**DENIED**

1. Insurance premium funding
2. Underwriting general life insurance
3. Real estate brokerage
4. Land development
5. Real estate syndication
6. Property management
7. Management consulting
8. Owning savings and loan associations (This activity may be the subject of further consideration by the Board)

**UNDER CONSIDERATION**

1. Leasing real property
2. Furnishing armored car and courier services
3. Providing mortgage guarantee insurance

Source: Regulation Y, 12 C.F.R. 225.4(a), for authorized activities; 12 C.F.R. 225.126 for activities denied on ground that they are not closely related to banking. The authorized activities set forth in 12 C.F.R. 225.4(a) have been broken down into their constituent parts for purposes of this table. Section 225.4(a) of Regulation Y and applicable interpretations by the Board should be consulted for precise language of authorization by the Board of Governors to engage in permissible nonbanking activities.

Thus far, 10 types of nonbanking activities, which may be broken down into at least 16 specific activities, have been authorized under Section 4(c)(8). Eight have been ruled to be not permissible, and three were under consideration at the time this article was completed. These are described in Table II.

No official figures have yet been published by the Board of Governors indicating the extent of entry by bank holding companies into nonbanking activities authorized under Section 4(c)(8) since this section was amended on December 31, 1970. Available unofficial information indicates, however, that during 1971 and 1972, bank holding companies published the required notification of *de novo* activities in 504 different instances, and filed 174 applications to acquire going concerns. As shown by Table III, the principal activities proposed to be undertaken appear to have been commercial and consumer finance; mortgage banking; insurance; personal property leasing; furnishing investment, financial, and economic advisory services; data processing; and factoring.

It seems clear that a substantial degree of affiliation already exists among banks owned by bank holding companies and nonbanking organizations authorized under Section 4(c)(8). It is reasonable to believe that affiliation of this type will become even more substantial in the future.

**Acting as Investment Adviser** The continuing influence of the 1933 affiliate legislation on permissible affiliation under the Bank Holding Company Act is particularly evident in the restrictions imposed by the Board of Governors on the performance of investment advisory services. The Board has ruled that while bank holding companies and their subsidiaries may act as investment advisers to both open-end and closed-end investment companies, a bank holding company may not sponsor, organize, or control a mutual fund. This restriction does not apply, however, to closed-end investment companies that are not primarily or frequently engaged in the issuance, sale, and distribution of securities. In no case may a bank holding company act as investment adviser to an investment company having a name that is similar to, or a variation of, the name of the holding company or any of its subsidiary banks, nor



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may it sell or distribute securities of any investment company for which it acts as investment adviser. Moreover, in view of potential conflicts of interest that may exist, bank holding companies and their subsidiaries are not permitted to: (1) purchase for their own account securities of any investment company for which the bank holding company acts as investment adviser, (2) purchase in their sole discretion any such securities in a fiduciary capacity (including as managing agent), (3) extend credit to any such investment company, or (4) accept the securities of any such investment company as collateral for a loan which is for the purpose of purchasing securities of the investment company.[22]

**Other Permissible Nonbanking Activities** Apart from Section 4(c)(8), eleven other paragraphs of Section 4 of the Bank Holding Company Act authorize various types of activities for bank holding companies, some of which may be performed by banks themselves and some of which may not. For example, Section 4(c)(5) permits bank holding companies to acquire investment securities of the kinds and amounts eligible for purchase by national and state member banks under Section 5136 of the Revised Statutes, while Sections 4(c)(6) and 4(c)(7) enable bank holding companies to acquire specified amounts of common stocks and other securities that are prohibited to national and state member banks for their own account. These and other provisions of Section 4 setting forth permissible activities for bank holding companies are summarized in the footnote below.[23]

**Permissible Geographic Expansion** In marked contrast to the provision of the Bank Holding Company Act limiting acquisitions of banks by bank holding companies to a single state, except where the state to be entered specifically allows it by statute, nonbanking subsidiaries may expand and operate across state lines unless prohibited by state law of the state into which they are expanding, except where the Board of Governors may impose limitations by order in individual cases.[24] Many leading bank holding companies have already established substantial business operations in authorized nonbanking areas, both within the states where their banking activities are principally conducted and across state lines as well. It is reasonable to expect further significant expansion of bank holding company activities along these lines.

## CONCLUSION

The present structure of Federal regulation of relationships among banks and their affiliates is the product of two different but not entirely unrelated events. The first of these was the development of affiliates by many large banks beginning about 1908, principally to engage in the securities business. Abuses developed and legislation was enacted in 1933 to correct these abuses. The term "affiliate" was broadly defined in this legislation to include situations involving common ownership or control of banks and nonbanking businesses by individual owners, bank holding companies, or other organizations. A pattern of regulation was based upon this definition involving complete separation of ownership and control of securities companies and mem-

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[22] Interpretation of Regulation Y, 12 C.F.R. 225.125. The interpretation also imposes certain other restrictions on bank holding companies acting as investment advisers.

[23] The following are authorized under Section 4(c):

(1) Acquiring shares of any company engaged or to be engaged in (a) holding or operating properties used by banking subsidiaries or acquired for future use, (b) conducting a safe deposit business, (c) furnishing services to or performing services for the bank holding company or its banking subsidiaries, and (d) liquidating assets, to the extent authorized;
(2) Acquisitions of shares by a bank in satisfaction of a debt previously contracted in good faith;
(3) Acquiring shares from subsidiaries that have been requested to dispose of the shares by Federal or State examining authorities;
(4) Acquiring or holding shares in good faith in a fiduciary capacity, except where specifically prohibited by Sections 2(b) and 2(g) of the Act;
(5) As discussed in the text, acquiring shares of the kinds and in amounts eligible for investments by national and State member banks and, in addition, (a) acquiring shares of any company which do not include more than 5 percent of the outstanding voting shares of such company, and (b) acquiring up to 5 percent of the voting shares of an investment company that is not a bank holding company and is not engaged in any business other than investing in securities, which securities do not include more than 5 percent of the outstanding voting shares of any company;
(6) Acquiring shares of companies authorized under Section 4(c)(8), as discussed in the text;
(7) Ownership of shares by or activities conducted by foreign bank holding companies, the greater part of whose business is conducted outside of the United States, under conditions imposed by the Board of Governors if the Board determines that the exemption would not be substantially at variance with the purposes of the Bank Holding Company Act and would be in the public interest;
(8) Continued ownership of shares lawfully acquired and owned prior to May 9, 1956, by a bank which is a bank holding company, or by any of its wholly-owned subsidiaries;
(9) Shares owned directly or indirectly by a one-bank holding company brought under regulation by the amendments effective December 31, 1970, in a company which does not engage in any activities other than those in which a bank holding company may engage under Section 4(c)(8), except that such subsidiary may not acquire any interest in or the assets of a going concern other than one which was a subsidiary on June 30, 1968;
(10) Ownership of shares or activities engaged in by companies brought under regulation in 1970 which, within specified time limits, either (a) cease to be bank holding companies or (b) cease to retain unauthorized shares or engage in unauthorized activities;
(11) Ownership of shares or activities engaged in by any company which does no business in the United States except as an incident to its international or foreign business, if the Board of Governors determines that, under the circumstances and subject to such conditions as it may impose, the exemption would not be substantially at variance with the purposes of the Bank Holding Company Act, and would be in the public interest.

The full text of Section 4(c) of the Bank Holding Company Act is found at 12 U.S.C. §1843.

[24] "Statement by Board of Governors of the Federal Reserve System Regarding Proposal by NCNB Corporation to Operate a Trust Company in South Carolina Through American Trust Company," March 9, 1973. In addition, the Board of Governors has permitted Edge Act corporations to operate in more than one state. Their activities, however, are restricted to international or foreign banking and financial operations.


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Table III

## DE NOVO NOTIFICATIONS AND PROPOSED ACQUISITIONS UNDER SECTION 4(c)(8) OF THE BANK HOLDING COMPANY ACT 1971 and 1972

| | De Novo Notifications | Proposed Acquisitions | Total Notifications and Proposed Acquisitions |
|---|---|---|---|
| Commercial and Consumer Finance* | 84 | 64 | 148 |
| Mortgage Banking | 109 | 36 | 145 |
| Insurance | 68 | 49 | 117 |
| Personal Property Leasing | 92 | 8 | 100 |
| Investment, Financial and Economic Advisory Services | 74 | 3 | 77 |
| Data Processing | 34 | 3 | 37 |
| Trust Operations | 13 | 2 | 15 |
| Factoring | 17 | 4 | 21 |
| Community Development | 12 | 1 | 13 |
| Other | 1 | 4 | 5 |
| | 504 | 174 | 678 |

*Includes industrial banks.

Figures reflect multiple activities involved in some notifications and proposed acquisitions.

Sources: Unofficial tabulations, staff, Board of Governors of the Federal Reserve System; **Bank Expansion Quarterly.**

ber banks of the Federal Reserve System. In addition, limitations were placed upon financial relationships between insured banks and their affiliates, and Federal bank supervisory agencies were empowered to examine and obtain reports from affiliates.

The second significant event that led to the present pattern of affiliate regulation was the growth of bank holding companies. Although the 1933 legislation contained provisions applicable to bank holding companies, these provisions proved to be inadequate and were entirely replaced with the Bank Holding Company Act of 1956, as extensively amended in 1966 and 1970. Although both the 1933 legislation and the Bank Holding Company Act cover situations where there is common ownership or control of a bank and other banks or nonbanking organizations, they differ significantly in the ways in which they specify what constitutes common ownership or control. Among other things, control by individuals in their individual capacities is not subject to regulation under the Bank Holding Company Act, although the 1933 affiliate provisions apply to situations of common control regardless of whether such control is by individuals or by organizations.

Unlike the 1933 legislation, which was designed to remedy actual abuses, the Bank Holding Company Act is intended to prevent potential abuses that might result from the uncontrolled ability of bank holding companies to acquire banks and engage in nonbanking activities. Accordingly, prior approval by the Board is required for any bank holding company to acquire additional banks or to engage in nonbanking activities, except to the extent that specified nonbanking activities are permitted by the Bank Holding Company Act itself. Acquisitions of banks are, in effect, limited to the state in which the principal banking activities of a bank holding company are conducted. There is no restriction in Federal law upon the geographical expansion of bank holding companies in nonbanking areas, however, provided the performance of such activities is not inconsistent with state law in the state to be entered, except to the extent that the Board of Governors may impose such limitations by order or regulation in individual cases.

*William F. Upshaw*



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# INTERNATIONAL AGRICULTURAL TRADE AND THE U. S. BALANCE OF PAYMENTS

Agricultural commodities have figured importantly in U. S. foreign trade since colonial times. Foreign markets have always been important to U. S. farmers and appear likely to be of increasing importance in the future. Currently, they provide an outlet for about 15 percent of total U. S. farm output. Trade in agricultural commodities is, of course, a two-way street and the U. S. is also a major market for many agricultural products produced abroad. In 1972,[1] for example, agricultural commodities accounted for about 12 percent of total U. S. imports. But at the same time, they accounted for approximately 18 percent of total exports, leaving this country with a sizable balance of trade surplus in agricultural products. Prospects that this surplus may be enlarged in the near future are a major reason to hope that the unsatisfactory balance in this country's trade with the rest of the world can be corrected soon.

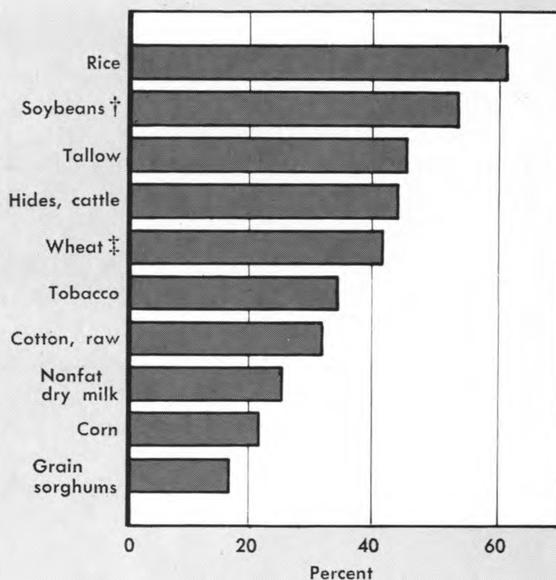
**Importance of Agricultural Exports** U. S. farmers in 1972 supplied about one-sixth of the agricultural commodities entering free world trade, with U. S. agricultural exports reaching a high of $8.05 billion. This was an increase of more than 57 percent since 1960. The output of 1 of every 5 harvested acres was exported in 1972 and foreign sales accounted for 15 percent of the total cash receipts from farm marketings. In that year, export sales accounted for more than one-half of the U. S. production of soybeans and rice, more than two-fifths of the cattle hides and tallow, and over one-third of the wheat and tobacco. Details of U. S. agricultural exports, by commodity groups, are given in Chart 1 and Table I. In terms of value, oilseeds and products was the most important export item in 1972, followed by feed grains and wheat and wheat flour. Soybeans and soybean products accounted for a large fraction of the value of oilseeds and products. Aggressive marketing in the face of strong foreign demand for high-protein feed, coupled with the sharply increasing U. S. harvest, has made soybeans the leading dollar earner in foreign markets. Soybeans now account for more than one-fourth of the total value of U. S. agricultural exports. This country's share of world soybean exports has risen from 2 percent in 1934-38 to approximately 90 percent in 1972. Production from more than one-half of U. S. soybean acreage is exported, and more than nine-tenths of all soybean and soybean product exports are commercial sales for dollars.

Fifth District tobacco producers also have a large stake in the export market. The United States is the world's largest exporter of unmanufactured tobacco, accounting for about one-fourth of world exports of this commodity. In recent years between 55 and 60 percent of this tobacco has been produced in Fifth District states.

Chart 1

**10 LEADING U. S. AGRICULTURAL EXPORTS**

AS PERCENTAGE OF FARM SALES, 1972*




*Year ended June 30.

†Including oil and meal.

‡Including products.

Note: Exports compared with farm sales, except with production for rice, cattle hides, tallow, cotton, tobacco, and nonfat dry milk.

Source: U. S. Department of Agriculture.

[1] Except where otherwise noted all data are for fiscal year 1972.

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Table I

### U. S. AGRICULTURAL EXPORTS

Fiscal Year 1972

| Commodity | Exports Under Government Financed Programs | Commercial Sales for Dollars | Total |
|---|---|---|---|
| | (millions of dollars) | | |
| Wheat and wheat flour | 371.7 | 675.3 | 1,047.0 |
| Feed grains, excluding products | 78.1 | 1,040.0 | 1,118.1 |
| Rice | 198.3 | 108.4 | 306.7 |
| Cotton | 96.2 | 433.3 | 529.5 |
| Tobacco, unmanufactured | 22.5 | 547.4 | 569.9 |
| Oilseeds and products | 135.9 | 2,086.5 | 2,222.4 |
| Dairy products | 96.0 | 99.1 | 195.1 |
| Animal and animal products except dairy products | 29.7 | 786.4 | 816.1 |
| Fruits and preparations | ...... | 381.3 | 381.3 |
| Vegetables and preparations | ...... | 229.9 | 229.9 |
| Other | 93.2 | 542.3 | 635.5 |
| Total exports | 1,121.6 | 6,929.9 | 8,051.5 |

Source: U. S. Department of Agriculture, **Foreign Agricultural Trade of the United States,** November 1972.

**Financing of Agricultural Exports** Agricultural exports are made through normal commercial channels resulting in dollar payments or through Government-financed programs. In recent years commercial sales for dollars have accounted for a rising proportion of total agricultural exports. Between 1960 and 1972 commercial exports increased from 72 percent to 86 percent of the total. Most Government-financed programs for farm exports are under the authorization of the Agricultural Trade Development and Assistance Act, popularly known as Public Law 480, or the Food for Peace Program. Exports under this program include sales for foreign currency, long-term credit sales, and donations. More than $21 billion worth of agricultural commodities have been exported under the authority of PL 480 since its inception in 1954. Government-financed exports are also made under authority of the mutual security (AID) programs.

**Major Export Customers** American farm products were shipped to 165 countries in 1972 but 15 countries received 60 percent of the total. The 50 largest markets accounted for 98 percent of total exports. Developed countries, such as Japan, Canada, Spain, and members of the European Economic Community, are the largest markets for U. S. agricultural exports. Nevertheless, shipments to developing countries are sizable.

Japan is the number one foreign customer for U. S. agriculture, and the United States is placing increasing emphasis on exports of food and agricultural raw materials to Japan to help alleviate its overall trade imbalance with that country. In 1972 the United States shipped approximately 14 percent of its total agricultural exports to Japan. Japan is the major foreign market for U. S. soybeans, feed grains, wheat, cotton, cattle hides, tallow, lemons, alfalfa meal, and raisins. Japan also takes sizable shipments of tobacco, poultry, nuts, fruits, and meats.

Rising incomes and living standards in Japan hold out the promise of a steady expansion in Japanese purchases of a growing variety of U. S. farm products. This important market would also be enlarged further if existing barriers to U. S. goods could be eliminated or liberalized. In any case, it appears likely that Japan will continue as a major customer for U. S. farm exports.

**Agricultural Exports by States** The value of agricultural exports as a proportion of cash receipts from farm marketings is one way to measure the importance of farm exports to individual states. On this basis the five leading agricultural exporting states in 1972 were Illinois, Iowa, California, Texas, and North Carolina. Rankings of other Fifth Dis-

Table II

### VALUE OF U. S. AGRICULTURAL EXPORTS TO 15 MAJOR MARKETS

Fiscal Year 1972

| Country | 1972 |
|---|---|
| | (millions of dollars) |
| Japan | 1,163.0 |
| Canada | 804.7 |
| Netherlands | 616.4 |
| West Germany | 607.3 |
| United Kingdom | 429.9 |
| Korea, Republic of | 316.9 |
| Italy | 305.6 |
| France | 214.1 |
| Spain | 200.8 |
| India | 193.0 |
| Taiwan | 169.0 |
| Belgium-Luxembourg | 147.8 |
| USSR | 136.0 |
| Mexico | 130.8 |
| Indonesia | 120.4 |
| 15 Major Markets | 5,555.7 |
| Other | 2,495.8 |
| Total | 8,051.5 |

Source: U. S. Department of Agriculture, **Foreign Agricultural Trade of the United States,** November 1972, p. 39.



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trict states were South Carolina, 20th; Virginia, 29th; Maryland, 35th; and West Virginia, 46th. Approximately 9 percent of U. S. farm exports in 1972 were produced in Fifth District states. The value of these exports represented more than one-fifth of District cash farm marketings. In both North and South Carolina the value of farm exports accounted for more than one-fourth of total cash farm receipts. Nearly three-fourths of U. S. tobacco exports and 15 percent of the poultry exports were produced in the Fifth District. In terms of value, tobacco was the most important export item for the District followed by feed grains, soybeans, and cotton in that order.

**Agricultural Imports** Imports of agricultural products into this country rose from around $3.7 billion in 1962 to about $6 billion in 1972. They come chiefly from developing countries and from such established agricultural suppliers as Australia, Canada, Denmark, and the Netherlands. Ten countries listed in Table III supplied 59 percent of our agricultural imports in 1972. Agricultural imports can be divided into two categories: those that compete directly with commodities produced in the United States and those that do not. The former class includes such items as animal, grain, cotton, and tobacco products. Some foreign goods, such as bananas, coffee, tea, and rubber, are noncompetitive because they either are not produced in this country or are produced in small quantities.

Sixty-five percent of the agricultural commodities imported in 1972 were competitive, compared to 55 percent in 1962. The three leading competitive imports are meat and meat products, sugar, and fruits, nuts and vegetables. Imports of meat and meat products in 1972 totaled 1.9 billion pounds. Boneless fresh or frozen beef accounted for roughly three-fifths of total imports of meat and meat products. Similar to U. S. cow beef, it is used primarily for hamburger or other meat products and is imported primarily from Australia, New Zealand, and Central America.

The Meat Import Law, enacted in 1964, provided for restrictions on imports of fresh, chilled, and frozen beef, veal, mutton, and goat. In response to increased demand and higher meat prices, however, quantitative restrictions imposed under this law were suspended in June 1972.

**The Agricultural Trade Balance** Exports of agricultural commodities exceed imports by a substantial margin and, consequently, provide one of the major bright spots in an otherwise negative U. S. balance of payments situation. The role of agricultural exports in helping curb the flow of dollars from the U. S. may be measured by their contribution to our balance of trade and the balance of payments. The balance of trade is the difference between the value of total merchandise exports and total merchandise imports. The balance of payments, on the other hand, records all types of economic transactions involving the exchange of goods, services, and financial assets between U. S. residents and residents of the rest of the world.

Table III

**U. S. AGRICULTURAL IMPORTS BY COUNTRY OF ORIGIN**

Fiscal Year 1972

| Country | Value in Millions of Dollars |
|---|---|
| Brazil | $ 617 |
| Mexico | 536 |
| Australia | 409 |
| Philippines | 369 |
| Canada | 322 |
| New Zealand | 222 |
| Colombia | 195 |
| Denmark | 166 |
| Dominican Republic | 161 |
| Netherlands | 152 |

Source: U. S. Department of Agriculture, **U. S. Foreign Agricultural Trade Statistical Report, Fiscal Year 1972.**

Although the U. S. has experienced deficits in its balance of payments in most years since the early 1950's, 1971[2] was the first year since 1935 that a trade deficit occurred. Agricultural, nonagricultural, and total balance of trade data since 1962 are shown in Chart 2. In agricultural trade, the U. S. balance with the rest of the world has been in surplus in every year of this period. This surplus amounted to $1.9 billion in 1971, only slightly below the peak for the period reached in the middle 1960's. Without this surplus, the overall U. S. trade deficit of $6.4 billion in 1972 would have been $9.4 billion.

*Balance of Payments* The USDA estimates the gross contribution of agriculture to the balance of payments in the following manner. Realized dollar returns and savings on noncommercial exports are added to the dollar value of commercial sales. These realized dollar returns and savings are in the form of (1) the dollar value of foreign currencies generated under PL 480 and used overseas by the Government to pay such bills as embassy expenses, mili-

[2] In the remainder of the paper data are on a calendar year basis unless otherwise noted.



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tary outlays, and costs of market development operations and (2) repayments for exports made under Government credit to foreign nations. Agricultural imports are then subtracted from this figure to determine the net contribution to the balance of payments (Table IV). In 1971 agriculture's net contribution to the balance of payments was $1.13 billion, the second largest net contribution since 1960. Agriculture has had a positive net influence on the U. S. balance of payments every year since 1961. The peak year in agriculture's net contribution was 1966 when it totaled $1.17 million.

**Factors Affecting Export Prospects** Estimates for fiscal year 1973 place agricultural exports at about $11 billion, almost $3 billion above 1972's record high. Most of the increase will be in grains and soybeans. While exports of these commodities to most customers will be up over last year, the large purchases by the Soviet Union are the single most important item. As of January 1973, Russia had purchased over 400 million bushels of wheat, around 250 million bushels of corn, and 40 million bushels of soybeans.

While agriculture's net contribution to the U. S. trade position is growing, agricultural trade as a share of total trade has declined recently. Since 1960 agricultural exports have declined from 24 to 18 percent of total exports. Recent large sales to communist bloc nations and improved prospects for additional sales to these countries notwithstanding, potential growth of farm exports faces several restricting factors. Foremost among these are (1) increased agricultural production in the less developed nations, which is diminishing the need for our aid exports; (2) numerous tariff and nontariff barriers on agricultural commodities; and (3) expansion of the European Economic Community to include the United Kingdom, Ireland, and Denmark[3] in the area under the Community's Common Agricultural Policy (CAP).

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[3] Other members are France, Italy, Germany, Brussels, the Netherlands, and Luxembourg.

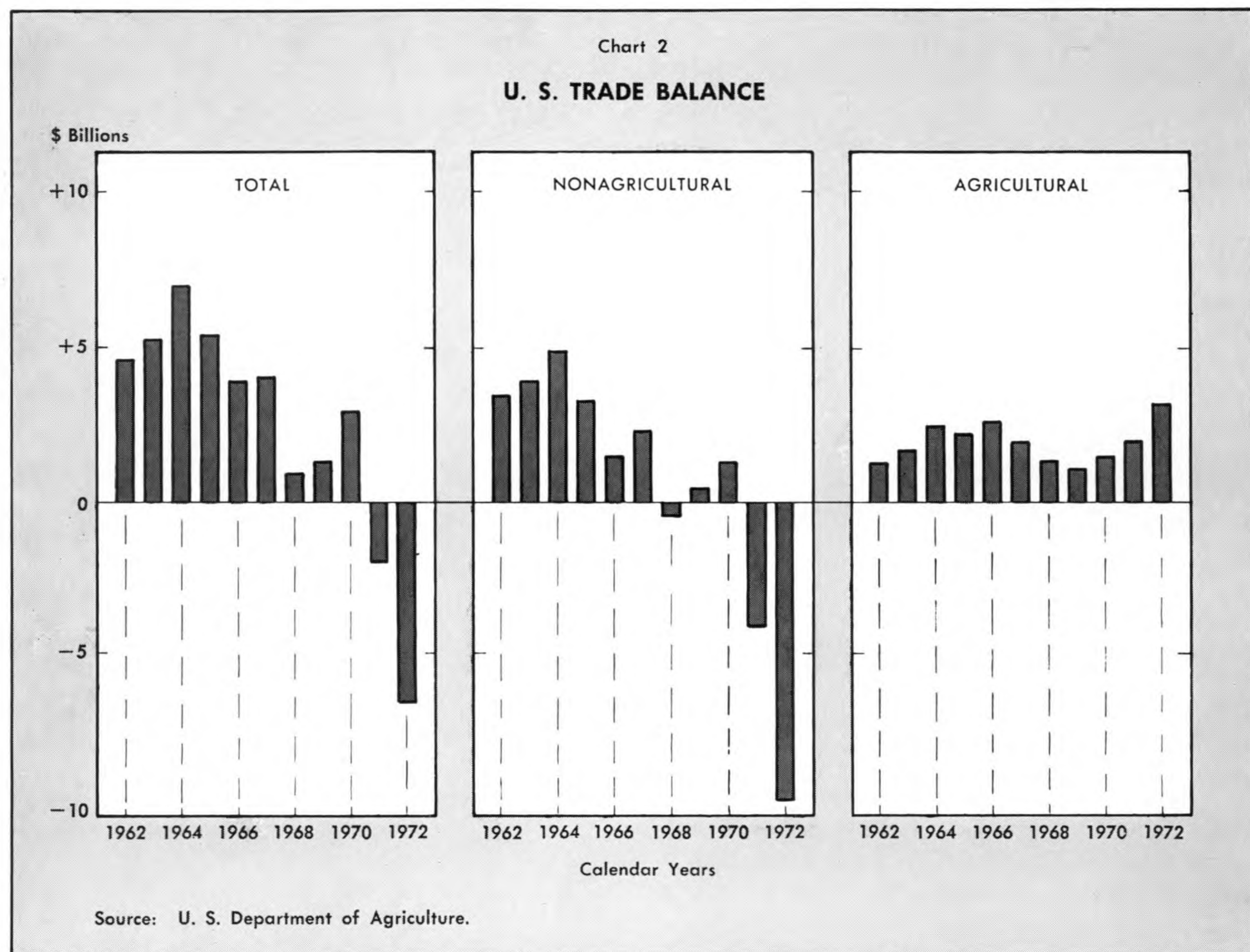




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Table IV

**THE CONTRIBUTION OF AGRICULTURE TO THE U. S. BALANCE OF PAYMENTS**

| Item | 1961 | 1971 |
|---|---|---|
| | (millions of U.S. dollars) | |
| Commercial agricultural exports | $3,569 | $6,556 |
| Plus: Realized dollar returns and savings on noncommercial agricultural exports | | |
| PL 480 | 155 | 322 |
| Mutual Security (AID) foreign currencies used by U. S. agencies | 15 | ..... |
| Export-Import Bank principal and interest dollar repayments | 31 | 80 |
| Gross contribution | 3,770 | 6,958 |
| Less: Agricultural imports | 3,756 | 5,826 |
| Net contribution of agriculture to U. S. balance of payments | 14 | 1,132 |

...... less than $500,000

Source: U. S. Department of Agriculture, **World Monetary Conditions In Relation to Agricultural Trade,** May, 1972, p. 29.

Common Market countries account for nearly two-fifths of the world's total imports and, in fiscal 1972, these nine nations took nearly a third of total U. S. farm exports. The United Kingdom alone bought $430 million worth of our farm products in fiscal 1972.

Exports to the Common Market are restricted by the Community's Common Agricultural Policy, and the recent expansion of the Common Market area is certain to have an unfavorable impact on U. S. exports of agricultural commodities. The CAP is a series of agreements among members designed to establish free agricultural trade within the Community and to protect domestic agriculture from imports. The CAP protects agricultural producers in member countries through variable levies and other devices that force final import prices above domestic prices. The biggest impact of Common Market expansion to include nations with previously less restrictive agricultural import policies will be on tobacco, grains, rice, and fresh and canned fruits and juices. Soybeans have been entering the Common Market countries without duties or other restrictions and will continue to do so in the expanded market.

While a record year for agricultural exports in fiscal 1973 seems assured, the factors listed above serve to make long-term forecasts difficult if not impossible. Nevertheless, it seems reasonable to assume that U. S. agricultural exports will continue to make significant contributions to the nation's balance of trade and balance of payments positions.

*Thomas E. Snider*



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## 1972 ANNUAL REPORT

The *1972 Annual Report* of the Federal Reserve Bank of Richmond features an article entitled "The Check Payments System and the Fifth District Regional Clearing Plan." The article reviews the historical development of the payments mechanism and describes the proposed Fifth District regional clearing system. The *Report* also includes highlights of the Bank's operations during 1972, comparative financial statements, and current lists of officers and directors of our Richmond, Baltimore, and Charlotte offices.

Copies of the *1972 Annual Report* are available upon request from the Bank and Public Relations Department, Federal Reserve Bank of Richmond, P. O. Box 27622, Richmond, Virginia 23261.

## NOTE

Corrected figures for year-to-year increases in cash receipts from farm marketings, which appeared on page 17 of the April 1973 *Monthly Review,* are as follows: 18 percent in West Virginia, 13 percent in South Carolina, 8 percent in North Carolina and Virginia, and 5 percent in Maryland.



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