COMPETITION IN BANKING ACT OF 1977

HEARINGS

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

NINETY-FIFTH CONGRESS

SECOND SESSION

ON

S. 72

TO AMEND THE BANK HOLDING COMPANY ACT AND THE BANK MERGER ACT TO RESTRICT THE ACTIVITIES IN WHICH REGISTERED BANK HOLDING COMPANIES MAY ENGAGE AND TO CONTROL THE ACQUISITION OF BANKS BY BANK HOLDING COMPANIES AND OTHER BANKS

MARCH 7 AND 8, AND JUNE 19 AND 26, 1978

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

COMPETITION IN BANKING ACT OF 1977

HEARINGS

BEFORE THE

COMMITTEE ON

BANKING, HOUSING, AND URBAN AFFAIRS

UNITED STATES SENATE

NINETY-FIFTH CONGRESS

SECOND SESSION

ON

S. 72

TO AMEND THE BANK HOLDING COMPANY ACT AND THE BANK MERGER ACT TO RESTRICT THE ACTIVITIES IN WHICH REGISTERED BANK HOLDING COMPANIES MAY ENGAGE AND TO CONTROL THE ACQUISITION OF BANKS BY BANK HOLDING COMPANIES AND OTHER BANKS

MARCH 7 AND 8; AND JUNE 16 AND 23, 1978

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

U.S. GOVERNMENT PRINTING OFFICE
24-094 O WASHINGTON : 1978

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

WILLIAM PROXMIRE, Wisconsin, *Chairman*

JOHN SPARKMAN, Alabama
HARRISON A. WILLIAMS, Jr., New Jersey
THOMAS J. McINTYRE, New Hampshire
ALAN CRANSTON, California
ADLAI E. STEVENSON, Illinois
ROBERT MORGAN, North Carolina
DONALD W. RIEGLE, Jr., Michigan
PAUL S. SARBANES, Maryland

EDWARD W. BROOKE, Massachusetts
JOHN TOWER, Texas
JAKE GARN, Utah
H. JOHN HEINZ III, Pennsylvania
RICHARD G. LUGAR, Indiana
HARRISON SCHMITT, New Mexico

KENNETH A. McLEAN, *Staff Director*
JEREMIAH S. BUCKLEY, *Minority Staff Director*
CHARLES L. MARINACCIO, *Special Counsel*

CONTENTS

LIST OF WITNESSES

Tuesday, March 7

Wednesday, March 8

Friday, June 16

Friday, June 23

Additional Statements and Data

Charts and Tables

COMPETITION IN BANKING ACT OF 1977

TUESDAY, MARCH 7, 1978

U.S. Senate,
Committee on Banking, Housing, and Urban Affairs,
Washington, D.C.

The committee met at 10 a.m., in room 5302, Dirksen Senate Office Building, Senator William Proxmire, chairman of the committee presiding.

Present: Senators Proxmire and Sparkman.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

The Chairman. The committee will come to order.

This morning we continue hearings on legislation to control the growth of bank holding companies and the concentration of banking assets in banking markets. In the last Congress we began hearings on the legislation but we did not have sufficient time to complete the hearing record. I hope we can complete the hearings on this legislation in this session and bring it to a vote of the committee.

Bank holding companies have experienced explosive growth during the past 25 years. They now control over two-thirds of the banking resources of the Nation. Although their subsidiary banks are prohibited from branching across State lines, no such restriction applies to the permissible activities of bank holding companies. As a result, bank holding companies have begun to operate in wide geographic areas and the largest operate from coast to coast.

It may be argued that this expansion enhances competition over certain loan functions or deposit-taking institutions. There is some merit to this argument. Nevertheless, bank holding companies have expanded way beyond the business of banking—that is to say the business of taking deposits and making loans—into a wide range of business and commerce which is destructive of fair competition and poses serious questions for the stability of the banking system.

The Federal Reserve has condoned the expansion of bank holding companies into such diverse areas as insurance underwriting, insurance sales including property and casualty insurance, data processing, armored car and courier services, and automobile leasing. Spokesmen for these industries and others—notably the securities industry and the travel agents—have complained of the premissiveness of the bank regulatory agencies in allowing bank holding companies and their banks to expand beyond banking. I'm inclined to agree with them.

Credit is allocated in our market economy to borrowers through the banking system. Banking organizations need to be prudent in making loans. They need to take risks—sometimes even make risky loans. But they need to make these important judgments free from the hope that if they make the loan they will also get collateral business—such as insurance premiums. This distorts the market not only for loans but also for insurance because when credit is scarce a borrower will likely buy his insurance from the bank as a "carrot" in order to induce the bank to make the loan, and there is no question that in periods of credit stringency—and we have had them in the past and we will have them in the future—that the bank has an enormous competitive advantage that has nothing to do with efficiency or competence or expertise and has everything to do with just plain clout induced by the fact that they have the capital.

Some banks have failed because of the expansive and poorly regulated activities of their bank holding companies. Perhaps the best example of poor Federal Reserve policy was in allowing bank holding companies to engage in real estate advisory services where the Fed engaged in the fiction that the trust was severable from the bank holding company thus sanctioning in real terms an unregulated affiliation where the incentives were all on the side of imprudent lending and all know the result was the REIT debacle. While passage of this bill will not by itself insure a safe and sound banking system, it will surely help by requiring banking institutions to stick to banking.

At the same time this legislation will begin to control the concentration of banking resources in the Nation by flatly prohibiting the bank acquisitions by bank organizations holding 20 percent of the banking assets in any State.

We are happy to have the head of the Antitrust Division of the Justice Department here this morning to be followed by Governor Coldwell of the Federal Reserve Bank as our principal witnesses.

Our first witness is the Honorable John H. Shenefield, Assistant Attorney General, Department of Justice. Incidentally, if you would like to summarize your statement—you have a substantial statement here, 23 pages—we hope you can do that in 10 minutes or so and we will have the entire statement printed in full in the record.

STATEMENT OF JOHN H. SHENEFIELD, ASSISTANT ATTORNEY GENERAL, DEPARTMENT OF JUSTICE

Mr. Shenefield. Thank you, sir. I will do my best.

My statement begins with an explanation of our interest in this area and our considerable responsibility. It's a matter of substantial continuing interest to us that the banking industry be as competitive and as free to move into important new areas of activity as possible. Those twin concerns have guided us throughout our enforcement program.

Section 101 of S. 72 would amend the Bank Merger Act to add new provisions relating to bank mergers. The proposal to place a statewide ceiling on the assets which may be held by a single banking organization raises difficult issues. A good deal can be said in favor of it and many questions can be raised as qualifications to it.

First of all, I think you have to start with the premise that the commercial banking system in this country is marked by a large number or local, independent, relatively small institutions, but it is also marked by a substantial amount of concentration among the largest banking organizations on a statewide basis. My statement contains some statistics having to do with the nature of that concentration.

Under the current framework of the law I think it is fair to say that horizontal mergers—that is, mergers between direct competitors—have largely been eliminated at least in particular localized banking markets. Some of those have been prevented at the agency level. Where the agency has been unwilling to take that step I believe the United States has been relatively successful in court. However, it is also true that mergers of banks which do not serve the same locality and therefore are not in that sense directly competitive, may in a significant and different sense be anticompetitive. Some mergers of that sort have been denied approval by the regulatory agencies; more have not. As a result we brought a number of so-called potential competition cases in the late 1960's and early 1970's which were by and large substantially unsuccessful in achieving a rule of law that would have prohibited what we feel to be anticompetitive potential competition mergers.

My statement recounts the progress of that litigation, specifically the *Marine Bancorp.* and *Connecticut National Bank* cases which together it seems to me give anyone—any serious observer of this area—real cause for concern over the viability of potential competition arguments in the field of commercial banking.

The proposal to establish a statewide ceiling on share of banking resources is one approach to the problem created by those cases and the anticompetitive problems that they address.

It is quite clear that it is important to be concerned over the evolution of State banking structures that seem likely to produce or may have produced what we in antitrust call highly concentrated oligopolies, where a very few large banks dominate major markets. A ceiling on banking resources that a single institution may acquire through merger is one approach to that problem and it's one that's been used by several States, but it does have its own problems.

For instance, if the proposals for financial regulatory reform are enacted, there may well be significant amounts of competition from nonbank financial institutions which ought to be considered. In addition, in major metropolitan areas where the characteristics of the banking market involve interstate economic transactions, it's important to consider that fact. Further, the electronic funds transfer system—the future of that development, and its impact on competition among banks—needs to be considered. Finally, whether it is appropriate to establish a single specific figure for all States needs to be given consideration. If it is on balance determined after a study of these rather complex issues that a statewide ceiling approach is appropriate, it seems possible to use to inquire whether the 20-percent figure is an appropriate figure.

For instance, we think it might well be possible, if the statewide ceiling approach is adopted, to consider whether a lower ceiling would really be more helpful in furthering the objectives sought by the proposal while not really placing any unreasonable limits on expansion through merger transactions.

A possible qualification to the language that would allow appropriate mergers could be found in the convenience and needs defense which the S. 72 proposal does not contain. The omission of a convenience and needs defense in S. 72 in effect subjects bank mergers in excess of the statewide ceiling figure to a stricter standard than those which would be outright violations of the antitrust laws. Thus, I would think it might well be considered whether a convenience and needs standard would be appropriate if the statewide ceiling approach were to be adopted.

We have not had, in general, a bad experience with the convenience and needs defense in regulatory agencies or in the courts and it seems to me that that kind of language might offer the possibility of approving a clearly procompetitive banking acquisition which would otherwise have to be disapproved.

My statement also discusses whether it is advisable to total assets as a ceiling figure as opposed to amounts of deposits and shares of deposits in a particular market.

The second substantive amendment to the Bank Merger Act and the Bank Holding Company Act made by S. 72 clarifies that the responsible agency may deny a merger acquisition on competitive grounds, even if the substantive standards of the antitrust laws or the statewide ceiling, if that's adopted, are not violated, where adverse competitive effects are not clearly outweighed by the convenience and needs of the community to be served. We support that provision.

This goes to the decision of the Ninth Circuit Court of Appeals in the *Washington Mutual* case, in which that court held that the FDIC could not disapprove a merger on competitive grounds unless it found an actual violation of the antitrust laws in the conventional sense. We doubt the wisdom of that rationale. The case did not receive a Supreme Court review. It seems to us in line with similar legislation in other regulatory contexts that in a balancing of public interests it would be appropriate for an agency to disapprove a merger that was on balance anticompetitive where all other regulatory aspects were neutral even though in a conventional sense the merger might not rise to a violation of the antitrust laws, particularly section 7 or section 2. We would suggest that a similar provision might well be added to the Savings and Loan Holding Company Act to clarify that the Federal Home Loan Bank Board may disapprove mergers on the same basis as the banking agencies.

I turn now in the final minutes of my summary to section 301(a) of S. 72, which has to do with activities of bank holding companies in closely related financial fields. You have summarized the present law, which is to the effect that a proposed activity, in order to be permitted to bank holding companies, must be so closely related to banking or managing or controlling banks as to be a proper incident thereto. In a variety of ways S. 72 changes that language by adding words that require a more direct relationship and a more necessary incident of that activity to the business of banking or managing or controlling banks in order for it to be approved by the appropriate regulatory agency.

It's a little difficult to assess these changes and their impact, although it appears clear that their intent is to limit the scope of permissible activities under section 4(c)(8).

In general, the current closely related standard has emerged from the 1970 legislative compromise between widely differing views. The question of how far afield bank holding companies should be permitted to venture is a difficult one because it reflects concerns about bank solvency on the one hand and unfair and discriminatory competition in the so-called target markets on the other.

In 1970 we in the Department of Justice advocated increased flexibility for bank holding companies because that flexibility held the promise of increased competition in related areas and we still think as a general matter that barriers to entry into new fields should be erected or maintained only upon showing of clear need. We in general defer to the Federal Reserve Board for expert comment on what kinds of activities are appropriate under this standard. We do have a general philosophical concern about raising entry barriers and we would suggest only that it is appropriate to examine most closely the contentions of those in the target industries that would be forced to confront new competition. We ourselves carry a philosophical skepticism into that kind of debate.

There are also provisions of section 301 that would have the effect of amending the so-called public benefits standard of section 4(c)(8) and again it is somewhat difficult to assess the significance of those changes.

We would make the same sort of comment with respect to that tightening as we did in connection with the closely related test.

In general we think the better general approach is to favor free new entry into an industry without an affirmative showing of public benefit. Thus, increasing the existing burden would represent a greater departure from normal competitive policy. The existing burden should be increased only if the Congress affrmatively finds that the present standard has resulted in actual and significant adverse effects to the public as opposed to a rather more speculative fear of new competition and possible adverse effects. We are not aware of evidence of harm to the public or complaints about this other than from the target industries. The Congress in its judgment may have better evidence and be able to form a more refined view.

I think, Mr. Chairman, the remainder of my statement has mostly to do with procedural aspects of the amendments.

In summary, S. 72 deals with what we consider a number of highly important and controversial issues concerning competition in banking and related areas. The provisions which would place certain limits on additional expansion of banking activities through mergers and acquisitions do represent one approach to a problem which is intricate and requires careful consideration. The proposed changes to section 4(c)(8) of the Bank Holding Company Act raise doubts as to their necessity or desirability and should be adopted we think only if there's clear evidence of their need and should, in that event, be specifically tailored to deal with particular problems without imposing unnecessary barriers to new entry.

The CHAIRMAN. Thank you very much, Mr. Shenefield.

[Complete statement follows:]

STATEMENT OF JOHN H. SHENEFIELD, ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION

Mr. Chairman and members of the committee, I appreciate the opportunity to discuss the important issues raised by S. 72, which would amend the Bank Merger Act and the Bank Holding Company Act in several competitively significant ways.

The Department of Justice has a special interest and responsibility in this area. We review hundreds of mergers and acquisitions each year and provide reports on their competitive effects to the federal banking agencies. Our role in the bank merger area is not limited to making recommendations to the agencies: where we deem it necessary, we bring independent actions under the antitrust laws challenging mergers and acquisitions we believe to be unlawful.

Because of the role of the banking industry as financial intermediary, competition in it is crucial to the well-being of the entire economy. Therefore, the Antitrust Division has always accorded high priority to competitive questions arising in banking. Following the Supreme Court's landmark decision in *Philadelphia National Bank*,[1] we have successfully challenged many direct horizontal bank mergers. We have been less successful, however, in prosecuting cases based upon other antitrust concepts, such as potential competition. In addition, we have been concerned about the competitive questions raised by bank holding company diversification into fields not traditionally associated with banking.

Section 101 of S. 72 would amend the Bank Merger Act to add two new provisions concerning the substantive standards to be applied to bank merger transactions. New subparagraph 5(c) would prevent approval of a transaction where "the acquiring, assuming, or resulting bank would upon consummation of the transaction hold more than 20 per centum of the total assets held by all banks located in the States in which such bank is located. . . ." The only qualification to this prohibition is where the approving agency determines that "immediate action is necessary to prevent the probable failure of a bank and that a less anticompetitive alternative is not available." The second substantive change would eliminate questions that have been raised as to whether the approving agency may disapprove a merger which is anticompetitive, although it does not violate the antitrust laws. Section 201 of the bill would make similar amendments to the Bank Holding Company Act.

The proposal to place a statewide ceiling on the assets which may be held by a single banking organization as a result of merger or acquisition clearly raises extremely difficult issues. The commercial banking system in the United States, in contrast to that in most other developed countries, is marked by a large number of local, independent, and relatively small institutions. In 1975, there were over 14,600 commercial banks in the country operating more than 44,000 offices. The vast majority of these banks have assets of under $100 million.[2] Despite this structure, however, our banking system is also marked by significant concentration among the largest banking organizations on a statewide basis. In eight states[3] and the District of Columbia the shares of the top four banking organizations totaled 75 percent or more as of December 31, 1976. In an additional 13 states,[4] the top four organizations have shares of between 50 percent and 75 percent as of the same date.

The existing legal framework governing bank mergers has been successful in blocking horizontal mergers which eliminates substantial existing competition in particular localized banking markets. Many such anticompetitive mergers have been blocked at the agency level, and we have been successful in court in those cases which were not. These cases have sometimes involved small banks located in small communities[5] as well as large institutions located in major financial centers.[6]

Mergers of banks which do not yet serve the same local retail customers may also be anticompetitive. Occasionally, such mergers are denied by the banking agencies, but since the late 1960s, most of our difficult bank merger litigation choices have arisen in this area. We have initiated a number of "potential competition" cases which typically have involved the acquisition of a leading local bank by a large bank outside the market. Such acquisitions eliminte the acquiring bank as a significant source of potential competition by eliminating it as an "actual" entrant *de novo* or through a procompetitive "toehold" acquisition. They also eliminate the procompetitive effect a potential entrant has on banks already

[1] United States v. Philadelphia National Bank, 374 U.S. 321 (1963).
[2] 1976 Statistical Abbstract of the United States 483–484.
[3] Alaska, Arizona, Delaware, Hawaii, Idaho, Nevada, Oregon, and Rhode Island.
[4] California, Connecticut, Maine, Maryland, Massachusetts, Minnesota, Montana, New Mexico, North Carolina, South Carolina, Utah, Vermont, and Washington.
[5] *E.g.*, United States v. Phillipsburg National Bank, 399 U.S. 350 (1970); United States v. County National Bank of Bennington, 339 F. Supp. 85 (D. Vt. 1972).
[6] *E.g.*, United States v. Philadelphia National Bank, *supra*.

in the market merely because of the threat it presents should they price too high or fall too low in quality of service.

In the first such case appealed to the Supreme Court, the adverse decision of the District Court was affirmed by an equally divided Court.[7] Subsequently, the Court decided two major "potential competition" cases adversely to the government.[8] While the Court accepted the relevance of "potential competition", it rejected use of a statewide market to measure the effects of the merger and emphasized as most important to the analysis of a particular case "the unique federal and state regulatory restraints on entry" [9] into commercial banking. Thus, the Supreme Court's rulings in *Marine Bancorp* and *Connecticut National Bank* provide real cause for concern over the viability of potential competition arguments in the field of commercial banking. The cases appear to establish standards of proof that may be so high as to make existing law inadequate to prevent many anticompetitive acquisitions by larger banks not presently operating in particular local banking markets of banks in those markets.

The proposal to establish a statewide ceiling on the share of banking resources which may be controlled by a single institution as a result of mergers or acquisitions is one approach to problems existing under present judicial determinations. Current law generally prohibits banks in one state from opening offices in another. Thus, the state boundaries are effective barriers to entry, and the states they enclose assume both legal and economic significance as far as the competitive effects of mergers and acquisitions are concerned. We have long been concerned over the possibility of state banking structures evolving into highly concentrated oligopolies, where the same few very large banks dominate all of the major local markets. Adopting a ceiling on the percentage of banking resources that a single institution may acquire through merger is an approach to this problem which has been used by several states.

The statewide ceiling approach is not, of course, without its problems. Other financial institutions provide competition to commercial banks, which may increase if financial regulatory reform comes to pass, although it should be noted that as recently as 1975, in the *Connecticut National Bank* case, the Supreme Court held that "commercial banking" remains a recognizable line of commerce for antitrust purposes. Some interstate banking competition does exist, particularly in major metropolitan areas which cross state lines. The interstate future of electronic funds transfer systems should also be considered. Finally, consideration should be given to whether a single percentage figure would be appropriate for all states, or whether an appropriate figure would have to vary from state to state.

Of course, any statewide ceiling approach would present the difficult task of deciding upon a figure for such a ceiling.[10] Predictable competitive effects depend not only on the market shares held by individual institutions but also upon the total share controlled by the leading banking organizations in a particular state. As previously noted, in 21 states (plus the District of Columbia) the "four-firm" concentration ratio exceeds 50 percent. In several of these states, however, the leading institution does not have a 20 percent share.

In several states, the leading institution does not control 20 percent of banking assets, but nonetheless a major acquisition by it would appear to be inappropriate if any other form of entry into the local market is available. For example, in Colorado the two leading banking organizations each have over 15 percent but less thn 20 percent of the statewide market, and the proposed ceiling would not have been effective in prohibiting the acquisition we challenged unsuccessfully in the *Greeley* case. If upon adequate study a ceiling approach is adopted, we recommend that Congress consider whether a lower ceiling would further the objectives sought by the proposal while not placing unreasonable limits on any expansion through merger transactions.

Also raised is the issue of whether a statewide ceiling should always be an absolute bar to acquisitions. S. 72 as presently drafted does not contain a "con-

[7] United States v. First National Bancorporation, Inc., 329 F. Supp. 1003 (D. Colo. 1971), *aff'd. by an equally divided Court*, 410 U.S. 577 (1973).
[8] United States v. Marine Bancorporation, Inc., 418 U.S. 602 (1974); United States v. Connecticut National Bank, 418 U.S. 656 (1974).
[9] 418 U.S. at 627.
[10] Several figures appear in differing state statutes. New Hampshire and New Jersey have 20 percent rules, Tennessee uses 16½ percent, Missouri uses 13 percent, and Iowa uses 8 percent.

venience and needs" defense such as presently contained in the merger sections of the Bank Merger and Bank Holding Company Acts. This provision permits approval of a merger, either by the regulatory agency or by the Court in a subsequent Clayton Act § 7 case, where the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served. The statewide ceiling provision would establish a stricter standard for certain mergers than does the Clayton Act as presently interpreted. We doubt that it is appropriate to permit approval of a merger which otherwise violates the Clayton Act on the ground that the "convenience and needs" of the community clearly outweigh the anticompetitive effects, but not permit approval of a transaction in a comparable situation solely because of a numerical ceiling on statewide market share. Therefore, we believe that a "convenience and needs" standard, strictly applied, would be appropriate if a statewide ceiling approach were adopted.

It is our experience that neither the regulatory agencies nor the courts have used the "convenience and needs" provision as a loophole to avoid the substantive competitive standards of the Clayton Act.[11] While we have disagreed with certain of the agencies from time to time over proper application of the defense, we have found the courts reluctant to accept it where other solutions to banks' problems are potentially available.[12] We assume that the same approach would be taken in the case of mergers which would result in a market share in excess of the statewide ceiling. Moreover, the existence of such a provision would allow approval of a clearly procompetitive acquisition which otherwise would have to be disapproved. For example, entry by a banking organization with a large statewide share into a highly concentrated local market through a truly "toehold" acquisition—a bank with only 2 or 3 percent of the local market—could often be desirable, particularly if other large statewide organizations are already present in that local market. The statute should be sufficiently flexible to allow such a transaction. Inclusion of a "convenience and needs" defense, we believe, would provide such flexibility without vitiating the basic prophylactic purpose of the ceiling.

Let me turn now to measuring concentration. The statewide ceiling provision in S. 72 is drafted in terms of a banking organization's share of assets held by all organizations located in the state. Ordinarily, in assessing the position of a bank, both the banking agencies and the Antitrust Division consider the amount of deposits held by the bank and its share of total deposits in the market. The choice of assets rather than deposits could be significant where either the bank involved in the merger proposal or other banks located in the state have substantial foreign holdings. This provision may limit in a particularly rigid fashion major money center banks whose overall strength is greater than their share of deposits in their home state. If a statewide ceiling approach were to be adopted, we believe use of state deposits rather than assets would provide a more accurate measure of the actual competitive situation in the particular state.

We note that Sections 102 and 202 of S. 72 confer a statutory cause of action on the United States to enforce the ceiling provision contained in the bill. Absent these provisions, we might not be able to independently seek to enjoin a merger or aquisition which violates the ceiling provisions since such a violation would not necessarily constitute a cause of action under existing antitrust laws. We suggest additional language which would allow use of the Antitrust Civil Process Act to investigate possible violations of the new standard where such becomes necessary.

The second substantive amendment to the Bank Merger Act and the Bank Holding Company Act made by S. 72 clarifies that the responsible agency may deny a merger or acquisition application on competitive grounds, even if the substantive standards of the antitrust laws (or the statewide ceiling) are not violated, where adverse competitive effects are not clearly outweighed by the convenience and needs of the community to be served. We fully support this provision.

The effect of this amendment would be to reverse the decision of the Court of Appeals for the Ninth Circuit in the *Washington Mutual* case.[13] That decision

---

[11] See United States v. First City National Bank of Houston, 386 U.S. 361 (1967).
[12] United States v. Third National Bank in Nashville, 390 U.S. 171 (1968).
[13] Washington Mutual Savings Bank v. Federal Deposit Insurance Corp. 482 F. 2d 459 (9th Cir. 1973).

held that the responsible agency may not disapprove a merger on competitive grounds unless the merger's anticompetitive effects rise to a violation of the antitrust laws. The decision was founded on legislative history of the Bank Merger Act dealing with the problem of forum shopping and the need to avoid inconsistent competitive policies among the three federal agencies which administer the Act.

The *Washington Mutual* case did not receive Supreme Court review, and we doubt the wisdom of its rationale. The effect is that a merger which is neutral with respect to "banking factors", but anticompetitive and thus overall adverse to the public interest *must* be approved. This certainly cannot or should not be the intended result of the Bank Merger Act. Moreover, a candid recognition of the subjective nature of the decision-making process, particularly in potential competition situations, suggests that forum shopping is still a real possibility even under the *Washington Mutual* holding. Therefore, even though we doubt the validity of this decision, corrective legislation as contained in S. 72 is appropriate. In addition, we suggest that a similar provison be added to the Savings and Loan Holding Company Act, 12 U.S.C. § 1730a, to clarify that the Federal Home Loan Bank Board may disapprove mergers on the same basis as the banking agencies.

Let me turn to other provisions in S. 72 which address activities of bank holding companies in closely related financial fields. Section 301(a) would make several substantive changes in the standards governing bank holding company entry into related financial fields under Section (4)(c)(8) of the Bank Holding Company Act. Section 4(c)(8), as amended in 1970, provides basically two tests which must be satisfied before bank holding company entry into a related industry is permissible. These are the "closely related" test and the "public benefits" tests.

Under present law, a proposed activity must be "so closely related to banking or managing or controlling banks as to be a proper incident thereto." S. 72 would alter this standard to require a determination that the activity be "so closely and directly related to banking or managing or controlling banks as to be proper and necessary incident thereto" (emphasis added). The significance of these changes is difficult to assess, although it appears clear that their intent is to limit the scope of permissible activities under Section 4(c)(8).

In *National Courier Association* v. *Board of Governors*, 516 F.2d 1229 (D.C. Cir. 1975), the Court of Appeals identified three factors which might justify a finding of "closely related" status under the existing standard. These factors are: (a) banks have in fact generally provided the service; (b) banks generally provide services that are operationally or functionally so similar to the proposed service as to equip them particularly well to provide the proposed service; and (c) banks generally provide services that are so integrally related to the proposed service as to require its provision in a specialized form.[14] We understand that the Federal Reserve Board has accepted this interpretation of the existing standard.

The current "closely related" standard is the product of a difficult legislative compromise in 1970 between those who wished to limit bank holding companies to "traditional" banking activities, and those who saw additional flexibility as potentially benefiting not only the industry but also the consuming public. Just how far afield bank holding companies should be permitted to venture is also of interest from the standpoint of assuring bank solvency. Finally, and not incidentally, it is of vital concern to those who see bank holding companies as threatening potential competitors.

In 1970, the Department of Justice advocated increased flexibility for bank holding companies in large part because of its promise of increased competition in related areas. We continue to believe, as a general matter, that barriers to entry into new fields should be erected, or maintained, only upon a showing of clear need. Thus, while we would defer to the Federal Reserve Board for particularied comment on its experience under the "closely related" standard since 1970, we have serious concerns with any proposal which would severely tighten the existing standard in the absence of a demonstration of general adverse effects stemming from it. We think that this Committee and the Congress should refrain from enacting remedial legislation solely on the basis of questions it may have

---

[14] See also, Alabama Association of Independent Insurance Agents v. Board of Governors, 533 F. 2d 224 (5th Cir. 1976), *cert. denied* —— U.S. —— (February 27, 1978).

with Board decisions and look instead for adverse experience under those decisions. An appropriate remedy con only be created after a specific problem is identified. Speculative concerns grounded in the fear of new competition are not, without more, the kinds of problems this Committee should be concerned with.

Whether the amendments to the "closely related" test in Section 4(c) (8) would in fact severely tighten the standard is, as I have indicated above, not certain. However, the addition of the term "directly" and "necessary" might make approval of virtually any new activity most difficult. For example, it could be argued that few, if any, activities which are not part and parcel of the business of banking itself are a "necessary" incident thereto.

Section 301(a) also amends the general "public benefits" standard of Section 4(c)(8). Under present law the Board is required to consider whether performance of a proposed activity "can reasonably be expected to produce benefits to the public . . . that outweigh possible adverse effects. . . ." S. 72 would require the Board to determine that a proposed activity "is likely to produce substantial benefits to the public which clearly and significantly outweigh possible adverse effects." Once again, while the significance of these changes is difficult to assess, their intent clearly is to alter and make heavier the burden of proof that must be borne by proponents of bank entry into related activities under Section 4(c)(8).

Our comments on the approach we feel should be taken to severely tightening the "closely related" test also apply here. Moreover, it should be remembered that the present 4(c)(8) standard is a departure from the usual approach in our economy which permits new entry into an industry without an affirmative showing of public benefit. Thus, increasing the existing burden would represent an even greater departure from normal competitive policy. We do not here question the concept of a "public benefits" test in the case of bank holding company expansion into related activities (and indeed the Justice Department supported this approach at the time of the 1970 Amendments); however, the existing burden should be increased only if Congress affirmatively finds that the present standard has resulted in actual and significant adverse effects to the public as opposed to simply fear of new competition and the possible "adverse" effects that might have on specific companies. At the present time, we are aware of no evidence of such harm to the public.

Section 301(a) also makes changes in the specific examples of "benefits to the public" and "possible adverse effects" presently contained in Section 4(c)(8). For example, the terms "increased competition" (in the list of benefits) and "decreased competition" (in the list of adverse effects) would be changed to add the words "over the course of time." Apparently, this is a response to the argument of opponents of bank holding company expansion that, while new entry might increase competition in the short run, the power and resources of commercial banks will inevitably lead to their domination of a proposed activity in the long run. The bill would also require the Board in specific cases to "take into consideration the relative economic size and market power of the bank holding company and that of those with whom the affiliate would compete."

One amendment with which we are particularly concerned would delete the current direction to the Board to appropriately recognize the competitive benefits of de novo entry, as opposed to entry by acquisition. The Department supported this current provision vigorously in 1970, and opposes its deletion now. The competitive concerns which must be dealt with whenever significant mergers or acquisitions are proposed are comparatively more serious than those presented by de novo expansion. Conversely, de novo entry promises new competition, spurred by a firm's desire for success sufficient to justify its investment.

While we would defer to the Board on the actual effect of all of the proposed changes, we believe that the Board should be and already is looking to long-run effects as well as short-term ones and to the general competitive structure of the industry involved in applying the present standards. More significantly, we think that the effect of all of the proposed changes would be to increase the burden on both proponents of new entry and the Board, strengthen the position of opponents of holding company expansion, and thus make much more difficult the approval of specific activities under Section 4(c)(8). Although we are not prepared to debate the merits of each particular decision of the Board under the present 4(c)(8) standard, as already noted we are unaware of actual evidence of adverse harm to the public which would justify the highly restrictive approach of Section 301(a) of the bill.

S. 72 also addresses procedural aspects of bank holding company expansion. Section 601 of S. 72 would make a number of procedural changes in the handling of Section 4(c)(8) applications by the Board and in judicial review of Board rules and orders. Section 701 would grant standing to any interested person to petition the Board to modify or revoke 4(c)(8) rules or orders. In general, we defer to the Board on the effect that these changes would have on the present procedures utilized in reviewing Section 4(c)(8) applications. We would offer some broad comments on these provisions.

Under existing judicial interpretation,[15] which we understand has been accepted by the Board, a full Administrative Procedure Act type hearing is required where there are material facts in dispute in the case of an application for permission to engage in related activities. Where the Board acts through rulemaking to determine whether an activity is "closely related", the Board need not hold a formal hearing. Section 601 would subject both rulemaking and adjudication of specific applications to a requirement that the Board act on the record after opportunity for a full Administrative Procedure Act hearing. Judicial review of Board rules as well as orders would be under a "substantial evidence" test. In addition, any party participating in a hearing could discover any non-privileged documents or information from the Board or an applicant and could require that the Board undertake studies to provide any absent relevant information.

These requirements obviously would place a substantial additional burden on the Board. In the case of rulemaking, the full hearing requirement represents a significant departure from current law and practice. In many instances, a rulemaking situation may not warrant a full hearing because it is based only on "legislative facts" and interpretations of law, and does not directly affect the rights of individual parties. On the other hand, we recognize that rulemakings, as well as adjudicatory proceedings, can involve controversial fact situations and can have a significant effect on the prospects for individual Section 4(c)(8) applications. Therefore, we are unable to precisely assess the likely competitive or substantive effect of the procedural changes contained in Section 601. We do believe, however, that regulatory processes should be no more burdensome than necessary to accomplish a legitimate regulatory objective. We would recommend, therefore, that these changes be adopted only if the present procedures in fact are inadequate to provide a fair opportunity for the presentation of all relevant facts and views, and if the changes do not create significant new barriers to approval of holding company entry into related activities which are in the public interest.

Section 701 provides that any interested party may petition the Board "to consider the issuance, amendment, or revocation of an order or regulation" promulgated under Section 4(c)(8). The Board may determine whether to grant the petition in whatever fashion it deems appropriate. One purpose of this provision apparently is to permit challenges to continuation of previously approved activities which may not meet the new standards contained in Section 301 of the bill.[16] In addition, however, Section 701 carries the potential to tie up the Board in endless relitigation of decisions made under Section 4(c)(8). Whatever the ultimate determination as to the appropriateness of bank holding company expansion into related areas, we believe that finality of litigation is a value which should not be lightly discarded. We question whether creating a new right to petition for unlimited review of decisions in the manner of Section 701 is likely to produce benefits which outweigh the costs which will be incurred in handling such petitions, both at the Board and in the District Courts.

In summary, S. 72 deals with a number of highly important and controversial issues concerning competition in banking and related areas. The provisions which would place certain limits on additional expansion of banking activities through mergers and acquisitions represent one approach to a problem which requires careful consideration. The proposed changes to Section 4(c)(8) of the Bank Holding Company Act raise doubts as to their necessity or desirability, and

---

[15] Independent Bankers Association of Georgia v. Board of Governors, 516 F. 2d 1206 (D.C. Cir. 1975); Patagonia Corp. v. Board of Governors, 517 F. 2d 803 (9th Cir. 1975); American Bancorporation, Inc. v. Board of Governors, 509 F. 2d 29 (8th Cir. 1974).

[16] We note that Section 301(b)(1) does provide a limited "grandfather" provision for activities engaged in by a bank holding company prior to November 1, 1975, but does not permit "the scope or size (in terms of volume of business) of those activities to expand to any significant degree."

should be adopted only if there is clear evidence of their need. Any such changes to Section 4(c)(8) should be specifically tailored to deal with the perceived problem without imposing unnecessary barriers to new entry.

Mr. Chairman, this concludes my proposed statement. I would be pleased to respond to any questions the Committee may have.

The CHAIRMAN. Mr. Shenefield, you support the provisions in this bill which would give the agencies authority to deny anticompetitive mergers in cases where the existing antitrust laws are not violated?

Mr. SHENEFIELD. That's correct.

The CHAIRMAN. You indicate that this provision would eliminate what you call "forum shopping." I don't understand that term. Can you explain how forum shopping would work? What does that mean?

Mr. SHENEFIELD. Well, as we understand it, bank holding companies and banks in general may predetermine a particular regulatory agency that will review a merger by fashioning the transaction in such a way as to have it wind up as within the jurisdiction of the FDIC or the Comptroller of the Currency or the Federal Reserve Board. Our thought was that to the extent that uniformity can be introduced into the regulatory procedures involving these agencies the desirability of forum shopping from the point of view of banking would be——

The CHAIRMAN. So this is one additional advantage of that particular provision. It would eliminate that shopping around wherever they can get the best break.

Mr. SHENEFIELD. Yes, sir.

The CHAIRMAN. I'm going to ask Mr. Marinaccio to follow up on that. He had a point.

Mr. MARINACCIO. I would just inquire as to the best way to insure that regulatory uniformity in view of the fact that competitive factor reports are now distributed among the agencies and there is now a lack of uniformity. Can you recommend any way in which to insure uniformity among the agencies perhaps short of unifying the three agencies?

Mr. SHENEFIELD. As I understand the ruling of *Washington Mutual*, it applies only to the Bank Merger Act and there is to some extent an open question about whether the rule would apply to decisions by other agencies under other statutes. As my statement indicates, some forum shopping is inevitable, due to the nature of the decision, and we don't think that reversing the *Washington Mutual* rule would increase the problem. For Congress to establish a clear rule reversing *Washington Mutual* that would be applicable across the board would at least to the extent itself promote uniformity.

The CHAIRMAN. You say if a percentage ceiling on mergers is adopted and one provision of the bill is that we provide a 20-percent limit—grandfather in those holding companies that have a larger share, but we have a 20-percent limit on the additional acquisitions within a particular State—20 percent of the total deposits in that particular State—it could be under the control of a specific one holding company. Now you say if the percentage is adopted Congress should consider a ceiling lower than 20 percent, and yet in your analysis of this you seem to indicate that there are arguments on both sides—that this isn't something on which we should come down very hard. There are good arguments for it and good arguments against it, and you surprise me by coming in and saying that something may be more restrictive and lower than 20 percent might be appropriate. I'm not sure I follow your reasoning on that.

Mr. SHENEFIELD. Well, Senator, it's an extremely intricate and difficult problem. It seems to me that the policy benefits and detriments are difficult to weigh, at least in the absence of any very precise analysis.

The statewide ceiling approach is the proposal embodied in S. 72. We were attempting to call to the attention of the committee what we considered significant possible disadvantages of such an approach, but in the event that the approach is adopted by the committee to offer perhaps a refinement in that a lower number might be appropriate.

The CHAIRMAN. Would you refine it further—you pointed out that in some States it's more appropriate than others. One obvious element that might be considered is the size of the State. Obviously 20 percent in Idaho is not like 20 percent in New York or California. Would that be a possibility—that you would have a lower percent in a very large State than you would in a very small State?

Mr. SHENEFIELD. Yes. It seems to me that would be entirely appropriate.

The CHAIRMAN. Now you say that our banking system "is also marked by significant concentration among the largest banking organizations on a statewide basis." What is your view of the effect on competition and on the consumers in the marketplace in concentrated markets?

Mr. SHENEFIELD. It's difficult to answer that question in general. One has the normal rather theoretical concerns about competition in that sort of a situation. One also must note the particular aspects of the banking industry, by which I mean that the pool of potential entrants that would deconcentrate individual local markets is in a sense limited by State lines. In addition, there are a variety of State regulations and laws that make it difficult at least in some States for banks to move across the State, across the county lines or in some States branch at all. So I guess that there are at least two major effects on competition of that sort of concentration. No. 1, you may well develop a kind of shared monopoly—that's the phrase we have used—and an interdependent oligopoly approach to pricing and services that would be less competitive than a more deconcentrated industry. Second, because of the existence of State lines and the relatively limited number of potential entrants in at least some States and the potential for deconcentrating those markets does not exist.

The CHAIRMAN. But since many markets are concentrated and anticompetitive, don't we need a percentage limitation on mergers as one tool to control increasing concentration?

Mr. SHENEFIELD. It seems to me if despite the qualifications we have suggested and the theoretical difficulties we have suggested the Congress adopts that route, clearly one of its major benefits would be to put a ceiling and deconcentrate—prevent the increasing concentration of such markets.

The CHAIRMAN. You recommend that if a percentage ceiling on mergers is adopted "that a convenience and needs standards be included as an exception." Now the legislation already has in it an exception for failing banks. How much further would you expect your convenience and needs exception to go?

Mr. SHENEFIELD. It seems to me that one major benefit of it might well be to permit acquisitions that would move the percentage only slightly beyond whatever figure the Congress chose, yet have procompetitive effects in local markets. That is to say, if Congress chose the 20-percent figure and there were an acquisition that would move the percentage of that bank—the resulting combination—to 20.5 but did so for what are judged to be very good reasons short of the failing company situation, such as allowing foothold entry into a concentrated market, a convenience and needs defense would at least be a regulatory outlet for bringing those kinds of judgments into play.

The CHAIRMAN. Let me ask you about what you called your philosophical skepticism about limiting competition. I can understand that. After all, you are head of the Antitrust Division of the Department of Justice and your responsibility is to fight for competition under almost any circumstances, but I think you have to recognize that here when banks move into competition with auto leasing firms, for example, and banks move into competition with securities firms, when banks move into competition with insurance firms, they come with a very, very sharp advantage that may not be fair. They have capital. They have capital at a time when capital may be the principal ingredient that's most important in whether or not a market can move and expand and grow and so on.

When I talked to auto lessors in Wisconsin—and I'm sure Senator Sparkman may have had this experience in Alabama—they are pretty desperate. They just don't see how they can survive if the banks are going to get into that business with them because their position is so feeble compared to the banks from a capital standpoint. They may be far more expert. They may do a much better job in knowing the business. That may be something they have done for 15 or 20 years and they may do it extremely well. When the bank comes along with a capital advantage—and capital is hard to get—why shouldn't that be a consideration confining banks to banking?

The general feeling about the Glass-Steigel Act that was passed years ago after the very serious problems we had in the 1920's and early 1930's in the stock market with banks getting into investment banking—banks being in investment banking the way they were—seems to have been healthy, seems to have been good from the standpoint of keeping the banks sound and responsible and credible and also certainly in my view at least the investment banking industry hasn't suffered, and confining banks to this particular area where they are so good and where they have the expertise seems to have been a wise policy.

Do you recognize any of that in your position you have taken?

Mr. SHENEFIELD. Yes, we do. First of all, I concur fully in the concern that you have voiced about the enormous power of financial institutions and banking in general to move into related areas, and you simply can't read the history of this country in the 1930's and not have a lingering concern, a residing skepticism about whether it is always appropriate for these institutions to move freely and without control into related or unrelated areas.

I had thought that the language that was incorporated in section 4(c)(8) and the balancing that was required which specifically, as I recall, mentions unfair competition, on the side of adverse effects, might have been sufficient to deal with particular problems and perhaps it has not been in the view of the Congress. Outside what I have called in shorthand the target industries—outside the industries into whose markets banks have moved as related activities, there hasn't been a lot of complaint as nearly as one can tell.

The CHAIRMAN. Well, I wonder about that. Do you really get complaints from customers under those circumstances? Aren't the people who are likely to make the case—isn't it predictable that the people that are going to make the case are the people whose ability to compete has been injured? Don't you traditionally find that?

Mr. SHENEFIELD. I agree that they certainly would make the case. It's only because their own self-interest is so clearly involved that I counsel an attitude of skepticism in evaluating the facts that underlie the case. It would be helpful and reassuring if there were corroborative complaints from customers whose own business firms weren't adversely affected competitively by this kind of entry. That was all I was suggesting. We are not clearly experts in the banking business, shocking as that may seem to some of the people who have received the benefit of our litigative efforts. We try in the best way we possibly can, however, to offer a mode of analysis and the mode of analysis I would suggest here is that you bring to the complaints of the insurance people and the travel agency people and the other people who are seriously concerned simply a skepticism. You require them to make the case. In effect, you put the burden of proof on them to show that there is competitive harm rather than on the banks to show that there is competitive benefit before seriously tightening the standard. I guess that's what I would suggest because what you're doing is making it difficult for firms to move into new areas where competition might be a good idea. That's all, and that's a very philosophical view I readily admit.

The CHAIRMAN. Senator Sparkman.

Senator SPARKMAN. No questions at this point, Mr. Chairman.

The CHAIRMAN. Thank you very much, Mr. Shenefield, for a very impressive presentation and for your excellent responsiveness to our questions.

The next witness is the Honorable Philip E. Coldwell, Governor of the Federal Reserve Board, who's always an impressive witness for this committee in the past. Mr. Coldwell, we would appreciate it if you could abbreviate your statement and if you do we will have your statement printed in full in the record. Go right ahead, sir.

STATEMENT OF PHILIP E. COLDWELL, GOVERNOR, FEDERAL RESERVE BOARD

Mr. COLDWELL. Thank you, Senator.

I will attempt to abbreviate the statement, assuming that the full statement will go into the record. I would like to concentrate my initial remarks on basically the first seven pages of the statement and then I will quickly summarize the last few.

[Complete statement follows:]

STATEMENT BY PHILIP E. COLDWELL, MEMBER, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. Chairman, I am pleased to appear before this Committee on behalf of the Board of Governors to testify on S. 72, the Competition in Banking Act of 1977. This bill would have far reaching implications for the regulation of banking structure in the United States. It affects not only the standards and administrative procedures employed by the Federal banking agencies in acting on proposed bank mergers but also those applied by the Board of Governors in reviewing proposed new activities for bank holding companies and deciding on particular acquisitions. Before addressing the major substantive provisions in the bill, I believe that it is important to comment briefly on the four basic findings and purposes of the bill which presumably provide the rationale for many of its specific provisions.

The bill's first finding is that there has been a continuing trend toward concentration of banking resources in the United States. However, recent Board studies fail to indicate that there has been a significant trend toward increased concentration of *domestic* banking resources nationally, statewide, or in most of the country's 400 most significant local banking markets. In fact, concentration appears to be declining.

For example, at the national level between 1968 and mid-1977, the 10 largest banking organizations' share of domestic deposits declined from 20.4 percent to 18.3 percent and the top 35's share dropped from 31.9 percent to 28.0 percent. The 100 largest organizations' share declined from 49.7 percent to 45.0 percent. over this period. A similar pattern is found at the statewide level. Moreover, it is important to note that the most concentrated states—all of which permitted statewide branching—typically had declines in concentration. (See attached table). The results of our review of over 400 local markets, including 213 SMSAs, between 1966 and 1975, indicate that the majority tended to become less concentrated and to exhibit a more competitive structure irrespective of the measures used. We also note that even these figures tend to overstate concentration since they do not reflect the rapid growth of bank type activities at savings and loans, mutual savings banks and credit unions. In many states, thrift institutions now provide substantial competition for commercial banks.

The sharpest growth in our largest banking organizations has been in the foreign sector; and it is only when deposits held abroad are included that there appears to be an increase in banking concentration. While it might be argued that foreign financial activities of U.S. banks contribute to their overall economic power, this argument is not particularly germane to the proposed bill which focuses on domestic and not worldwide concentration and competition.

The second finding of the bill points to the fact that an increasing portion of the Nation's banking resources have come under bank holding company control. The registered bank holding company share of domestic U.S. deposits did increase from 16 percent in 1970 to 70.8 percent in 1977 but about two-thirds of this increase resulted from the inclusion of over 1,100 one bank holding companies under the umbrella of the Act in 1971. This includes 16 of the Nation's 25 largest banks. Also, it is important to note that while bank holding companies account for 70.8 percent of domestic bank deposits, all but about 8 percent of these deposits are in the lead banks of holding companies. Thus, expansion of bank holding companies' share of deposits has been due principally to conversion in the legal status of existing banking organizations to the holding company form and not to acquisitions of existing banks by multi-bank holding companies.

A third finding of the bill is that bank holding companies have expanded into activities beyond those directly related to banking. Specific activities cited are: insurance agency and underwriting services, leasing, accounting, travel, and courier services; management and data processing services; and marketing securities. While these descriptions do not comport with the list of permissible activities issued by the Board, several points are worth noting with respect to this general finding.

In administering Section 4(c)(8), the Board has generally determined various activities to be "closely related" to banking if they satisfied one or more of the following four criteria:

(1) The activity was one in which a significant number of banks have engaged in for some years (e.g., trust services);

(2) The activity involves either the acceptance of deposits or lending (e.g., consumer finance companies);

(3) The activity is complementary to the provision of a banking service (e.g., acting as an insurance agent for credit related policies);

(4) The activity is one in which banks possess considerable expertise (e.g., data processing for banks).

So far, the Board has only approved 17 activities as being permissible for bank holding companies—12 by rulemaking and 5 by order. An additional 11 were denied, including travel agencies (mistakenly mentioned above in the findings of the bill as an approved activity) as well as property management, real estate brokerage and operating a savings and loan association. Generally, activities approved, except underwriting of credit life insurance, were, in fact, permissible activities for national banks or their subsidiaries at the time they were authorized. Moreover, the Board did not provide for carte blanche entry into those activities as is implied by the findings of the bill. In many cases, the activities were severely restricted to those that are bank or finance related and, in some instances, such services may only be provided to a customer in connection with a bank related service (such as the sale of credit life insurance).

Furthermore, by far the largest number of bank holding company expansions in the nonbank area have been de novo and not by acquisition; over 3,100 de novo nonbank notifications were received between January 1971–September 10, 1977 as compared with only 461 acquisitions of existing firms approved by the Board; 54 applications were denied.

Finally, despite the number of acquisitions acted upon by the Board and de novo notifications received, nonbanking assets still account for less than 4 per cent of bank holding company assets. In view of these considerations, we question whether this finding of the bill describes a development of any real significance to the economy.

The fourth finding is that credit resources of the Nation have been misallocated by bank holding companies. The basis of this finding is not stated and is unclear. Objectively, there appear to be several reasons why bank holding companies might be expected to facilitate a more efficient allocation of credit. Bank holding company expansion in restrictive branching states, together with the provision of various bank type lending services on an interstate basis through nonbank affiliates, probably has resulted in increased competition in local and regional markets and has facilitated inter-regional credit flows. Both could be expected to provide more rapid and efficient allocation of loan funds geographically. Similarly, the ability to attract funds from cheaper sources through the debt and equity markets, particularly during periods of tight money, may have moderated financing pressures on holding company banks and helped maintain their ability to accommodate credit demands.

The causal factors cited in the bill for such misallocation of resources are that the Federal Reserve has not adequately protected the public interest in approving activities in which bank holding companies could engage and has not maintained continued oversight over the activities of bank holding companies in a manner which protects the public interest. In my view, the facts would not support either finding. A review of Board orders issued in connection with action on applications clearly demonstrates that all statutory factors, i.e., competition, convenience and needs of the public, and financial and managerial resources, are carefully weighed. In the area of public benefits, the Board has taken definitive action such as obtaining commitments for reduced rates on reinsurance activities. With respect to financial considerations, the Board has long held to the philosophy that bank holding companies should serve as a source of strength for their subsidiary banks. In many instances, the Board has obtained commitments from holding companies to supply additional capital to their subsidiary banks and has urged that nonbank subsidiaries be adequately capitalized. In 1974, when certain banking firms began to experience sharp increases in problem loan situations, the Board instituted a go-slow policy with respect to further expansion. Consistent with this policy, the Board has denied a number of applications, some for the Nation's largest banking organizations.

Since 1970, the Board has taken a number of steps to improve its ongoing surveillance and supervision of bank holding companies. For example, as a supplement to its other surveillance activities, the Board recently announced a new inspection program whereby most large bank holding companies will be subject to an on-site inspection annually. The Board also collects detailed information on intra-holding company transactions which are routinely monitored. Additionally, recent changes in the reporting forms for banks have been instituted and special emphasis is being placed on the analysis of foreign operations and risk exposure of large organizations.

As my comments suggest, our review of the facts reveals little in the way of evidence or analytical support for the bill's four principal findings. This gives rise to a general conclusion on the part of the Board that the actual adverse effects, which the bill seeks to redress, are small. The Board feels that restrictions should not be imposed nor regulation intensified without demonstrated need, especially when the longer run effects may be to inhibit competition, or to protect existing firms from competitive forces. At the same time, we also recognize that there may be some specific areas affecting the Federal regulation of bank and bank holding company structure which need review and the Board would support Committee efforts in these areas. I shall now turn to the major substantive features of the bill and our reactions to them.

The proposed legislation would establish an outright prohibition of any bank merger or holding company acquisition of a bank in which the resulting company would control more than 20 per cent of the banking assets in any state. The one exception would be where the proposed acquisition is necessary in order to prevent a bank failure and no less anticompetitive alternative is available. The Board questions the desirability of such an absolute limit, especially in view of the wide differences in bank structures in the various states and the lack of evidence that there has been a trend towards concentration of resources at the statewide level. We are particularly concerned that such a limitation would have the anticompetitive effect of protecting some banks from actual competition or the threat of future competition that could result from relatively modest additional acquisitions by large banking organizations. Undoubtedly, the effect of the instant legislation would also be to significantly inhibit the growth of some banking organizations by even the de novo route. The Board believes that there are few instances when such expansion would not be procompetitive and to restrict de novo expansion would not be in the public interest.

The proposed percentage limitation, as drafted in terms of total assets, would also discriminate against those institutions which derive a significant portion of their business assets from the national and international markets. These institutions' domestic expansion by acquisition within a state would be curtailed even though they might hold a significantly smaller proportion of the business originating within the state than other smaller institutions. The focus on bank assets also overlooks the fact that expanded powers of nonbank financial intermediaries, such as thrift institutions, are blurring the distinction between banks and these other institutions and are increasing competition in the markets for some banking services.

Should the Congress choose to adopt such a percentage limitation, the Board believes that it should be based on domestic resources. However, because of the uniqueness of each state, the Board strongly feels that no single percentage figure would be appropriate. Use of a single figure would ignore important factors such as (a) the number and powers of competing institutions operating in each state, (b) their size distribution, (c) the general economic environment in each state and (d) restriction on branching and geographical expansion. Federal imposition of an overall constraint would interfere with the right of a state to decide what type of structure best meets its needs. The Board feels that the present case-by-case approach better serves the public interest, since it provides the Board the needed flexibility to weigh the unique competitive, structural and other important factors associated with a given state.

Despite concern for the bill's asset limitation, which the Board opposes, there are several other provisions pertaining to bank mergers and holding company acquisitions of banks which provide useful clarifications of existing law. In particular, the Board favors those provisions which permit denial of acquisitions even when the level of the possible anticompetitive effects does not constitute violation of the antitrust laws or the 20 per cent limitation, if the responsible agency believes that the proposed acquisition would not be in the public interest and the anticompetitive effects are not clearly outweighed by the probable consequences for community convenience and needs. This feature has the desirable effect of clarifying that competitive considerations should dominate the banking agencies' decisions on proposed acquisitions.

As currently drafted, S. 72 would result in major changes in Section 4(c)(8) of the Bank Holding Company Act, which governs the nonbanking activities of holding companies. At present, bank holding company proposals to engage in nonbanking activities must pass two tests—the "closely related" test and the "public benefits" test. S. 72 would make both tests more stringent.

The "closely related" test now contained in Section 4(c)(8) requires that a proposed activity be "so closely related to banking or managing or controlling banks as to be a proper incident thereto." In contrast, S. 72 would require that a proposed activity be "so closely and directly related to banking or managing or controlling banks as to be a proper and necessary incident thereto." It is not clear what these additions would mean for the "closely related" test. One possibility is that it would limit permissible 4(c) (8) activities to "banking activities", that is, activities in whch banks themselves generally can engage. If so, the exsting list of permissible activities would not be greatly affected, since banks can now engage in most of the present 4(c)(8) activities, including such important ones as mortgage banking, consumer lending, leasing, factoring and data processing. But there are other possible interpretations of the proposed wording changes in the "closely related" test, and these different interpretations could have significantly different effects. In any event, the Board believes that it is important to draft any wording changes in the "closely related" test so as to minimize subsequent controversy over the meaning of the test.

The Board also believes that there should be no changes in the "closely related" test without a thorough review and analysis of the impact that bank holding companies have had in the various nonbanking areas since the passage of the 1970 amendments. As the Committee is aware, the Board's staff is nearing completion of a comprehensive review of recent research on all aspects of the bank holding company movement. The Board believes that this study, as well as all other available evidence, should be carefully reviewed and considered before changing the present standards for permissible activities.

The provisions of S. 72 would also alter the "public benefits" test of Section 4(c)(8), making it substantially more stringent. The present statute requires that a proposed activity "can reasonably be expected to produce benefits to the public that outweigh possible adverse effects." S. 72 would require that the activity "is likely to produce substantial benefits to the public which clearly and significantly outweigh possible adverse effects." The specific factors to be considered in determining the substantial benefits and adverse effects would also be expanded.

The Board believes that the meaning of the proposed "public benefits" test is likely to produce controversy. But more important, the Board does not believe that the proposed public benefits test would serve the public as well as the existing test. Under the proposed test, the Board would have to deny nonbanking significantly outweigh possible adverse effects." The specific factors to be conbenefits would only slightly outweigh adverse effects. In contrast, the Board can approve such applications under the present standard. The Board sees no reason to deny the public the opportunity to derive benefits when there is a reasonable probability that these benefits, on balance, will outweigh any adverse effects.

S. 72 would provide grandfather rights for bank holding companies engaged in nonbanking activities that would be made impermissible by the bill. If S. 72 is enacted, the Board would strongly support grandfather provisions, but would urge that the effective grandfather date be the date that the bill was introduced in the current Congress, rather than November 1, 1975, as proposed in S. 72. Also, we would suggest the elimination of the provision in S. 72 that would prevent a holding company from increasing to any significant degree the volume of business of a grandfathered nonbanking subsidiary. Such a provision would tend to discourage the holding company subsidiary from competing aggressively and meeting the needs of the public.

The bill also specifies that the Board shall require that bank holding companies and their subsidiaries be capitalized and otherwise financed in a safe and sound manner. Certainly this objective cannot be criticized. However, it should be recognized that the Bank Holding Company Act already requires the Board in bank acquisitions to "take into consideration the financial and managerial resources and future prospects of the company or companies and the banks concerned." Similarly, Section 4(c)(8) of the Act requires the Board to consider such possible adverse effects as unsound banking practices in nonbank acquisitions. In carrying out both of these charges, the Board carefully considers the capitalization and overall financial condition of the holding company and its subsidiaries. Furthermore, as part of its ongoing responsibilities for supervising bank holding companies, the Federal Reserve conducts inspections of the parent companies and their nonbanking subsidiaries, examines subsidiary banks that are State member banks, and reviews the examination reports of other subsidiary banks that are examined by either the Comptroller of the Currency or the FDIC.

The bill also specifies that the Board require bank subsidiaries to refrain from discriminating in favor of their parents and nonbank affiliates in making loans or establishing terms and conditions of credit. The Board agrees that the practices referred to are improper if the terms or conditions of the loan are more favorable than the bank would make to a non-affiliated borower of comparable credit worthiness. But we oppose the provision with respect to the making of loans to subsidiaries which could have the effect of unduly restricting the flow of funds within the holding company organization. At present, bank examiners closely review bank loans to affiliates and will criticize a loan to an affiliate made on preferential terms that are adverse to the bank. It should also be noted that bank loans to holding company affiliates are covered by Section 23A of the Federal Reserve Act. This Act places quantitative limitations on such loans, as well as requiring that all loans be fully secured by high grade collateral. Indeed, the collateral requirements on bank loans to affiliates tend to be significantly more stringent than collateral provisions on bank loans to non-affiliated borrowers. The Board feels that a better way to deal with transactions involving intra-company fund flows is through Section 23A. In this connection, a new proposal to modernize and strengthen Section 23A has been completed by the Board and is being transmitted to Congress.

S. 72 contains a provision that would require each bank holding company to submit to the Board each year a report detailing the terms and conditions of all intra-company loans and investments. Moreover, the Board would be required to make such reports available to the public. The Board does not believe that these provisions are necessary. First, the Board is already receiving an intra-company transactions report on a quarterly basis from medium and large size bank holding companies. Second, bank examines carefully review transactions between bank subsidiaries and the rest of the holding company system, and the Federal Reserve now periodically inspects the financial affairs of parent companies and nonbank subsidiaries. In the Board's judgment, these examinations and inspections, along with existing reports, supply the supervisory authorities with sufficient information on intra-company transactions. In addition, the potential reporting burden associated with such a proposal would be substantial, especially since most intra-company transactions individually would not be material. The general problem of the appropriate level of public disclosure of insider transactions, of which intra-company transactions are a subset, is currently under review by the SEC, the accounting profession, the banking agencies, and Congress. We believe it preferable to wait until the general issues have been resolved before legislative reporting in this area.

Turning to that portion of the bill dealing with administrative procedures and judicial review, the Board strongly objects to the proposals contained in Section 601. These proposals represent a step backwards to the burdensome and time-consuming procedures of the Bank Holding Company Act prior to the 1970 Amendments. Section 601 would depart from the basic concept of the Administrative Procedure Act embodied in the Board's current procedures by requiring a formal hearing for the issuing of new regulations and for all individual case determinations.

We believe that the precedents in administrative law clearly demonstrate that the public interest is best served by avoiding the cumbersome procedures of formal adversary hearings except in those instances contemplated by the Administrative Procedure Act. In connection with rulemaking, the experience of those few agencies that have used formal hearings as opposed to informal proceedings has been that such rulemaking proceedings are unreasonably lengthy. At a time when the Government is endeavoring to accelerate the decision making process within administrative agencies, the proposal would impose the burdensome procedures of formal rulemaking and its attendant formal hearings upon a type of decision making generally recognized by the Administrative Procedure Act and the courts as not requiring an adversary type proceeding.

The Board's present procedures provide opportunity for the presentation of views by interested parties. In situations where facts are in dispute, the Board's procedures currently provide for a formal hearing, after which the case is decided on the basis of the hearing record. Where no such disputed facts exist, there is no need for a formal hearing. Section 601 would eliminate this administrative flexibility to the detriment of the public interest.

We are equally concerned with the provisions of Section 701 that would require the Board to process a petition to commence a proceeding to consider the issuance, amendment or repeal of any order or regulation relating to nonbank activities. We note that under the Administrative Procedure Act any person already has the right to petition the Board for the adoption or amendment of a regulation. Aditionally, we believe that the procedure established to challenge the operation of individual companies would provide a continuing possibility of attacks on a bank holding company wishing to engage in a bank related activity. This possibility could deter many bank holding companies from engaging in nonbanking activities or seriously impair their nonbanking subsidiaries' abilities to compete with unaffiliated companies engaged in the same activity. Such an outcome would tend to reduce competition and innovation in bank related fields, and could hardly be in the public interest.

PERCENTAGE OF DOMESTIC STATEWIDE COMMERCIAL BANK DEPOSITS IN 3 LARGEST BANKING ORGANIZATIONS

	1960	1976	Change
Statewide branching States:			
Arizona	95.8	86.8	−9.0
Nevada	93.5	83.2	−10.3
Rhode Island	92.8	87.4	−5.0
Hawaii	89.2	78.6	−10.6
Oregon	86.7	78.3	−8.4
Delaware	79.8	76.9	−2.9
Idaho	74.5	75.3	+.8
Alaska	68.2	67.5	−.7
California	65.7	60.4	−5.3
Utah	65.6	60.5	−5.1
Washington	61.1	61.7	+.6
North Carolina	46.8	49.2	+2.4
Connecticut	42.7	46.6	+3.9
Maryland	42.7	44.6	+1.9
South Carolina	42.4	42.8	+.4
South Dakota	37.5	44.3	+6.8
Maine	34.7	46.6	+11.9
Vermont	25.6	44.0	+18.4
Virginia	20.2	34.6	+14.4
Average of statewide branching States	61.3	61.5	+.2
Limited branching States:			
Massachusetts	49.3	45.7	−3.6
Georgia	48.6	37.8	−10.8
New Mexico	43.0	46.0	+3.0
Michigan	40.8	34.2	−6.6
New York	40.0	40.0	0
Wisconsin	31.4	27.4	−4.0
Alabama	31.2	37.5	+6.3
Louisiana	29.3	17.8	−11.5
Tennessee	28.7	28.8	+.1
Pennsylvania	27.9	22.9	−5.0
Kentucky	27.6	20.9	−6.7
Mississippi	24.9	27.7	+2.8
New Hampshire	24.3	33.6	+9.3
Ohio	24.2	24.6	+.4
Indiana	23.8	18.0	−5.8
New Jersey	16.8	22.2	+5.4
Average limited branching States	32.0	30.3	−1.7
Unit banking States:			
Minnesota	58.6	51.6	−7.0
Montana	48.7	45.5	−3.2
North Dakota	46.6	40.6	−6.0
Colorado	37.9	41.0	+3.1
Illinois	35.5	31.8	−3.7
Wyoming	35.1	40.3	+5.2
Oklahoma	32.6	20.5	−12.1
Nebraska	31.6	20.0	−11.6
Missouri	26.6	28.9	+2.3
Texas	21.1	20.5	−.6
Florida	17.9	24.5	+6.6
Arkansas	17.3	14.2	−3.1
West Virginia	17.3	9.3	−8.0
Kansas	14.3	9.0	−5.3
Iowa	14.2	15.1	+.9
Average for unit banking States	30.4	27.5	−2.9
Average for all States	42.7	41.3	−1.4

Mr. COLDWELL. Incidentally, as the Senator knows, we are in the process of finishing up a study of the bank holding company movement. We expect to complete it the latter part of this month, and some of the results may bear closely on the question of the definitions in these tests. So we would suggest that Congress await the results of the study since it is so close to being completed, before legislating on this matter.

The CHAIRMAN. You say the latter part of this month that will be available? The study will be completed?

Mr. COLDWELL. We promised, I believe a date of March 31, Senator, and we plan to meet that date.

Regarding the grandfather test, the only comment I have made there is I would hope that if you legislate you would make the grandfather date the date of the introduction of this bill in the current Congress.

With regard to the report on intracompany loans and investments, the testimony does point out that we already have intracompany transaction reports which we monitor continuously. We don't think additional requirements are needed in this field.

Finally, I'd like to make just a couple comments about the administrative procedures required by the bill. We have adopted, following the passage of the 1970 amendments a procedure according to the Administrative Procedure Act by which formal hearings are held only when there are disputed facts in the case. We have found this to be an efficient and effective way of handling these procedures. We would be considerably disturbed if the Congress thought we had to go into a formal hearing for every acquisition or every challenge made with regard to the Board's rulings. We do provide arrangements whereby the views of interested parties are given a chance to be heard, but the situations where facts are in dispute are the only ones where we think a formal hearing is required.

We are concerned with the provision of section 701 which would require the Board to process a petition to commence a proceeding to consider the issuance, amendment or repeal of any order or regulation relating to nonbank activities. We think this could be a "go" sign for a considerable amount of formal activity and we don't think it's really necessary.

I would close my introductory remarks on that, Mr. Chairman, and be pleased to try to answer any questions.

The CHAIRMAN. Thank you very much, Governor Coldwell, for a very impressive analysis and you certainly went over the bill very carefully and we appreciate that care and consideration you gave it.

First, let's start with the good news, and there is some good news in your statement as far as the bill is concerned. You say the Board favors those provisions of the bill which would permit the denial of an anticompetitive bank acquisition even if it does not violate the antitrust laws or the 20 percent limitation set out in the bill. You say that this feature has the desirable effect of clarifying a competitive consideration should dominate the banking agency's decisions on proposed acquisitions.

Mr. COLDWELL. Right.

The CHAIRMAN. Now I appreciate your support for that provision and I wonder if you could expand on your reasons for support a bit more. For example, do you feel that some anticompetitive mergers have been approved for convenience and needs reasons that should not have been approved?

Mr. COLDWELL. I can't isolate any particular case for you, Senator. I think there have been marginal or borderline situations where we found the convenience and needs test did outweigh the adverse implication, but we were uneasy about it. Normally we approve an application if the convenience and needs test outweigh the anticompetitive side.

We have been exercising judgment in these matters and we have put that line, a rather broad band, in there and tried to exercise judgment where we thought there were more significant elements which might lead toward a denial even though we find some favorable consequences for the communities' convenience and needs.

These are not clear-cut cases all the time. In fact, most of them are not. And our problem is to not only where are we today on competitive needs, but where are we going to be tomorrow? What will happen if we permit the acquisition of a particular bank in a community and that bank looks like it will provide a good competitive stance against the other institutions within the community; but we look down the road and say, "Well, now does this community need this kind of muscle in its structure in order to maintain a competitive stance? Are there adverse effects which we really can't measure too well on, say, the profitability of smaller banks in that community?" These are tests or problems which we face in trying to measure all of these. Even the determination of the banking market becomes difficult for us sometimes. You get a large community, a standard metropolitan area, and maybe that's a single banking market in our definition, but when you get out into the suburbs maybe 10 miles from that central city limit, do you have another separate banking market? Well, there have been some argument that we ought to treat this as accepted banking market, but it's a part of a broad market and the people moving to and from the central locations do have access to other banking communities in that whole market. It's been a difficult kind of determination but one that we have worked hard on.

The CHAIRMAN. You have worked hard on it and it may well be— that I'm going to ask a question that doesn't pertain to this bill because I can't resist asking it from what you say. It may well be that the present restrictions on entry are wise. If I want to start a haberdashery or a garage or any kind of a business like that, I'm free to go ahead and do it and no regulatory agency is going to say, "You can't do it because we think it would be too tough on the people who are in the business now." Of course, as you know, small businesses are started every day and many of them fail and many of them succeed as part of the market apparatus, and it's part of the reason we have a very efficient market system in this country. But banks have that protection of convenience and needs and let me go a little farther.

Supposing we drop that entirely and permitted the basis on which a bank would be permitted to operate on to be whether it had adequate capital, whether it had adequate and competent leadership and management but not on whether or not it would have an adverse effect on local competition. What's your feeling about that? I think we ought to be thinking about legislation like that. I'm not talking about this particular bill. It doesn't do that. But whether we ought to be thinking in that area. I have had a strong feeling that maybe our country would be better served if we didn't provide this protection for banks and encouraged competition on any able, properly capitalized group that wanted to establish a bank.

Mr. COLDWELL. Well, you're going back to the heart of our problem, Senator, Banks can't go into business without a charter. We don't do this for the other types of firms which are allowed to go into business, and allowed to fail. With very few exceptions, we have virtually arranged now, through FDIC assisted purchase and assumptions, that banks are not liquidated anymore. Certainly there may be losses, but not huge ones. We have had roughly 105 banks "fail" since 1960. But there were very few of them where the depositors were paid off and the bank doors were closed. Most of the time the bank is purchased by another organization.

The idea of having this wide open to anybody who wants to come in without a charter, provided only that the institution has adequate capital and—I'm not quite sure how you do that because we haven't been able to achieve it over many years of regulatory endeavor—has some attraction to it. But there are also some risks because, we are dealing with the public's money. This latter point convinces me that we still ought to keep a fairly close rein on banking and depository institutions.

The CHAIRMAN. Now you take issue with the premise in the legislation that banking resources are becoming more highly concentrated. The way you do it is I think very effective. I'm not sure that I would buy the fundamental premise. You cite domestic deposit data to support your argument rather than the overall deposits. Isn't your reliance on domestic deposits misleading? After all, when all deposits are taken into account your concentration ratio has increased markedly. For example, from 1950 to 1974, the 10 larger banks' control of bank deposits increased from 19.7 to 28.9 percent—in other words, from 20 to about 30 percent—while your fixed based only on domestic deposits shows a small decline during the past 10 years. Shouldn't we include all deposits in determining concentration ratios on the grounds that all deposits represent the real competitive power that a bank has in the marketplace and that in this day and age we are operating in an international basis and that if you talk about big banks, of course, that's where the action is. I notice that the eight biggest banks in New York in the year ended last June 30 increased their foreign loans by over 26 percent and they reduce their domestic loans by 2 percent.

Now it seems to me that we should take notice of that. That's part of the business, part of the power and clout that they have. They get deposits from abroad. They can make loans wherever they wish. They may choose to make loans abroad or make loans here, but they have that discretion.

Mr. COLDWELL. I won't disagree with you that a strong international department of a bank may give that bank a little more power. I think, though, if you are looking at the idea of whether we ought to restrict competition or restrict access within the States, we ought to be looking at State deposits.

The CHAIRMAN. Before we get to that point, I think the thing to look at is the concentration. Is there concentration or isn't there? If you look at it overall on the basis of the total deposits, the concentration is there. You say it's not relevant because all we should really be concerned about for this purpose is the domestic deposits.

Mr. COLDWELL. Well, if we are talking about international competition, yes, we ought to include the international deposits, clearly. But if we are talking about U.S. concentration, it seems to me we ought to be talking about U.S. deposits. That was the whole purpose of the analysis as we went through, of the 10, 25, and 100 largest organizations and we went through a similar analysis with regard to the percentage of domestic deposits for the 3 largest organizations. Again, we show a slight diminution of their percentage of concentration.

The CHAIRMAN. But here what we're talking about, holding companies, whether or not holding companies may be moving into a situation that may not be as competitive as it should be. It seems to me that the power that these additional deposits that are received from other countries are an element that shouldn't be completely ignored. You shouldn't just concentrate on domestic deposits.

Mr. COLDWELL. Well, I guess we have a difference in view on the proper way to measure concentration. To me, concentration within the United States should be measured on the domestic side.

The CHAIRMAN. Now you also take issue with the finding of the legislation that more and more banking resources are coming under bank holding company control. You point out that most of this growth has been in the one-bank holding companies, but bank holding companies do allow not only greater geographic expansion than banks are allowed, but allow expansion into nonbanking areas. Aren't you concerned with the concentration of the banking system into a bank holding company system which has greater powers? If this expansion is so healthy, why shouldn't the banks—why shouldn't Congress let the banks do it directly?

Mr. COLDWELL. The banks are doing a good share of what we approve for the holding companies. As I indicated——

The CHAIRMAN. They are, but why require them to have any restruction at all? Why not let them—if the First National Bank of Chicago wants to get into these businesses, why have the First Chicago Corp. as the means by which they can do it? Why not just let the First National Bank of Chicago go into it without having a holding company?

Mr. COLDWELL. Well, you'd have to change the law somewhat to do it, Senator.

The CHAIRMAN. Then why not change the law to do that?

Mr. COLDWELL. It would mean you would put nonbank holding company activities under a bank and that bank then would be operating over the entire country. At present it's the holding company that does this.

The CHAIRMAN. Well, you've described it exactly. That's precisely the situation. What we are doing is permitting the banks in effect, because we know that the banks and the bank holding companies in many of these cases one bank holding company—is pretty much the same. The management is very closely connected. You're really letting the banks get away with this national operation which as you say the laws don't permit. Why not knock out those laws if they are not right or face them directly anyway rather than have this kind of an artificial system by which they can get into these other areas?

Mr. COLDWELL. Well, this comes down to a very deep philosophical question and one which I think the Congress would, I hope, think about. Should we be regulating nonbank activities or should these activities be set aside and not subjected to bank type regulation? Let me illustrate.

Suppose you have a bank holding company that has a data processing subsidiary. This data processing subsidiary has to compete in the data processing world. Now the rest of the data processing companies don't have banking type of regulation. If we put banking type regulation over the data processing subsidiary we are interfering with the competitive equality between affiliated and independent firms.

Now we have compromised on this. We have shaded here, there and beyond. We are now doing some looking at some of these nonbank elements. We have not gone to the point or applying bank-type examination standards to the nonbank subsidiaries. What we have done is to say, "Well, you are part of the holding company, and since the holding company also has banks, we've got to have some sort of a wall here to make sure that the nonbank problems—if you develop problems in your nonbank subsidiaries—don't spill over through the holding company down to the bank." So we have built some walls in here to keep them separate.

In a few cases those walls have broken down, but largely because of illegal activity on the part of the organization. I don't see any way we can legislate to force a man to abide by the law. He's going to abide by it or not.

The CHAIRMAN. It would be easier to enforce the law if he didn't have that capability of the bank holding companies getting into these areas and instead—you weren't using the bank holding companies by the device by which they do. If the bank examiners had responsibility for the whole bank operation and you abolished bank holding companies and simply gave the banks this authority and power that the bank holding company has, why wouldn't the examination process be much more comprehensive, much more effective, and be able to act with greater solarity in preventing these activities that the holding company engages in from having the adverse effect as it has had, as you say, on banks in the past?

Mr. COLDWELL. Well, in very few situations. But we come back to the question, "Do we put some elements in an industry under banking type regulation and leave other ones free?"

Senator SPARKMAN. May I ask a question?

The CHAIRMAN. Go ahead.

Senator SPARKMAN. Governor, I have enjoyed greatly your presentation. I think it has been a wonderful presentation dealing with something that to me is a very difficult subject, but I was particularly interested in your reference to the bank holding company legislation and you correctly quoted the law with reference to their activities being closely related. I believe you used that term and that term is in the law. I remember quite well when we had a very difficult time dealing with the question of bank holding companies. I believe Senator Robertson was chairman of the committee at that time. I remember the conference we had between the House and the Senate when we were tied up for quite a little time and finally we resolved it by using that term "closely related." I think that has been the safeguard throughout the times. I don't care to ask you any further questions, but I did want to make that comment. I think you have made a wonderful presentation.

Mr. COLDWELL. Thank you, Senator.

The CHAIRMAN. Governor, you take issue with the bill's finding that bank holding companies have expanded their operations beyond those activities directly related to banking but under your own test you show that this is so. You say that insurance sales are complementary to banking and banks possess in your terms considerable expertise in data processing. I recall you're saying that. Wouldn't you agree that logically under these tests there isn't much that a bank holding company could not do?

For example, why should banks engage in the auto rental business? That is what leasing is. Don't you see that banking and commerce should remain separated or do you feel that should be?

Mr. COLDWELL. I'm in thorough agreement that there ought to continue to be a separation between basic commerce and banking in this country because otherwise I think you end up with too much power in the credit institutions.

The CHAIRMAN. How can you do this?

Mr. COLDWELL. Well, I think we have done exactly what Senator Sparkman said. We have applied the test of "closely related." Now a good many of these activities, Senators, were fully approved for banks before being approved for bank holding companies. There are a large number of activities which were approved for banks, some of which we have not approved for holding companies, for example, travel agency activities, janitorial service on property owned or leased by the bank, title insurance and abstracts. We have not approved those things and yet the banks have——

The CHAIRMAN. Didn't you rule that travel agencies are not a permissible activity for the banks?

Mr. COLDWELL. We ruled it was not a permissible activity for bank holding companies. We have no control over the——

The CHAIRMAN. The courts ruled that travel agency activities are not a permissible activity for national banks.

Mr. COLDWELL. Well, we took the same position on bank holding companies. There's no difference.

The CHAIRMAN. Now you take issue with the bill's finding that the Federal Reserve is not adequately regulating bank holding companies in the public interest. I think the record may show otherwise. There have been bank failures where holding company activities have been the cause of it. In fact, the *Hamilton National* case is the example that comes to mind as perhaps the most conspicuous. The GAO found that Federal regulation of bank holding companies needed upgrading. Of 20 bank holding companies causing problems for their subsidiary banks the Federal Reserve in 15 cases did not detect weaknesses until after the subsidiary banks were damaged. Wouldn't you agree that that history lends strong support for the provisions of this bill which requires that bank holding companies and their nonbank subsidiaries be adequately capitalized?

Mr. COLDWELL. Well, we are in perfect agreement with that statement, Mr. Chairman. We think they should be adeqeuately capitalized. In fact, we have turned down some applications to us where we thought that the company would not maintain adequate capitalization over the period of the acquisition and we have a court case right now going to the Supreme Court in which the lower court said, "You can't apply that test."

The CHAIRMAN. This puts it in the law and, as I understand it, you simply require that test when you're approving the application, but we would put it in the law here.

Mr. COLDWELL. Well, I have no objection to that. I think it's exactly what we are doing with bank holding companies, and banks ought to be adequately capitalized.

The CHAIRMAN. How about their nonbank subsidiaries?

Mr. COLDWELL. Well, the nonbank subsidiaries, they ought to have adequate capital either supplied by the holding company or supplied internally. I don't know that we are in the position of being able to go into, say, a finance company and judge if it is adequately capitalized by *x* amout of dollars. All we have is the industry experience on this as a measure of whether a particular finance company is adequately capitalized. The same thing with a mortgage company.

The CHAIRMAN. You say the Board study nearing completion should be reviewed for any change in the "closely related" test and you just told us that will be completed at the end of the month. Does that mean you are not opposed to this bill at this time but wish to give the matter further consideration?

Mr. COLDWELL. Well, I think we would put it this way, Mr. Chairman: if we are going to change these tests, I hope we change them in clear and unambiguous wording so we have some reasonable chance of enforcing this law. For example, I don't know what you mean by "substantially and clearly outweigh anticompetitive effects." Does that mean that we can't approve an acquisition where there are public benefits which outweigh the anticompetitive effects, if any? What does "substantial" mean? Does that mean 20, 40, 100 percent? We would like to have the law very clear if we are going to change this procedure.

The CHAIRMAN. What it does is put the burden of proof on the bank to show that there is a clear, demonstrable public benefit.

Mr. COLDWELL. Well, that's where it is now, Senator.

The CHAIRMAN. I'm not so sure.

Mr. COLDWELL. When an application comes in and we look at it and say it's an adverse situation in a competitive mode, we require that bank to show convenience and needs and benefit to the community before it can be approved.

The CHAIRMAN. Now you take strong exception to the provisions of this bill which would require the Fed's rulemaking process when it aproves an activity for bank holding companies to be on the record. In formulating such rules the Fed is acting in a legislative capacity on behalf of the Congress. In these circumstances, isn't the public entitled to know the full record upon which these decisions are based? Why not have full disclosure?

Mr. COLDWELL. Well, the thing I was objecting to particularly was formalized hearings, Senator, which to us takes a terrible amount of time. We would have to hire a whole bunch of administrative law judges to conduct hearings. After all, we are looking at 300 to 400 applications a year. Now if we are going to have to have a formal hearing on every one of those, we are going to have not a 91-day rule; we are going to have to have a 391-day rule.

The CHAIRMAN. Well, the bill simply requires an opportunity for a hearing. We certainly don't want to enact any legislation now in view of all the complaints we have had already about the paperwork and about delay and about requiring too much cost and so forth, but we do want disclosure. We want it on the record. As I say, this is a matter of extending the Congress legislative authority which is done, as you know, in the public now in virtually every phase of our operation, and for that reason we want to have that provision of the bill enacted but we will look it over and if there is anything in there that would require a greater amount of cost—if you have to hire additional judges and so forth, we will certainly do our best to amend that. That's a good objection.

Mr. COLDWELL. If we read the bill right, it would be a major problem in terms of the burden.

The CHAIRMAN. If your rulemaking has to be on the record?

Mr. COLDWELL. I'm talking about a formal hearing type approach which we interpret this law to require.

The CHAIRMAN. Well, in a rulemaking procedure you do act as a legislative body in the sense that your determinations have the force of law. For that reason it would seem——

Mr. COLDWELL. They are challengable by court.

The CHAIRMAN. Yes, but the whole process ought to be a matter of public record.

Mr. COLDWELL. Well, in a good many of these instances, especially where we get a protest, the protest is written to us, we supply the protest to the holding company, the holding company writes back to the protestant and to us, and there's clear disclosure of the facts of the situation. That's all we are saying, that the facts are open and don't require a formal hearing.

The CHAIRMAN. Now I just have one other question. Section 401 of this bill will prohibit a national bank from engaging in any activity which the Federal Reserve has found to be an improper activity for a bank holding company. Would you support that provision? For example, the Federal Reserve has said that operating a travel agency is not permissible for bank holding companies and yet the Comptroller refuses to take national banks out of the travel agency business.

Mr. COLDWELL. Well, Senator, I think that's a matter which you ought to discuss with the Comptroller of the Currency.

The CHAIRMAN. Yes. I'm just giving you an example. I'm asking you, however, whether you would favor that part of the bill, Section 401 of the bill, which would prohibit a national bank from engaging in any activity which the Federal Reserve has found to be an improper activity for a bank holding company.

Mr. COLDWELL. If this is a device to centralize the examinations and control of the agencies, it does so beautifully by the back door because if we ruled a holding company activity impermissible, the Comptroller could not approve it for national banks.

The CHAIRMAN. It has nothing to do with examinations. We are just talking here about permissible activity where you have the responsibility and your determination ought to be respected.

Mr. COLDWELL. We are determining it for holding companies. Now there could be an argument that in a small local community national bank that you're not damaging anything to allow that bank to do it within its own community. If we approve it for a holding company they not only can do it in that community, they can do it across the Nation. I think there's a difference here, Senator. I would hope you would look at it carefully.

The CHAIRMAN. All right, sir. Well, I want to join in Senator Sparkman's comment, and I am very impressed, as I have always been. You do an excellent job and we are most grateful to you. Thank you very much, sir.

Mr. COLDWELL. Thank you.

The CHAIRMAN. We have one final witness this morning, Mrs. Evelyn Davis, editor of Highlights and Lowlights.

Mrs. Davis, we are happy to have you before us.

STATEMENT OF EVELYN Y. DAVIS, EDITOR, HIGHLIGHTS AND LOWLIGHTS

Mrs. DAVIS. Good morning, Mr. Chairman. My name is Evelyn Y. Davis, editor of Highlights and Lowlights, and I am a small stockholder in 128 corporations of which 12 are bank holding companies, and also, municipal bondholder in various States, including the distinguished State of Wisconsin.

It is with great pleasure today that I am supporting this very necessary legislation. In the last few years the bank holding companies through their going into too many nonbanking activities have become much too big and diversified, and have been unable and unwilling to account to their own stockholders. They have rescheduled their stockholder meetings to take place at the same time and dates as many other bank holding companies, some of their own correspondent banks and/or some of their biggest corporate customers in order to deprive questioning stockholders from attending annual meetings and to circumvent the proxy rules of the SEC or Comptroller of the Currency, in my opinion.

Apparently those chairmen of bank holding companies who do this do either not know the answers to stockholders questions regarding all these nonbanking activities, or are unwilling and afraid to account to their owners. Also they may have engaged sometimes in unsound and/or questionable practices that they are afraid their stockholders may know about and make public.

And this is not funny either. According to figures I received yesterday from my broker, at the end of 1973 the Standard and Poor New York City Bank index stood at 69.57, and at the end of 1977, at 42.11, which is a decline of 39.47 percent, almost 40 percent, while at the same time the Standard and Poor Index of 500, at the end of 1973 stood at 97.55, and at the end of 1977 at 95.10, which is off only by about 2½ percent.

So these banks going into nonbanking interests has not been in the interest of public stockholders, and they have also been unable to give enough supervision to what they should stick to, namely banking, and a lack of supervision by top management has resulted in a lot of these bad loans, real estate, and overseas.

If they would stick more to banking maybe these things wouldn't have happened.

Now the National Bank of Georgia and J. P. Morgan, after having received a resolution from me re disclosure of loan and overdraft policy to officers, directors, and/or politicians, now meet on the same date, one in Atlanta and the other in New York.

As we all know from reading the paper today, J. P. Morgan is the lead bank in Omni International which is in difficulties and which is based in Atlanta. So there may have been collusion there.

Citicorp, which received a similar resolution and which they tried to keep unsuccessfully out of the proxy statement, because the SEC told them they had to include it in the proxy statement, now for the first time meets in Chicago, and the bank is based in New York, on the same date that Bankers Trust and Chase Manhatten, as well as some of their bigger corporate customers meet in New York City, as well as Citizens and Southern in Atlanta. How can one be in all of those places at the same time?

BankAmerica, which also had to include the same aforementioned resolution in their proxy statement by order of the SEC, this year is meeting at the same time and date in California, while Eastern Air Lines, Merck, Warner Lambert meet in the New York area, and the New York Times Co. meets in Lakeland, Fla., and some other companies meet elsewhere. Chemical New York is on the same date as its bigger corporate customers: General Electric and Westinghouse, two so-called competitors, and Pepco. Dupont just changed to conflict with Pfizer, while United Technology Corp. switched to the same date as IBM, American Express, and others, all meeting in different parts of the country. And so on.

In a few years the game of musical chairs could very well result in just one meeting, one bank holding company for stockholders to attend.

If banks would no longer be allowed to engage in all of those nonbanking activities, with the exception of underwriting of municipal bonds, which is one activity as a municipal bondholder, which I believe they should remain in, in order to assure a more liquid and orderly market for individual investors, then perhaps they would not have to do so much homework for their annual meetings and would be back to nonconflicting dates, as they did many years ago before they engaged in all of those extracurricular activities.

John Heimann, the Comptroller of the Currency, and Harold Williams, the SEC Chairman, have looked and are looking into this matter of conflicting meeting dates, yet no action has been taken yet. It has only been words and promises. Nor has either one made a public statement of this matter yet, but that really is not surprising, since regulators almost always take jobs with the banks, the corporations and/or their law firms eventually.

Senator Proxmire, I heard you mention previously the First National Bank of Chicago. What do you expect, with the former Comptroller of the Currency being the executive vice president of that bank?

Bill Miller, our new Federal Reserve Chairman, has stated to me in a telephone interview that he believes there is a need for more corporate democracy, that he will personally look into this matter, and may make a public statement on this subject perhaps.

Most of these aforementioned bank holding companies and corporations also have interlocking directorates amongst themselves. This is an area of abuse that this Committee ought to look into. And in particular, since the SEC has oversight over the New York Stock Exchange, something very easily could be done. The New York Stock Exchange could recommend to the banks and the corporations when they should be meeting. But of course nothing is being done, because Mr. Batten, the current chairman of the New York Stock Exchange, is still, while being chairman of the New York Stock Exchange, on the Boards of companies he regulates, like J. C. Penney, and A.T & T., for instance, and J. C. Penney is also meeting on conflicting dates.

Once again, I support Senator Proxmire on this particular bill, and I wish to thank him for having given me the opportunity to express my views here today.

I would like to answer any questions you may have.

The CHAIRMAN. Well, thank you very much, Mrs. Davis, for a forceful statement.

Much of what you say, of course, is above and beyond our concern about this particular bill, particularly the timing of meetings by corporations.

As you know, there are, what, 1,500 corporations listed on the New York Stock Exchange, something like that, maybe more, but roughly that number.

Of course there are many other companies that are listed. When you are as diversified a stockholder as you are, I think you are just up against that kind of a situation.

After all, there are only a couple of hundred business days a year, that means with 1,500 firms, there are seven or eight firms meeting every day, if they meet Monday through Friday, and I imagine many of them would not meet in the summer, or be less likely to meet in the summer, and not meet on holiday periods, and so forth.

So there are a limited number of days and I just don't know how you could arrange it so you wouldn't have a number of conflicts.

It is an interesting situation, however, and maybe it is something that the SEC ought to think about. I don't know if they could do anything about it, or should do anything about it.

Mrs. DAVIS. Senator, what I am trying to bring out is many years ago, before the banks went into all of these nonbanking activities, they met on nonconflicting dates. It is only in the last 5 or so years that they have all changed. I am not talking about companies that have always had these dates. But they have deliberately, each year, it is a musical chairs game, each year five or six switch over, so eventually there will be nothing left.

It is a conspiracy and collusion between the bankholding companies amongst each other and their principal corporate customers.

It is true there are 350 business days in the year, or 300 business days. Why do all of the companies have to meet on a huge concentration now in about 6 or 7 days, in April and May, Tuesday and Wednesday toward the end of April, and toward the end of May? Even if they want to meet in April and May, there are many nonconflicting dates. But they have purposefully picked those dates for certain stockholders, such as myself, so we cannot attend. And there are plenty of other nonconflicting dates, even in April and May.

It is a concentration on these five, six, or seven dates in April and May where each year a few of them have added to. They have made no effort to go to nonconflicting dates. And the SEC has not done its oversight work.

The committee has oversight over the SEC, and the SEC in this respect has failed to do its job by making even a public statement on this.

Of course, what can you expect, when some SEC Commissioners and staff members all take jobs with the corporations and/or law firms?

The CHAIRMAN. Well, we will look into it. I am not sure that the SEC has the authority under the law to do this. I don't know, as I said, that the SEC has the authority under the law to determine that a corporation must meet at a certain time or can meet at another time. Maybe they should have; maybe not.

We will have to look into that and we will. I appreciate very much your calling it to our attention.

Mrs. DAVIS. Thank you very much, Senator. Like I say, they could make, at least Mr. Williams could make a public statement, he has made public statements of value to stockholders on other subjects, he could make a public statement. The New York Stock Exchange could make suggestions to the companies when to meet. They put out a bulletin every week.

Another thing I ask you, have the staff study the New York Stock Exchange bulletins for April and May, which come out one a week, and compare now when these companies meet to just 5 years ago, and you will see that I am right. They are all going little by little to those five, six, or seven particular dates, when they all conflict.

The CHAIRMAN. Very good. Thank you very much. The committee will stand in recess until 10 o'clock tomorrow.

[Thereupon, at 11:30 a.m. the hearing was recessed, to reconvene at 10 a.m. the following day.]

[Complete statement of Mrs. Davis, a copy of S. 72, and communications from the Comptroller of the Currency and the Federal Deposit Insurance Corporation follow:]

PREPARED STATEMENT BY EVELYN Y. DAVIS, EDITOR, HIGHLIGHTS AND LOWLIGHTS

With great pleasure today I am supporting this VERY necessary legislation. In the last few years the bankholding companies through their going into too many non-banking activities have become MUCH too big and diversified and have been unable and unwilling to account to their own stockholders. They have rescheduled their stockholder meetings to take place at the same time and dates as many other bankholding companies, some of their own correspondent banks and/or some of their biggest corporate customers in order to deprive questioning stockholders from attending annual meetings and to circumvent the proxy rules of the SEC or Comptroller of the Currency in my opinion. Apparently those chairmen of bankholding companies who do this do either not know the answers to stockholder questions re all these nonbanking activities or are unwilling and afraid to account to their owners. Also they may have engaged sometimes in unsound and/or questionable practices that they are afraid their stockholders may know about and make public!! National Bank of Georgia and J. P. Morgan after having received a resolution from me re disclosure of loan and overdraft policy to officers, directors and/or politicians, now meet on the same date, one in Atlanta, the other in

New York. Citicorp which received a similar resolution and which they tried to keep UNSUCCESSFULLY out of the proxy statement (the SEC told them they had to include it in the proxy statement) now for the first time meets in Chicago, on the same date that Bankers Trust and Chase Manhattan as well as some of their biggest corporate customers meet, as well as Citizens and Southern!!! BankAmerica which also HAD to include the same aforementioned resolution into the proxy statement by order of the SEC, this year is meeting at the same time and date as Eastern Air Lines, Merck, Warner Lambert, the New York Times Company and some others.

Chemical N.Y. is on the same date as its big corporate customers: GE, Westinghouse and Pepco. Dupont just changed to conflict with Pfizer, while UTC switched to the same date as IBM, American Express and others. And so on; in a few years the game of musical chairs could very well result in just ONE meeting, on bankholding company meeting, being left for stockholders to attend. If Banks would be no longer allowed to engage in all those non-banking activities with the exception of the underwriting of municipal bonds which is one activity I believe they should remain in, in order to insure a more liquid and orderly market for individual investors, than perhaps they would not have to do so much "homework" for their annual meetings and would go back to non-conflicting dates as they did many years ago, before they were in all those "extracurricular" activities. John Heimann, the Comptroller of the Currency and Harold Williams, the SEC chairman have looked and are looking into this matter of conflicting meeting dates, yet NO action has been taken yet, nor has either one of them made a public statement on this matter YET. But that really is not surprising, since regulators almost always take jobs with the banks, the corporations and/or their law firms eventually!!! Bill Miller, our NEW Federal Reserve Chairman has stated to me in a telephone interview that he believes there is a need for more corporate democracy, that he will personally look into this matter, and may make a public statement on this subject perhaps. Most of these aforementioned bankholding companies and corporations also have interlocking directorates amongst themselves. This is another area of abuse that the Committee ought to look into. Once again, I support Senator Proxmire on this particular bill, and I wish to thank him for having given me the opportunity to express my views here today.

[S. 72, 95th Cong., 1st sess.]

A BILL To amend the Bank Holding Company Act and the Bank Merger Act to restrict the activities in which registered bank holding companies may engage and to control the acquisition of banks by bank holding companies and other banks.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled

SHORT TITLE

SECTION 1. This Act may be cited as the "Competition in Banking Act of 1977".

FINDINGS AND PURPOSES

SEC. 2. Congress finds that—

(a) concentration of the banking resources of the Nation into fewer hands has continued unabated; and

(b) the explosive growth of bank holding companies has resulted in an increasing share of such banking resources coming under the control of those institutions; and

(c) bank holding companies have extended their services into product markets beyond those directly related to banking, thereby eroding the line between banking and commerce in the Nation: (i) in offering insurance agency and underwriting services, (ii) in offering leasing, accounting, travel, and courier services, (iii) in offering management and data processing services, and (iv) in marketing securities; and

(d) credit resources of the Nation have been misallocated by the activities of bank holding companies and the Federal Reserve has not adequately protected the public interest in approving activities in which bank holding companies could engage and the Federal Reserve has not maintained continued oversight over the activities of bank holding companies in a manner which protects the public interest.

STANDARDS FOR BANK MERGERS

SEC. 101. Paragraph (5) of section 18(c) of the Federal Deposit Insurance Act is amended to read as follows:

"(5) The responsible agency shall not approve—

"(A) any proposed merger transaction which would result in a monopoly, or which would 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, or

"(B) any other proposed merger transaction whose effect in any section of the country 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 it finds that the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served, or

"(C) any other proposed merger transaction if, either as a result of such merger transaction or because of its preexisting assets, the acquiring, assuming, or resulting bank would upon consummation of transaction hold more than 20 per centum of the total assets held by all banks located in the State in which such bank is located: *Provided, however,* That this subparagraph shall not apply to any merger or consolidation of banks in which the responsible agency finds that immediate action is necessary to prevent the probable failure of a bank and that a less anticompetitive alternative is not available.

For purposes of this paragraph, if any company has, or upon consummation of the merger transaction would have, control, as defined in section 2 of the Bank Holding Company Act of 1956, over the acquiring, assuming, or resulting bank, total assets held by all banks over which the same company has control shall be attributed to such bank. As used in this paragraph, the terms "bank" and "company" have the meaning ascribed to such terms in section 2 of the Bank Holding Company Act of 1956. In every case, the responsible agency shall take into consideration the financial and managerial resources and future prospects of the existing and proposed institutions, and the convenience and needs of the community to be served. Nothing contained in this paragraph or in any other paragraph of this subsection shall prevent the responsible agency from disapproving any other merger transaction on the grounds that such transaction would have adverse effects on competition or concentration in any market, region, State, or other area which, although not requiring disapproval under subparagraph (A), (B), or (C) of this paragraph, are not clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served.".

SEC. 102. Section 18(c) of the Federal Deposit Insurance Act is amended by inserting in paragraph (8) after "(the Clayton Act)" the words paragraph (9) of this subsection, and"; and by renumbering section "(9)" section "10"; and by adding a new paragraph "(9)" as follows:

"(9)(A) Every merger transaction having the effects set forth in subparagraph (C) of paragraph (5) of this subparagraph is declared to be illegal.

"(B) The district courts of the United States have jurisdiction to prevent and restrain violations of subparagraph (A) of this paragraph, and it is the duty of the United States attorneys, under the direction of the Attorney General, to institute proceedings in equity to prevent and restrain such violations. The proceedings may be by way of a petition setting forth the case and praying that the violation be enjoined or otherwise prohibited. When the parties complained of have been duly notified of the petition, the court shall proceed, as soon as possible, to the hearing and determination of the case. While the petition is pending, and before final decree, the court may at any time make such temporary restraining order or prohibition as it deems just. Whenever it appears to the court that the ends of justice require that other parties be brought before it, the court may cause them to be summoned whether or not they reside in the district in which the court is held, and subpenas to that end may be served in any district by the marshal thereof.

"(C) In any action brought by or on behalf of the United States under subparagraph (A) of this paragraph, subpenas for witnesses may run into any district, but no writ of subpena may issue for witnesses living out of the district in which the court is held at a greater distance than one hundred miles from the place of holding the same without the prior permission of the trial court upon proper application and cause shown.

"(D) Nothing contained in this paragraph shall be construed as affecting in any manner the right of the United States or any other party to bring an action under any other law of the United States or of any State, including any right which may exist in addition to specific statutory authority, challenging the legality of any merger transaction which may be proscribed by this paragraph.".

STANDARDS FOR BANK HOLDING COMPANY ACQUISITIONS OF BANKS

SEC. 201. Paragraph (c) of section 3 of the Bank Holding Company Act of 1956 is amended to read as follows:

"(c) The Board shall not approve—

"(1) any acquisition or merger or consolidation under this section which would result in a monopoly, or which would 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, or

"(2) any other proposed acquisition or merger or consolidation under this section whose effect in any section of the country 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 it finds that the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served, or

"(3) any other proposed acquisition, merger, or consolidation transaction under his section if, either as a result of such transaction or because of the preexisting bank assets over which it has control, the acquiring or resulting company would have control over aggregate total banking assets exceeding 20 per centum of the total banking assets held by all banks and bank holding companies located in the State in which such company is located: *Provided, however*, That this paragraph shall not apply to any acquisition, merger, or consolidation transaction in which the Board finds that immediate action is necessary to prevent the probable failure of a bank and that a less anticompetitive alternative is not available.

In every case, the Board shall take into consideration the financial and managerial resources and future prospects of the company or companies and the banks concerned, and the convenience and needs of the community to be served. Nothing contained in this chapter shall prevent the Board from disapproving any other acquisition, merger, or consolidation transaction on the grounds that such transaction would have adverse effects on competition or concentration in any market, region, State, or other area which, although not requiring disapproval under paragraph (1), (2), or (3) of this subsection, are not clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served.".

SEC. 202. The Bank Holding Company Act of 1956 is amended by inserting in section 1849(f) after "(the Clayton Act," the words "subsection (g) of this section"; and by adding to section 1849 a new section (g) as follows:

"(g)(1) Every acquisition, merger, or consolidation transaction having the effects set forth in paragraph (3) of subsection (c) of section 3 of this chapter is declared to be illegal.

"(2) The district courts of the United States have jurisdiction to prevent and restrain violations of paragraph (1) of this subsection, and it is the duty of the United States attorneys, under the direction of the Attorney General, to institute proceedings in equity to prevent and restrain such violations. The proceedings may be by way of a petition setting forth the case and praying that the violation be enjoined or otherwise prohibited. When the parties complained of have been duly notified of the petition, the court shall proceed, as soon as possible, to the hearing and determination of the case. While the petition pending, and before final decree, the court may at any time make such temporary restraining order or prohibition as it deems just. Whenever it appears to the court that the ends of justice require that other parties be brought before it, the court may cause them to be summoned whether or not they reside in the district in which the court is held, and subpenas to that end may be served in any district by the marshal thereof.

"(3) In any action brought by or on behalf of the United States under paragraph (1) of this subsection, subpenas for witnesses may run into any district, but no writ of subpena may issues for witnesses living out of the district in which the court is held at a greater distance than one hundred miles from the place of holding the same without the prior permission of the trial court upon proper application and cause shown.

"(4) Nothing contained in this subsection shall be construed as affecting in any manner the right of the United States or any other party to bring an action under any other law of the United States or of any State, including any right which may exist in addition to specific statutory authority, challenging the legality of any acquisition, merger, or consolidation transaction which may be proscribed by this subsection.".

STANDARD FOR BANK HOLDING COMPANY ENTRY INTO BANK RELATED ACTIVITIES

SEC. 301. (a) Section 4(c)(8) of the Bank Holding Company Act of 1956 is amended to read as follows:

"(8)(a) shares of any company the activities of which the Board, on the record and after due notice and opportunity for hearing, has determined (by order or regulation)—

"(A) to be so closely and directly related to banking or managing or controlling banks as to be a proper and necessary incident thereto, and

"(B) is likely to produce substantial benefits to the public which clearly and significantly outweigh possible adverse effects. For the purposes of this subparagraph, (i) the term 'substantial benefits to the public' includes increased competition over the course of time and greater convenience or gains in efficiency of operation that will substantially benefit the public, and (ii) the term 'adverse effects' include undue concentration of economic or financial resources, decreased competition over the course of time, unfair competition, conflicts of interest, unsafe or unsound banking or business practices, risk to the financial soundness of a bank holding company or its banking subsidiaries, and interference with the primary responsibility of a bank holding company or its banking subsidiary to provide effective banking services to the public. For the purposes of determining in specific cases whether the performance of a particular activity by an affiliate of a bank holding company is likely to produce substantial benefits to the public which clearly and significantly outweigh possible adverse effects, the Board, in addition to its other considerations, shall take into consideration the relative economic size and market power of the bank holding company and that of those with whom the affiliate would compete.".

(b)(1) Notwithstanding the provisions of subsection (a), and subject to the provisions of subparagraph (2) of this subsection, a bank holding company may continue to engage in those activities in which it directly or through a subsidiary (A) was lawfully engaged on November 1, 1975 (or on a date subsequent thereto in the case of activities carried on as the result of the acquisition by such bank holding company or subsidiary thereof, pursuant to a binding written contract entered into on or before November 1, 1975, of another company engaged in such activities at the time of the acquisition), and (B) has been continuously engaged since November 1, 1975 (or such subsequent date), except that such a bank holding company shall not permit the scope or size (in terms of volume of business) of those activities to expand to any significant degree.

(2) The Federal Reserve Board by order or regulation, after opportunity for hearing, may terminate the authority conferred by subparagraph (1) on any bank ho'ding company to engage directly or through a subsidiary in any activity otherwise permitted by subparagraph (1) if the Board determines, having due regard for the purpose of this Act, that such action is necessary to prevent undue concentration of economic or financial resources, decreased competition over the course of time, unfair competition, conflicts of interest, unsafe or unsound banking or business practices, risk to the financial soundness of a bank holding company or its banking subsidiaries, or interference with the primary responsibility of a bank holding company or its banking subsidiary to provide effective banking services to the public.

UNIFORM APPLICATION OF STANDARDS GOVERNING ENTRY INTO BANK RELATED FIELDS

SEC. 401. (a) Subject to the provisions of subsection (b), no national bank shall directly or through a subsidiary engage in any activity which is found—

(1) pursuant to a regulation of the Federal Reserve Board issued after the effective date of this Act to be an improper activity for bank holding companies under section 4(c) (8) of the Bank Holding Company Act of 1956, or

(2) pursuant to an order of the Federal Reserve Board issued after the effective date of this Act to be an improper activity for the bank holding company of which such national bank is a subsidiary.

(b) Nothing contained in this section shall be interpreted or construed as authorizing a national bank to engage in any activity prohibited to it under any other provision of law.

STANDARDS FOR SOUND AND COMPETITIVE FINANCING OF NONBANKING ACTIVITIES

SEC. 501. (a) Section 4 of the Bank Holding Company Act of 1956 is amended by inserting at the end thereof the following new subsection:

"(f) In keeping with its responsibilities to administer and carry out the purposes of this Act, and with particular attention to the standards established under subparagraph (8) of subsection (c) of this section, the Board shall require, both in connection with a bank holding company application to engage in a particular activity and in connection with the Board's ongoing supervision of bank holding companies, that (1) bank holding companies and their subsidiaries be capitalized and otherwise financed in a safe and sound manner, and (2) bank subsidiaries of bank holding companies refrain from discriminating in favor of their parent holding company or their affiliated subsidiaries in the making of loans or in the establishing of terms and condition of credit."

(b) Subsection (c) of section 5 of the Bank Holding Company Act of 1956 is amended by striking out "(c)" and inserting in lieu thereof "(c)(1)" and by inserting at the end of such subsection the following new subparagraph:

"(2) In addition to such other reports as the Board may from time to time require, the Board shall require each bank holding company to submit to the Board each year a report detailing the terms and conditions of all intercompany loans and investments, as between the bank holding company and its subsidiaries and as between any such subsidiaries, made during the twelve-month period immediately preceding such report. The Board shall make such reports available to the public.".

ADMINISTRATIVE PROCEDURES AND JUDICIAL REVIEW

SEC. 601. (a) The Bank Holding Company Act of 1956 is amended by redesignating sections 9, 10, 11, and 12 as sections 10, 11, 12, and 13, respectively, and by inserting immediately after section 8 the following new section:

"SEC. 9. (a) The provisions of subchapter II of chapter 5 of title 5 of the United States Code (relating to administrative procedure) shall apply with respect to all Board proceedings under section 4(c) (8).

"(b) All Board determinations (whether by order or regulation) under section 4(c) (8) shall be made on the record after opportunity for hearing, and the provisions of sections 556 and 557 of title 5 of the United States Code shall apply with respect thereto. The Board shall give all interested persons an opportunity to participate in any such hearing.

"(c)(1) In connection with any proceeding under section 4(c)(8), no person shall, directly or indirectly, make or attempt to make any ex parte communication in connection with the subject matter of any such proceeding to any member of the Board or any member of the Board staff participating in such proceeding.

"(2) No application made under section 4(c)(8) shall be held or considered to be an application for an initial license within the meaning of subsection (d) of section 554 of title 5 of the United States Code.

"(d) In connection with any proceeding under section 4(c) (8) to which the requirements of sections 556 and 557 of title 5 of the United States Code are being applied, any interested person participating in such proceeding may call upon (1) the Board, or, (2) in the case of the consideration of an application, the applicant, for any information or documents, not privileged, for purposes of discovery or for use as evidence. In addition, in any such proceeding where there is an absence of relevant information, the Board. upon its own motion or that of any interested person participating in such proceeding, shall undertake such studies (and make reports thereon available) as will provide the relevant information required.".

(b) Section 9 of the Bank Holding Company Act of 1956 (as in effect immediately prior to the enactment of this Act) is amended (1) by inserting "or regulation" immediately after "order" each place that it appears, and (2) by striking out "as provided in section 2112 of title 28, United States Code" and inserting in lieu thereof the following: "in the same manner as provided in section 2112 of title 28, United States Code, with respect to orders of administrative agencies".

PUBLIC'S RIGHT TO PETITION FOR MODIFICATION OF ORDERS AND REGULATIONS

SEC. 701. The Bank Holding Company Act of 1956 (as amended by section 501 of this Act) is further amended by inserting at the end of the new section 9 thereof the following new subsection:

"(e)(1) Any interested person, including a consumer or consumer organization, may petition the Board to commence a proceeding to consider the issuance, amendment, or revocation of an order or regulation promulgated under the authority of section 4(c)(8). Such petition shall set forth (a) facts which it claimed established that the issuance, amendment, or revocation of an order or regulation is necessary, and (b) a description of the substance of the amendment or of the order or regulation it is claimed should be issued, as the case may be.

"(2) The Board may conduct a public hearing or may conduct such investigation or proceeding as it deems appropriate in order to determine whether or not such petition should be granted. Facts which warrant the issuance, amendment, or revocation of an order or regulation shall include, in addition to such other matters as the Board may from time to time determine to be appropriate, the following matters:

"(A) a finding that a particular activity conducted on the part of a bank holding company or its subsidiary fails to conform to the scope of the activity for which Board approval was originally given;

"(B) a finding that a particular activity conducted on the part of a bank holding company or its subsidiary fails to conform to new or amended Board orders or regulations judicial determinations altering the scope of the activity for which Board approval was originally given;

"(C) a finding that the continued conduct of a particular activity on the part of a bank holding company or its subsidiary has ceased to produce, within the meaning of section 4(c)(8), substantial benefits to the public which clearly and significantly outweigh possible adverse effect; or

"(D) a finding that the continued conduct of a particular activity on the part of a bank holding company or its subsidiary otherwise violates the standards established under section 4(c)(8) for permissible bank holding company activity.

"(3) Within one hundred and twenty days after filing of a petition referred to in subparagraph (1), the Board shall either grant or deny the petition. If the Board grants such petition, it shall promptly proceed to determine, on the record and after opportunity for hearing, whether to issue, amend, or revoke such order or regulation. If the Board denies such petition, it shall publish in the Federal Register its reasons for such denial.

"(4) If the Board denies such petition, or if the Board fails to grant or deny such petition within one hundred and twenty days after the filing of the petition, the petitioner may commence a civil action in a United States district court to compel the Board to grant such petition. Any such action shall be filed within sixty days after the Board's denial of the petition, or, if the Board fails to grant or deny the petition within one hundred and twenty days after the filing of the petition, within sixty days after the expiration of the one hundred and twenty day period. If the petitioner can demonstrate to the satisfaction of the court, by a preponderance of evidence in a de novo proceeding before such court, that sufficient facts exist to justify the granting of the petition, the court shall order the Board to grant such petition.

"(5) In any action under this subsection, the district court shall have no authority to compel the Board to take any action other than to grant such a petition.".

EFFECTIVE DATE

SEC. 801. The Act and the amendments made by this Act shall take effect upon the expiration of ninety days following the date of enactment of this Act.

COMPTROLLER OF THE CURRENCY,
ADMINISTRATOR OF NATIONAL BANKS,
Washington, D.C., March 6, 1978.

Senator WILLIAM PROXMIRE,
Chairman, Senate Banking Committee,
Washington, D.C.

DEAR MR. CHAIRMAN: This is in response to your request for the comments of this Office on S. 72, the "Competition in Banking Act of 1977."

The bill is intended to restrict concentration in banking by legislating standards for bank mergers and for bank holding company acquisitions of banks. The standards for bank mergers set in the bill would be uniform among all federal banking agencies. Similar standards would apply to Federal Reserve review of bank acquisitions by holding companies. The bill would set a standard for activities of national banks and their subsidiaries which is intended to be the same as that which applies to activities of bank holding companies. Also included are sections which would affect the financing of bank holding company subsidiaries and which would apply the Administrative Procedure Act to Federal Reserve determinations concerning the entry of bank holding companies into bank-related activities. The final section of this legislation would grant any interested person, including consumers and consumer organizations, the right to begin a proceeding before the Board concerning the issuance, amendment or revocation of a decision affecting a holding company's entry into a bank related activity.

Reasons for the introduction of S. 72 are stated in section 2. While we disagree that a need for this legislation has been demonstrated, we find particularly inappropriate the broad statement in subsection 2(c) that certain product markets into which bank holding companies have ventured are not directly related to banking. To the contrary, most of the activities now permitted to bank holding companies by Federal Reserve Regulation Y appear to us to be legitimate activities which are sanctioned by federal law and integrally connected with traditional financial services. In any event, we do not believe that specific Federal Reserve Board determinations in this area should be drawn into question in an ambivalent fashion. Rather, if Congress disagrees with a specific determination, it would seem more appropriate to address that activity directly and legislate a reversal.

Section 101 of the bill would add new criteria to existing standards for all banking agencies to follow in reviewing bank mergers. Section 201 would operate in a virtually identical manner with respect to Federal Reserve review of bank holding company acquisitions. No proposed merger or acquisition could be approved where the banking assets of the acquiring, assuming or resulting bank or holding company would amount to more than 20 percent of the assets held by all banks in the state in which the bank or holding company is located. A proviso would permit the responsible agency to ignore this standard if the transaction is necessary to prevent a failure and no less anti-competitive alternative is available.

We believe that the issues raised by the addition of a rigid standard such as that proposed require more extensive consideration by Congress, bank regulators and others. You stated when introducing S. 2721, the predecessor to S. 72, "An analysis of the growth of large banking institutions reveals that over the course of the past 25 years, the 10 and 25 largest banking institutions have increased their share of the nation's bank deposits from 20 percent and 30 percent respectively, to 29 percent and 39 percent." These figures fail to demonstrate any clear trend toward concentration of banking assets in this country when it is understood that the computations include foreign, as well as domestic, deposits. Without taking foreign deposits into account no trend is evident, as over the last two decades the percent of total domestic deposits held by the 100 largest banks has remained relatively constant. In fact, during the period of most rapid holding company expansion, from 1968 to 1975, aggregate concentration actually declined by nearly one percentage point.

In connection with the specific test used by the bill to determine concentration, a review artificially limited to bank assets only, as opposed to assets of all competing financial institutions, is of questionable legitimacy. With the trend toward diminution of distinctions among financial institutions, any amendment requiring banking agencies to ignore the competition to banks and bank holding companies posed by other financial institutions must be approached cautiously. Representative of the growing intensity of this competition are the margin-based cash management program recently initiated by Merrill, Lynch, third party payment share drafts offered by credit unions, and N.O.W. accounts available at thrift institutions in New England.

A second problem with the 20 percent of statewide bank assets standard is that it would give no recognition to competition presented by out-of-state banks. A significant number of Standard Metropolitan Statistical Areas include portions of more than one state. An agency reviewing a proposed bank merger affecting a bank in any of those SMSA's should not be required to ignore other financial institutions in the area merely because they happen to be chartered in a different state.

Finally, facts may not bear out the presumption of excessive concentration inherent in the application of a strict numerical standard such as that proposed in sections 101 and 201. Today, more than 15,000 commercial banks are actively doing business across the nation, not to mention thousands of other institutions, including savings and loan associations and credit unions, which also accept deposits, extend cred t and provide other financial services.

Section 102 would amend 12 U.S.C. 1828(c) by adding a new paragraph (9), which primarily would establish an independent right of the Justice Department to challenge mergers which do not conform to the standards of 12 U.S.C. 1828(c)(5). In this regard more particularly, this new paragraph would also declare illegal any bank merger which has the effect described in the proposed new subparagraph (C) of 12 U.S.C. 1828(c)(5). Thus, a merger which exceeds the 20 percent of statewide bank assets test would be per se illegal. Section 202 would amend the Bank Holding Company Act with the same results.

No other industry is subject to such a strict numerical standard for per se illegality. Furthermore, the U.S. Supreme Court has indicated in recent cases that it no longer views statistical demonstrations of market shares as conclusive indicators of anticompetitive effects (See *U.S.* v. *General Dynamics Corp.*, 415 U.S. 486 (1974). This trend began with the landmark decision of *Brown Shoe* v. *U.S.* in which the Court noted:

"Statistics reflecting the shares of the market controlled by the industry leaders and the parties to the merger are, of course, the primary index of market power; but only a further examination of the particular market—its structure, history and probable future—can provide the appropriate setting for judging the probable anticompetitive effect of the merger." 370 U.S. 294 at 322, n. 38.

In light of the difficulties in this area we would hope the Committee will proceed with careful deliberation.

On a separate matter, we find section 401 to display a serious conceptual fault. The apparent intent of the section is to legislate uniformity of all bank and bank-related activities, whether engaged in directly or indirectly by a bank holding company or a national bank. However, by limiting national banks to those activities approved by the Federal Reserve for bank holding companies, section 401 would seem to create a circular standard which not only begins at the wrong place but also is inconsistent with specific statutory authority conferred upon national banks—See, e.g., 12 U.S.C. 24(7), 92. Under the provision as now drafted, a national bank could be barred from engaging in an activity for the wholly illogical reason that that activity is prohibited to a holding company even when the activity is plainly proper for the bank itself.

Moreover, such an approach could lead to curious competitive inequalities between national and state member banks. If the concept were valid, it would seem that proper regard for its impact would call for extending it to all insured banks.

This is not to say that I am completely satisfied with the present regulatory structure over bank holding companies. I am not. As I have testified before the Committee, this system, with authority divided between bank regulators and the Federal Reserve System, does not always work smoothly. A bank holding company shares common identity and assets with its subsidiaries. However, the Comptroller has no authority to issue cease-and-desist orders, to approve or disapprove applications, or to take other supervisory measures against a holding company, even if the only subsidiary of the holding company is a national bank.

Clearly, this divided responsibility should be modified in a constructive way. Therefore, I have recommended that the federal regulatory agency which is responsible for supervising the bank or banks which hold a majority of assets of a bank holding company serve as the principal supervisor of that holding company as well. Of course, I recognize that a shifting of charters within a multibank holding company may result in undesirably frequent change in regulators. To address this problem, I have also suggested that after the initial regulator has been determined by the majority of assets in a holding company, change of regulators not occur unless two-thirds of the assets change from one type of charter to another.

I trust that these views will be helpful in Committee deliberation on S. 72.

Sincerely,

JOHN G. HEIMANN,
Comptroller of the Currency.

STATEMENT BY GEORGE A. LEMAISTRE, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

We appreciate this opportunity to submit our views on S. 72, the "Competition in Banking Act of 1977."

In general terms, S. 72 would (1) prohibit any bank merger or acquisition if the resulting bank or its parent holding company would thereafter control more than 20 percent of the banking assets in a particular State except where essential to prevent a bank failure and where no feasible, less anticompetitive, alternative solution were available, (2) narrow the statutory standards under which the Federal Reserve determines what activities are permissible for bank holding companies and formalize the administrative procedures by which the Board makes these determinations, (3) prohibit national banks or their subsidiaries from engaging in activities in which the Federal Reserve does not permit bank holding companies to engage, and (4) direct the Federal Reserve to require that bank holding companies and their subsidiaries (including all banking subsidiaries) be capitalized and otherwise financed in a safe and sound manner and that bank subsidiaries refrain from discriminating in favor of their parent holding companies or affiliated subsidiaries in extending credit.

Section 2 of the bill recites congressional findings to the effect that (a) concentration of banking resources has "continued unabated," (b) the "explosive growth" of bank holding companies has contributed to this concentration, (c) bank holding companies have extended their services into areas "beyond those directly related to banking" such as selling insurance, underwriting and marketing securities, offering leasing, accounting, travel and courier services, as well as management and data processing services, and (d) the Nation's credit resources have been "misallocated by the activities of bank holding companies" without the Federal Reserve having adequately exercised its oversight responsibilities to protect the public interest.

In my opinion, S. 72 would not effectively achieve its goal of promoting competition among financial institutions and it could, in fact, be anticompetitive to the extent that it would prevent bank holding companies from offering the types of services cited in the preceding paragraph.

In addition, by empowering the Federal Reserve to delineate the charter powers of national banks and to determine capital adequacy for all banks in a bank holding company system (including national and State nonmember banks), enactment of the bill would represent a major and fundamental departure from the present Federal bank regulatory structure. While I am not wedded to the existing bank regulatory structure, I am concerned by the changes this bill would make in the structure. Giving the Federal Reserve authority to prescribe capital adequacy for national banks and insured State nonmember banks that are affiliated with holding companies and to circumscribe indirectly the permissible activities of national banks would be a major step toward centralizing the Federal regulation of banks in the Federal Reserve. I have stated in previous testimony on the Federal Bank Commission Act before this Committee my tentative conclusion that bank supervision and regulation should be divorced from the formulation and execution of monetary policy.

BANKING CONCENTRATION

The bill's prohibition against any merger or holding company acquisition resulting in one banking institution controlling more than 20 percent of the banking assets in a given State is premised upon the "explosive growth" of bank holding companies. Evidence on the concentration of domestic deposits in the largest 100 banking organizations was presented by Samuel H. Talley in the March 18, 1975 issue of Washington Financial Reports as follows:

TRENDS IN NATIONWIDE CONCENTRATION, 1957–73

Percent of total domestic deposits held by the 100 largest banking organizations					Percentage point change	
1957	1961	1966	1968	1973	1957–68	1968–73
48.2	49.4	49.3	49.0	47.0	+0.8	−2.0

Source: Board of Governors of the Federal Reserve System.

Based on these figures, no trend toward increased aggregate concentration is evident. Indeed, from 1968–1973, aggregate concentration declined by two percentage points, despite the fact that this was a period of rapid holding company expansion.

Interestingly enough, while holding company acquisitions accounted for only 2.8 percent of the growth of the 20 largest banking organizations between 1968–73, 30.0 percent of the growth of the "next 80" banking organizations during this period was accounted for by holding company acquisitions. These differences may reflect the constraining influence of existing antitrust laws and bank regulatory standards on acquisitions by the nation's largest holding companies. They may also reflect the fact that during this time period the largest banks turned their attention toward foreign markets.

However, because S. 72 would limit acquisitions on the basis of Statewide concentration and is apparently motivated by a desire to stop trends toward increased concentration, it would be more instructive to examine changes in Statewide concentration in recent years. The table below presents Statewide concentration figures, based on the three largest banks or banking organizations for 1960 and for 1975, as well as changes in concentration over that period. States are grouped according to branching status at the end of 1975. Within branching categories States are ranked in descending order based on concentration in 1960.

PERCENTAGE OF STATEWIDE COMMERCIAL BANK DEPOSITS IN 3 LARGEST BANKS OR BANK GROUPS

	1960	1975	Change
Statewide branching States (20):			
Arizona	95.75	86.90	−8.85
Nevada	93.52	83.07	−10.45
Rhode Island	92.81	89.91	−2.90
Hawaii	89.23	77.26	−11.97
Oregon	86.67	80.10	−6.57
Delaware	79.82	71.06	−8.76
Idaho	74.49	75.57	1.08
Alaska	68.21	70.49	2.28
California	65.72	62.42	−3.30
Utah	65.61	60.80	[1] −4.81
Washington	61.10	63.17	2.07
North Carolina	46.78	54.20	7.42
Connecticut	42.74	49.44	[1] 6.70
Maryland	42.66	44.92	[1] 2.26
South Carolina	42.39	43.47	1.08
South Dakota	37.50	38.12	.62
Maine	34.66	46.56	[1] 11.90
Vermont	25.59	45.00	19.41
Virginia	20.18	34.76	[1] 14.58
New Jersey	16.81	21.04	[1] 4.23

See footnote at end of table.

PERCENTAGE OF STATEWIDE COMMERCIAL BANK DEPOSITS IN 3 LARGEST BANKS OR BANK GROUPS

	1960	1975	Change
Limited branching States (15):			
Massachusetts	49.29	46.64	[1] −2.65
Georgia	48.56	50.02	[1] 1.46
New Mexico	42.98	48.68	[1] 5.70
Michigan	40.75	34.74	[1] 6.01
New York [2]	40.04	42.55	[1] 2.51
Wisconsin	31.42	28.28	[1] −3.14
Alabama	31.24	38.32	[1] 7.08
Louisiana	29.33	18.99	−10.34
Tennessee	28.71	27.58	[1] −1.13
Pennsylvania	27.88	24.73	−3.15
Kentucky	27.63	22.28	−5.35
Mississippi	24.92	31.36	6.44
New Hampshire	24.28	35.01	[1] 10.73
Ohio	24.15	25.72	[1] 1.57
Indiana	23.80	19.55	−4.25
Unit banking States (15):			
Minnesota	58.62	52.45	[1] −6.17
Montana	48.85	46.30	[1] −2.55
North Dakota	46.60	42.51	−4.09
Colorado	37.87	41.76	[1] 3.89
Illinois	35.51	37.18	1.67
Wyoming	35.09	38.56	[1] 3.47
Oklahoma	32.62	21.79	−10.83
Nebraska	31.60	20.55	−11.05
Missouri	26.57	28.28	[1] 1.71
Texas	21.09	22.85	[1] 1.76
Florida [3]	17.88	24.24	[1] 6.36
Arkansas	17.27	14.32	−2.95
West Virginia	17.26	10.47	−6.79
Kansas	14.28	12.27	−2.01
Iowa	14.18	15.07	[1] .89

[1] Denotes the presence of active multibank holding companies in individual State.
[2] Since Jan. 1, 1976, statewide branching is permitted in New York.
[3] On Jan. 1, 1977, Florida went to countywide branching.

An analysis of these data indicates that there is no overall trend toward increased concentration. Between 1960 and 1975, Statewide branching States experienced an average increase in concentration of 0.80 percentage points. Limited branching States and unit banking States, in turn, experienced an average decrease of 0.035 and 1.78 percentage points, respectively. here is also no trend toward increased concentration evident in the data if States are grouped according to whether holding companies are permitted.

In general, the most concentrated States experienced declines in concentration, and the least concentrated States had increases. Each of the four instances where States had increases of more than 10 percent (Maine, New Hampshire, Vermont and Virginia) can be explained in large part by changes in the States' banking laws. Hence, S. 72's finding that concentration of banking resources has "continued unabated" clearly is not borne out by these figures. What the figures do indicate, however, is that concentration levels vary considerably among the several States. The thrust of S. 72 ignores these differences.

Another recent study in banking concentration is summarized in the May 1977 Federal Reserve Bulletin. The purpose of this study was to identify recent trends in the structure of 213 standard metropolitan statistical area (SMSA) banking markets and 233 county banking markets over the 1966–75 period.

The results of this Federal Reserves study indicate that most SMSA and county banking markets acquired a more competitive structure between 1966 and 1975. Moreover, these procompetitive changes tended to be quite sizeable. This study also found that procompetitive changes in banking market concentration occurred with greatest frequency and in largest magnitude in those SMSA and county banking markets that had a relatively high concentration ratio in 1966.

Finally, the study examined changes in banking market structure according to the branching laws of the States in which the markets were located. In all three branching classifications—unit banking, limited branching, and Statewide branching—it was found that most markets experienced procompetitive structural changes between 1966 and 1975. The most frequent and largest procompetitive structural changes occurred in markets located in States with unit banking or with Statewide branching.

Although no alarming trend toward increased banking concentration is evident, it is true that concentration has remained high in some markets and has increased in some. Even in the Statewide branching States exhibiting the greatest declines in concentration, the three largest institutions still control about 75 percent or more of the States' banking resources.

A basic shortcoming of the proposed legislation, however, is the assumption that Statewide concentration figures are relevant measures of banking competition. The Supreme Court in the past has consistently rejected the use of Statewide deposit concentration figures when considering cases under Section 7 of the Clayton Act.[1] In this context the State is neither a "section of the country" nor a "relevant geographic market." Aggregating assets or deposits from the many economically diversified and geographically dispersed markets across a State does not necessarily yield a meaningful measure of the banking structure and level of competition in the separate markets within that State. Furthermore, a foothold acquisition by a large banking organization in a highly concentrated market could well have procompetitive effects within that market and negligible adverse effects in other less concentrated markets throughout the State. However, such an acquisition, if it exceeded the 20 percent "cap," would be prohibited by the Competition in Banking Act.

I do not believe, therefore, that the proposed 20 percent limitation would make a meaningful contribution toward keeping the concentration of banking resources within bounds that are compatible with the maintenance of competitive banking markets.

Another problem with the proposed prohibition of a merger or acquisition where the resulting bank or holding company would control more than 20 percent of the banking assets in the State is that it would impose an arbitrary standard which would not permit consideration of such factors as competition from other financial institutions.

Furthermore, the 20 percent of Statewide bank assets standard would give no recognition to competition presented by out-of-State banks. A significant number of Standard Metropolitan Statistical Areas include portions of more than one State. An agency reviewing a proposed bank merger affecting a bank in any of those SMSAs should be able to consider the activities of all other financial institutions in the area.

Section 102 would declare illegal any bank merger which exceeds the 20 percent of Statewide bank assets test, thus making such mergers per se illegal. No other industry is subjected by Federal statute to such a strict numercial standard for per se illegality. The Supreme Court has indicated that it does not view statistical market shares alone as conclusive indicators of anticompetitive effects, *United States* v. *General Dynamics Corp.*, 415 U.S. 486, 498 (1974). In *Brown Shoe Co.* v. *United States*, 370 U.S. 294 (1962) at 322 n. 38, the court stated as follows:

"Statistics reflecting the shares of the market controlled by the industry leaders and the parties to the merger are, of course, the primary index of market power; but only a further examination of the particular market—its structure, history and probable future—can provide the appropriate setting for judging the probable anticompetitive effect of the merger."

For the foregoing reasons, an arbitrary cutoff for acquisitions of 20 percent of Statewide assets, as suggested in the bill, is unnecessary and, in my opinion, inappropriate.

Apart from the desirability of imposing a Statewide limit on bank concentration, there is a significant technical defect in the bill as it is now written. The portion of the bill limiting bank mergers (Section 101) uses the total assets of all banks within a State as a basis for the 20 percent calculation. However, the portion applying to holding company acquistions (Section 201) uses as a base the "total banking assets held by all banks and bank holding companies located in the State." For holding companies, this would appear to include banking assets held in other States. While such instances are not prevalent, the consequences can result in sizable inequities. In Minnesota, for example, Northwest Bancorporation had total assets of $7.5 billion as of December 31, 1975, of which $3.3 billion was held by subsidiary banks outside of Minnesota. Hence, under the bill as drafted independent banks in the State would be limited to acquisitions

[1] *United States* v. *Marine Bancorporation*, 418 U.S. 602 (1974), and *United States* v. *Connecticut Nat'l Bank*, 418 U.S. 656 (1974).

where the resulting bank would hold less than 20 percent of Statewide assets, while the holding company would be able to use as a base Statewide assets plus the $3.3 billion. The result would be that a bank would reach its asset ceiling at $3.5 billion in Minnesota while such a holding company could make acquisitions until it surpasses $4.2 billion.

A further technical defect in the bill is its use of bank assets as a basis for measuring concentration. Assets do not necessarily reflect the relative competitive strengths of banking organizations within a particular State. U.S. securities, for example, are not competed for within any localized geographic market, and loans can be made, purchased or sold irrespective of the area from which the funds were generated. A concentration ratio using total domestic deposits, however, while not a perfect measure either, would be more relevant to the bill's apparent goals. Virtually all domestic deposits are subject to competitive pressures and are more likely than assets to have been acquired in a localized area. Hence, domestic deposits would seem to be a preferable basis for measuring relative competitive strengths of banking firms operating with a given market area.

STATUTORY STANDARDS FOR BANK HOLDING COMPANIES

Section 301 of S. 72 would restrict permissible activities for bank holding companies under Section 4(c)(8) of the Bank Holding Company Act to those "directly" related to banking—narrowing the present "closely related" standard. Under the amended public benefit test—

1. It would be necessary that the activity be "likely" (in lieu of "can reasonably be expected") to produce benefits to the public;
2. It would be necessary that the activity be likely to produce increased competition over time, not just in the short run as suggested by present law;
3. It would be necessary that the beneficial effect of the activity "clearly outweigh" adverse effects, not just "outweigh" as provided by present law;
4. It would be necessary that the activity not have a tendency to lead to an undue concentration of "economic or financial" resources, not just "economic resources" as provided by present law;
5. It would be necessary that the activity not lead to decreased competition over time, not just in the short run;
6. It would be necessary that the activity not risk the financial soundness of the bank holding company or its banking subsidiaries (the present law is silent on this point); and
7. It would be necessary that the activity not interfere with the primary responsibility of the bank holding company or its banking subsidiaries to provide banking services to the public (the present law is silent on this point).

The bill would grandfather those activities in which a bank holding company was lawfully engaged on November 1, 1975, so long as the bank holding company does not expand the scope or size (in terms of volume of business) of the grandfathered activities to any significant degree.

It should be noted that bank holding companies have provided healthy competition in areas where there had been little or no competition before, as well as convenient one-stop service for consumers of banking, travel, insurance, and other services. This has increased competition in these service markets and has afforded bank holding companies the potential to diversify risk through product diversification. Drawing a stricter public benefit test could reduce or eliminate such benefits.

Let me stress again that any anticompetitive effects of undue concentration of economic or financial resources should be considered for both banking and nonbanking functions of bank holding companies, and determinations should be based on the relevant facts in each case. While antitrust suits against bank holding companies may be time-consuming and expensive, this possibility exists for all antitrust proceedings, and should not be the basis for imposing limitations on bank holding companies which could limit competition and be detrimental to consumers.

Nor should bank holding company activities be restricted merely because a potential for abuse exists. Unfair competition and other abuses should be dealt with by the regulatory agencies, as necessary, for both banks and bank holding companies. Also, any likely adverse effects on the financial soundness of banks resulting from any banking or nonbanking activities of bank holding companies can best be dealt with by effective regulation based on the particular circumstances, rather than by across-the-board statutory restrictions.

It is my view, therefore, that Congress should consider very carefully whether legislation designed to protect various types of industries from the vigorous competition of bank holding companies is truly in the overall public interest. It may well be that such a legislative approach could have a serious anticompetitive impact.

CORPORATE POWERS OF NATIONAL BANKS AND CAPITAL ADEQUACY OF ALL BANKS CONTROLLED BY BANK HOLDING COMPANIES

Section 401 of the bill would prohibit national banks or their subsidiaries from engaging in activities found by the Federal Reserve to be prohibited to bank holding companies under section 4(c)(8) of the Bank Holding Company Act of 1956. This provision is designed to prevent situations where the Comptroller of the Currency could permit national banks to enter activities directly that the Federal Reserve had not approved under section 4(c)(8).

By requiring national banks to follow the standards of the Federal Reserve regulations, Section 401 may prohibit national banks from participating in some currently permissible bank-related activities. Thus, the section can be viewed as a device for protecting some industries from the effects of competition. Furthermore, enactment of the section in its present form cannot provide full uniformity of standards, for some of the laws governing activities of national banks are more restrictive than those governing holding company activities.

Section 501 would require that (1) bank holding companies and their subsidiaries be capitalized and otherwise financed in a safe and sound manner as determined by the Federal Reserve, (2) bank subsidiaries of bank holding companies refrain from discriminating in favor of their parent or their affiliated subsidiaries in the making of loans or in the establishing of terms and conditions of loans, and (3) bank holding companies disclose on a regular basis to the Federal Reserve the terms and conditions of all loans to or investments in bank holding company subsidiaries. The Federal Reserve in turn would be required to make this information public.

As discussed earlier, I believe that Sections 401 and 501 would be a major step toward realigning the Federal regulation of banks. While assuring uniform treatment in some areas, these sections would not eliminate the existing fragmented regulatory framework under which a bank holding company could be supervised by all three Federal banking agencies. As I indicated last September in testimony on the proposed Federal Bank Commission Act (S. 684), I believe that fragmentation of bank holding company supervision is a serious inadequacy in the present regulatory framework at the Federal level. Recent events have illustrated that the existing framework has not only been costly because of the overlapping and conflicting jurisdictions involved but also simply has not functioned properly in some instances.

In three of our largest bank failures—the insolvencies of Hamilton National Bank of Chattanooga and the American City Bank of Milwaukee and the distress merger of the Palmer National Bank of Sarasota, Florida—the cause was massive unsafe and unsound lending practices occurring in the essentially unsupervised environment of a non-banking holding company affiliate. The failure of the Hamilton National Bank is perhaps the most graphic case. Hamilton Mortgage Corporation, based in Atlanta, Georgia, got into difficulty during 1974 when its borrowing capacity evaporated and it was unable to fund its loans or commitments to lend. More than $130 million out of a portfolio of $200 million in real estate loans, concentrated primarily in speculative land acquisition and construction loans, was funded by Hamilton banking subsidiaries through the purchase of loan participation. Many of the loans originated by the mortgage company were of inferior quality and when the real estate market collapsed in 1974 Hamilton banking affilates, particularly Hamilton National Bank of Chattanooga, were left holding a large volume of bad loans.

These cases illustrate two points which should be recognized by both the banking agencies and the Congress. First, one segment of a holding company system cannot easily be insulated from the remainder of the system. These cases also have shown that because a holding company tends to be operated as a integrated enterprise, it is simply a form of self-deception to assume that the lead bank, or any other holding company banking affiliate, is in a safe and sound condition because its last examination was satisfactory, if other facets of the holding company system are not undergoing equally rigorous scrutiny.

Second, it makes little sense for as many as three Federal bank regulatory agencies to have safety and soundness jurisdiction over various segments of an integrated business enterprise. Inevitably, this approach will be at times conflicting and uncoordinated.

During the congressional debate over the 1970 Amendments to the Bank Holding Company Act of 1956, holding company safety and soundness supervision was not a matter of great concern. The emphasis at that time was on providing safeguards against undue concentration of economic power stemming from bank holding company acquisitions of banking and non-banking subsidiaries. For example, in testimony before the Senate Banking and Currency Committee on the 1970 Amendments, Charles Walker, then Under Secretary of the Treasury, stated that legislation was required to stop the trend toward the merging of banking and commerce that was taking place through the vehicle of the one-bank holding company. Federal Reserve Board Chairman Arthur Burns voiced similar concern. Although there was discussion during consideration of the 1970 Amendments about dispersing supervision and regulation of bank holding companies among the three Federal bank regulatory agencies, the emphasis on the competitive and banking structure aspects of the bank holding company movement, coupled with the Federal Reserve's responsibility for administering the 1956 Bank Holding Company Act, led the Congress ultimately to delegate responsibility for administering the 1970 Amendments to the Federal Reserve System.

That such little consideration was given to the consequences of fragmenting responsibility over the different segments of a holding company system probably reflected, in part, the prevailing theory that the respective entities within a system could be effectively insulated from troubles elsewhere in the system. It also may have reflected the notion that the larger institutions in the holding company system, like the lead bank, would be a source of strength for all the components of the system. Events since the passage of the 1970 Amendments have demonstrated flaws in these assumptions and the inherent weakness of the existing fragmented regulatory framework. In spite of the rhetoric about the legal separateness of each entity within the bank holding company, it has become more and more apparent as we have gained experience that a bank holding company should be regarded as a single, integrated unit.

In sum, I believe that Sections 401 and 501 would exacerbate that current overlapping and conflicting jurisdictional framework for the regulation and supervision of bank holding companies. By giving the Federal Reserve express, ongoing supervisory authority over the capital position of all subsidiary banks of bank holding companies and over the corporate powers of national banks, these Sections represent a significant increase in the Board's supervisory powers over banks and a significant diminution in the supervisory powers of the Comptroller, the FDIC and the States. Arguably, Section 501 could place the Federal Reserve in a preeminent position over the Comptroller and the FDIC in the matter of bank capital adequacy largely because there would be an express and continuing statutory mandate for the Federal Reserve Board to make determinations as to capital adequacy. There is no comparable express statutory provision so directing the Comptroller and the FDIC, except, of course, with respect to bank applications.

Section 501 is also objectionable because it is indefinite and provides no guidance as to how it is to be implemented and administered. There is no hint as to how the power over capital adequacy given to the Federal Reserve Board is to mesh with similar existing powers of the Comptroller or the FDIC. Nor is there any provision establishing a means or method of enforcing the Section. What happens if the Board and the Comptroller or the FDIC disagree as to the capital adequacy of a subsidiary bank? The bill is silent on both grounds.

In my judgment, the Federal bank agency charged with supervising the lead bank of a bank holding company complex should be given responsibility for supervising the entire system, including the holding company itself.

Under a lead bank arrangement, the Federal Reserve Board could function in much the same manner as it does now. That is, the Board could issue regulations and interpretations for all bank holding companies and could even retain authority to approve or disapprove applications under the Act. However, ongoing supervision of each bank holding company would rest with the Federal agency having primary jurisdiction over the lead bank. The lead bank could be determined on the basis of total deposits or total assets as of year-end preceding enactment of the amendment to the Act.

The one bank holding company would, of course, present no particular problem. However, for a multi-bank holding company situation comprised of a mixture of national and State member and nonmember banks, it would mean that the supervisor of the lead bank would supervise all banks within the bank holding company family regardless of whether the banks were national, State member or nonmember banks. Thus, there would be uniformity as to the scope of activities of bank holding companies and as to the criteria, and application of the criteria, for entry and acquisition, while at the same time the present fragmented and ineffectual supervisory framework would be eliminated and corrected.

Section 501 also provides that "bank subsidiaries of bank holding companies refrain from discriminating in favor of the parent holding company or their affiliated subsidiaries in the making of loans or in the establishing of terms and conditions of credit." In addition, Section 501 mandates the Board to require each bank holding company to file a report with the Board detailing the "terms and conditions of all inter-company loans and investments" for the 12-month period immediately preceding the report.

Rather than a flat statutory prohibition, I would prefer to see a statute drafted along the lines of the FDIC's insider regulation (§ 337.3), whereby insider transactions are not proscribed *per se* but Board review and approval is mandated, appropriate records and minutes must be maintained for examiner review, and the agency has the prerogative of taking action where abuse is present even though the statute (or regulation) has been followed.

Perhaps the best way to accomplish this would be to provide that the Federal Reserve must issue a regulation dealing with insider transactions of bank holding companies and to prescribe certain statutory guidelines which must be included in the regulation, without prohibiting insider loans including those that may be made on more favorable grounds than to outsiders of comparable creditworthiness. There may be instances where the economics of a situation may warrant making a loan on more favorable terms to a member of the bank holding company organization. Such a flexible alternative, rather than absolute prohibition, would enable the Federal Reserve to deal more effectively with the dynamics of the situation in much the same way as the FDIC can in enforcing its insider regulation.

CONCLUSION

In conclusion, let me summarize our views on S. 72.

First, I do not believe that the bill's premise of drastically increased banking concentration has been substantiated. On the contrary, objective analysis of available data suggests a net decrease of concentration in Statewide banking markets in recent years. However, the State is generally not a relevant banking market and a Statewide limitation on banking concentration would not be procompetitive in most circumstances. The bill would also tend to be anticompetitive to the extent it prevents bank holding companies from expanding their services into bank-related activities.

Furthermore, in giving the Federal Reserve power to define capital adequacy for national banks and for State-chartered banks which are not members of the Federal Reserve System as well as the power to delineate the corporate powers of national banks, the bill to a large extent prejudges the merits of consolidating the Federal bank regulatory structure without really focusing on the issues involved in such a centralization. Alternatively, I would recommend a realignment of holding company regulation along the lines suggested above. In any event, I would strongly recommend that reorganization of the Federal bank regulatory structure be approached directly and openly and not decided by indirection on a piecemeal basis.

For these reasons, I oppose enactment of S. 72.

COMPETITION IN BANKING ACT OF 1977

WEDNESDAY, MARCH 8, 1978

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, D.C.

The committee met at 10 a.m., in room 5302, Dirksen Senate Office Building, Senator William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire, Sparkman and Brooke.

The CHAIRMAN. This is in its second day of hearings on the Competition in Banking Act.

We have this morning a panel of distinguished witnesses: Mr. Raymond Campbell, president of the Oberlin Savings Bank of Oberlin, Ohio and vice president of the Independent Bankers Association of America; Mr. J. Rex Duwe president of the Farmers State Bank in Lucas, Kans., and former head of the American Bankers Association; and Mr. John C. Geilfuss, chairman of the Marine Corp., Milwaukee, Wis., Association of Bank Holding Companies.

Well, I understand that Mr. Campbell has another matter that has come up that is extremely urgent and no way he could avoid it, so he won't be here, but a substitute is coming to take his place and will be here in 20 minutes, so we will start off with Mr. Duwe.

Senator BROOKE. I have an opening statement.

The CHAIRMAN. I beg your pardon.

STATEMENT OF SENATOR BROOKE

Senator BROOKE. I appreciate that, Mr. Chairman.

Mr. Chairman, I deeply regret that my schedule did not permit me to attend yesterday's hearings. I believe that the subject of regulation of bank holding companies which is dealt with in your bill, S. 72, is one that deserves very close examination by this committee. And, as you know, I was deeply involved in the consideration of the bank holding company legislation which led to the enactment of the Bank Holding Company Act amendments of 1970 and I continue to be interested in this area.

I have reviewed the testimony which the committee received yesterday from the Justice Department and the Federal Reserve Board and I was interested in the point made by Assistant Attorney General Shenefield that the burden of proof of the need for restrictions on the activities of bank holding companies should be on those who would oppose such restrictions. There's no question that there is potential for abuses in any situation where a creditor may link the granting of the credit to the provision of other services which he has to offer through his bank holding company. However, in seeking to prevent abuses, we should be careful not to stifle legitimate competition.

So, Mr. Chairman, having said that, I look forward to hearing the testimony of the fine panel of witnesses who are appearing before the committee this morning not only on the subject of the activities of bank holding companies but on the question of concentration of banking resources which you also address in S. 72. I thank you.

The CHAIRMAN. Thank you, Senator Brooke.

Mr. Duwe, we would be happy to have you go ahead. I might say, if you abbreviate your statement in any way, it will be printed in full in the record.

STATEMENT OF J. REX DUWE, CHAIRMAN, FARMERS STATE BANK, LUCAS, KANS.; AND PAST PRESIDENT OF THE AMERICAN BANKERS ASSOCIATION

Mr. DUWE. As you stated, I am chairman of the Farmers State Bank in Lucas, Kans. and a past president of the American Bankers Association whose membership includes approximately 92 percent of the Nation's nearly 15,000 full service banks. I welcome this opportunity to present the views of our association on S. 72, the Competition in Banking Act.

[Complete statement follows:]

STATEMENT OF J. REX DUWE

Mr. Chairman and members of the Committee, my name is J. Rex Duwe of Lucas, Kansas. I am Chairman of the Farmers State Bank in Lucas, Kansas. I am also a past President of the American Bankers Association whose membership includes approximately 92 percent of the nation's 14,000 banks. I welcome this opportunity to present the views of our Association on S. 72, the Competition in Banking Act.

The American Bankers Association believes the Competition in Banking Act (S. 72) is misnamed and misdirected. Even though the title suggests this legislation would enhance competition in the financial system, we believe S. 72 is really anticompetitive and would, in fact, have a negative impact on the competitive environment. Procompetitive legislation is usually designed to benefit the public, but we feel the primary beneficiaries of S. 72 will be industries with an interest in preventing or delaying bank and bank holding company entry into banking related activities and thereby preventing them from offering competitive services to the public.

Specifically, we believe, the Competition in the Banking Act would:

1. Make unnecessary additions to current long-standing antitrust standards with respect to bank and bank holding company acquisitions, mergers and consolidations.
2. Virtually repeal the 1970 Amendments to Section 4(c)(8) of the Bank Holding Company Act which gave bank holding companies, through strict Federal Reserve Board supervision, greater flexibility in order to meet the changing needs of their customers.
3. Move toward a de facto consolidation of the federal bank regulatory agencies by giving the Federal Reserve Board broader authority over national banks and state-chartered nonmember banks.

In short, we do not believe these proposed changes can be justified by the facts, and would if enacted, actually result in less competition between institutions offering financial services.

SECTIONS 101 AND 201

Sections 101 and 201 would establish new antitrust standards for bank and bank holding company acquisitions, mergers and consolidations by limiting such transactions to institutions with less than 20 percent of the banking assets in the state in which the bank or bank holding company is located. Sections 101 and 201 would also give the bank regulatory agencies the discretionary authority to deny bank or bank holding company transactions which do not violate the Sherman Act or the Clayton Act if the anticompetitive consequences of such acquisitions, mergers or consolidations are not clearly outweighed in the public interest by the probable effects of such transactions in meeting the convenience and needs of the community.

The American Bankers Association believes that both the Sherman and Clayton Acts as well as existing antitrust provisions of the Bank Merger Act and Bank Holding Company Act are sufficient to prevent anti-competitive acquisitions, mergers or consolidations that are not in the public interest. Therefore, to authorize the banking agencies to deny transactions which do not violate the well established principles of the antitrust laws is unnecessary. More importantly, this power would impose stiicter standards on banks and bank holding companies than are applied to any other industries or other types of financial institutions.

More specifically, the Bank Merger Act and the Bank Holding Company Act direct the appropriate federal bank regulatory agency to disapprove any anticompetitive bank or bank holding company acquisition, merger or consolidation unless the agency concludes that the anti-competitive effects of the transaction "are clearly outweighed by the probable effect of the transaction in meeting the convenience and needs of the community to be served." These Acts also direct the regulatory agencies to prohibit any transaction "which would result in a monopoly, or which could be in furtherance of any combination or conspiracy to monopolize or attempt to monopolize the business of banking in any part of the United States." In all cases, the regulatory agencies are required to consider the financial and managerial resources and the future prospects of the existing and proposed institutions as well as the convenience and needs of the community to be served.

An additional safeguard exists in the 30-day waiting period which is imposed before the transaction becomes effective. This gives the Justice Department time to review all the information relating to approved transaction, and to determine whether or not the transaction comports with antitrust laws.

We believe this comprehensive process has been and continues to be very effective in preventing anti-competitive bank and bank holding company acquisitions, merger or consolidations that would not be in the public interest.

Two of the proposed findings in Section 2 of this legislation would have Congress find that:

Concentration of the banking resources of the nation into fewer hands has continued unabated.

The explosive growth of bank holding companies has resulted in an increasing share of banking resources coming under the control of these institutions.

Although it is clear that there has been an increase in both the number of registered bank holding companies and their share of total bank deposits, as shown in Table 1, the changes in nationwide concentration shown in Table 2 indicate these shifts in organizational form have not had a significant effect on the concentration of banking resources.

TABLE 1.—GROWTH OF REGISTERED BANK HOLDING COMPANIES, 1970–76

	1970	1971	1972	1973	1974	1975	1976
Companies	121	1,567	1,607	1,677	1,752	1,821	1,912
Banks	895	2,420	2,720	3,097	3,462	3,674	3,791
Branches	3,260	10,832	13,441	15,374	17,131	18,382	19,199
Total offices	4,155	13,252	16,161	18,471	20,593	22,056	2,990
Offices as a percentage of all bank offices	11.8	36.1	42.1	45.7	48.2	49.4	50.0
Deposits (in billions)	$78.0	$297.0	$379.4	$446.6	$509.7	$527.5	$553.6
Deposits as a percentage of all bank deposits	16.2	55.1	61.5	65.4	68.1	67.1	66.1

Source: Federal Reserve Board.

TABLE 2.—NATIONWIDE CONCENTRATION IN BANKING, SELECTED YEARS, 1971–75

	1961	1966	1968	1973	1974	1975
Percent of domestic deposits held:						
Largest banking organization	4.6	4.2	4.0	3.8	3.9	4.2
5 largest banking organizations	14.3	14.3	14.3	12.1	13.5	13.5
100 largest banking organizations	49.4	49.3	49.0	47.0	NA	48.1
300 largest banking organizations	63.0	62.9	62.8	NA	NA	63.4

Source: M. Jessee and S. Seelig, "Bank Holding Companies and the Public Interest," Lexington Books, 1977, p. 149.

While we recognize that statewide or nationwide information does not indicate the competitive situation in a particular market, a 1977 Federal Reserve Board Staff Study used approximations for local banking markets that are frequently employed by the bank regulatory agencies, the Department of Justice and the courts. (S. Talley, *Recent Trends in Local Banking Market Structure*, Staff Economic Study No. 89, Board of Governors of the Federal Reserve System, 1977.)

We believe the results of that study not only confirm the adequacy of current antitrust standards, but also refute the proposed finding which makes the claim that concentration of the banking resources of the nation into fewer hands has continued unabated.

The study examined 213 standard metropolitan statistical area (SMSA) banking markets and 233 county banking markets over the 1966–1975 period. For each banking market, trends were measured by changes in (1) the number of banking organizations in the market; (2) the percentage of total market deposits held by the three largest banking organizations in the market; and (3) the Herfindahl Index which takes into account both the number and size distribution of organizations in the market.

The study found:

1. The Nation's major banking markets as a group experienced significant pro-competitive market structure changes over the period 1966–1975.

2. The magnitude of the pro-competitive changes in market concentration generally were greatest in those markets that had the highest level of concentration in 1966.

For these reasons, we question any need fór giving the bank regulatory agencies within their discretion, additional authority to deny transactions that do not violate current antitrust standards. Moreover, given the fact that a recent Circuit Court decision found that the FDIC could not apply more stringent antitrust standards to acquisition applications than contained in Section 7 of the Clayton Act, this proposed provision is not and should not be viewed as simply a clarification of existing authority. (*Washington Mutual Savings Bank* v. *Federal Deposit Insurance Corp.*, 482 F. 2d 459 (9th Cir. 1973).) Giving the agencies additional authority in this area would, in our judgment, unnecessarily complicate what is already a very costly and time-consuming process.

In addition, although Sections 101 and 201, are supposedly designed to control the concentration of bank resources and ensure competition in the banking industry, we believe they are really anticompetitive and would, infact, have a negative impact on the competitive environment.

Using a concentration ratio to increase competition, as proposed in Sections 101 and 201, may actually disguise more than it reveals about the competitive environment in a state. For example, a five bank concentration ratio of 100 percent could mean five banks competing vigorously with one another in each of the significant markets in the state. Alternatively, it could mean each bank is dominant in a sector of the state with very little competition within each of the sectors. Or, to take another example, a four bank asset concentration ratio of 60 percent does not tell us anything about the relative size of banks below the four largest. It could be that the four have equal shares of 15 percent followed by three more of 13 percent or they might have equal shares and be followed by ten or more banks, none of which have more than four percent. The two would present quite different competitive situations and, poss'bly, different behavior.

In addition, limits on statewide concentration ratios would not be in the public interest as they could not reflect the economic, geographic, or demographic factors that vary from state to state. For example, trying to achieve the goal of a balanced banking structure by imposing an inflexible statutory ceiling on banking assets may make it impossible for banks in sparsely populated states, like New Mexico and Utah, to meet the needs of their customers. An inflexible statutory ceiling on banking assets could also prevent the combining of smaller banks that may wish to compete more effectively with larger banks in a neighboring state.

Contrary to the premises of Sections 101 and 201, restricting statewide concentration may actually encourage local concentration. For example, a large statewide bank might be prohibited from entering a highly concentrated local market when a de novo or foothold entry would probably deconcentrate the market and enhance competition. In fact, according to information included in a study prepared for the American Bankers Association by Golembe Associates of Washington, D.C., a number of the bank mergers and bank holding company acquisitions that would have been prohibited by a 20 percent ceiling in effect from 1966–1975 would have involved de novo banks or the kind of market entry encouraged by long-standing antitrust policies.

Moreover, because some banking services (e.g., commercial loans) are frequently offered on a nationwide or regional basis, placing an inflexible statutory statewide ceiling on banking assets may have a negative impact on economic and social priorities by limiting the flow of funds to capital deficit areas. Imposing identical limits on all states could undermine economic and social priorities as well.

In summary, our Association believes that no case has been made for the establishment of additional antitrust standards to govern bank and bank holding company acquisitions, mergers and consolidations and we oppose Sections 101 and 201 for that reason.

SECTION 301

The 1970 amendments to Section 4(c)(8) of the Bank Holding Company Act allowed bank holding companies to be in any business that the Federal Reserve Board determined to be "so closely related to banking . . . as to be a proper incident thereto." The 1970 amendments also added a "public benefits" test to be used in Board decisions on bank holding company expansion.

In determining whether a particular activity is a proper incident to banking or managing or controlling banks, the Board shall consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices. (Section 4(c)(8) of the Bank Holding Company Act.)

Section 301 of S. 72 would place stricter standards on bank holding company expansion by prohibiting Federal Reserve Board approval of bank holding company activities under Section 4(c)(8) unless the activity was both "so closely and directly related to banking as to be a proper and necessary incident thereto." (Changes from existing law underlined).

Section 301 would also tighten the existing "public benefits" test. For example:

1. It would be necessary that the activity be "likely" (in lieu of "can reasonably be expected") to produce benefits to the public;
2. It would also be necessary that the beneficial effect of the activity "clearly outweigh" possible adverse effects, not just "outweigh" as provided by present law.

Additionally, the Findings and Purposes section (Section 2) of S. 72 would have Congress find that:

Bank holding companies have extended into product markets beyond those directly related to banking thereby eroding the line between banking and commerce in the Nation:

1. in offering insurance agency and underwriting services,
2. in offering leasing, accounting, travel, and courier services,
3. in offering management and data processing service, and
4. in marketing securities.

Credit resources of the Nation have been misallocated by the activities of bank holding companies and the Federal Reserve has not adequately protected the public interest in approving activities in which bank holding companies could engage and the Federal Reserve has not maintained continued oversight over the activities of bank holding companies in a manner which protects the public interest.

When considered together, Section 301 and the Findings and Purposes section virtually create a list of activities that would be prohibited to Bank Holding Companies if S. 72 is enacted. This would be in direct contradiction to and a repudiation of the judgment of the Congress in 1970. That Congress made a conscious decision not to include a so-called negative laundry list of activities prohibited for bank holding companies in the interest of allowing the Federal Reserve Board greater flexibility in meeting the financial needs of the nation.

Bankers throughout the nation are vitally concerned with preserving the effectiveness of banks and their ability to provide imaginative and dynamic services for the public in the future. We recognize that the financial needs of the American people are changing and we believe that banking must remain flexible in order to respond productively to new demands for financial service. In fact, we believe the case for maintaining flexibility is even stronger today than it was eight years ago. Congressional recognition of this need and objective is also clearly reflected in the legislative history accompanying the 1970 Amendments to the Bank Holding Company Act.

In its report on the 1970 amendments, this Committee agreed with FDIC Chairman Frank Wille's statement on the need for greater flexibility in determining what bank-related activities and acquisitions were to be permitted bank holding companies:

Inasmuch as the economy and its financial requirements are constantly changing, the Corporation considers it essential that banks and bank holding companies have the flexibility to engage in new types of bank-related activities that may be needed now and in the future if the financial needs of the people are to be met efficiently, competitively, and at reasonable cost. Likely changes in technology, the nature of financial competition and the economic and legal functions of commercial banking all lead to a conclusion that retaining such flexibility is the wise course for the future. (Senate Committee on Banking and Currency, Report on the Bank Holding Company Act Amendments of 1970, August 10, 1970, page 13.)

The Committee's report also noted the support of the Federal Reserve Board, the Department of the Treasury, the Department of Justice, and the Comptroller of the Currency for permitting greater flexibility.

The Senate version of the 1970 Amendments passed by a vote of 77–1. And, during this Committee's hearings on the Amendments, Federal Reserve Board Chairman Arthur Burns stated:

If banks and bank holding companies are to be prohibited from offering service simply because it might compete with a nonbank business, we can expect a stagnant banking system and, perhaps also, a consequent drag on our economy. (Senate Committee on Banking and Currency, Hearings on the One Bank Holding Company legislation of 1970, May 14, 1970, page 144.)

It should also be remembered that the 1970 Amendments to the Bank Holding Company Act became law approximately one year before the Hunt Commission on Financial Structure and Regulation submitted its final report to the President. In describing its approach, the Commission cited a statement in the 1970 report of the Council of Economic Advisors.

Financial services required by tomorrow's economy will differ in as yet undefinable ways from those appropriate today. The demands on our flow of national savings . . . will be heavy in the years ahead, and our financial structure must have the flexibility that will permit a sensitive response to changing demands. (*The Report of The President's Commission on Financial Structure and Regulation*, December 1971, page 7.)

Moreover, as shown in Table 3, close to 70 percent of the 2406 firms established by bank holding companies in nonbanking activities during the 1971–1975 period involved de novo entry. As discussed later in my testimony, the difference between de novo expansion and expansion by acquisition is an important distinction when considering the implications on competition. This distinction was recognized by the 1970 Congress and was clearly embodied in Section 4(c)(8). Our Association disagrees with the elimination of this important distinction under the proposed amendments to Section 4(c)(8).

TABLE 3.—ACQUISITIONS OF NONBANK FIRMS BY BANK HOLDING COMPANIES, BY ACTIVITY AND YEAR, 1971-75

Activity	Approved acquisitions					Total, 1971-75
	1971	1972	1973	1974	1975	
Mortgage banking	2	11	34	33	12	92
Finance companies	2	26	231	160	21	440
Factoring		4	3	2		9
Insurance agencies		13	25	34	33	105
Insurance underwriting			13	13	13	39
Trust activities	1	1	4	1	3	10
Leasing	1	1	8	4	3	17
Community development						0
Financial advice			5	11	1	17
Data processing		1	6	7	4	17
Others		2	3		5	10
Total	6	59	332	264	95	756
De novo entries into all activities	77	251	495	542	285	1,650

Source: M. Jessee and S. Seelig, "Bank Holding Companies and the Public Interest," Lexington Books, 1977, p. 40.

We believe bank holding company involvement in "closely related" activities has had a positive impact on the financial systems' responsiveness to consumer needs. In contrast, we feel the proposed changes in Section 301 would actually decrease competition as well as interfere with efforts to provide consumers with a wider range of financial services in a more efficient and convenient way.

The expansion of bank holding company activities has provided and will continue to provide an alternate source of service that can stimulate competition. Competitively induced rate reduction on banking and nonbanking services is an important direct benefit to the public and leads to an improvement in the quality of competition in the market for the services involved.

We also believe the Federal Reserve Board's current approach to bank holding company regulation has not resulted in a weakening of the banking system. Despite fears that the 1970 Amendments would "unleash" the banking industry into divergent nonbanking areas, this has not occurred. The Board has not gone much beyond, and in some respects has not even gone as far as, the activities described to the Senate Banking Committee as probably permissible during the hearings on the 1970 Amendments.

In fact, although approximately 2,000 bank holding companies currently control over $700 billion in assets, or close to 70 percent of all commercial bank assets, nonbanking subsidiaries account for less than 5 percent of the total consolidated assets of bank holding companies, and about 3 percent of the assets of the fifty largest bank holding companies.

Our Association endorses the Federal Reserve Board's current approach to monitoring ban holding company activities because we believe it balances and reflects the importance of both a safe and sound banking system and the need for changes that improve convenience or meet expanded needs. For this reason we believe Section 301 of S. 72 is an unnecessary and unneeded alteration of the current Bank Holding Company Act, and we therefore oppose this section.

SECTIONS 601 AND 701

While the proposed amendments to Section 4(c)(8) of the Bank Holding Company Act in Section 301 would effectively inhibit the entrance of bank holding companies into related activities, the enactment of Sections 601 and 701 of of S. 72 would also create the same result by greatly increasing the procedural burdens necessary before bank holding companies could enter into these banking related areas. Therefore, I will comment on these sections before discussing Sections 401 and 501.

Section 601 of S. 72 would subject both the rulemaking and individual bank holding company application procedures of the Federal Reserve Board to the formal trial-type hearing requirements of Sections 556 and 557 of the Administrative Procedure Act. This would mean that all orders and regulations of the Federal Reserve Board under Section 4(c) (8) would have to be conducted on the record after opportunity for hearing. Section 701 of S. 72 would permit any interested person to petition the Federal Reserve Board "to commence a proceeding to consider the issuance, amendment or revocation of an order or regulation promulgated under the authority of Section 4(c)(8) of the Bank Holding Company Act." Due to the increased burdens created by these two sections, and the necessarily anticompetitive, stifling effect upon the entrance of bank holding companies into banking related activities, the American Bankers Association must oppose Sections 601 and 701.

Our Association believes the case for procedural reform has not been made. More importantly, we believe the case for de facto repeal of the 1970 legislation or even for substantial modification of the judgment of that Congress clearly has not been made. Contrary to the implication in the section-by-section analysis of S. 72, the formulation of regulations by the Federal Reserve Board with respect to what constitutes permissible 4(c)(8) activities is already subject to the requirements of the Administrative Procedure Act under Section 553 which governs the rulemaking process. These provisions for informal hearings applicable to the rulemaking process have been judiciously followed by the Federal Reserve Board, and it appears there is no evidence to the contrary. In addition, the Federal Reserve Board's present procedures provide for an adjudicative hearing on individual applications when there are disputed questions of fact.

One of the arguments made for the inclusion of Section 601 in S. 72, is that due process is denied under the procedures now in effect for administering Section 4(c)(8), namely, the procedures under Section 553 of the Administrative Procedure Act. Contrary to this contention, due process in rulemaking does not call for the kind of trial-type hearings that are proposed in Section 601. These formal trial-type hearings require that determinations be made on the record after interested parties are given the opportunity to present evidence, to present written or oral argument, or both, and to cross-examine opposing witnesses.

Not only does due process not require that formal trial-type hearings be available in the administrative process, but these types of hearings are generally believed to be the least conducive to a smoothly functioning administrative rulemaking process. As Professor Kenneth C. Davies states in his *Administrative Law Treatise* at p. 379: "A trial is designed for resolving issues of fact, not for determining issues of law, policy or discretion. In rulemaking, the method of trial has no place except when specific facts are at issue, and even then it should seldom be used when the disputed facts are legislative." In fact, according to Davis, due process does not even require an informal hearing. "Of all the many Supreme Court decisions concerning the requirement of opportunity to be heard, not a single clearcut decision has been found in which due process is deemed to require an argument type of hearing . . . ." (Davis, *Administrative Law Treatise*, page 436.) Therefore, although the right to cross-examine is usually deemed appropriate at least as to adjudicative facts, a number of courts have held in cases involving complex and technical factual controversies that written submissions, possibly supplemented by oral argument, suffice, *Virgin Island Hotel Ass'n.* v. *Virgin Islands Water & Power Authority*, 476 F.d 1268 (3rd Cir. 1973).

The important aspect of the rulemaking process is to assure that challengers are accorded timely access to the critical reasoning process of the agency. This opportunity is present in the informal process as well as the complex and time-consuming formal trial-type procedure. Therefore, it is not unreasonable to assume that some of the attractiveness of the formal rulemaking procedure allowing for cross-examination is due to other aspects inherent in the procedure, rather than the desire for due process. The cross-examination offers challengers an opportunity for delay, a valuable bargaining tool with the agency, and a mode of exerting pressure upon the agency and other interested parties.

The procedures proposed in Sections 601 and 701 will be time-consuming and expensive and will unnecessarily delay Board decisions on regulations establishing permissible activities under Section 4(c)(8) and individual applications by bank holding companies to engage in these permissible activities. Even under present procedures there is the ability to forestall bank holding company expansion into related industries. This is evidenced by the history of the insurance industries' attempt to defer bank holding company expansion into insurance activities connected with extensions of credit. This effort resulted in over 5 years of delay in the allowance of bank holding company expansion into this area. This demonstrates that existing procedures have enabled competitors to significantly delay facing additional competition, and it is clear that their ability to do so in the future would be greatly enhanced if the procedural sections contained in S. 72 are ever enacted.

The way in which S. 72 contradicts the 1970 amendments is evident when the history of the procedural requirements is considered. Prior to 1970, Section

4(c)(8) required that a formal hearing be held on each application thereunder, even in the absence of any interest or testimony by anyone other than the applicant. As stated by Dr. Burns before the Senate Banking Committee in 1970: "This is a time-consuming and expensive procedure, which should be limited to instances where a hearing is requested by an interested party." (Testimony of Arthur F. Burns, Chairman, Board of Governors of the Federal Reserve System, Hearings on H.R. 6778, Senate Banking Committee, 91st Congress, 2d Sess. p. 143.) In response to this request by the Federal Reserve Board, the Congress eliminated the requirement of formal on-the-record hearings, for the very purpose of providing greater flexibility in the applicable procedures.

Another result of S. 72 would be to eliminate the distinction between activities commenced de novo and activities commenced by the acquisition, in whole or in part, of a going concern. This would be accomplished by the deletion of the last sentence of Section 4(c)(8) as mentioned previously and, more significantly, through the requirement of Section 601 that all Board determinations under Section 4(c)(8) of the Bank Holding Company Act be made on the record after opportunity for hearing as provided by Sections 556 and 557 of the Administrative Procedure Act.

The advisability of distinguishing between those two methods of expansion was addressed by Dr. Burns before the Senate Banking Committee in 1976. In discussing the approval of individual applications, he stated ". . . while approval would be required whether the expansion is to be achieved by establishing a new company or by acquiring an existing one, de novo entry would be favored since a company newly entering a market must, of course, face the competition of those already in it." Ibid, p. 143. This concept was embodied in the last sentence of Section 4(c)(8), and the reasoning behind the distinction was reiterated in the Conference Report accompanying H.R. 6778 at page 17.

"One of the asserted justifications for permitting bank holding companies to engage in activities that the Board has determined independently to be closely related to banking, is to permit the introduction of new innovative and competitive vigor into those markets which could benefit therefrom. Where a bank holding company enters a market through acquisition of a major going concern, it may not have the incentive to compete vigorously, thereby bringing the possible benefits into play, as it would immediately succeed to what it might consider its fair share of the market. On the other hand, where a bank holding company enters a new market de novo, or through acquisition of a small firm, as opposed to acquisition of a substantial competitor, its desire to succeed in its new endeavor is more likely to be competitive. *This legislation specifically emphasizes the importance of the manner in which a bank holding company may enter new activities.*" (emphasis added). (The Conference Report on the Bank Holding Company Act Amendments of 1970, December 15, 1970, page 17.)

This Committee's report contained a similar statement:

"The committee approved a provision which states that in making its determinations under section 4(c)(8), 'the Board may differentiate between activities commenced de novo and activities commenced by the acquisition in whole or in part of a going concern.' The committee believes that an activity commenced de novo will tend to have competitive effects, and consequently should be viewed more favorably than the commencement of an activity through the acquisition of an existing concern." (Senate Committee on Banking and Currency Report on the Bank Holding Company Act Amendments of 1970, August 10, 1970, page 15.)

Since the Federal Reserve Board was authorized to differentiate between de novo entries and acquisitions of a going concern, the result was a procedural embodiment of this concept in Section 225.4(b) of Regulation Y. In this section, the Federal Reserve Board designed different procedures for a bank holding company engaging in permissible activities de novo, and the procedures for a bank holding company applying to acquire or retain the assets of a company already engaged in permissible activities. The essence of the procedural difference is that de novo entries require a much simpler and less formal procedure, unless it appears appropriate to apply more formal procedures. These more formal procedures are normally implemented in response to adverse comments of a substantial nature. By the enactment of Section 601, these procedural distinctions will be eliminated, and all entries by bank holding companies into areas of permissible activity will be subject to formal trial-type hearings conducted on the record. The impact of this new requirement is particularly important in view of the fact that approximately 70 percent of the entries of bank holding companies into related areas are commenced de novo.

It may be useful to trace the procedural path under the proposed amendments of the adoption of a new activity under 4(c)(8), and an application submitted pursuant thereto.

(Following scenario as developed by Golembe Associates in *Administration of the Bank Holding Company Act*, p. 18.) Let us say that activity "X" has been suggested to the Board by potential applicant and the Board concludes that the activity has sufficient merit to justify the inauguration of the rulemaking process. The Board would begin the process by publishing notice in the *Federal Register* that it will commence rulemaking proceedings. A formal trial-type hearing would ensue and a record would be developed for and against the inclusion of Activity "X" in the permissible list. If the activity is controversial the process is likely to be lengthy, not only because of the time required for satisfying all of the procedural requirements for a formal hearing, but also because of the discovery rights of participants in the proceeding and the opportunity to elicit from the Board special studies that may be necessary to provide relevant information. By way of contrast, rulemaking under present practice would be informal, with opportunity accorded all parties to submit written comments and to make an oral presentation to the Board.

Assuming that activity "X" is finally approved by the Board, applicant bank holding company "Y" may then seek approval to commence the activity on a de novo basis. Under the proposed procedure, once again a formal trial-type hearing would have to be held, with cross-examination and the development of a record. Under present procedures, all that may be required (because of the de novo character of the applicant's proposal) is advance publication of the nature of the proposal and notification of the appropriate Federal Reserve Bank, with authority to proceed unless notified to the contrary by the Reserve bank or unless a protest is submitted within 45 days. However, if a protest has been filed or the matter is otherwise non-routine, the Board itself may process the application and, if requested, a formal trial-type hearing will be held.

If, after conclusion of the formal hearing on its application, Company "Y" receives approval from the Board to engage in Activity "X," and does so, protestants may then petition the Board under Section 701 to commence a proceeding for revocation of its order. Presumably, some brief period of operation would be necessary before such a petition would be considered, although the proposed new statute does not spell out how long that period should be. In any event, a hearing on the petition would be held by the Board, at which many of the same issues covered previously are likely to be raised again.

Assuming that the Board denies the petition, protestants may commence a civil action in a U.S. District Court to compel the granting of the petition. The trial will be de novo and the evidence considered by the Court would again be similar to that originally heard by the Board.

The complexity and unavoidable length of these procedures can only serve to frustrate bank holding companies' efforts to enter into banking related industries, and therefore will probably totally deter banking entry into these areas. This too will directly contradict the intent of the 1970 Congress in amending Section 4(c)(8), which was to encourage bank expansion into related areas. As stated by Senator Sparkman in the Conference Report of 1970, the amendments "... provided the necessary flexibility of regulation and administration which the Federal Reserve Board requested in order to permit it to depart from past precedents and to permit expansion of bank and bank-related activities which will be required in order to meet fully the rapidly expanding and varying financial needs of the economy of the nation." (*Congressional Record*, December 19, 1970, S-20638). Therefore, the result of S. 72 will be to negate the purpose of the 1970 amendments by discouraging the entrance of bank holding companies into banking related areas, and thereby inhibiting competition.

For the foregoing reasons, the American Bankers Association opposes the adoption of Section 601 and 701 of S. 72. This would result in a regression to the state of the law before 1970, and impose unnecessarily long and complex procedures upon a system which has proven adequate in the area of bank holding company expansion. More importantly, we believe these procedures would have an anticompetitive impact, which would contradict the title and [illegible]

SECTION

Section 401 would prohibit [illegible]
the Federal Reserve Board

rently, the Comptroller of the Currency, under provisions of the National Banking Statutes, has that authority. Additionally, if the Federal Reserve Board denies a parent company's application to engage in an activity through a holding company subsidiary, then a national bank subsidiary of the bank holding company would be prohibited from engaging in the activity as well.

According to the section-by-section analysis that accompanied S. 72, "Under the law as it currently exists national banks under some circumstances are permitted by the Comptroller of the Currency to engage in activities which have been found by the Federal Reserve Board, after lengthy hearings and deliberations, to be outside the scope of permissible bank activities." However, as of March of last year, nearly all the activities permissible to national banks had been approved by the Federal Reserve Board for bank holding companies under Section 4(c)(8), as shown in Table 4.

Also, the American Bankers Association believes that applying Federal Reserve Board decisions on holding companies to the activities of national banks could threaten the delicate balance of competitive equity as between state and national banks and lead to an increase in the number of state-chartered banks. We also believe this additional authority would undermine an important competitive and innovative influence in the banking industry—the independence of the Federal bank regulatory agencies.

For these reasons, we oppose Section 401.

TABLE 4.—STATUS OF BANK HOLDING COMPANY NONBANKING ACTIVITIES UNDER SECTION 4(c)(8) (AS OF MARCH 11, 1977)

Activities approved by the Board:

1. Dealer in bankers' acceptances [2]
2. Mortgage banking [2]
3. Finance companies [2]
   a. consumer
   b. sales
   c. commercial
4. Credit card issuance [2]
5. Factoring company [2]
6. Industrial banking
7. Servicing loans [2]
8. Trust company [2]
9. Investment advising [2]
10. General economic information [2]
11. Portfolio investment advice [2]
12. Full payout leasing [2]
    a. personal property
    b. real property
13. Community welfare investments [2]
14. Bookkeeping & data processing services [2]
15. Insurance agent or broker—credit extensions [2]
16. Underwriting credit life & credit accident & health insurance
17. Courier service [2]
18. Management consulting to nonaffiliate banks [2]
19. Issuance of travelers checks [2]
20. Bullion broker [2]
21. Land escrow services [1,2]
22. Issuing money orders and variable denominated payment instruments [1,2,4]

Activities denied by the Board:

1. Equity funding (combined sale of mutual funds & insurance)
2. Underwriting general life insurance
3. Real estate brokerage [2]
4. Land development
5. Real estate syndication
6. General management consulting
7. Property management
8. Nonfull-payout leasing [1]
9. Commodity trading [1]
10. Issuance and sale of short-term debt obligations ("thrift notes")
11. Travel agency [1,2]
12. Savings and loan associations [1]

Activities pending before the Board:

1. Armored car services [2]
   insurance [3]
2. Underwriting mortgage guarantee
3. Underwriting & dealing in U.S. Government and certain municipal securities [2,3]
4. Underwriting the deductible part of bankers' blanket bond insurance (withdrawn)
5. Management consulting to nonaffiliated, depository type, financial institutions [1,2]

[1] Added to list since January 1, 1975.
[2] Activities permissible to national banks.
[3] These were found to be "closely related to banking" but the proposed acquisitions were denied by the Board of Governors as part of its "go slow" policy.
[4] To be decided on a case-by-case basis.

Source: Dale S. Drum, "Nobanking Activities of Bank Holding Companies," *Economic Perspectives*, Federal Reserve Bank of Chicago, March-April, 1977, page 14.

SECTION 501

Giving the Federal Reserve Board the authority to determine the capital adequacy of subsidiary banks as proposed in Section 501 would be an additional step toward a de facto consolidation of the French bank regulatory agencies. The American Bankers Association opposes this provision because we believe the present tri-parte bank regulatory structure has fostered the development of innovative and more efficient bank customer services by maintaining a careful balance between the protection of customer deposits and competition within a dual banking chartering system.

Another provision of Section 501 would require that bank subsidiaries of bank holding companies refrain from discriminating in favor of their parent or their affiliated subsidiaries in the making of loans or the establishing of terms and conditions of loans. We believe this provision would be an unnecessary addition to current law.

Section 23A of the Federal Reserve Act currently imposes limitations on a bank investing in the securities of any affiliate, and making loans to the affiliate or to others when collateralized by securities of an affiliate, to 10 percent of the bank's capital and surplus in the case of any single affiliate, and to 20 percent of capital and surplus for all affiliates combined. But perhaps most importantly, no bank may make any loan or extension of credit to an affiliate unless it is collateralized by bonds or similar obligations having a market value from 100 to 120 percent of the loans with the lower figure applicable only if the collateral consists of U.S. Government obligations or of paper eligible for Federal Reserve discount.

What this means, for all practice purposes, is that an affiliate of a bank or bank holding company is so rigidly limited in both the amount and the collateralization of its borrowings from the bank involved that it often precludes such borrowing.

In this connection, three additional points deserve mention:

1. Among those precluded from borrowing (except on the terms noted) is the holding company itself, which since 1966 has been included in the definition of affiliate.
2. The extension of credit has been broadly defined to include, for example, discounting notes or other paper of the affiliates, with or without recourse; and purchasing from affiliates such items as mortgages and automobile or appliance paper.
3. All three Federal banking agencies have specific statutory authority to examine bank affiliates.

Section 501 would also provide for public disclosure of all intercompany loans and investments between bank holding companies and their subsidiaries on an annual basis. To the extent public disclosure might limit intercompany loan and investment transactions, there could be less funds available to serve the public, e.g., a loan to a finance company subsidiary. For this reason, we believe information that is kept confidential for competitive purposes should be exempted from public disclosure standards and procedures.

For the above stated reasons, our Association also opposes this provision of Section 501 of S. 72.

CONCLUSION

In summary, the American Bankers Association opposes the Competition in Banking Act because it would:

1. Make unnecessary additions to long established antitrust standards with respect to bank and bank holding company acquisitions, mergers and consolidations.
2. Virtually repeal the 1970 Amendments to Section 4(c)(8) of the Bank Holding Company Act.
3. Move toward a de facto consolidation of the Federal bank regulatory agencies.

The staff of the Federal Reserve Board is scheduled to complete a comprehensive study of bank holding company operations later this month. That study should be valuable in determining what additional changes may be needed to improve the effectiveness of bank holding company regulation and supervision. We believe the best interests of both banking and the public will be well served by this approach.

The American Bankers Association appreciates the opportunity to express its views on this proposed legislation.

The CHAIRMAN. Thank you very much, Mr. Duwe.

As we indicated earlier, Mr. Campbell cannot be here, but I understand Mr. Richard Peterson, Washington counsel for the Independent Bankers Association, is present. Mr. Peterson, you have a most impressive statement here, 33 pages, with substantial appendixes added to that and lots of other exhibits. We will be happy to place that entire statement in full in the record. It's a brilliant job I think, but we obviously would appreciate it if you could summarize it in about 10 minutes.

STATEMENT OF RICHARD PETERSON, LEGISLATIVE COUNSEL, INDEPENDENT BANKERS ASSOCIATION OF AMERICA; ACCOMPANIED BY TERRENCE H. KLASKY

Mr. PETERSON. Mr. Chairman, I am Richard Peterson, legislative counsel of the Independent Bankers Association of America, on whose behalf I appear today. The association regrets not being able to provide one of its officers as a witness. We are in the middle of a convention in Florida and are faced with quite a few policy planning problems that require immediate solution. Consequently, none of IBAA's officers is available. I also apologize for being late, but my schedule has been considerably tightened in the last 24 hours trying to keep the membership from burning a prominent newscaster in effigy if not in the flesh.

I am accompanied by Terry Klasky, another legislative counsel of IBAA, who will be available to answer questions.

We appreciate the opportunity to present our views with respect to S. 72 and the need to strengthen existing legislation regulating bank holding companies. We agree that a thorough review of bank holding company legislation and its administration by the Federal Reserve Board is urgently needed in view of the rapid growth of multibank holding companies and what we view as the adverse effects of their growth on the concentration of control of commercial banking.

We are in basic support of S. 72 provided certain changes are made. In summary, we would urge the committee to fortify the capability of independent banks by:

1. Strengthening the standards and administrative procedures for the approval of bank mergers and holding company acquisitions, including a requirement that those seeking such approval establish clear and convincing evidence of a public need.

2. (I am glad to see that the Senator from New Hampshire is not here.)—"McFaddenization" of the Bank Holding Company Act.

3. Exempting small one-bank holding companies from the act.

4. Requiring prior disclosure of tender offers under detailed procedures.

5. Grandfathering existing nonbank subsidiary activities of small one-bank holding companies and permitting such activities in the primary service area of the main banking office.

At the outset, we should point out that since 1956 a large number of independent banks have been absorbed by multibank holding companies. If their growth by mergers and acquisitions is not abated, the strength of the independent sector of commercial banking will be seriously eroded to the detriment of the communities they serve.

[Complete statement follows:]

STATEMENT OF THE INDEPENDENT BANKERS ASSOCIATION OF AMERICA

Mr. Chairman, my name is Raymond Campbell. I am first-vice president of the Independent Bankers Association of America and president of the Oberlin Savings Bank of Oberlin, Ohio.

We appreciate the opportunity to appear before this Committee on behalf of the 7,400 members of IBAA to present our views with respect to S. 72 and the need to strengthen existing legislation regulating bank holding companies. We agree that a thorough review of bank holding company legislation and its administration by the Federal Reserve Board is urgently needed in view of the rapid growth of multibank holding companies and what we view as the adverse effects of their growth on the concentration of control of commercial banking.

Our review of S. 72 suggests that this bill would begin to address concerns our Association has observed in the Federal Reserve Board's administration of the Bank Holding Company Act. As the Committee will recall our Association was formed in 1930 to combat the centralization of economic power through deposit concentration which arises via multibank holding companies and large branch banking grids. For many years our Association sought regulation of bank holding companies—a concern finally shared by Congress in 1956. That first effort to stem the concentration of financial power has gone awry in the hands of the Federal Reserve Board, and we agree that the time has come to substitute specific limitation for unbridled discretion.

We appear here today in basic support of S. 72 provided certain enhancements are made consistent with our belief that this Committee is concerned about the future of independent banking. In summary we would urge the Committee to fortify the capability of independent banks by:

1. Strengthening the standards and administrative procedures for the approval of bank mergers and holding company acquisitions, including a requirement that those seeking such approval establish clear and convincing evidence of a public need.
2. "McFaddenizing" the Bank Holding Company Act.
3. Exempting small one-bank holding companies from the Act.
4. Requiring prior disclosure of tender offers under detailed procedures.
5. Grandfathering existing nonbank subsidiary activities of small one-bank holding companies permitting such activities in the primary service area of the main banking office.

At the outset, we should point out that since 1956 a large number of independent banks have been absorbed by multibank holding companies. If their growth by mergers and acquisitions is not abated, the strength of the independent sector of commercial banking will be seriously eroded to the detriment of the communities they serve.

IBAA is concerned by these developments because its membership, for the most part, is comprised of a large number of relatively small community banks. More than 80 percent of our member banks have assets under $25 million. About half of our members are located in communities of 5,000 or less; and 90 percent in towns and cities of less than 30,000. Most of our members are found in the middle third of the country, mainly the agricultural states of the midwest and south. Consequently, they are heavily involved in rural financing, especially agriculture. In 1976, commercial banks with assets under $25 million accounted for 46 percent of the credit extended to agriculture by all commercial banks in the United States. Additionally, our member banks supply the backbone of rural credit to meet the housing and consumer needs of the population as well as meeting the credit needs of small business. By supplying a major share of bank credit to rural needs, the nation's independent banks are making a considerably larger contribution to the nation's economic well-being than one might assume from asset size alone.

THE PRINCIPLE OBJECTIVES OF FEDERAL BANK HOLDING COMPANY LEGISLATION

One of the principal objectives of federal legislation designed to regulate companies which manage and control banks, was to prevent concentration in the banking business. Congress believed that adequate safeguards should be provided against undue concentration of control of banking activities because of the importance of the banking system to the economy. Therefore, Congress sought to protect and foster the growth of independent unit banks. The holding company device, whereby control of a group of banks has been acquired and the banks thereafter operated in effect as branches, has been a major factor in concentrating banking control into fewer hands. It was the declared view of Congress that independent banking was being thwarted by indirect branch banking, through the holding company mechanism. Congress in enacting legislation to regulate bank holding companies sought to limit the ability of bank holding companies to increase the share of commercial banking in a particular area which could be brought under a single control and management.[1]

Each time the Congress has been urged to permit branches, regardless of state bank laws, on a trade area basis or on an interstate or Federal Reserve District basis, Congress has opted for a system of local independent and competitive banks and has left the matter of branches to the states to determine, each state for itself. Despite this consistent policy the holding company device has been used, in the absence of state law, to concentrate control into fewer and fewer hands. This prompted the House Banking Committee to comment that the difference between branches and affiliated, or subsidiary banks, was only one of form and, in effect, holding company banking was nothing more than branch banking.[2] The legislative history of the Bank Holding Company Act of 1956 clearly expresses the intent of Congress to restrain holding company growth as will be apparent from an examination of Appendix Exhibit I.

Because the Bank Holding Company Act of 1956 applied only to bank holding companies controlling or owning two or more banks, one-bank holding companies were exempt from regulation under the Act. The Bank Holding Company Act Amendments of 1970 were enacted primarily to bring one-bank holding companies within the regulation of the 1956 Act. In addition, the 1970 amendments eliminated a partnership exemption from the definition of the term "company." The 1956 standard for determining what bank-related activities a bank holding company may engage in was retained. One-bank holding companies were subjected to potential Federal Reserve Board jurisdiction under the Bank Holding Company Act regardless of when they were created. The 1970 amendments were designed to prevent concentration and to affirm the long-standing policy of separating banking from commerce.[3] In the late 1960's, a large number of banks began converting to one-bank holding companies to avoid regulation by the Fed under the Bank Holding Company Act. In addition, many significant nonbank corporations began acquiring a single bank, thus mixing banking and non-banking in complete contravention of the purpose of both Federal banking laws going back to the 1930's and the Bank Holding Company Act of 1956. Left unchecked, the trend toward the combining of banking and business could ultimately result in the formation of a relatively small number of power centers dominating the American economy.[4]

BANK HOLDING COMPANY LEGISLATION HAS NOT ACHIEVED THE OBJECTIVES INTENDED BY CONGRESS

The growth of bank holding companies since the Bank Holding Company Act was enacted by Congress clearly reveals its failure to restrain the growth and influence of bank holding companies. In the 17 year period 1959–1976, the number of registered multi-bank holding companies increased almost six-fold from 48 to 298; the number of banks and branches they operated rose more than eight times, from 1,380 to 12,022, and their deposits multplied 17 times from $17.3 billion to $287 billion.[5] The growth of one-bank holding companies in the period 1955–1976 was even more rapid. Their number increased almost thirteen times from 117 to 1,504 and their bank deposits rose 20-fold from $11.6 billion to $267.1 billion. However, most of the deposit growth of one-bank holding companies occurred in the short three-year period 1965–1968 when 200 one-bank holding companies were organized expanding the aggregate deposits held by all one-bank holding companies from $15.1 billion in 1965 to $108.2 billion at the close

---

[1] *Federal Bank Law Reporter*, vol. 3, Commerce Clearing House, 1973, pp. 22–051–52, paragraph 43,042.
[2] House Committee Report No. 609, 84th Cong., 1st Sess., pp. 2–3.
[3] *Op. Cit.*, CCH, Federal Banking Law Reporter, pp. 22,053–54.
[4] Conference Report No. 1747, 91st Cong., 2nd Sess., pp. 11–12 .
[5] *Federal Reserve Bulletin*, Aug. 1960, p. 813, June 1975, p. A79; *Annual Statistical Digest*, Federal Reserve Board, 1976.

of 1968, an increase of 600 percent.[6] Enactment of the 1970 amendments to the Bank Holding Company Act slowed but did not halt the growth of one-bank holding companies. Between 1968 and 1976 the number of one-bank holding companies grew from 890 to 1,504, an increase of 72 percent, and their aggregate deposits rose 47 percent from $181 billion to $267.1 billion.[7]

IMPACT OF BANK HOLDING COMPANIES ON THE AVAILABILITY OF AGRICULTURAL CREDIT

Although studies of the impact of holding company ownership on the cost, terms or the relative amount of credit extended to agriculture have been limited, there are indications that affiliates of multibank holding companies tend to reduce their proportion of farm loans while increasing consumer installment, business and mortgage loans.[8]

A study of farm lending patterns of holding company banks in Florida found that between 1962 and 1970, on the average, farm loans tended to decrease soon after banks became affiliated with holding companies, while at the same time farm loans at independent banks were continuing their upward trend. For banks first affiliated in 1969, farm loan volume in both that year and the next was lower than in the five preceding years, although total loans continued to rise.[9]

The growth of multibank holding companies, particularly in the many agricultural states where unit banking systems are prevalent, could have a significant impact on the availability of credit to agriculture if, as the aforementioned studies indicate, bank holding companies tend to shift the lending policies of the independent banks they acquire from agricultural loans to other types of loans.

A large number of the smaller banks in the nation not only hold a large portion of their loan portfolios in farm loans, but they also supply a major share of total bank lending to agriculture. In 1974, for example, banks across the nation that had less than $25 million in deposits held 55 percent of the agricultural loans held by all banks. This is a remarkably high percentage in view of the fact that total deposits at these smaller banks amounted to less than one-tenth of the deposits of all banks in the nation.[10]

THE EFFECT OF THE GROWTH OF BANK HOLDING COMPANIES IN CONCENTRATION OF COMMERCIAL BANKING

The growth of bank holding companies has been a significant factor in raising the level of concentration of commercial banking. Nationwide concentration of commercial banking reached the point in 1976 where the 50 largest banking companies controlled $535 billion of assets or 51 percent of all commercial bank assets. The share of commercial bank deposits held by multibank holding companies has risen from 18 percent in 1959 to 34 percent in 1976. When the deposits of one-bank holding companies are added to the deposits of the multibank holding companies their combined share of deposits rose to 65 percent in 1976.[11] However, it is the very large multibank and one-bank holding companies which exert the most influence in raising the level of concentration in commercial banking. By far, the largest number of one-bank holding companies are relatively small. In 1976, 36 of the 1504 one-bank holding companies had deposits in excess of one billion dollars and accounted for 63 percent of the aggregate deposits of all one-bank holding companies. Consequently, the one-bank holding companies which exert the greatest influence on the structure of banking are these very large companies with deposits over a billion dollars. These companies are listed in Appendix Table No. 2.

Probably the most accurate measure of bank holding company control of commercial bank deposits is the share of deposits held by the 298 multibank holding companies and the 36 largest one-bank holding companies. In 1976 these 334 bank

---

[6] "The Growth of Unregistered Bank Holding Companies: Problems and Prospects." Staff Report for the House Committee on Banking and Currency, 91st Cong., 1st Sess., Feb. 11, 1969.

[7] "Recent Changes in the Structure of Commercial Banking," *Federal Reserve Bulletin*, March, 1970, p. 200; and *Annual Statistical Digest*, Federal Reserve Board, 1976.

[8] *Op. Cit.*, Robert J. Lawrence, *The Performance of Bank Holding Companies.*

[9] Gene D. Sullivan, "Impact of Holding Companies on Farm Lending by Banks in Florida," in *Improved Fund Availability at Rural Banks*, Report of the Committee on Rural Banking Problems, Board of Governors, Federal Reserve System, June 1975.

[10] Mary Hamblin, "Bank Lending to Agriculture an Overview," *Monthly Review*, Federal Reserve Bank of Kansas City, November 1975, p. 15.

[11] *Annual Statistical Digest 1976*, Federal Reserve Board.

holding companies controlled deposits of $454.8 billion, 54 percent of the nation's commercial bank deposits.[12]

The proliferation of multibank structures in a given geographic area and the consequent elimination of independent banks increases the concentration of banking resources to the ultimate detriment of the public. To determine whether the growth of holding companies has altered concentration levels in banking requires an examination of concentration nationwide; and at the state and local levels. Aggregate concentration at the national level, while significant, is of a lower order of significance than at the state and local levels. The growth of bank holding companies of large absolute size raises the issues of concentration of economic resources and the point at which growth in absolute size endows a firm with the ability to wield excessive social, political or economic powers. Concentration influences the composition and structure of state and local markets and reduces the vigor of competition between banks as these banking markets become more concentrated.[13]

We emphasize this distinction between the small one-bank holding companies and the larger one—and multibank holding companies to justify our belief that a limited exemption from the provisions of the Bank Holding Company Act should be granted to one-bank holding companies with banking assets of less than $50 million and nonbank assets of less than $15 million. Historically, institutions of this size have been formed to facilitate the sale or the formation of a bank or the consolidation of ownership which may have occurred through testamentary transfer. The motivation for the creation of these small one-bank holding companies is, therefore, very much different from the large multi or one-bank holding companies where the ultimate result is expansion and concentration of economic resources and the goal is increase in the price per share of stock.

Our position is not novel. In previous testimony before this Congress in 1969, William McChesney Martin, then chairman of the Federal Reserve Board, recommended that the Act provide an exemption for small banks along the lines we have suggested. He did this in part to meet the concerns expressed by the Senate during its 1966 review of bank holding companies. In pointing out that the absence of an exemption would make it 'more difficult to hold or form small independent banks," he accurately forecast the problems of concentration which have brought us to this point today. Any impediment which can reasonably be removed in order to promote the formation and continued existence of small independent banks should be of paramount concern to this Committee. We believe our recommendation will go a long way, in conjunction with other comprehensive changes in the current law, to prevent further concentrations of economic power.

THE IMPACT OF BANK HOLDING COMPANIES ON THE CONCENTRATION OF DEPOSITS AT THE STATE LEVEL

The structure of banking within the boundaries of a state is shaped by state regulation creating a relevant political, if not a purely economic, market for the analysis of competition. Therefore, it is appropriate to examine concentration within state boundaries and the influence of bank holding company growth on the level of state concentration.

Changes in banking structure at the state level, are significantly affected by laws that regulate multiple-office banking. Thus, in 19 states and the District of Columbia which permit branching statewide, the level of concentration of commercial bank deposits, measured by the share of deposits held by the five largest banks or bank groups, is higher than it is in the remaining 31 states which limit or prohibit branching. Concentration in the statewide branching states in 1975 ranged from a low of 49 percent of deposits held by the five largest banking organizations in South Dakota to a high of 97 percent in Nevada. In limited branching states the level of concentration ranged from 24 to 64 percent. Concentration ratios were lowest in the unit banking states where the share of deposits held by the five largest organization's ranged from 16 to 56 percent.[14]

[12] *Bank Holding Companies and Subsidiary Banks as of Dec. 31, 1974*, Federal Reserve Board, 1975.

[13] Jack S. Light, "Bank Holding Companies—Concentration Levels in Three District States," *Business Conditions*, Federal Reserve Bank of Chicago, June, 1975, p. 10.

[14] "Relative Size of Largest Commercial Banks or Bank Groups in States, Classified by Status of Branch Banking," FDIC, *Summary of Accounts and Deposits, June 30, 1975*, Table K, p. 17.

The close relationship between the presence of bank holding companies in the market and high levels of banking concentration is revealed by the fact that 67 of the 100 largest banks[15] in the statewide branching states where concentration ratios are the highest are bank holding companies. In California, for example, four of the state's five largest banks are one-bank holding companies and in 1976 controlled 72 percent of the state's deposits. The largest bank controlled 38 percent; the second largest bank 15 percent; and the third largest 10 percent. All five of the largest banks in Rhode Island which control 94 percent of the state's deposits are one-bank holding companies. The largest accounted for 41 percent in 1976; the second largest 26 percent; and the third largest 24 percent. In Maryland 61 percent of the state's commercial bank deposits in 1976 were held by the five largest banks or bank groups, all of which are bank holding companies. The largest controlled 20 percent; the second largest 14 percent; and the third largest 11 percent. And finally, in the state of Washington, the three largest banks are bank holding companies which controlled 61 percent of the state's deposits in 1976. The largest company held 35 percent; the second largest 19 percent; and the third largest 7 percent.[16]

These are but a few of the examples of the role bank holding companies play in concentrating control of a state's commercial bank deposits in the hands of a few large banks. It also reveals that the largest bank holding companies in California, Rhode Island and Washington have already captured a higher percentage of control over their state's deposits than would be permitted under the 20 percent ceiling proposed by S. 72 and demonstrates the urgent need for Congressional action to slow further multibank holding company expansion.

Although Congress has consistently endorsed a national banking policy aimed at preventing the increased concentration and control of banking, bank holding company legislation has not been effective in carrying out this policy since the sharpest rise in the number of bank holding companies has occurred in the fifteen unit banking states. At the end of 1976, there were 1342 bank holding companies in these states, an increase of 24 percent from 1971. Furthermore, 68 percent of all the bank holding companies in the United States were located in the unit banking states. One of the principal reasons advanced for the growth of multibank holding companies in unit banking states is the prohibition or geographical limitation on full-service branches, whether de novo or by merger.

The holding company form of organization was devised as an alternative for developing multiple office organizations on a geographically extensive basis where state branching laws restrict such development. On the other hand, however, it controverts the state's preference for unit banking as a state policy. To protect and foster independent unit banking and the integrity of state branching laws, bank holding company legislation should be made a more effective instrument for restraining the growth of bank holding companies by merger and acquisition. While continuing efforts are being made on the state level to prevent controversion of state policies designed to prevent concentration, we believe, it is time for the Federal government to reaffirm its concern by enacting legislation to close these bank holding company loopholes.

THE IMPACT OF BANK HOLDING COMPANIES ON THE CONCENTRATION OF DEPOSITS AT THE LOCAL LEVEL

Inasmuch as most banks are retail banks serving local communities, the closest approximation to a relevant market in which to consider banking structure is the Standard Metropolitan Statistical Area (SMSA). While individual SMSAs may be either larger or smaller than relevant market areas determined by detailed market analysis, they serve as reasonably valid approximations of banking market areas.

In the statewide branching states where concentration of deposits in the state's five largest banking organizations is highest, concentration levels in SMSAs generally exceed that of the state. For example, the five largest bank organizations in California held 79 percent of the state's deposits in 1975 while in 16 of the state's 18 SMSAs the five largest firms controlled from 80 to 96 percent of the SMSA's deposits and the median concentration ratio was 85 percent. In North Carolina five-firm concentration at the state level in 1975 was 68 percent but in

[15] Comprised of the 5 largest banks or bank groups in the 19 statewide branching states and the District of Columbia.
[16] *Op. Cit.*, FDIC Tabulation.

the state's seven SMSAs concentration ranged from 79 to 97 percent with the median being 86 percent. The pattern was the same in Connecticut where five-firm concentration at the state level was 62 percent but ranged from 80 to 100 percent in the state's eleven SMSAs with a median of 89 percent. For the 19 statewide branching states and the District of Columbia, as a whole, five-firm concentration in 1975 ranged from 51 to 97 percent of deposits at the state level but was substantially higher in each of the 69 SMSAs in these states.[17]

In Florida, until very recently a unit banking state, the ten largest multibank holding companies increased their share of the state's deposits from 38 percent in 1964 to 55 percent in 1974. In the state's 14 SMSAs, however, the share of deposits held by multibank holding companies ranged from a low of 64 percent to a high of 93.5 percent reflecting a significantly higher degree of concentration than that found at the state level.[18]

Bank holding companies which control a large share of the state's deposits also tend to exhibit a corresponding degree of control in the state's SMSAs. In Connecticut, for example, the largest banking organization with 22 percent of the state's deposits was also the dominant firm in two of the state's largest SMSAs and had a foothold in a third. The state's second largest bank holding company with 19 percent of the state's deposits was a major factor in three of the state's largest SMSAs and a minor factor in a fourth. And finally, the third largest firm with 9 percent of state deposits operated banks in four major SMSAs and held a substantial share of deposits in two.[19] Many of the largest multibank holding companies have penetrated major banking markets in states with high levels of concentration. Thus, they face each other in these markets recognizing their mutual interdependence and adopt pricing and other practices that dampen competition. Such behavior tend to make them less responsive to the needs of individual customers and the local community.[20]

FACTORS RESPONSIBLE FOR THE GROWTH OF BANK HOLDING COMPANIES

A. *State banking laws*

One of the factors claimed to be most responsible for the rapid growth of bank holding companies is state law restricting branching. The holding company vehicle provides a means for circumventing geographic restrictions of state branching laws and the penetration of every market within a state. It also enables banking organizations to expand into new product and geographic markets across state boundaries through nonbanking subsidiaries. Prohibition of the establishment of full service branches, whether de novo or by merger, has often been advanced as the principal reason for the growth in importance of multibank holding companis in unit banking states. While the largest number of holding companies are found in these states, they are of about the same importance in limited and statewide branching states. The holding company form of organization has provided a means for developing multiple-office organization on a geographically extensive basis where banking laws prohibit or restrict such development by banks.[21]

Banking organizations in unit banking states, where bank holding companies are permitted, rely entirely on holding company acquisitions for expansion. Organizations in limited branching states use the holding company device to expand outside the limited area within which they are permitted to branch. In statewide branching states, where banking organizations can expand anywhere in the state through branching, the holding company is not an essential instrument for geographic expansion. At the end of 1975 there were only 50 multibank holding companies in the statewide branching states compared to 138 in the limited branching states and 139 in the unit banking states.

State branching laws were, therefore, responsible for the significant growth of bank holding companies in recent years in such states as Florida, which was a

---

[17] *Summary of Deposits in All Commercial and Mutual Savings Banks, June 30, 1975*, FDIC, Table K, p. 17. *Op. Cit., Relative Size of the Largest Commercial Banks*, FDIC.

[18] B. Frank King, "Banking Structure in Florida," *Monthly Review*, Federal Reserve Bank of Atlanta, September, 1975, pp. 145–146.

[19] Katherine Gibson, George H. Gonyer, Gina Rogers, *Changing Commercial Bank Structure in New England*, Federal Reserve Bank of Boston, Research Report 59, June 1975, p. 31: *Relative Size of Deposits of Largest Bank Groups in Each State*, FDIC, Dec. 1974.

[20] Samuel H. Talley, *The Impact of Holding Company Acquisitions on Aggregate Concentration in Banking*, Federal Reserve Board Staff Economic Study No. 80, 1974, p. 2.

[21] "Recent Changes in the Structure of Commercial Banking," *Federal Reserve Bulletin*, March 1970, pp. 204–205.

unit banking state until 1976, New York, which, until recently, was a limited branching state, and New Jersey another limited branching state. Effective restraint on the growth of bank holding companies by merger has been achieved only in the thirteen states which prohibit multibank holding companies. In eight of these states five-firm concentration was under 36 percent in 1974.

In statewide branching states where five-firm concentration has reached very high levels the major factor restraining further multibank holding company expansion by merger is the self-restraint exercised by the largest bank holding companies due to the fear of regulatory opposition to further acquisitions.

For a number of reasons our Association does not take much solace in the prospects of self-imposed expansionary restraint. History has taught us that large financial institutions go through cycles of expansion. It just so happens that these institutions are still cutting their losses from their last reach for the stars, and therefore, we seem to be in a period of relative calm. So we laud the Committee for considering amendments to the Bank Merger Act and the Bank Holding Company Act which would limit the degree of concentration a bank or bank holding company could obtain by acquisition or merger to 20 percent of the aggregate assets of the banks in the state in which the bank is located. Unfortunately, we do not believe that these amendments as they appear in Sections 101 and 201 of S. 72 go far enough. While we will discuss Sections 101 and 201 in connection with an analysis of antitrust enforcement to date, we urge you to prevent further concentration by closing a loophole created by Section 7 of the Bank Holding Company Act.

Our Association has adopted several convention resolutions calling for the "McFaddenization" of multibank holding company acquisitions. Under such legislation (1) further multibank holding company activity in any state would be permitted only to the extent permitted by its legislature and (2) where multibank holding companies are now permitted due to an absence of state legislation, any further bank acquisitions would require specific state enabling legislation. Such uniform control of multibank holding companies under state standards is highly desirable because this form of banking structure is comparable in practical effect to branching as already noted. This uniformity would require an amendment to Section 7 of the Federal Bank Holding Company Act. Currently, that section provides that in the absence of state legislation, bank holding companies are free to operate without restriction, other than by approval of the Federal Reserve Board.

B. Federal Reserve Board Administration of the Bank Holding Company Act

The policies pursued by the Federal Reserve Board in administering the Bank Holding Company Act reflect a departure from the objectives Congress intended the Act to achieve. Instead of pursuing policies which would prevent an increase in concentration in banking and foster the growth of unit banks, the Board has sharply increased the number of multi-bank holding companies; has permitted them to acquire a large number of viable independent banks; and has raised the levels of concentration in banking.

The policy pursued by the Board with respect to multi-bank holding companies has been to effectively foster large banking organizations capable of offering banking services on a statewide basis. In pursuit of this policy the Board has favored the formation of holding companies by the large dominant banks in local markets and encouraged their expansion through mergers and acquisitions ostensibly for the purpose of making them large enough to achieve economies of scale.[22]

Over the fourteen year period 1963–76, for example, the Board approved the formation of 830 bank holding companies under Section 3(a)(1) of the Act while denying only 53. In the same period the Board approved multibank holding company acquisitions of 1619 banks under 3(a)(1) of the Act but denied only 112 such acquisitions indicating a highly permissive attitude toward multibank holding company acquisitions. Similarly, the Board's policy toward the entry of bank holding companies into non-banking activities reveals the desire to expand the area of permissible activities. Under Section 4(c)(8) of the Act the Board, since the 1970 amendments, has approved or permitted 2,649 entries of bank holding companies into non-banking activities but denied only 179.[23]

---

[22] "The Federal Reserve and the Bank Holding Company," Remarks of George W. Mitchell, Vice Chairman, Board of Governors, Federal Reserve System, Boca Raton, Fla., Feb. 13, 1975.

[23] Annual Reports of the Federal Reserve Board, 1963–76.

While the majority of the Board has exhibited a strongly pro-bank holding company posture, sharp opposition to this policy has been expressed by minority Board members in a number of instances. These dissents express the view that the Board's policy of approving acquisition of viable independent banking organizations by large multibank holding companies is inconsistent with the Congressional mandate to prevent further concentration of banking resources in a few large organizations.[24] Dissatisfaction with the majority's pro-holding company posture was expressed in a dissent from the Board's approval of an Alabama bank holding company's application to acquire an independent bank. Governor Brimmer, in his dissent, noted that Alabama was well on its way to becoming a state where four statewide organizations would dominate the banking scene and that if the Board continued to permit the big four to acquire the large independent banks in the state it would discourage the development of additional competitive holding companies. Furthermore, by fostering four sizable organizations which confront each other in the large local markets in Alabama, an oligopolistic environment will be created permitting the dominant firms to adopt similar policies and reduce the vigor of competition.[25]

It was not until 1973 that the Board began to shift to a "go slow" policy which retarded all forms of multibank holding company expansion. The Board, at that time, began to disapprove acquisitions which would add to a holding company's debt burden. This change in policy was prompted by concern over the issue of "capital adequacy" raised by the continuing decline in the capital ratios of banks and multibank holding companies.[26]

About the same time, the Board also revised its treatment of competitive factors considered in bank holding company acquisitions by placing greater emphasis on the acquisition's effects on potential competition. Early in 1974 the Board denied several merger applications where there was no existing competition between the applicant and the bank or nonbank company to be acquired but where potential competition would be adversely affected.[27] While shifts in the Board's attitude toward "capital adequacy" and the adoption of the potential competition doctrine may have contributed to a decline in bank holding company acquisitions since 1974, it could also be attributed to a sharp reduction in the market price of holding company shares, especially those of the nation's largest bank holding companies.[28]

FEDERAL RESERVE BOARD BANK HOLDING COMPANY POLICY UNSUPPORTED BY HOLDING COMPANY PERFORMANCE

The pro-holding company policy pursued by the Federal Reserve Board in its administration of the Bank Holding Company Act has, as has been noted, been founded on the premise that the formation of multibank holding companies by the large dominant banks in local markets and their expansion through mergers and acquisitions would make them large enough to achieve the maximum level of efficiency obtainable through economies of scale.[29] Thus the cornerstone of Fed policy has been predicated on the assumption that most independent banks could not achieve the economies of scale and portfolio diversification essential to the improvement of bank performance.[30]

A number of studies of multibank holding company performance, many of which were sponsored by the Federal Reserve Board since 1968, do not support the basic premise of the Fed's bank holding company policy. These studies have found that, at best, affiliation with a holding company results in very modest changes in performance, mainly in portfolio composition after affiliation.

One of the earliest studies of multibank holding company performance found that the operating efficiency of acquired banks did not improve when measured by operating ratios.[31]

---

[24] Dissenting Statement of Governors Robertson, Maisel, and Brimmer in the Application of First National Bancorporation, Inc., Denver, Colorado, *Federal Reserve Bulletin,* April 1971, p. 357; See also 1970 *Federal Reserve Bulletin*, p. 543.

[25] Dissenting Statement of Governor Brimmer, in Alabama Bancorporation application to acquire independent banks in Tuscaloosa and Anniston, Ala., *Federal Reserve Bulletin,* August 1973, p. 586.

[26] Harvey Rosenblum, "Bank Holding Company Review 1973/74 Part I" *Business Conditions*, Federal Reserve Bank of Chicago, February 1975, p. 7.

[27] *Idem.*

[28] *Ibid.* pp. 8–9.

[29] *Op. Cit.*, George W. Mitchell remarks, Boca Raton, Fla., Feb. 13, 1975.

[30] Arthur G. Fraas, *The Performance of Independent Bank Holding Companies*, Staff Economic Study No. 84, Federal Reserve Board, 1974, p. 1.

[31] Robert J. Lawrence, *The Performance of Bank Holding Companies*, 1967, Board of Governors, Federal Reserve System, pp. 24–25.

A later study to determine the significant differences in operating performance associated with changes in individual bank ownership overlooked the efficiency issue but found that banks with new owner-managers tended to increase loan availability in their communities by placing greater emphasis on higher interest rate consumer loans.[32]

A 1971 study to determine the effects of bank holding company acquisitions on bank performance examined 18 banking ratios for 82 banks acquired by holding companies between 1966 and 1969. The study found that the major effect of holding company acquisitions was to alter the portfolio composition of the acquired banks by switching out of U.S. Government securities into state and local government securities and high-yielding installment loans. While portfolio changes suggest that the acquired banks made more credit available in their localities, the acquired banks made no significant changes in their capital, prices, expenses or profitability. Therefore, the conclusion to be drawn from the study was that holding company acquisitions did not noticeably enhance the performance of acquired banks.[33]

The most reliable studies on production efficiencies in banking indicate that economies of scale may exist up to about $100 million in deposits, but are not observable above that level. Apart from the separate issue of management efficiency, there is no persuasive argument that economies will result from holding company affiliation per se.[34]

The record of the Federal Reserve Board's administration of the Bank Holding Company Act has demonstrated the need for statutory changes which will ensure that the Act will be administered to achieve the objectives intended by the Congress. It has been demonstrated that the policies pursued by the Board under the Act have favored the formation of holding companies by the large dominant banks in local markets and encouraged their expansion through mergers and acquisitions so that they could achieve economies of scale. But, the Board belatedly came to recognize that there are clear limits to the achievement of such economies and embarked on a "go slow" policy with respect to multibank holding company growth by merger and acquisition.

Unfortunately, the evidence is clear that once a market becomes highly concentrated deconcentration is not only extremely difficult but also painfully slow. A recent study of the Federal Reserve Board brought this into sharp focus when it found that in the period 1966 to 1975 there was an average decline of about six percent in three firm concentration ratios in 171 SMSA's where the three firm concentration ratios ranged from 50 to 100 percent.[35] At this rate of reduction of three firm concentration it would require approximately 66 years to bring the degree of control exercised by these firms down to the more acceptable, but not necessarily ideal level, of 50 percent of the market.

We have already addressed some issues which would go a long way in statutorily preventing future expansionist policies—and we have suggested ways to strengthen the bill along those lines. At the same time, we believe that we have demonstrated that the failure of the current law to achieve its purposes is in substantial part due to the recalcitrance of the Federal Reserve Board to heed the legislative intent of Congress. While we are confident that the proposed amendments will go a long way in solving the problems we all recognize, we have also seen how a clever lawyer or economist can twist the law or the facts to justify an opposite result. The Board seems to have an abundance of this talent.

Since we agree that it is time to start afresh the fight against concentration of economic power, we urge the Committee to replace the current administrator of the Bank Holding Company Act with either another existing agency or a specially constituted body. We frankly have no specific thoughts on this matter other than the need to make you realize that the current caretakers of your efforts have not done the job.

---

[32] Paul F. Jessup, Changes in Bank Ownership: *The Impact on Operating Performance*, Board of Governors, Federal Reserve System, 1968, pp. 23–24.

[33] Samuel H. Talley, *The Effect of Holding Company Acquisitions on Bank Performance*, Board of Governors, Federal Reserve System, 1971, pp. 2, 13.

[34] Samuel B. Chase, Jr. and John M. Mingo, *The Regulation of Bank Holding Companies*, Paper presented at American Economic Association meeting, San Francisco, Calif., Dec. 28, 1974.

[35] Samuel H. Talley, *Recent Trends in Local Banking Market Structure*, Staff Economic Study No. 89, May 1977, Table 4.

POLICIES OF THE FEDERAL RESERVE BOARD WITH RESPECT TO THE REGULATION OF NONBANK ACTIVITIES OF BANK HOLDING COMPANIES

The determination of nonbank activities closely related to banking which bank holding companies are permitted to enter is a responsibility of the Federal Reserve Board under Section 4(c)(8) of the 1970 amendments to the Bank Holding Company Act. By late 1974, the Board had approved 21 general classes of nonbank activities as being permissible for bank holding companies but subsequently took a more cautious stance toward broadening the permissible areas. In its September 9, 1974 order declaring that the underwriting of mortgage guarantee insurance would not be an appropriate bank related activity, the Board stated that under current conditions it would be desirable for bank holding companies generally to slow their rate of expansion and to direct their energies principally toward strong and efficient operations within their existing modes, rather than toward expansion into new activities. While not representing a 180 degree turn in position, this view represents a very different philosophy than the Board expressed in its statement of principles of February 20, 1968 that bank holding companies should be allowed to enter certain nonbanking areas which would facilitate broader services for the public consistent with the continued growth and development of the economy.[36]

Initially, the Board's view was that banking management needed to move away from thinking like bankers and to think instead like corporate managers looking out over a related set of businesses which included one or more banks.[37] More recently, however, the Board expressed the view that bankers should devote more time to the business of banking and give reduced priority to expansion into new areas. However, the Board began to manifest disagreement as to whether all bank holding companies should be constrained or whether the permissible list should be closed to new activities until there has been a reversal of the emerging industry trend toward deteriorating capital ratios. The majority of the Board has opted for a policy which would restrain bank holding companies from adding to their debt burden by acquiring leveraged companies requiring periodic infusions of capital.[38]

The expansion of bank holding companies into nonbanking activities exposes a holding company's banks to new risks which could jeopardize the soundness of these banks. Holding companies' earnings have been adversely affected by the REIT disaster depressing their stock prices and their ability to raise sorely neded capital for their banks. Bank holding company legislation needs to provide more protection for the banks in the holding company from the risks of nonbanking affiliates; and to provide for closer supervision and regulation of the soundness of nonbank ventures entered into by bank holding companies.

Furthermore, a recent Federal Reserve Board study, *The Performance of Bank Holding Company-Affiliated Finance Companies*, by Stephen A. Rhoades and Gregory E. Boczar, found that after affiliation with a holding company the affiliated company was found to have higher interest and debt expense, lower profits, greater leverage, and higher growth than the independent companies. Moreover, affiliated companies, subsequent to affiliation, did not have lower losses, did not open more offices and did not have lower operating expenses than independent companies. The study did not confirm the arguments of bank holding companies that their entry into the consumer finance industry will yield numerous public benefits.

Section 301 of S. 72 seeks to address the concerns which we have just discussed, by changing the regulatory test to those activities which are directly related to banking and in which specific public benefits are shown. While we would agree that some bank holding companies have gone too far afield, we are concerned that an attempt to corral their activities may ensnare small bank holding companies engaged in longtime legitimate activities.

First, we reiterate our petition for an exemption for small one-bank holding companies with banking assets of less than $50 million and nonbanking assets of less than $15 million.

---

[36] Harvey Rosenblum, "Bank Holding Company Review 1973/74 Part I," *Business Conditions*, Federal Reserve Bank of Chicago, February 1975, p. 5.

[37] Jeffrey M. Bucher, "Bankers and the Bank Holding Company," Speech before the 79th Annual Convention of the Florida Bankers Association, June 23, 1973.

[38] *Op. Cit.*, Harvey Rosenblum, pp. 5–6.

Second, we believe that any nonbank services offered by a one-bank holding company should be limited to the primary service area of the main banking office.

Finally, we would support the grandfathering clause as set forth in Section 301(b) of S. 72 as a reasonable basis for allowing continued operations of existing companies.

THE IMPACT OF ANTITRUST ENFORCEMENT ON BANK HOLDING COMPANY EXPANSION

Antitrust enforcement under the Clayton and Bank Merger Acts has had a profound effect on bank mergers and bank holding company acquisitions of independent banks since the 1960's when the Supreme Court in the *Philadelphia National Bank* case made it clear that bank mergers were subject to the provisions of the Clayton Act. Initially, antitrust enforcement focused primarily on the application of the Clayton Act to horizontal bank mergers. Successful litigation of these cases closed the door to such mergers and prompted banks and bank holding companies to acquire banks located in markets in which they did not compete. This shift in acquisition policy gave rise to serious antitrust enforcement problems.[39]

The growth in importance of geographic market extension acquisitions by bank holding companies moved both the Federal Reserve Board and the Justice Department's Antitrust Division to broaden their horizons toward a concern for the protection of competition in statewide markets. The Antitrust Division, in challenging banking acquisitions of the geographic market extension type relied on the doctrine of potential competition in the absence of any evidence of competitive overlap in conventional local markets affected by the acquisition.

In moving against these mergers the government's main concern was the prevention of the domination of commercial banking in a state by a very few banking institutions. By challenging market extension bank mergers, the Antitrust Division was attempting to establish a rule that in effect said that the largest bank organizations in a state cannot acquire other large banking organizations where concentration is already high, i.e., where the top four banks or banking organizations in the state were doing well over half of the banking business in the state.[40]

In pursuit of the establishment of this rule, the Department filed 21 antitrust suits to enjoin mergers between banks operating in separate markets that it believed would have the effect of eliminating substantial potential competition. In eight consecutive potential competition cases, which were litigated, the District Courts ruled against the government. However, it was not until the Supreme Court ruled in *U.S.* v. *Marine Bancorporation, et al*, that the doctrine of potential competition was fully examined by the Courts. In its majority opinion sustaining the District Court, the Supreme Court held as follows:

"In applying the doctrine of potential competition, courts must, as we have noted, take into account the extensive federal and state regulation of banks. Our affirmance of the District Court's judgment in this case rests primarily on state statutory barriers to de novo entry and to expansion following entry into a new geographic market. In states where such stringent barriers exist and in the absence of a likelihood of entrenchment the potential competition doctrine—grounded as it is on relative freedom of entry on the part of the acquiring firm—will seldom bar a geographic market extension merger by a commercial bank. In states that permit free branching or multibank holding companies, courts hearing cases involving such mergers should take into account all relevant factors, including the barriers to entry created by state and federal control over the issuance of new bank charters. . . ."

The Court's decision in *Marine Bancorporation* makes it next to impossible for the government to challenge geographic market extension mergers by banks in states which limit branching or bank holding companies. The government's inability to utilize the doctrine of potential competition in challenging geographic market extension mergers by banks has the effect of immunizing such mergers from antitrust challenge in some 31 states which limit branching and/or bank holding companies. Unfortunately, this gap in antitrust enforcement will open the door to market extension mergers by bank holding companies in states which have consistenly had the lowest levels of concentration and is bound to

---

[39] "The Competitive Standard Utilized by the Department of Justice with Respect to Bank Holding Company Expansion," Remarks by Barry Grossman, Acting Deputy Assistant Attorney General, Antitrust Division, Apr. 8, 1974.

[40] "Bank Holding Company Expansion in the Southwest—An Antitrust Look," Remarks by Donald I. Baker, Director of Policy Planning, Antitrust Division, May 28, 1973.

result in substantial increases in banking concentration unless Congress acts to overturn the *Marine Bancorporation* decision and subject these mergers to challenge under the antitrust laws.

By way of background, it should be noted that the governments' reliance on the doctrine of potential competition in challenging market extension mergers by banks was necessitated by the narrow geographic scope adopted by the government and the Courts in defining relevant banking markets in horizontal merger cases. Bank holding companies, finding themselves foreclosed from making acquisitions of banks in their own geographic markets by the government's successful challenge of these mergers, turned to merger partners in more remote markets within their states. In the absence of evidence of a lessening of direct competition the government adopted the doctrine of potential competion to challenge these mergers. This doctrine held that the acquiring bank would be most likely to enter de novo the market of the bank to be acquired. The limitations now imposed on the government by *Marine Bancorporation* will necessitate changing existing legislation to broaden the geographic concept of the relevant market in which such mergers should be tested for competitive impact.

Sections 101 and 201 begin to address the problems of indiscriminate acquisition of independent banks for the sake of expansion with the resultant concentration of economic resources. As we have intimated we do not believe these provisions go far enough.

First, we would support these two sections provided the alternative permissible percentage limits are set at 10 percent. As we view the 20 percent limit, five holding companies, each with 20 percent of the state's banking assets could control the market—creating an unacceptably high level of concentration which will work to the detriment of the consumer. Additionally, the bill would exempt bank holding company acquisitions from the percent limit where necessary to prevent immediate failure of a bank. This brings into question the issue of the interstate acquisition of banks which, at one time, was advocated by the Federal Reserve Board. We strongly oppose this proposal and urge that the legislative history of S. 72 reflect the view that nothing in the Act should be construed to permit holding company acquisition across state lines.

Second, we believe that no merger or acquisition should be approved unless there is clear and convincing evidence of a public need. The utilization of such a new standard would obviate the problems currently faced by the regulators in enforcing the current Sherman and Clayton Act language, which has proved to be ineffective.

Third, we believe there should be a formal trial-type hearing conducted at the site of the proposed acquisition or merger, in every case.

Fourth, in conjunction with the hearing procedure, we would urge a requirement of prior disclosure and adequate administrative procedures designed to prevent secret bank takeovers. In some cases, multibank holding companies gain acceptances of tender offers by obtaining the signatures of the holders of the controlling shares one at a time. In this manner, control is acquired without the knowledge of other shareholders. The FTC tender offer rules recently promulgated would be a good starting point.

These recommendations, when adopted by this Congress will form the basis for the continuing viability of independent banking. We hope to work closely with this Committee in the days to come in pressing the early passage of S. 72 with our recommended changes. We appreciate the opportunity to appear before this Committee today and will be glad to answer any questions you may have regarding our statement.

Appendix Exhibit I.—Excerpts From the Legislative History of the Bank Holding Company Act of 1956

The legislative history of the Bank Holding Company Act of 1956 shows clearly that Congress was convinced that bank holding companies were thwarting national banking policy; that they posed a threat to competition in banking; and that immediate controls were urgently required. We believe it will be helpful to the Committee to have the pertinent parts of this history.

Following are excerpts from House Report No. 609, *supra*,:

"The need for immediate legislation which would at the same time control the future expansion of bank holding companies and force them to divest themselves of nonbanking business has been established to the complete satisfaction of your committee."

* * * * * * *

"Evidence developed during the hearings has convinced your committee that bank holding companies are not in accord with the very precepts upon which our banking system rests. The United States early in its history, it should be recalled adopted a democratic ideal of banking. Other countries, for the most part, have preferred to rely on a few large banks controlled by a banking elite. There has developed in this country, on the other hand, a conception of the independent unit bank as an institution having its ownership and origin in the local community and deriving its business chiefly from the community's industrial and commercial activities and from the farming population within its vicinity or trade area. Its activities are usually fully integrated with local economic and social organization. The bank holding company device threatens to destroy this democratic grassroots institution."

* * * * * * *

"Your committee believes that the destruction of the American unit banking system, resulting in the further concentration of credit facilities, would have revolutionary effects upon our free-enterprise system. Ultimately, monopolistic control of credit would entirely remold our fundamental political and social institutions."

* * * * * * *

"The time for action is now. We dare wait no longer, for already we are rapidly following the example of England whose many banks became the Big Five."

"While our banking structure has evolved down through the years to meet changing economic requirements, this country has held steadfast to the doctrine that competition should prevail in the banking industry. Our national banking policy has aimed at protecting and fostering the growth of independent unit banks."

* * * * * * *

"Your committee believes it is obvious that the declared will of Congress in favor of independent competitive banking is being thwarted by indirect branch banking, through the mechanism of the holding company."

* * * * * * *

"Independent unit banks, by their willingness to bear substantial local risks, have accelerated the economic development of the United States * * * As the Commercial and Financial Chronical has so well stated:

"'Unit banking is peculiarly suited to the genius of the American people, to the democratic republican form of government which we have developed, to the nature of our business and industrial organizations to our social institutions, and to the individualism which is the foundation of our national progress * * * Let us never despise the day of small beginnings nor the virtue inherent in small things.'

"Your Committee should like to reemphasize the fact that this is the only country left where most communities are served by home-owned and home-managed banks which are aware of and responsive to the needs of the people of their areas. Our independent banking system has been a vital factor in the development of the United States. Like yeast cells in a loaf of bread, each working in its immediate area, our banks scattered throughout the country have cooperated to produce the greatest and most general economic development the world has known.

"Other countries must depend on 3, 4, or 5 banks having up to thousands of branches. Policies and important credit decisions are made hundreds or thousands of miles from any of the branches. The interest of an enterprising local customer may run counter to that of a large main office account, in which event the former might suffer. This inevitably tends toward concentration in all lines, cartels, the stifling of new enterprises, and stagnation, what has been termed the 'mature economy.'"

* * * * * * *

"The holding company device lends itself readily to the amassing of vast resources obtaned largely from the public, which can be controlled by the relatively few who comprise the management of the holding company, giving them a decided advantage in acquiring additional properties and in carrying out a program of expansion. Such power can be used to acquire independent banks by measures which leave local management and minority stockholders little with which to defend themselves except their own protest * * *"

This House report was followed, in the second session of the 84th Congress, by Senate Report No. 1095, supra, from which we quote the following pertinent excerpts:

"In the opinion of your committee, public welfare requires the enactment of legislation providing federal regulation of the growth of bank holding companies and the type of assets it is appropriate for such companies to control."

* * * * * * *

"The dangers accompanying monopoly in this field are particularly undesirable in view of the significant part played by banking in our present national economy."

* * * * * * *

"It is upon the basis of these factors [the five factors of Sec. 3(c) of Act; 12 U.S. 1824(c)] that the Federal Reserve Board is to measure whether each application should be granted or denied in the public interest. It will be noted that these factors extend beyond the nature of those primary in importance to bank supervisory authorities in the exercise of their supervisory powers. * * * The factors required to be taken into consideration by the Federal Reserve Board under this bill also require contemplation of the prevention of undue concentration of control in the banking field to the detriment of public interest and the encouragement of competition in banking. It is the lack of any effective requirement of this nature in present Federal laws which has led your committee to the conviction that legislation such as that contained in this bill is needed."

Following are excerpts from House Report No. 1416 (U.S. Code, Cong. & Adm. News, 86th Cong., 2nd sess., 1960, p. 1995 et seq.) on the 1960 amendment to the FDIC Act, supra, controlling bank mergers and acquisitions of bank assets. While this act is not directly applicable to this review, the House report views the banking scene at the time the Pipistone bank acquisition was being considered by the Board, and constitutes the most recent expression of our national banking policy.

"Vigorous competition in banking stimulates competition in the entire economy, in industry, commerce, and trade. There is no question that competition is desirable in banking, and that competitive factors should be considered in all aspects of the supervision and regulation of banks.

* * * * * * *

"The number of commercial banks in the United States has been slowly but steadily declining in the past ten years."

* * * * * * *

"The large numbers of mergers in recent years, the vast resources involved in these mergers, and the increases in the size of large banks, particularly those which have grown through mergers, all give rise to concern for the maintenance of vigorous competition in the banking system and in the industry and commerce served by the banking system. The reduction in the number of banks and the loss of competition between merged banks also give rise to concern."

* * * * * * *

"Sad experiences in our history have demonstrated that to maintain a sound banking system in this country banks must be regulated much more strictly than ordinary businesses."

* * * * * * *

"Where demonstrable benefits would flow from a proposed merger, these should be weighed against any adverse effect on competition. * * *"

* * * * * * *

"We do however reject the philosophy that doubts are to be resolved in favor of bank mergers. At the risk of saying the same thing another way, we feel the burden should be on the proponents of a merger to show that it is in the public interest, if it is to be approved.

"After all the factors have been weighed, the transaction should be approved only if the supervisory agency is satisfied that, on balance, its effect will be beneficial."

APPENDIX TABLE NO. 1.—50 LARGEST BANK HOLDING COMPANIES RANKED BY ASSET SIZE, DECEMBER 1976

Rank	Company	Total assets (millions)	Type of holding company: Multibank	Type of holding company: 1 bank
1	BankAmerica Corp., San Francisco, Calif.	$73,913		X
2	Citicorp, New York, N.Y.	64,282	X	
3	Chase Manhattan Corp., New York, N.Y.	45,600	X	
4	Manufacturers Hanover Corp., New York, N.Y.	31,483	X	
5	J. P. Morgan & Co., New York, N.Y.	28,353		X
6	Chemical New York Corp., New York, N.Y.	26,614	X	
7	Bankers Trust New York Corp., New York, N.Y.	22,249	X	
8	Continental Illinois Corp., Chicago, Ill.	21,974		X
9	First Chicago Corp., Chicago, Ill.	19,834		X
10	Western Bancorporation, Los Angeles, Calif.	19,672	X	
11	Security Pacific Corp., Los Angeles, Calif.	16,401		X
12	Wells Fargo & Co., San Francisco, Calif.	12,969		X
13	Marine Midland Banks, Inc., Buffalo, N.Y.	10,719	X	
14	Crocker National Corp., San Francisco, Calif.	10,711		X
15	Charter New York Corp., New York, N.Y.	10,209	X	
16	Mellon National Corp., Pittsburgh, Pa.	9,353		X
17	First National Boston Corp., Boston, Mass.	8,498	X	
18	Northwest Bancorporation, Minneapolis, Minn.	8,358	X	
19	First Bank System, Inc., Minneapolis, Minn.	7,844	X	
20	National Detroit Corp., Detroit, Mich.	7,552	X	
21	First Pennsylvania Corp., Philadelphia, Pa.	7,200		X
22	First International Bancshares, Inc., Dallas, Tex.	7,167	X	
23	Republic of Texas Corp., Dallas, Tex.	6,521	X	
24	Seafirst Corp., Seattle, Wash.	5,310		X
25	First City Bancorporation of Texas, Inc., Houston, Tex.	5,256	X	
26	Bank of New York Co., Inc., New York, N.Y.	5,202	X	
27	NCNB Corp., Charlotte, N.C.	4,433		X
28	Union Bancorp, Los Angeles, Calif.	4,233		X
29	Philadelphia National Corp., Philadelphia, Pa.	4,151		X
30	First Wisconsin Corp., Milwaukee, Wis.	4,035	X	
31	Nortrust Corp., Chicago, Ill.	3,805		X
32	BancOhio Corp., Columbus, Ohio	3,595	X	
33	Wachovia Corp., Winston-Salem, N.C.	3,560		X
34	Southeast Banking Corp., Miami, Fla.	3,394	X	
35	Pittsburgh National Corp., Pittsburgh, Pa.	3,363		X
36	Citizens & Southern National Bank, Citizens & Southern Holding Co., Savannah, Ga.	3,159	X	
37	Mercantile Bancorporation, Inc., St. Louis, Mo.	3,113	X	
38	Fidelcor, Inc., Rosemont, Pa.	3,105		X
39	Rainier Bancorporation, Seattle, Wash.	3,055		X
40	Lincoln First Banks, Inc., Rochester, N.Y.	2,806	X	
41	Maryland National Corp., Baltimore, Md.	2,787		X
42	United Virginia Bankshares, Inc., Richmond, Va.	2,602	X	
43	Barnett Banks of Florida, Inc., Jacksonville, Fla.	2,444	X	
44	Shawmut Corp., Boston Mass.	2,419	X	
45	First National State Bancorporation, Newark, N.J.	2,347	X	
46	First Security Corp., Salt Lake City, Utah	2,322	X	
47	First Union Corp., Charlotte, N.C.	2,308		X
48	American Fletcher Corp., Indianapolis, Ind.	2,296		X
49	Industrial National Corp., Providence, R.I.	2,208		X
50	First National Holding Corp., Atlanta, Ga.	2,141		X
	Total	566,925	27	23

Sources: "Bank Holding Company Facts", spring, 1977 edition, Association of Bank Holding Co., Washington, D.C.; "Bank Holding Companies and Subsidiary Banks as of December 31, 1976" Federal Reserve Board.

APPENDIX TABLE NO. 2.—1-BANK HOLDING COMPANIES WITH DOMESTIC DEPOSITS OF $1,000,000,000 OR MORE AS OF DEC. 31, 1976

Deposit bank	Holding company	Commercial bank	Location	Domestic deposits of bank (millions)
1	Bank America Corp	Bank of America, N.T. & S.A.	San Francisco	$33,502
2	Chase Manhattan Corp	Chase Manhattan Bank N.A.	New York	19,957
3	Security Pacific Corp	Security Pacific National Bank	Los Angeles	10,549
4	J. P. Morgan & Co., Inc	Morgan Guaranty Trust Co	New York	9,766
5	Wells Fargo & Co	Wells Fargo Bank, N.S	San Francisco	9,616
6	Continental Illinois Corp	Continental Illinois National Bank	Chicago	8,724
7	First Chicago Corp	First National of Chicago	Chicago	8,361
8	Crocker National Corp	Crocker National Bank	San Francisco	8,140
9	Marine Midland Banks, Inc	Marine Midland Bank	Buffalo	6,392
10	Mellon National Corp	Mellon Bank, N. A	Pittsburgh	5,025
11	First Pennsylvania Corp	First Pennsylvania Bank, N. A	Philadelphia	3,351
12	Union Bancorp., Inc	Union Bank	Los Angeles	3,250
13	Bank of New York Co., Inc	Bank of New York	New York	3,226
14	Wachovia Corp	Wachovia Bank & Trust Co	Winston-Salem	2,611
15	U.S. Bancorp	United States National Bank	Portland, Oreg	2,483
16	Pittsburgh National Corp	Pittsburgh National Bank	Pittsburgh	2,436
17	Philadelphia National Corp	Philadelphia National Bank	Philadelphia	2,397
18	NCNB Corp	North Carolina National Bank	Charlotte, N. C	2,369
19	Nortrust Corp	Northern Trust Co	Chicago	2,368
20	Bancal Tri-State Corp	Bank of California, N. A	San Francisco	2,211
21	Girard Co	Girard Trust Bank	Bala Cynwyd, Pa	2,073
22	Fidelcor, Inc	Fidelity Bank	Rosemont, Pa	1,810
23	Equimark, Corp	Equibank, N. A	Pittsburgh	1,539
24	First Union Corp	First Union National Bank of North Carolina.	Charlotte, N. C	1,481
25	Hartford National Corp	Hartford National Bank & Trust Co	Hartford	1,476
26	Industrial National Corp	Industrial National Bank of Rhode Island.	Providence	1,399
27	American Fletcher Corp	American Fletcher National Bank & Trust Co.	Indianapolis	1,370
28	Republic New York Corp	Republic National Bank of New York	New York	1,323
29	Lloyds First Western Corp	Lloyds Bank, California	Wilmington, Del	1,299
30	Indiana National Corp	Indiana National Bank	Indianapolis	1,247
31	Provident National Corp	Provident National Bank	Philadelphia	1,206
32	Whitney Holding Corp	Whitney National Bank of New Orleans	New Orleans	1,123
33	Hawaii Bancorp., Inc	Bank of Hawaii	Honolulu	1,083
34	Walter E. Heller International Corp.	American National Bank & Trust Co	Chicago	1,082
35	Northwestern Finance Corp	Northwestern Bank	North Wilkesboro, N. C.	1,057
36	National Central Finance Corp	National Central Bank	Lancaster, Pa	1,010
	Total deposits			168,312

Source: "Bank Holding Companies and Subsidiary Banks as of December 31, 1976" Federal Reserve Board.

The CHAIRMAN. Thank you very much, Mr. Peterson, for a fine summary.

Our last witness this morning is Mr. John Geilfuss, a distinguished citizen of Wisconsin. Mr. Geilfuss has a fine record not only in banking but in many other respects in our State and he's chairman of an outstanding bank holding company in Wisconsin, the Marine Corp.

You also have a rather detailed statement. We would appreciate it if you could possibly boil it down to 10 minutes.

Mr. GEILFUSS. I will abbreviate it.

The CHAIRMAN. We will print the full statement in the record.

STATEMENT OF JOHN C. GEILFUSS, CHAIRMAN, EXECUTIVE COMMITTEE, THE MARINE CORP., MILWAUKEE, WIS., ACCOMPANIED BY DONALD L. ROGERS, PRESIDENT OF THE ASSOCIATION OF BANK HOLDING COMPANIES

Mr. GEILFUSS. Mr. Chairman and members of the committee, it's a real pleasure to appear before you. I had an opportunity to appear last May before you on S. 71 and I was delighted to be able to speak in favor of all of it, but, unfortunately, this time I am not in that same position. I am here on behalf of the Association of Bank Holding Companies and Donald L. Rogers, its president, is with me. As you all know our association is a voluntary trade association established in 1958 to represent bank holding companies regulated by the Federal Reserve Board.

In addition to the positions named in my prepared testimony, I am also serving this year as president of the Wisconsin Bankers Association. In this capacity I have had the privilege of meeting with many of the 618 members of the association throughout Wisconsin. It may come as a shock to some, but we in the holding company movement in Wisconsin get along quite well with our colleagues who hail from unit banks. Traditionally, we have preferred to view banking as banking rather than to engage in philosophical disputes. We believe strongly in Wisconsin that there is a role for both bank holding companies, large and small, and for independent banks. The spirit of cooperation, accommodation, and compromise, which has been evidenced in our work in Wisconsin with consumer groups on such items as the Wisconsin Consumer Act and our electronic funds transfer legislation and rules, has functioned equally well in establishing and governing the State's interbank relationships. We feel the present Federal laws, administered by the Federal Reserve with overview by the Department of Justice, have protected quite adequately the interests of bank holding companies, their competitors, and the public at large. We see no need for imposing any further restraints on bank expansion from Washington.

[Complete statement follows:]

STATEMENT OF THE ASSOCIATION OF BANK HOLDING COMPANIES

Mr. Chairman and members of the committee, my name is John C. Geilfuss, and I am chairman of the executive committee of The Marine Corporation, Milwaukee, Wisconsin. I am appearing here today on behalf of the Association of Banking Holding Companies. Accompanying me is Donald L. Rogers, president of our association.

Our association is a voluntary trade association established in 1958 to represent bank holding companies regulated by the Federal Reserve Board ("Board") pursuant to the Bank Holding Company Act of 1956 ("Act"). We agree with the Board, the Comptroller of the Currency and the Federal Deposit Insurance Corporation that the provisions of S. 72 would drastically change the future regulation of bank holding companies and banks. Therefore, we have a vital interest in this bill, and we appreciate having this opportunity to present our views.

The provisions of S. 72 raise a host of issues fundamental to the structure and operation of commercial banking in the United States. In the course of this statement, we intend to deal with these issues in turn. But to do so effectively, we believe it is imperative that a record be made of what has transpired in the implementation of the Act, particularly since the enactment of the 1970 amendments to the Act. Unless this historical perspective is set forth, there is a danger that proposals will be made, and responses provided, without the benefit of the factual data that is needed to permit an informed judgment.

BANKING HOLDING COMPANIES PRIOR TO 1956

Although bank holding companies first appeared in the United States around the turn of the century, the first substantial number of companies was organized in the late 1920's. The Banking Act of 1933 recognized the existence of these companies and subjected those companies affiliated with Federal Reserve member banks to certain restrictions and to limited surveillance by the Board.

During the 1930's and 1940's, bank holding companies grew moderately in size and number. After World War II, concern was expressed by the Federal banking agencies and by some members of the Congress that the unregulated acquisition of banks and nonbanking businesses by bank holding companies could cause potential problems in the future. These concerns led to the enactment of the Bank Holding Company Act of 1956.

THE 1956 ACT

The 1956 Act gave the Board authority to regulate bank holding companies controlling two or more banks. In regard to bank acquisitions, prior approval of the Board was required for each acquisition and no bank could be acquired outside the home state of the bank holding company unless the state to be entered specifically authorized such acquisitions. Bank holding companies operating in more than one state were "grandfathered" by the 1956 Act. The limited authority for bank holding company entry into nonbanking businesses was further restricted by interpretation to those activities where there was a significant and direct connection between the activity and the business of managing and controlling banks. By the end of 1956, 53 companies had registered with the Board. The banks affiliated with these companies held 7.5 per cent of total commercial bank deposits.

THE 1966 AMENDMENTS

In 1966, the Congress amended the Act to incorporate a number of technical changes necessitated by the Board's experience in administering the Act. More significantly, the amendments established new competitive standards for future acquisitions of banks parallelling the provisions of the Bank Merger Act of 1966. In effect, Congress applied traditional antitrust standards to these future acquisitions, and required that the Board take them into account in reaching decisions on individual applications. Moreover, the Justice Department was explicitly given the opportunity to challenge in court Board decisions approving any future acquisitions of banks. Since this provision relates to later discussion, I should like to quote the provision now (Section 3(c)):

(c) The Board shall not approve—

(1) any acquisition or merger or consolidation under this section which would result in a monopoly, or which would 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, or

(2) any other proposed acquisition or merger or consolidation under this section whose effect in any section of the country 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 it finds that the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served.

In every case, the Board shall take into consideration the financial and managerial resources and future prospects of the company or companies and the banks concerned, and the convenience and needs of the community to be served.

The effect of this provision in the Act is to establish uniform standards for the Board and the courts in evaluating the legality of the acquisition of banks by bank holding companies. These provisions assure the preservation of the public's interest in the promotion of free and fair competition. Bank holding companies are required to furnish the Board a great deal of specific information when submitting their applications for the acquisition of banks, and the Board supplies copies of the applications to the Department of Justice for comment. Because of the extensive nature of the information sought by the Board, the preparation of applications has become a specialized undertaking of its own, consuming more and more human and financial resources. In many cases, the Board's staff will seek additional data in order to clarify or add to information already in hand. The result of this process is the compilation of exhaustive data that serves as a basis for the Board's decision on each application. Each such decision is subject to challenge by the Justice Department and to review by the Federal Court of Appeals.

We believe this process, while costly to the applicant holding companies, fully meets the Congressional concern expressed in the Act to carefully weigh as to each application: (1) the competitive consequences; (2) the financial and managerial resources and future prospects of the institutions involved; and (3) the convenience and needs of the communities to be served. To propose further restrictions on bank holding company acquisitions suggests that the existing provisions and related administration are inadequate. Our Association believes very strongly that the present statutory safeguards have proven more than adequate to protect the public interest. We believe the evidence provided by the Board's administration of the Act supports this view. It is incumbent on proponents of additional restrictive proposals to come forward with more than undocumented assertions that the operation of present law is inadequate.

By the end of 1966, there were 65 bank holding companies regulated by the Board, and banks affiliated with these companies held 11.6 per cent of commercial bank deposits.

THE 1970 AMENDMENTS

As indicated earlier, the 1956 Act applied only to holding companies owning or controlling two or more banks. In the late 1960's, public officials became concerned about the growth of corporations controlling only one bank, the so-called "one-bank holding companies", the nonbank activities of which were unregulated. This concern was the principal cause of the enactment of the 1970 Amendments to the Act.

As we see it, the major purposes of the 1970 legislation were as follows:

(1) *Regulation of One-Bank Holding Companies.*—The Amendments extended the provisions of the Act to cover corporations and partnerships owning or controlling one bank. The impact of this provision is illustrated by the fact that the number of bank holding companies regulated by the Board increased during the first year of the Board's administration of the 1970 Amendments from 121 companies (as of December 31, 1970) to 1,567 a year later. Since 1971, the number of bank holding companies registered with the Board has increased at a much slower rate and at the end of 1976, there were 1,912 registered companies.

It is important to recognize that much of the "growth" in bank holding company assets that has occurred in recent years has simply been the result of the decisions of bank managements to reorganize into a holding company format. Obviously, when a bank converts to a one-bank holding company, that action adds nothing to aggregate concentration in local, state or national banking markets. This fact is so central to our discussion that I should like to comment on it in greater detail.

The effect of the movement to the holding company structure in commercial banking, and the enactment by Congress of the 1970 Amendments, was to produce a gigantic one-time jump in the amount of banking deposits controlled by bank holding companies. At the time of the 1970 Amendments, deposits in multiple bank holding companies' bank subsidiaries came to 16.2 per cent of total bank deposits ($78.1 billion). Total deposits in subsidiary banks of one-bank holding companies at that time came to about 38 per cent of total bank deposits ($191 billion). Combining the deposit totals for the two types of holding companies can make it appear that an undesirably large expansion in bank holding companies occurred when, in fact, all that took place was a corporate restructuring in many hundreds of banks. This restructuring produced no change in the underlying deposits or competitive position of the individual institutions. Accurate analysis of banking data related to competition clearly requires more than simply coming up with rough aggregations of measures such as total bank holding company deposits. (See "Aggregate Bank Competition and the Competition in Banking Act of 1975" by Manfred O. Peterson, *Issues in Bank Regulation*, Bank Administration Institute, Summer 1977, p. 37.)

Because of the evolution of the Act and the efforts by the Board to conscientiously administer it, a wealth of data has been assembled that has been utilized by researchers to develop measures to indicate degrees of competition in markets for banking and other services offered by bank holding companies. A recent study, "Concentration Ratios and Commercial Banking: Use and Limitations", commissioned by our Association and conducted by Golembe Associates, illustrates the limited value of using ratios to measure concentration. Another study, by Samuel H. Talley of the Board's staff, reporting on trends in aggregate concentration in banking, deserves the particular attention of the Committee. Mr. Talley found that, during the period 1968 to 1975, nationwide concentration (the per cent of total domestic deposits held by the 100 largest banking organizations) fell 1.1 percentage points, from 49.0 to 47.9 per cent. This contrasts with the experience of the period 1957 to 1968, when nationwide concentration rose slightly from 48.2 per cent to 49.0 per cent.

It should also be noted that the percentage of commercial bank deposits held by all banks affiliated with bank holding companies has *declined* from 68.1 percent in 1974 to 67.1 percent in 1975 to 66.1 percent in 1976.

We agree that all data of this nature should be used judiciously because concentration in banking markets can be judged on different levels—international, national, regional, state and local—and by different measurements. Nevertheless, the data do at least provide a caution to those who might be unduly impressed by simple aggregations of numbers.

(2) *Expansion of Section 4(c)(8) Activities.*—Another important result of the 1970 Amendments was revision of section 4(c)(8) of the Act to permit bank holding companies to broaden the range of financial services offered to the public. The old language of the section, as interpreted by the Board, had been recognized as unnecessarily constricting and as thwarting efforts by bank holding companies to meet the financial needs of their customers. There had been fewer than 30 approvals by the Board under the old language and almost all of these related to insurance activities. When Board Chairman Burns testified before the Senate in 1970, he outlined the scope of activities that the Board might consider permissible under the proposed amendment to section 4(c)(8):

". . . In the Board's judgment, authorized subsidiaries might well include those engaged in lending funds on their own account or for the account of others; acting as investment adviser; operating a 'no-load' mutual fund; leasing equipment where the lease is really a form of security for financing; performing insurance functions in connection with services offered by other subsidiaries; providing bookkeeping or data processing services; originating, servicing, and selling mortgage loans; acting as travel agent or issuing travelers checks; and making equity investments in community rehabilitation and development corporations engaged in providing better housing and employment opportunities for people of low or moderate incomes." (Senate Committee on Banking and Currency, Hearings on One Bank Holding Company Legislation of 1970, May 14, 1970, page 142.)

After extensive hearings, the Board has adopted regulations (Regulation Y) authorizing all of these activities with certain limitations and conditions, except those of operating a "no-load" mutual fund and of acting as travel agent. The Board's list of permissible activities also includes trust services, full pay-out leasing of real property, courier services and consulting services for non-affiliated banks, subject to restrictions in each instance. We submit that these approved activities are not only "closely related to banking", as required by the statute, but actually are "banking" in the sense that many banks have engaged directly in virtually all of these activities for a number of years.

It is important to note that section 4(c)(8), as amended in 1970, requires the Board in passing on each individual application to engage in a "closely related" activity to determine also: . . . whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased 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 . . .

The Board has taken its regulatory responsibilities under section 4(c)(8) very seriously. Much time, effort and expense has gone into sophisticated and thorough analyses to provide the Board with information on which to base its decisions in light of the statutory purpose. As an example of the care with which the Board has proceeded, it is useful to list the activities the Board has found to be impermissible for bank holding companies under section 4(c)(8):

(*a*) Insurance premium funding—that is, the combined sale of mutual funds and insurance (*b*) Underwriting life insurance that is not sold in connection with a credit transaction

(*c*) Real estate brokerage

(*d*) Land development

(*e*) Real estate syndication

(*f*) Management consulting for nonbanking organizations

(*g*) Property management not part of trust activities

(*h*) Acting as travel agent

(*i*) Savings and loan association

We have not agreed with all of these decisions of the Board, but we do believe it is entirely clear that the Board has strictly construed the language of section 4(c)(8).

(3) *Public Benefits.*—As indicated in the above-quoted portion of section 4(c)(8), Congress was concerned that, in allowing bank holding companies to engage in activities under section 4(c)(8), the Board should perceive public benefits. One aspect of this concern is that Congress expressly provided in section 4(c)(8) an encouragement for de novo entry into permissible activities, so that new sources of competition for financial services could more readily emerge as consumer alternatives to established businesses. The overwhelming majority of applications approved by the Board under section 4(c)(8) have been for de novo activities as opposed to the acquisition of going concerns. We estimate that more than 80 percent of the applications approved have been for the establishment of new businesses.

Another concrete example of how the public has benefitted from bank holding companies' engaging in approved activities shows up in credit life insurance underwriting. The first two applications approved by the Board, in February 1973, contained commitments from the applicants to reduce premium rates on credit life insurance by 15 percent in one case and from 7 to 20 percent in the other. (See applications of Fourth Financial Corporation to retain Fourth Financial Insurance Company and Industrial National Corporation to acquire Consumer Life Insurance Company.) This same pattern of reduced premium rates or increased policy benefits has been followed in all credit life insurance applications approved by the Board since then.

The Board's decisions on numerous applications are replete with examples of its insistence on the need for applicants to demonstrate how their proposals are expected to benefit the public. The Board has required specifics, Board generalities are not sufficient.

A detailed analysis of benefits to the public in section 4(c)(8) acquisitions is found in the study by Golembe Associates entitled "Evaluation of Public Benefits Arising from Bank Holding Company Nonbank Expansion."

(4) *Protection of Competitors.*—Congress in 1970 amended the Act to make sure that in the interests of competitors in section 4(c)(8) activities were respected. The Board has adopted procedures to assure competitors of an opportunity to participate in proceedings to formulate regulations and to express their views on individual applications filed pursuant to the Board's regulations. They also may avail themselves of the judicial review provisions of the Act. It is extraordinary that competitors, even potential competitors, can by statutory authority intervene to prevent someone else entering into business in competition against them. To put it mildly, our competitors have not been timid in availing themselves of the opportunities provided for them.

The procedures now in effect can be well illustrated by the protracted history associated with the consideration by the Board of the conduct of insurance agency activities by bank holding companies. Banks traditionally have engaged directly or indirectly in the insurance agency business, and prior to the 1956 Act, this was true also of bank holding companies. Although the language controlling the Board's authority in this area under the 1956 Act was narrowly drawn and interpreted, the Board prior to 1970 recognized that this activity was in the public interest and had acted to permit bank holding companies to acquire subsidiaries that served as insurance agencies where the insurance was related to the business of the companies' bank subsidiaries. Senator Bennett of Utah, one of the Senate Conferees, alluded to this fact during the Senate debate on the Conference Committee Report on the 1970 Amendments, when he had the following discussion with the Senate Banking Committee Chairman, Senator Sparkman of Alabama:

"Senator Bennett: . . . The Federal Reserve Board under the existing language of section 4(c)(8) for the past 14 years has approved insurance activities for bank holding companies, and there was no intent on the part of the conference committee to overrule these past decisions. Furthermore, the new language of section 4(c)(8) clearly gives the Federal Reserve Board broader discretion than it now has to make determinations of permissible activities. Federal Reserve Chairman Burns stated in his testimony before our committee that the Board believed that insurance was one of the activities bank holding companies should be permitted to engage in. Therefore, the Board will have ample authority to approve insurance activities, and we expect the Board will do so when it considers them proper.

"I should like to ask the chairman, the Senator from Alabama, whether he agrees with this.

"Senator Sparkman: I feel that is a fair statement. I suppose it might be well to point out, as the Senator from Michigan will recall, that the House bill had in it the so-called 'laundry list'. We decided in the Senate that that was not the way to handle the matter. First of all, we did not know whether we could include all of them. We do not know what the situation will be 10 years in the future, and so forth.

"We reached a decision that the whole thing ought to be flexible, that it ought to be lodged in the hands of the Federal Reserve Board to carry out the guidelines we set. I think the answer would be that it is left in that manner." (Daily Congressional Record, December 18, 1970, page S. 20645.)

In view of this past history, it came as no surprise when, on January 29, 1971, the Board issued its first proposed regulation under the amended section 4(c)(8), the following activity was included:

(7) Acting as insurance agent or broker principally in connection with extensions of credit by the holding company or any of its subsidiaries;

All interested parties were given an opportunity to submit comments to the Board on this proposal. Subsequently, at the request of the insurance agents, the Board announced that it would hold a hearing on the proposed insurance agency activity. A hearing was held May 12, 1971, and the insurance agents and other interested parties participated. Following this hearing, the Board on August 5, 1971, amended its proposal and adopted a final regulation effective September 1, 1971, permitting a bank holding company, with prior Federal Reserve approval, to engage in the insurance agency activity under certain conditions.

Pursuant to this regulation, a number of bank holding companies filed applications beginning in September 1971 to engage in this activity. However, representatives of the insurance agents objected to these applications and requested hearings on each individual application.

In March 1973, the Board announced that the hearings requested by the insurance agents on the pending insurance agency applications would be held before an administrative law judge (hearing examiner). The hearings were held beginning June 11, 1973. The administrative law judge rendered a decision on one application September 7, 1973, and on five other applications November 9, 1973. The Board in January 1974 approved one of these applications, subject to certain conditions, and the insurance agents filed a petition for a review of the Board's decision with the Court of Appeals. In September 1977, that court rendered a final decision, and last month the Supreme Court denied certiorari. Subsequently, the Board approved additional applications in July 1974 and September 1974, with the last group of approvals being announced July 14, 1975. These decisions were also appealed by the insurance agents and the court cases are still pending.

Clearly, the interests of the insurance agents have been well protected. But the fact that the final decision in some cases has been delayed for over six years, with no certainty that final resolution is imminent, raises other questions of equity.

While these cases have dragged on, competition has been stifled, substantial costs, including but not limited to attorneys' fees, have been incurred, and the regulatory process has gained further notoriety. Arriving at equitable public policy decisions is a complex and demanding task, and we readily accept the need for federal regulation of bank holding companies. At some point, however, a line needs to be drawn between giving opponents of an action a fair hearing, on the one hand, and the suppression of fair competition and the distortion of free market forces, on the other.

Needless to say, we believe Congress should focus on ways of permitting regulatory decisions to be more timely. More timely decisions will save money, and hold out the promise of increased competition, leading to benefits to the consumer in lower costs and wider choices. At the very least, Congress should not encourage measures that will increase paperwork, raise costs, and promote delays in regulatory actions. Today's economy is not working the way our economy did ten or twenty years ago, and some of the blame has to go to the enormous increases in work and costs needed to accomplish relatively simple objectives, such as opening a new business. Our nation simply cannot afford to allow federal regulatory policy, no matter how well meaning, to stifle competition, smother businessmen in paperwork, and raise prices.

(5) "*Tie-Ins.*"—Congress evidenced its concern with possible unfair competitive practices by adopting section 106 of the 1970 Amendments. This provision specifically prohibits "tie-ins" involving bank holding companies and banks, and is in addition to the general federal antitrust law prohibitions against "tie-ins" and other coercive practices. The effectiveness of section 106 was emphasized in a speech by Donald I. Baker, then Director of Policy Planning in the Antitrust Division of the Department of Justice:

"The Department of Justice supported section 106 in 1970 as a useful and workable provision. We are delighted to see this vindicated by broad-scale compliance since then." (*The Bank Holding Company Amendments Revisited*, July 20, 1972, American Bankers Association National Governmental Affairs Conference.)

We are pleased that there has been no change in the Justice Department's view since that time, as is shown by the statement of Russell T. Baker, Jr., Deputy Assistant Attorney General, that: ". . . we believe that the general compliance noted by the Department in 1972 is continuing." (Subcommittee on Financial Institutions Supervision, Regulation and Insurance, House Committee on Banking, Finance and Urban Affairs, Hearings on *The Safe Banking Act*, H.R. 9086, Part 3, September 20, 1977, p. 1577.)

BANK HOLDING COMPANIES TODAY

We believe that the overall goals Congress sought in enacting the 1956 Bank Holding Company Act, and the subsequent amendments to the Act, have been achieved. We believe the Board should be commended for its accomplishments in administering the Act over the years and particularly for its conscientious implementation of the Act as broadened by the 1970 Amendments. There is no doubt that bank holding companies are subject to detailed and comprehensive regulation, but regulation resulting in clear benefits to the economy in the addition of new services and jobs. We support the Board's proposals contained in S. 71, which the Senate passed last year, for additional penalties and remedies. which would enhance the execution of the Act. Beyond that, the Congress should encourage the Board to administer the Act with the foremost aim of allowing bank holding companies to better serve the public.

This goal can be accomplished with minimal additional legislation. The framework to assure full and fair competition exists in the Act, the regulation and supervision thereunder by the Board, and in the antitrust laws. To go beyond these proven safeguards and impose additional constraints on top of those that now exist would serve only to impede innovation, and would erect barriers against competition while creating areas of privilege for a selected few.

We submit that Congress should be proud of the results of its legislative efforts in the bank holding company field. By legislating wisely and avoiding draconian measures, Congress has permitted bank holding companies, both large and small, the flexibility necessary to meet the needs of their communities for increasingly sophisticated financial services. Through their banking and other affiliates, bank holding companies offer even small communities a wide range of financial services otherwise available only from large banks or banks with extensive branching systems. This is especially important in small towns and cities traditionally served by small banks. A holding company bank in such a community is a local institution which, through affiliation with the parent holding company, is capable of satisfying the growing consumer demands for financial services inherent in a dynamic economy. Thus, the bank holding company has proven to be a flexible instrument capable of meeting the diverse needs of American consumers in populous and sparsely populated areas, in cities and in agricultural areas, making new financial innovations available to a broad spectrum of the nation's people.

Employees of bank holding companies benefit as well. The bank holding company provides its employees with all of the advantages of larger organizations, including salary, insurance, medical and retirement benefits, that small organizations find difficult to match. In addition, employees of bank holding companies and their affiliates benefit from extensive training programs, varied job experiences, and greater opportunities for advancement. In fact, many of the Association's members have pioneered job training and placement programs designed to help job applicants from disadvantaged backgrounds become productive citizens. Only the extensive managerial support possible in such institutions as a bank holding company can carry out such an ambitious undertaking.

And, we emphasize, over all of this activity presides the Board, charged by Congress to insure that bank holding companies, no matter how large or how small, comply with the law and conduct their activities in a pro-competitive manner so as to provide public benefits.

COMMENTS ON S. 72

We believe that the record outlined above regarding the regulated activities of bank holding companies leads inexorably to the conclusion that S. 72 is not needed and would be detrimental. The Board's stewardship of its responsibilities under the Act has been characterized by cautious, conscientious and, when appropriate, firm administration. The Board has moved with characteristic expertise and care in authorizing formations of bank holding companies and in approving acquisitions of banks by the regulated companies. In addition, we believe the Board has administered the provisions of section 4(c)(8) in an extremely conservative manner. In fact, we see little likelihood that the Board will permit any significant expansion of bank-related activities any time soon. Virtually all of the bank-related activities approved up to now have been functions that banks have carried on themselves for decades.

In light of the close and constant supervision and oversight of the Board, and the conservatism of its regulatory policy, it would be unfortunate if the Board were foreclosed from acting at some future time to approve activities for bank holding companies that seem well suited to them and that promise public benefits. The only beneficiaries of such a rigid policy would be other businessmen who are not subject to federally imposed restrictions on their activities. Certainly, consumers would gain nothing from a deliberate federal policy of limiting competition.

Let me turn now to a section-by-section commentary on S. 72.

Section 1.—This section proposes that the bill be entitled the "Competition in Banking Act." We believe our testimony will show that this title is a misnomer.

Section 2.—We have grave reservations about the accuracy of the assertions contained in this section. Has concentration of banking resources "continued unabated"? If the findings of Mr. Talley cited earlier can be given credence, the trend in recent years has been for banking to become less, rather than more, concentrated. An official of the Justice Department testified in 1975 before this Committee's Subcommittee on Financial Institutions that, on a national basis, banking is "one of the most unconcentrated major industries in the country." (Joe Sims, Acting Deputy Assistant Attorney General, Subcommittee on Financial Institutions, Hearings on S. 890, July 28, 1975, page 91.)

In considering local banking markets—which are the basic competitive units—the degree of concentration varies. Where significant degrees of concentration exist, however, the cause can frequently be traced to artificial limitations imposed on new entrants into those markets. A typical impediment would be a restrictive state branching law or a law against multiple bank holding companies. The distinguished Chairman of your Subcommittee on Financial Institutions has undertaken a reexamination of the statutory restrictions on multiple office banking. We are in complete agreement that a study of this nature is badly needed and long overdue. We would go further and argue that the effect of these laws over time has been to insure pockets of monopoly and to reinforce tendencies toward undue concentration. The remedy for this ill lies in removing the artificial barriers preventing competition among banks while continuing to assure that the resulting competition will be fair.

Section 2(b) asserts that "an increasing share of . . . banking resources" has come under the control of bank holding companies. Technically this is undeniably true, as we indicated earlier, because of the conversion of many banks to the holding company format, but it is not meaningful from the standpoint of public policy. Again, we would cite Mr. Talley's paper as providing an objective analysis of the concentration issue.

Section 2(c) of the bill asserts that some of the services offered by bank holding companies go "beyond those directly related to banking" and have eroded "the line between banking and commerce in the nation." This is a puzzling "finding" since, as we have noted already, virtually all of the activities approved for bank holding companies by the Board have been carried on by banks themselves for many years.

We have previously named the limited activities that the Board, after exhaustive consideration, has listed in its regulation as permissible for individual bank holding companies, on application, to engage in under section 4(c)(8) of the Act as amended in 1970. Such activities, we emphasize, have been carefully circumscribed by the Board either in its regulations or interpretations, or by its orders in particular cases.

Some of the one-bank holding companies brought under the Act by the 1970 Amendments, of course, engage in other activities by virtue of either the indefinite or 10-year "grandfather" benefits given them by the statute. These "grandfathered" activities, obviously, should not be confused with the activities listed by the Board as permissible since 1970.

Among the services criticized in section 2(c) of the bill are the "offering of insurance agency and underwriting services". We have noted elsewhere the vigorous opposition to bank holding company entry into this area from the insurance agency business. It might be useful to observe, for example, that the Board, in permitting limited insurance agency activities, has allowed an insurance agency of a bank holding company to offer any kind of insurance in communities under 5,000 population. But this parallels an authority for banks that has been in the National Bank Act since World War I. In communities over 5,000, however, the sale of insurance to the public by bank holding companies is strictly limited to insurance related to credit or services supplied by them or their subsidiaries, and allows other insurance sales only as a "convenience" so long as the premium income from such sales "does not constitute a significant portion of the aggregate insurance premium income of the bank holding company." Furthermore, the Board has ruled that "a significant portion" may be no more than 5 percent of the aggregate, and has outstanding a proposal that would be even more restrictive.

The Board's regulation, in a similar vein, limits insurance underwriting by a bank holding company to "credit life insurance and credit accident and health insurance which is directly related to extensions of credit by the bank holding company system."

Another criticized service in section 2(c) is "leasing". Banks engage directly in this service where the lease is made on a full pay-out basis and is the functional equivalent of a loan to acquire the leased property. Such leases have been listed as permissible for bank holding companies subject to detailed limitations to assure their preservation as instruments functionally equivalent to extensions of credit.

Two other criticized services in section 2(c) are "accounting" and "data processing". The Board has not approved bank holding companies' serving the public as accountants. The Board does allow them to do bookkeeping, data processing and storing of financial information, subject to certain conditions. But this is not accounting.

Section 2(c) also lists among the criticized activities "travel . . . courier . . . and . . . management" services. The Board has ruled that travel agency services are impermissible for bank holding companies. The Board has allowed bank holding companies to provide limited courier services typical of the kind that banks have operated, but carefully hedged to protect the interests of competitors. Bank holding companies also may offer management consulting advice, but only to unaffiliated banks, and subject to elaborate restrictions to guard against improper influence. Management consulting, of course, is a normal correspondent banking service.

The last criticized service listed in section 2(c) is "marketing securities". This is not clear, but it may have reference to the Board's limited permission for bank holding companies to provide investment, financial or economic advice, including service as investment adviser to investment companies. The Investment Company Institute has pending against the Board a law suit challenging that service. In our view, the Board has exercised extreme caution to prevent bank holding companies from stepping beyond the advisory function which, of course, is typical of a function long available from banks generally.

Section 2(d) asserts that the nation's credit resources "have been misallocated" by the activities of bank holding companies and that the Board has been derelict in its duties in administering the Act. We categorically reject both of these assertions. No evidence has been produced to support either contention.

TWENTY PERCENT TEST

Moving now to the substantive provisions of the bill, sections 101 and 102 establish a novel antitrust standard. The bill would flatly prohibit mergers or acquisitions where the resulting bank or company controls more than 20 percent of the banking assets of its state. There is, clearly, no similar federal standard applicable in any other industry. The justification or logic for applying this simplistic standard to external banking expansion escapes us. As we see it, enactment by Congress of this standard would "freeze" the external growth of 20 bank holding companies scattered throughout the country from Massachusetts to Washington. What public policy objective would be served by doing so is not made clear in the bill, but it would remove as competitors in certain geographic areas a few bank holding companies and banks. We believe it would be a mistake to substitute a mechanical standard for the careful examination by the federal bank regulatory agencies and the Justice Department of each application. Examination must include an analysis of each relevant market in the light of the various factors affecting entry into that market.

The limitations of applying a mechanical percentage test is illustrated by the fact that the proposed 20 percent test would restrain only two of the ten largest banking organizations and only six of the 25 largest. In our three largest money centers, the 20 per cent test would have no impact on banking organizations in New York City and Chicago, and would affect only one organization in San Francisco. Thus, the restraints fall principally on regional banking organizations in states such as Arizona, Georgia, Idaho, Maryland, Minnesota, Montana, New Mexico, North Carolina, Oregon, Rhode Island, South Carolina, South Dakota and Utah, where growth offers potential for competition with money center banks in the national market. We submit that it is not in the public interest to suppress the growth of regional banking. We note that the Board, the Comptroller of the Currency and the Federal Deposit Insurance Corporation also oppose this simplistic approach.

Another proposal in S. 72 would allow the bank regulatory agencies the discretion to go beyond present antitrust standards and the new 20 per cent standard to deny mergers or acquisitions having "adverse effects on competition . . . not clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served." This is a very amorphous standard, and would result in endless litigation as the courts attempted to define its parameters. We see no purpose to be served in adding to the burden of the courts when existing antitrust standards are working effectively. It also runs directly counter to the antitrust philosophy set forth in the "Grays Harbor" decision (*Washington Mutual Savings Bank* v. *Federal Deposit Insurance Corporation*, 482 F. 2d 459 (9th Cir. 1973)).

NEW SECTION 4(C)(8) RESTRICTIONS

In changing the standards for bank holding company entry into bank-related activities, section 301 of the bill adds new restrictive provisions to the present section 4(c)(8). The result, in our view, will be to effectively eliminate this provision from the Act, bringing to an abrupt end the entire beneficial process that Congress has permitted since it first decided in 1956 to subject bank holding companies to federal regulation. This drastic result would take place with no showing having been made that there has been any adverse impact on any segment of the public. We think Congress should endorse the idea of vigorous, fair competition rather than appearing to support privileged sanctuaries for our competitors in the financial markets.

Moreover, in reading the "negative laundry list" of activities set forth in section 2(c) in light of the new "directly related" and other restrictive tests proposed in section 301, the bill seems to be prescribing a new definition of what constitutes banking. As we have noted, virtually all of the activities approved by the Board of bank holding companies have been offered by Banks themselves for years. But if these traditional functions are to be specified by Congress as not being directly related to banking, then the bill constitutes a retrenchment in the scope not only of permissible activities for bank holding companies but for banks as well. This approach is given concrete form in section 401, which would bar a national bank from conducting itself any activity the Board has not permitted for bank holding companies after the effective date of this bill.

Comptroller of the Currency Heimann stated his concern with the comparable provision of H.R. 9086, as follows:

"By requiring national banks to follow the standards of the Federal Reserve regulations, section 1311 may prohibit banks from participating in some currently permissible bank-related activity. Thus, the section would perhaps unintentionally protect some industries from the effects of competition, an unusual result when the primary purpose of the title seems to be to foster greater competition." (Subcommittee on Financial Institutions Supervision, Regulation and Insurance, House Committee on Banking, Finance and Urban Affairs, Hearings on *The Safe Baking Act*, H.R. 9086, Part 4, September 28, 1977, p. 2293.)

We are doubtful that this is the right moment for Congress to attempt to redefine the business of banking. We live in a time when the entire concept of credit, and credit-related services, is undergoing a searching examination by lenders and others. The onset of electronic fund transfer devices has generated a state of flux in banking markets that is without modern day parallel. In this time of almost continuous innovation, should Congress revert to specific and narrow definitions of what is and what is not banking? If it does, then progress could continue only among other purveyors of financial services not hemmed in by the maze of federal regulations that would flow from the enactment of S. 72. Our large retailers, for example, have already made enormous strides in the offering of insurance and credit services, and there is every reason to believe that they will continue to do so. By enacting sections 301 and 401, the Congress will assure that this Committee will be presiding over a declining banking industry caught up in stultifying regulation.

A specific anticompetitive element in section 301 is the elimination of existing language in section 4(c)(8) permitting the Board, as we have noted above, to differentiate for regulatory purposes between activities commenced de novo and those commenced by acquisition. The existence of this provision has permitted the Board to expedite applications proposing the establishment of new businesses, which, by their very definition, carry with them the promise of increased public benefits from new competition. We have already noted that, under this authority, the Board has approved many individual applications for the conduct of bank-related activities. We estimate that about 80 percent of all application approved under section 4(c)(8) have been for de novo undertakings. To discourage de novo entry would be an extremely anticompetitive step. As Board Governor Coldwell has stated:

"We believe the authority to encourage de novo acquisitions has promoted competition and we strongly recommend that it be retained." (Hearings on H.R. 9086, Part 4, September 28, 1977, p. 2253.)

CAPITALIZATION OF SUBSIDIARY BANKS

Section 501 gives the Board explicit authority to set standards for capital in both state and national banks that are affiliated with bank holding companies. The Board up to now has been moving on a case-by-case basis, and, in some instances, urging applicants under the Act to improve their capital positions. However, this is not an area of simple or determinative guidelines, but rather one where flexibility is essential. We believe it would be wrong to give one agency total authority to determine what is or is not adequate capital for banking subsidiaries, while ignoring the informed opinions of other regulators, both federal and state.

As to bank holding companies themselves and their nonbank subsidiaries, however, these limitations obviously fall within the direct jurisdiction of the Board, which is pursuing a responsible policy regarding capital adequacy at the present time. To this extent, therefore, the provision is superfluous.

A second provision of section 501(a) requires the Board to insure that bank subsidiaries of bank holding companies refrain from discriminating in favor of their parent company or their affiliated subsidiaries in the making of loans or in the establishment of terms and conditions of credit. Up to now, section 23A of the Federal Reserve Act has been the principal means by which unsafe and unsound loans and similar financial transactions among affiliates of a holding company have been policed, and the authority contained in the section has been used vigorously by the Board. In fact, the Board has sent a letter to all bank holding companies (December 5, 1975) explaining and amplifying its policies under section 23A ". . . with respect to situations in which a bank holding company's banking subsidiary may have been exposed to adverse consequences because of transactions with the company's nonbank subsidiaries." In light of the ample present statutory authority and its enforcement, this provision also appears redundant.

The Committee might be interested in a paper prepared for our Association by Carter H. Golembe Associates on the background of section 23A and the policy issues it presents. The paper is entitled "Loans By Banks To Their Affiliates and Section 23A of the Federal Reserve Act".

NEW PROCEDURAL REQUIREMENTS

As to section 601 of the bill, the Board's functions under section 4(c)(8) of the Act already must be exercised in conformity with the Administrative Procedure Act, whether the function is determining to list in its Regulation Y permissible activities for bank holding companies (rule-making) or acting on the necessary individual applications of particular companies to engage in any listed activity (adjudication). This is evident not only from the statutes involved, but from the Board's rules and regulations, its practice, and court decisions.

The apparent thrust of section 601, therefore, is to go further and impose new limitations, the main one being to subject the Board's rulemaking function under section 4(c)(8) to formal trial-type hearings of the kind traditionally reserved for adjudication. Section 601 thus would remove this recognized distinction in administrative law and further restrict and burden the Board in administering the law. This, together particularly with the restrictive provisions of section 301, would make even more certain the virtual denial to consumers of the future benefits of the increased competition envisaged by the 1970 Amendments.

We therefore oppose section 601, which would play directly into the hands of established competitors of bank holding companies who vigorously oppose the 1970 changes in section 4(c)(8) and have already amply demonstrated the adequacy of present means for participating in and challenging both the rulemaking and adjudicating functions of the Board.

ENFORCEMENT BY INDIVIDUALS

Section 701 of the bill would invite "interested persons" at any future time to challenge past Board section 4(c)(8) decisions and regulations and reopen issues that were considered settled years ago. This novel approach for the enforcement of a federal statute by private individuals would create an administrative nightmare and would lead to endless delays and uncertainties.

That there is no need for section 701 becomes evident from the Board's practice and present law. Clearly, the Board may amend, rescind or otherwise modify its regulations, and, needless to say, Board approval orders under section 4(c)(8) are based on the facts of the particular case. Furthermore, each such order carries a specific condition reserving to the Board authority to require such modification or termination of the activities of the applicant or any of its subsidiaries as the Board finds necessary to assure compliance with the Act and the Board's regulations or orders, or to prevent evasions thereof.

The legal basis for this is clear not only from section 4(c)(8) itself, but also from section 5 of the Act under which the Board has broad responsibility to examine and require reports from each bank holding company and its subsidiaries, and to issue such regulations or orders as may be necessary to enable it to administer its functions and to prevent evasions. The Board obviously has authority to exercise continuing oversight of bank holding companies and does so. And, it may act either on request or on its own motion.

To be noted also is the recent action of the Congress, requested by the Board and supported by our Association, that extended to section 4(c)(8) matters specifically, the Board's "cease-and-desist" authority under the Financial In-

stitutions Act of 1966. Criminal penalties have always been provided for violations of the law or regulations or orders of the Board, as well as provisions for court review of Board actions, as previously noted. I also mentioned earlier the Senate passage of the bill, S. 71, which contains the Board's recommendations for new civil penalties for violations of the Act and is endorsed by our Association.

Clearly, there is no more need for section 701 than for section 601, and, like section 601, section 701 would provide further aid and comfort to competitors of bank holding companies in their continuing attempts to stifle efforts of bank holding companies to provide needed alternative sources of financial services to the consuming public. A detailed discussion of these two onerous sections is contained in a Golembe Associates study entitled "Administration of the Bank Holding Company Act: An Evaluation of the Procedural Sections of S. 72, 'Competition in Banking Act' ".

We appreciate having the opportunity to share our concerns regarding the far reaching implications of this legislation. I shall be happy to answer any questions you may have.

The CHAIRMAN. Thank you very much, Mr. Geilfuss. As I understand it, Senator Brooke has to leave shortly, so I will yield to him first for questioning. Senator Brooke.

Senator BROOKE. Thank you, Mr. Chairman. Mr. Peterson, do you think the 20-percent limitation on banking assets which is included in S. 72 would adversely affect the growth of banks and holding companies in the areas that are not considered money centers?

Mr. PETERSON. No.

Senator BROOKE. I want to be sure you understand. For example, a bank holding company outside of New York may be large compared to other holding companies or banks in its locale but it may be smaller than most of the banks in New York with which it may be trying to compete on a regional or even a national basis. Thus, placing a 20-percent limitation on such a holding company might not affect its stature within its home State, but it seems to me it would probably hinder it from trying to compete for business with larger money center banks.

Mr. PETERSON. I don't think so. As I understand it, the intent of the 20-percent limitation is to prevent acquisition of deposits by purchase of many banks and not by any kind of internal growth that banks or bank holding companies might be able to engender through different kinds of marketing techniques.

I believe it is primarily aimed at situations, such as we had in North Carolina, where in a very very short period of time, after the passing of a statewide branch banking statute in North Carolina, the number of independent banks just dropped drastically due to mergers and holding company activities. The entire center of economic power drifted into two or three banks in North Carolina.

I don't think that it would prevent any kind of internal growth. I think the idea is to prevent acquiring the deposits by purchase and by exchange of shares.

I believe the committee should be aware of the fact that there are heavy inducements in the tax laws for small bankers to sell to multi-bank holding companies by exchange of small bank shares for holding company shares. For instance, the gains tax is deferred on such an exchange while it would not be so deferred if the small proprietary type banker sold, say at retirement, to local individuals for cash. This tax situation is one of the real catalysts for holding company expansion.

Senator BROOKE. Now you indicate in your statement that many banks which have been acquired by holding companies tended to make more consumer business and mortgage loans and decrease their level of agricultural and farm loans.

Are other institutions still making the farm loans?

Mr. PETERSON. No. You mean nonbanking institutions?

Senator BROOKE. Yes.

Mr. PETERSON. No, we are having a terrible time with it.

The insurance companies are completely out of the market. We are very heavily loaned up right now in the Midwest. We have gone to the Agriculture Committees, both on the House and Senate side, asking for more guarantees—more guaranteed loans to see a lot of these people over. But just by way of an aside, we have gone through a traumatic experience at this convention in Florida, because we know that the loan guarantees aren't going to get these people out of trouble.

Senator BROOKE. You say they are out of the market?

Mr. PETERSON. Insurance companies are out of it.

Senator BROOKE. It has been suggested that having a uniform statewide bank asset ceiling does not accurately reflect the competition situation in many States, since several States, such as New Hampshire, New Jersey, Tennessee, Missouri, and Iowa have imposed ceilings ranging from 8 to 20 percent.

Why shouldn't the Federal Government leave the setting of such ceilings to the State governments?

Mr. PETERSON. I think it is mostly a matter of inducement right now.

Quite frankly, we would prefer to see the State governments put into a position whereby they would have to adopt a policy on this.

The "MacFaddenization" suggestion that we have made here as far as an addition to S. 72 would compel the State legislatures to take action.

As is well known, IBAA is a very strong States rights organization, and whereas we see benefit in a national policy of setting the limits at 10 percent, if the truth be known, I think the membership would prefer to see the Congress compel the States to address the issue and set their own limits.

But since it is up in front of you, and it is the only game in town right now, we will take the 10 percent.

Senator BROOKE. Mr. Geilfuss, in your statement you indicated on a national basis banking is one of the most unconcentrated major industries in the country.

While this may be true because of the limitations on interstate banking, what we are concerned with in our consideration of S. 72 is concentration within States.

Now in that regard, the Justice Department has indicated that in 21 States the top four banking organizations have market shares in such States of 50 percent or more.

Does this indicate to you that there is concentration on the State level?

Mr. GEILFUSS. I think statistically, it does. But it seems to me that there has to be considerable interpretation of those statistics. First of all, I don't know whether there is eliminated from the figures any international business. Its inclusion would dispute the figures.

Second, I think you have a very different situation where you get banks which are handling customers on a national basis or regional basis as distinguished from that part of their banking business which affects consumers and retail business.

If you limit it as to retail business, then it seems to me there is some validity in looking at that kind of concentration.

But what I fear is if you restrict banks in States like ours—we don't get up to the 20 percent test in Wisconsin—which are not in the principal money centers, you keep banks or bank holding companies in those States from competing nationally—nationally against those in the money centers.

We have found in Wisconsin that we frequently are unable, among our banks, to serve needs of the larger corporations in the State, forcing them to go to New York or Chicago, or somewhere else, whereas when you go up to the Twin Cities, or Indianapolis, you get much larger bank sizes than we happen to have in Wisconsin. This is due primarily to branching regulations, at least in Indiana.

Senator BROOKE. What are your views of the Justice Department figures?

Mr. GEILFUSS. I am not sure I am knowledgeable about them, sir. I would be happy to check into them. I just don't know. I read their statement of yesterday rather hurriedly, last evening, and I haven't tried to analyze their figures.

Senator BROOKE. Bank holding company applications to acquire banks in small communities often indicate that affiliation with a holding company will provide new services to the communities to be served.

Now what are examples of such services?

Mr. GEILFUSS. Our experience has been that there frequently has been very limited consumer credit activity on the part of some banks in smaller communities that we have added to our holding company. Trust services is another one, international banking services, more readily ability to service the large customers in the area through help vantage of these services?

Senator BROOKE. Do people in these communities actually take advantage of these sevirces?

Mr. GEILFUSS. Yes, and I think there are studies that have indicated that this is so.

Senator BROOKE. Mr. Duwe, under S. 72, a holding company controlling 20 percent of bank assets in a State would be prohibited from acquiring another bank in the State, even if the other bank only controlled 1 or 2 percent of total bank assets in the State. I understand that you believe a prohibition against such small acquisitions, commonly referred to as toehold acquisitions, would be particularly anticompetitive. That is your position, is it not?

Mr. DUWE. Yes.

Senator BROOKE. Since small acquisitions by holding companies are a way of entering new local markets and have been fairly common, I would like to know whether, over a period of years, the banks acquired in these situations have grown faster than the other banks in the relevant markets?

Mr. DUWE. Senator, I doubt very much that those individual banks acquired by holding companies in the isolated areas have grown faster.

As a matter of fact, I am affiliated with three banks, all in little towns, and if a new bank moved to town, I would hope it would be affiliated with a holding company; I would like to compete against a bank like that.

But let me state that it is the position of the American Bankers Association that any caps, any limitations, should be determined by the States.

Every one of our 50 States is different from the other, the credit needs, the mix of the financial institutions. As you mentioned, there are five States that have imposed caps or limits.

But I think the important thing to note is that there are 45 that haven't imposed these caps. So if a situation in an individual State requires or seems to demand a cap, then we think that is a problem for the State to deal with. We believe a monolithic cap applied at the Federal level would end up being counterproductive, rather than productive.

Senator BROOKE. Now your Farmers State Bank in Lucas, Kans., is that an independent bank?

Mr. DUWE. It sure is.

Senator BROOKE. Now in your——

Mr. DUWE. And those other two banks I am affiliated with are members of Mr. Peterson's organization.

Senator BROOKE. In your market area, do you compete with any holding company banks?

Mr. DUWE. Yes. As a matter of fact, multibank holding companies are not permitted in Kansas. I think that is another thing that needs to be brought out, that it is up to the States, to decide whether or not multibank holding companies shall be permitted.

Senator BROOKE. So they are subsidiaries of one-bank holding companies, rather than multi?

Mr. DUWE. That is right. One-bank holding companies are permitted. As a matter of fact, I began two of them.

Senator BROOKE. What is your view of your bank's holding company competition? Do you believe the holding companies have unfairly hindered your bank's growth?

Mr. DUWE. Oh, absolutely not, they haven't hindered the growth. I don't think they have helped the growth.

Senator BROOKE. They have helped?

Mr. DUWE. I don't think they have helped the growth, but I do know that they have been instrumental in providing a service to these three little communities that those communities would not have had, and that is the only insurance agencies in town.

Senator BROOKE. Does your bank sell credit-related insurance?

Mr. DUWE. Oh, yes. Not the bank, but the insurance agency.

Senator BROOKE. How do your bank rates compare with those of its holding company competitors?

Mr. DUWE. You mean its credit life rates?

Senator BROOKE. Yes.

Mr. DUWE. Well, credit life rates in the State of Kansas all seem to be about the same. However, let me point out that over a period of the last several years, probably 5 years, the rate has been coming down for everybody.

Senator BROOKE. Do you offer any other nonbanking services?

Mr. DUWE. No, only the insurance agency services.

Senator BROOKE. Thank you. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Peterson, you make a good case for legislation to deal with the concentration of banking assets.

Incidentally, I might observe, first, that this is a very, very helpful panel. I think it is unusual that we get a panel that represents an industry and has this kind of diversity of view. I think that is very helpful.

Mr. Peterson, of course, generally favors legislation of this kind, and Mr. Duwe and Mr. Geilfuss both oppose it.

I think that gives us a nice contrast of experts in the industry, so you can give us advice on it.

As I say, Mr. Peterson, you make a good case for legislation to deal with the concentration of banking assets.

In your statement you say that banks in concentrated markets, and I quote:

> Face each other in these markets recognizing their mutual interdependence and adopt pricing and other practices that dampen competition. Such behavior tends to make them less responsive to the needs of individual customers and the local community.

I think it is important to quantify for the record how consumers are adversely affected.

First, does the money tend to flow out of the local communities in your judgment for local needs, and into money centers?

Mr. PETERSON. Senator, I am going to have to beg off on that statistical question. I think we can supply the answer to you in short order. A good deal of the statistical work on this testimony was prepared by Lewis Markus, who used to be the chief economist of the Antitrust Division of the Justice Department and who is our economist. He happens to be out of the city at the present time. But I would be glad to respond in detail when he returns.

The CHAIRMAN. Yes, I want that and for the record maybe you can give me this: Less money for housing and farming?

Mr. PETERSON. Yes.

[The following letter was received for the record:]

INDEPENDENT BANKERS ASSOCIATION OF AMERICA,
Washington, D.C., March 24, 1978.

Hon. WILLIAM PROXMIRE,
Chairman, Banking, Housing and Urban Affairs Committee, Dirksen Senate Office Building, Washington, D.C.

DEAR SENATOR PROXMIRE: In the course of my testimony on March 8, 1978 with respect to S. 72, a bill to amend the Bank Holding Company Act and the Bank Merger Act, I agreed to furnish responses to certain questions which you raised and to which I could not respond fully. I believe the following will be responsive to your questions and respectfully request that you make this letter a part of the hearing record.

At the hearing you asked how consumers are adversely affected when banks in concentrated markets, recognizing their mutual interdependence, adopt pricing and other practices that dampen competition.

While it is difficult to quantify, with any degree of precision, precisely how consumers are affected by an increase in the level of concentration in banking markets, there is some evidence which measures the impact of concentration. A number of studies of the relationship of market structure to market performance in banking have found that increases in market concentration can be expected to lead to a deterioration of bank performance. One such study which measured performance by prices of services and loans and such services as overdraft checking privileges and banking hours found that an increase in concentration resulting from a merger between two banks with market shares of 15 and 8 percent, respectively, in a fairly unconcentrated market, would lead to an increase in the interest rate on new car loans of almost 40 basis point:[1]

Another study which reviewed some 39 banking structure-performance studies conducted since 1960 revealed the consensus that there is a statistically significant relationship between market structure and market performance and that prices and profits are directly related to the structure of the market.[2]

You also asked whether money tends to flow out of the local communities for local needs and into money centers when concentration increases as a result of the growth of multibank holding companies.

The extent to which such outflows of funds may take place is directly related to the degree of control of the operations and policy decisions of subsidiary banks exercised by the holding company. The greater the degree of centralization of control the greater the liklihood that funds will be moved more freely among the communities in which the holding company's subsidiaries operate as well as interregionally.

Studies reveal that multibank holding companies or the lead bank closely control securities investments, federal funds transactions, bank correspondent relationships and loan participations. The ability to control these functions and effect interregional flows of bank credit is one of the most important advantages claimed for multibank holding companies over independent unit banks. Loan participations, particularly, are an important means of shifting loanable funds among subsidiary banks.[3]

The conjunction of the centralization of control of a growing number of banks affiliated with multibank holding companies and the growth of multibank dominance of banking markets creates an environment likely to foster the movement of funds away from the communities which generate them.

Some bank holding companies have used subsidiary bank funds to purchase loans originated by non-bank subsidiaries. This practice has, for the most part, diverted funds from the communities served by the subsidiary bank. During 1974 and 1975, many bank holding companies suffered large losses as a result of their non-bank subsidiaries, including mortgage banking, leasing, commercial factoring, consumer finance, and REIT advisor subsidiaries. In some cases, these losses were absorbed by transferring income from bank subsidiaries to the troubled non-bank subsidiaries which siphoned off potential capital from the subsidiary banks at a time when they should have retained such income to strengthen their capital positions.[4]

You also asked whether the concentration of banking in multibank holding companies would be likely to make less money available for housing and farming?

The evidence seems to indicate that the adverse impact of holding company affiliation on farm credit is more serious than the impact on housing credit. Studies which have sought to measure the impact of holding company ownership of banks on the cost, terms, or relative amount of credit extended to agriculture found that affiliation tends to reduce farm loan volume as funds are shifted to higher yielding consumer installment loans. A study of farm lending patterns of multibank holding companies in Florida in the period 1962–1970 found that, on average, the volume of farm loans tended to decrease soon after affiliation while farm loan volume was rising at independent banks.[5]

A study of the effect on farm lending in Ohio of holding company affiliates found that, on average, farm loans declined after banks became affiliated with multibank holding companies. Over a three-year period following acquisition, acquired banks reduced the ratio of farm loans to gross loans by about one per-

---

[1] Arnold A. Heggestad and John J. Mingo, "Prices, Nonprices and Concentration in Selected Banking Markets," in Conference on Bank Structure and Competition, March 28–29, 1974 Federal Reserve Bank of Chicago, pp. 69–95.

[2] Stephen A. Rhoades, "Structure-Performance Studies in Banking: A Summary and Evaluation," Federal Reserve Board, 1977.

[3] Robert J. Lawrence, "Operating Policies of Bank Holding Companies, Part I," Federal Reserve Board, 1971.

[4] Ralph Nader and Jonathan Brown, "Disclosure and Bank Soundness: Non-Bank Activities of Bank Holding Companies," June 30, 1976.

[5] Gene D. Sullivan, "Impact of Holding Companies on Farm Lending by Banks in Florida" "Improved Fund Availability at Rural Banks," Report of the Committee on Rural Banking Problems, Federal Reserve Board, June 1975.

cent the first year; a little less than one percent the second year and a little over one percent the third year.[6]

Other studies have found that holding companies affiliation result in: a) a reduction in farm loans; b) a shift in lending to higher yielding installment loans; and c) no significant change in business or residential mortgage loans.[7]

The growth of multibank holding companies through the acquisition of small banks, particularly in agricultural states poses a real threat to the supply of credit to farmers. The small banks, those with deposits of $50 million or less, are the major source of commercial bank credit for agriculture. Since there is evidence that these banks tend to reduce their volume of lending to farmers after affiliation, expanded control of these bankers would reduce the credit available to agriculture.

In 1975 small banks accounted for 72 percent of the credit extended to farmers by commercial banks. Multibank holding companies currently control approximately 13 percent of the nation's small banks. Since holding company affiliation tends to reduce farm lending a reduction of farm credit by these affiliated banks could have an adverse effect on the volume of credit available to the agricultural sector.

In some agricultural states holding company control of small banks has already reached major proportions. In Florida, for example, multibank holding companies, in 1975, controlled 64 percent of the small banks in the state. In Missouri 26 percent of the state's small banks were affiliated with multibank holding companies while in Minnesota, Colorado, Wisconsin and Texas, holding companies controlled 25, 20, 16 and 12 percent, respectively, of the small banks in these states.[8]

I trust that you will find the foregoing fully responsive to your questions but if you desire further information I will be pleased to furnish it upon request.

Very truly yours,

RICHARD W. PETERSON,
Legislative Counsel.

The CHAIRMAN. And the third is the cost of money to local borrowers has increased. Any statistical data you can give us on that would be very appropriate.

Now in your statement you discuss the impact of the bank holding company movement on agricultural credit.

Yesterday the Justice Department said they had received no complaints from consumers on the bank holding company issue.

My question is this: In your view has this impact substantially reduced agricultural credit, has it made farm loans more costly, and if so, why don't we hear from the farmers on this?

Mr. PETERSON. Well, I think, as we note in the statement, there is a dirth of information on the exact impact on agricultural credit. I do think that it is evident that from the studies that have been done that holding companies shift somewhat into consumer credit and to that extent I suspect that you can say the "consumer" is being reasonably well served by the holding company, at least with respect to consumer loans.

---

[6] Robert F. Ware, "Performance of Banks Acquired by Multi-Bank Holding Companies in Ohio," "Economic Review," Federal Reserve Bank of Cleveland, March/April, 1973, pp. 20, 24.

[7] Robert J. Lawrence, "The Performance of Bank Holding Companies," Federal Reserve Board, June, 1976;
Arthur Fraas, "The Performance of Individual Bank Holding Companies," Federal Reserve Board, 1974:
Paul F. Jessup, "Changes in Bank Ownership: The Impact on Operating Performance," Federal Reserve Board, 1969;
Robert J. Lawrence, "Operating Policies of Bank Holding Companies, Part I," Federal Reserve Board, 1971;
Jack S. Light, "Effects of Holding Company Affiliation on De Novo Banks," Federal Reserve Bank of Chicago, 1974.

[8] "Bank Holding Companies and Subsidiary Banks as of December 31, 1975," Federal Reserve Board;
"Assets and Liabilities, Commercial and Mutual Savings Banks, December 31, 1975," Federal Deposit Insurance Corporation;
"Annual Report of the FDIC, 1975."

I don't think we can deny that very much. I think there is some evidence that they begin to cut off agricultural loans.

But, on the other hand, I think that when you are chosing between what kind of social policies you want, you cannot always sacrifice, "just to the benefit of the consumer" by meeting consumer credit demand. There are other countervailing practices and problems that are involved in making your selection.

To the extent that the consumer is not concerned as a consumer or an individual with what is going to happen to the overall social and political fabric of the country through concentration, I just don't think that many consumers are very much aware of that situation. But you are, so Congress must pick and choose.

The CHAIRMAN. I don't mean to say I don't hear the farmers complaining about high interest rates. They have always complained about them, though, as they complain about everything else, and that is one of the marvelous things about farmers, they never stop complaining, whether it is high interest rates or high prices for tractors or whether it is high taxes. But it is hard to distinguish a particular concern for this problem. I think you are right, I think it is a little too much to expect that they would say now the holding company is responsible for this. That is not the way they would look at it.

Are there any other areas of the economy besides agricultural credit where credit has been curtailed or made more costly by the bank holding company movement, in your view?

Mr. PETERSON. Our prepared statement gives a fairly comprehensive analysis of our views on what has occurred as far as holding companies are concerned. I think that the benefits that have been frequently claimed and that the Fed hoped for, higher efficiencies, have not been borne out by the record.

We say: [See page 71.]

Thus, the cornerstone of Fed policy has been predicated on the assumption that most independent banks could not achieve the economies of scale and portfolio diversification essential to the improvement of bank performance.

And thereafter we say:

A number of studies of multibank holding company performance, many of which were sponsored by the Fed itself, since 1968, do not support the basic premise of the Fed's bank holding company policy. These studies have found at best affiliation with a holding company results in a very modest change in performance, mainly in portfolio composition after affiliation.

So, as far as the benefit of efficiency that have been claimed for the holding company mode, it would be our opinion that they are nonexistent.

But as far as other areas of lending outside of agriculture, specific lending sectors, such as mortgages and consumer loans, I have my doubts that the holding company movement has either harmed or helped very much.

I do think, as far as certain services are concerned, especially in the area of insurance, that the holding company mode for one-bank holding companies has proven to be of benefit to the public.

The CHAIRMAN. You recommend what you call McFaddenizing the Bank Holding Company Act. What do you mean specifically by that? And how would it work?

Mr. PETERSON. Well, as you are aware, currently the Holding Company Act leaves to the States under their general chartering authority, corporate chartering authority, what they are going to do as far as holding companies are concerned.

However, as long as the States remain silent, the holding companies may do whatever they wish.

Our idea of McFaddenizing it would be to place an amendment in S. 72 that would compel the States to adopt a specific policy by affirmative language in their codes and statutes to regulate one bank holding companies and multibank holding companies.

As it is right now, many of them have not acted. Only 13 States have really adopted any kind of holding company legislation.

The CHAIRMAN. I would like to work with you on that. That is a very interesting suggestion. I think it might be very constructive.

Mr. PETERSON. Senator McIntyre won't like it at all.

The CHAIRMAN. Well, you might be surprised. Why wouldn't Senator McIntyre like that? He is a very openminded fellow.

Mr. PETERSON. Oh, primarily because he has been attempting to repeal the McFadden Act, I guess for 2 years.

The CHAIRMAN. Well, he might want to approach it in a different way.

I think its fundamental objective might be acceptable, even though he wants to repeal the McFadden Act.

Mr. Geilfuss, you cite various statistics which indicate that concentration of banking is decreasing, as did Mr. Duwe. You both agree on that. And as did the Federal Reserve Board, Governor Coldwell, when he testified before us yesterday.

I think in every case it is for the same reason, what you have done is taken domestic deposits and set aside the deposits that come from overseas.

If you include the deposits, all deposits, including deposits from foreign countries, then the concentration is clear, particularly with respect to the big banks. There has been a big increase in concentration in the last 10 years, particularly among the biggest banks in the country, the 10 biggest banks, especially, I am familiar with that, going from something like close to 20 to 30 percent of all banking assets.

The reason I think we shouldn't just dismiss out of hand the international deposits is because the market power of an institution would seem to me be based at least largely on its overall deposits.

If, for example, Iran buys a $1 billion CD or a $500 million CD from a very large bank in this country, it gives that bank obviously more strength to loan, and gives them more power.

Why shouldn't we consider that?

Mr. GEILFUSS. It seems to me if you consider that, you ought to start considering all banks in the world, and we have many foreign banks in the United States, where they now have representative offices or branches, and it seems to me that we then want to compare the U.S. banks with banks headquartered in all other places.

The CHAIRMAN. Fortune does this every year, it seems to me, they have a list. We do awful when you compare the size of our banks with other banks. If you do that, there is still a concentration of banking.

Let me ask Mr. Duwe if he would like to comment on that.

Mr. DUWE. If you take foreign deposits into consideration, you should offset foreign loans against those deposits.

I agree that domestic deposits are a measurement of concentration of banking in the United States. But I think we would have to take a look at the situation on a worldwide basis if we are going to be comparing apples with apples.

The CHAIRMAN. It seems to me that you have to look at the whole thing, you have to look at profitability and of course profitability is affected very much. As you know, one of the biggest banks in the country, National City Bank, made, I think, 80 percent of its profits from overseas activity last year.

It seems to me that this whole picture is significant. It seems to me it is just unwise to say that you should only consider domestic deposits made in your own town. If people from outside come in from Wichita and make a big deposit, it seems to me that would have an effect on the power that that bank would have.

Mr. DUWE. I wish some would.

The CHAIRMAN. I bet you do.

Mr. Peterson, could you comment on this?

Mr. PETERSON. What was the question again? I was thinking about the snow, frankly.

The CHAIRMAN. I have been thinking about that all morning, too. It gives us a nice Wisconsin touch.

The question is that the other witnesses have cited the domestic deposits and indicated on that basis the concentration in banking has not been increased in the last few years.

The international deposits, if you look at the total deposits, including international, there has been a concentration.

They say the relevant consideration is the domestic deposits. Do you feel that the true market power of an institution should be measured by all of its deposits, or just domestic deposits?

Mr. PETERSON. I think probably just by its domestic deposits. I believe our figures were edited for those purposes.

The CHAIRMAN. I didn't make the point I have been trying to make, and I am sorry you don't agree with me. It looks like the panel unanimously disagrees with my position on that. That is not the first time.

Mr. PETERSON. I think in terms of that, it is bona fide only to really look at domestic deposits, when you attempt to determine concentration ratios, because I think fundamentally what you are dealing with is a social policy that you either want to promote or you want to cripple.

Here in the United States, when you get into international deposits, you are beginning to talk about all kinds of matters having to do with recycling oil money flows, et cetera.

The CHAIRMAN. At any rate, looking at just domestic deposits, I think there is a problem.

And you argue that what is relevant here, this is a bank holding company bill, and as far as the concentration of bank holding companies is concerned, there has been an increase in concentration on the part of a few very large bank holding companies. You document that in spades in your testimony. Is that right?

Mr. PETERSON. Yes.

The CHAIRMAN. That is what you think is relevant as far as this legislation is concerned.

Mr. Geilfuss, you said that this legislation would not only cut back on the permissible activities of bank holding companies, but traditional banking activities as well.

This is not the intent of the legislation. For example, case law prohibits national banks from selling property and casualty insurance and engaging in data processing and acting as travel agents, because these activities are not banking activities.

This bill would apply these restrictions on a consistent basis. Don't you agree that banks, by virtue of their control of credit, have a potential to compete unfairly in nonbanking matters and therefore banks should be prohibited from expanding into fields of that kind?

Mr. GEILFUSS. If you are talking about nonbanking markets, completely nonbanking, I agree heartily.

The CHAIRMAN. What has auto leasing got to do with banking?

Mr. GEILFUSS. Only if it is the same thing as a loan. It is a different device, different mechanical device to accomplish the same purpose.

Many people would perfer to rent automobiles rather than buy them. And if you can finance their acquisition of automobiles by handling the leasing on a full payout basis, as we are all required to do, it seems to me you accomplish the same financing result as though you were making an automobile loan.

The CHAIRMAN. I wish you had been with me one day when we had a meeting in Milwaukee of the automobile dealers who were selling automobiles. They said that there is a big shift in this country toward leasing automobiles. They don't know how long it will take, but they think it may well be half, maybe three-quarters, of the market in the future may be leasing instead of buying.

They were very concerned that the banks were moving into this area in such an emphatic way with their enormous capital and they would lose their business. These are people who have devoted their lives to this, they have built up a business, they are expert in the area, they have done very well, they serve a vital purpose.

They had a strong case that the banks were getting into, in effect, selling automobiles, and into an area where it seems to me they are not qualified, except that you have the clout to do it with your enormous capital.

Mr. GEILFUSS. We have no interest in doing that. But I still don't see any difference between financing leases in the same kind of way that one makes a loan.

The CHAIRMAN. That is it, there is a subtle situation here. I think you are very sincere in making that argument. But if you look at it from the standpoint of an automobile dealer, you can understand how concerned he is when he sees this kind of competition. You come in with your bank, with a whale of a lot more capital than he could ever dream of having, and he thinks the competition is just going to overwhelm him.

Mr. GEILFUSS. Of course, by and large, he deals with people like GMAC, as distinguished from banks, which have that kind of capital. He, by and large, doesn't do his leasing himself. Somebody finances that leasing.

Senator SPARKMAN. Mr. Chairman, I have to leave. I wanted to ask just one or two questions.

The CHAIRMAN. By all means. Senator Sparkman.

Senator SPARKMAN. It has been a very interesting discussion. I want to pose this question to Mr. Geilfuss, primarily, but I would be glad to have comments from any of you.

The bill we are having hearings on is S. 72. I take it from the criticism which you make of that bill, Mr. Geilfuss, and others, to some extent, that you just don't consider it a good bill. Is that right?

Mr. GEILFUSS. We think a lot of it is already covered adequately and that there are some provisions we just plain disagree with as not being in the best interests of the people in the industry.

Senator SPARKMAN. I was impressed with the fact that you pretty well tore it up in your objections to various sections.

Mr. GEILFUSS. All right, I will say yes.

Senator SPARKMAN. That is the way it impressed me. Do you think we ought to have any legislation?

Mr. GEILFUSS. I think S. 71 which the Senate adopted last year should certainly become law. It is highly desirable to give more clout to the banking agencies in areas where I think, with that clout, they can do a much better and more effective job and avoid many of the criticisms that are levied at them.

Senator SPARKMAN. But you do not advocate a new bill at this time?

Mr. GEILFUSS. No.

Senator SPARKMAN. How about you other gentlemen?

Mr. PETERSON. Well, no, IBAA feels that something has to be done. I think in many ways, Senator, what concerns us—one has to have a little bit of background, I suppose, about the Independent Bankers Association. It is a pretty much populist-oriented kind of organization. It was formed by a man who is extremely active in the Farmer-Labor Party in Minnesota originally. And its real motivating force is a definite concern about over-concentrations of economic power.

We feel that those kinds of concentrations are going on, via the bank holding company expansion, and we believe that the Congress should do something about it.

Senator SPARKMAN. Do you feel that S. 72 is the proper vehicle for making those improvements that you suggest?

Mr. PETERSON. I think, with work, yes. There are a number of changes we would like to see made. But S. 72 is a starter, very much so.

Senator SPARKMAN. And you, Mr. Duwe?

Mr. DUWE. I agree that, the American Bankers Association agrees that S. 71 should become law. As a matter of fact, the American Bankers Association has, as the chairman knows, supported S. 71 all of the way through the Senate, and still supports S. 71.

As far as this bill is concerned, we think, Senator Sparkman, that the committee you chaired in 1970 came up with an ingenious way to balance the holding company movement, to provide the flexibility necessary to benefit the consumer and to supply new competition. I might add that almost all of the criticism of the holding company operations since the 1970 amendments has come from the competitors that have been affected. We have heard very few, if any, complaints from consumers.

But I would like to point out one thing for the record that is not widely known. And that is the fact that before—and this has been true since 1966—before any acquisition by a bank or a bank holding company, any merger, any consolidation, can become a fact, the Justice Department has 30 days to file a complaint. And that puts an automatic hold on it.

Let me point out that this is true only of banks and bank holding companies, and not of any other type of institution. That safeguard is there. And we are not complaining about that at all, we think it ought to be there.

But it applies only to banks and bank holding companies. For this reason, we think the concern about concentration of assets, concentration of power, and concentration of resources is a fear of the unknown. We don't think it is fact.

Senator SPARKMAN. Well, I am not sure I can understand clearly what you are saying, or that you have answered my question.

Are you in favor of enacting into law or reporting out of this committee S. 72?

Mr. DUWE. I thought I made that eminently clear. We are not in favor of S. 72.

Senator SPARKMAN. That is the answer I wanted.

Mr. DUWE. I am sorry I took so long in getting to it.

Senator SPARKMAN. I want to express my appreciation, Mr. Chairman, to these witnesses. I think it has been a very fine discussion.

I am going to have to leave.

The CHAIRMAN. Gentlemen, I will just take a few more minutes. I just have a couple of questions for Mr. Duwe.

Mr. Duwe, the statistics you cite in your statement show since the passage of the 1970 amendments to the Bank Holding Company Act, the bank holding companies have become dominant in the banking industry. They now control over two-thirds of bank deposits, with almost 4,000 subsidiary banks.

Now the character of the banking system seems to have altered because of that change. Doesn't it concern you that this industry, with all of the power that it derives from the use of depositors' funds, may come to dominate industries such as insurance or data processing, if it is not controlled?

Mr. DUWE. It has not happened yet. The bottom line of table No. 1, shows deposits as a percentage of all bank deposits. This is for all registered bank holding companies, in other words, all bank holding companies in the Nation. Bank holding company deposits as a percentage of all bank deposits has actually declined since 1974, from 68 percent in 1974, to 66 percent in 1976.

Table 2 shows the percent of domestic deposits held by the 300 largest banking organizations has actually declined or stayed about the same since 1961, and there has been relatively little movement in so-called concentration.

I hear a lot about how this might happen, or this could happen, but the point is that it hasn't happened. And in the meantime, I think consumers have been benefited by the bank holding company movement.

The CHAIRMAN. Well, let me just point out, as I look at these statistics in your presentation, you had a very sharp increase. In 1971 you had 2 acquisitions, in 1972, 11, in 1973, 34, in 1974, 33, and then you did drop down in 1975. There are two elements of that that occur to me, and the same pattern is true throughout.

For one thing, you are already acquiring a very large amount of assets in some of these areas. And in the second place, 1975, of course, last year, was not the kind of a year that banks were going out and acquiring anything. The banking business was in pretty bad shape that year, comparatively bad shape, it was a bad year for banks, a recession year for banks.

So I think if we look at the statistics, if we could have brought the statistics up through 1977, you might have a different picture.

So I think on that we might certainly have an area of concentration.

Mr. DUWE. Could I comment on that, sir?

The CHAIRMAN. Yes, sir.

Mr. DUWE. I think the significant thing in table 3, again, is the bottom line. You will note that from 1971 to 1975, the total of acquisitions was 756. But the number of de novo entries, which is the most competitive pro-consumer type of entry, was 1,650.

The CHAIRMAN. What is the significance of that again?

Mr. DUWE. De novo entry is the most pro-consumer type of bank holding company entry into a market. That is a new business that is being put into the field to compete and hopefully to bring more efficiency.

The CHAIRMAN. I understand that. Of course the way they go into mortgage banking de novo, or whether you go in by acquistion, the fact is that you go in, in the view of the independent mortgage bankers, as an entity that in many cases of course has a strong capital advantage. And in a sense may constitute unfair competition.

All three of you gentlemen are representing the banking industry, but a few months ago when we had the other people up here, you can understand how they were not seeing the situation the same as you do.

Let me ask another question of Mr. Duwe. You discuss the rulemaking provisions of this bill. I think you make a good case for their passage. You contrast this bill's requirements for on-the-record rulemaking with the informal present practices, where there is of course opportunity to submit written comments and make an oral presentation to the Fed.

Since the Board acts on behalf of the Congress in these proceedings, the outcome of which may change entire industries, why shouldn't the Board be required to lay all of its evidence on the table and subject it to cross-examination, before rules are made permitting bank holding companies to expand, for example, into the insurance business? Why shouldn't all this be on the public record? After all, the important things to recognize is this has the effect of law. It is really a delegated authority of the Congress.

Why shouldn't there be appropriate procedures which insure that the public interests are protected as much as possible?

Mr. Chairman, the current procedures do insure that the public interest is protected, and they are the appropriate procedures for rulemaking. This is recognized by the authorities in administrative law, who believe that trial type hearings, with opportunity to cross examine, have no place in administrative rulemaking proceedings. If trial type hearings are required for all orders and regulations under 4(c)(8), the ability of competitors to significantly delay and possibly prevent bank holding company expansion into related activities will be greatly enhanced.

Now if that is the extent, it is my belief that that is what is going to happen. And it is terribly expensive, too.

The CHAIRMAN. How terribly expensive is it? Isn't it after all very important that when you take actions that are this far-reaching and this fundamental, that have this kind of effect on the entire industry, that you should have the most complete protection that is possible, you should bring out as much as you can through cross-examination, and you ought to have a formal record that is made public promptly?

Mr. DUWE. It is our belief that the safeguards are there now. And that it is not necessary to have cross-examination trial type hearings in most cases. Now in some cases it is. Whenever there is a complaint, or whenever there is an issue of fact that is being disputed, trial-type hearings are taking place today. But not very many.

Mr. GEILFUSS. Mr. Chairman, might I comment?

The CHAIRMAN. Yes, sir, I wish you would. That is the last question, so go right ahead.

Mr. GEILFUSS. It seems to me that there is some confusion about being on the record. Everything is on the record with the Federal Reserve Board on these hearings. There is a record made. But it is not an adversary proceeding.

The CHAIRMAN. Maybe we better get into that. We disagree whether it is all on the record or not. It is an informal proceeding, a good deal of it is agency discretion, which is really the point.

Mr. GEILFUSS. This is in rulemaking.

The CHAIRMAN. We are talking about submitting surveys, putting in economic data, having a clear objective base for judgment, rather than discretionary intellect.

Mr. GEILFUSS. My observation is there always is that kind of thing going on.

The CHAIRMAN. If it is, then there wouldn't be any burden on anybody or any problem.

Mr. GEILFUSS. Excepting getting into trial proceedings, where you have cross-examination. You have things of this sort, which to the best of my knowledge doesn't go on in any rulemaking in any other Federal agency, under the Administrative Procedure Act.

This would just change that completely, as far as banking and the Federal Reserve are concerned.

I have difficulty understanding why this should be any different from other kinds of rulemaking that go on in other agencies.

The CHAIRMAN. Mr. Peterson?

Mr. PETERSON. Well, I think we would agree as far as 4(c)(8) procedures are concerned, especially for our people, it could turn into a very difficult kind of operation, if you start to talk about cross-examination.

As it stands right now, the small bank has a great deal of difficulty getting access to competent attorneys who can handle these kinds of matters. And it is very very expensive when we want to go into any kind of 4(c)(8) operations.

There is just no denying that. And you have to remember that by number the bulk of the banks in this country are small businesses. And they have got a lot of problems.

I would suggest this, however——

The CHAIRMAN. We are talking about this being done by the Federal Reserve, not by the small banks.

Mr. PETERSON. Well, we would have to be involved.

Let me offer one suggestion, though, in this area that I think could be used as a substitute for this kind of thing.

When you are talking about acquisitions there should be a requirement for a previous notification, even when tender offers are going out, whether it is to acquire something that is bank related or another bank. We have had some very very bad experiences in holding company States, where established management has been placed in the position of suddenly finding that a tender offer is already signed, and the bank has been purchased quite without management's knowledge.

I think this has probably occurred in some 4(c)(8) activities as well.

So I think that procedures along those lines would allow the established management of a bank-related firm or the language itself to enter into its own defense as far as getting a feeling for what is going on in its stock ledger.

I think that might be a reasonable proxy for what you are talking about.

The CHAIRMAN. Gentlemen, thank you very very much. I appreciate your testimony.

The committee will stand adjourned subject to the call of the Chair.

[Thereupon, at 11:40 a.m. the hearing was adjourned.]

COMPETITION IN BANKING ACT OF 1977

FRIDAY, JUNE 16, 1978

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING,
AND URBAN AFFAIRS,
Washington, D.C.

The committee met at 10:05 a.m. in room 5302, Dirksen Senate Office Building, Senator William Proxmire (chairman of the committee) presiding.

STATEMENT OF CHAIRMAN PROXMIRE

The CHAIRMAN. The committee will come to order.

This morning we continue hearings on S. 72, the Competition in Banking Act. The main thrust of this legislation is to foster competitive banking markets by restraining the growth of dominant bank holding companies in banking by acquisition and to assure that bank management focuses their attention on banking activities by prohibiting their entry into nonbank fields not directly related to banking.

Passage of this legislation will provide a framework for desirable bank holding company growth along with competitive market structures.

Since the last set of hearings on S. 72 on March 7 and 8, the Federal Reserve has completed a staff study of the bank holding company movement to 1978. The findings of the study show that bank holding company expansion has had adverse effects on competition in both banking and nonbanking markets. For example, there's evidence that bank holding company banks, while experiencing similar growth rates to independent banks, have riskier portfolios and lower capital ratios. There's also evidence that bank holding company mortgage banking and consumer finance subsidiaries operate with lower capital ratios than their competitors in these nonbank fields.

We search in vain in the Fed's report for factual evidence which shows that bank holding company entry into nonbank fields demonstrably provides benefits to the public that outweigh adverse factors such as unsound practices or concentrations of resources. Many industries have expressed concern over this expansion by banks. After all, banks have the one thing that everybody wants—credit, the lifeblood of business enterprise. When the credit granting function is combined with nonbank business there's potential for harm through unfair competition to both.

Gentlemen, we welcome you here. We have a panel to begin with consisting of Mr. Richard Farrer, chairman of the Legislative Committee, National Association of Realtors; Mr. William Hemphill, president, Mortgage Insurance Cos. of America; and Mr. Robert Masterton, chairman of the Committee on Federal Legislation, National Association of Mutual Savings Banks. We have a panel following this panel. Our first witness will be Mr. Richard Farrer, chairman of the Legislative Committee, National Association of Realtors.

STATEMENT OF RICHARD FARRER, CHAIRMAN, LEGISLATIVE COMMITTEE, ACCOMPANIED BY PAUL PRESTON, DIRECTOR OF MORTGAGE FINANCE, AND JOAN MOORE, LEGISLATIVE ANALYST, NATIONAL ASSOCIATION OF REALTORS

REALTOR®

NATIONAL ASSOCIATION OF REALTORS®
Tom Grant, Jr — President
H Jackson Pontius — Executive Vice President
Albert E. Abrahams — Staff Vice President
Government Affairs
925 15th Street, Washington, D C. 20005
Telephone 202 637-6800

STATEMENT OF

RICHARD C. FARRER

CHAIRMAN

LEGISLATIVE COMMITTEE

NATIONAL ASSOCIATION OF REALTORS®

Before the

Senate Committee on Banking, Housing and Urban Affairs

on

S. 72

June 16, 1978

The NATIONAL ASSOCIATION OF REALTORS® is comprised of more than 1,712 local boards of REALTORS® located in every State of the Union, the District of Columbia and Puerto Rico. Combined membership of these boards is in excess of 600,000 persons actively engaged in sales, brokerage, management, counseling, and appraisal of residential, commercial, industrial, recreational and farm real estate. The Association has the largest membership of any association in the U.S. concerned with all facets of the real estate industry. Principal officers include: Tom Grant, Jr., President, Tulsa, Oklahoma; Donald I. Hovde, First Vice President, Madison, Wisconsin; and H. Jackson Pontius, Executive Vice President. Headquarters of the Association are at 430 North Michigan Avenue, Chicago, Illinois 60611. The Washington office is located at 925 15th Street, N.W., Washington, D.C. 20005. Telephone 202/637-6800.

Mr. Chairman, my name is Dick Farrer, I am a REALTOR® from Castro Valley, California, and Chairman of the Legislative Committee of the National Association of REALTORS®. Accompanying me here today are Albert E. Abrahams, Staff Vice President, Government Affairs, and Paul Preston, Director of Mortgage Finance for the National Association of REALTORS®.

The National Association of REALTORS® is a nationwide trade association comprised of almost 600,000 members engaged in virtually every facet of the real estate industry. We are deeply appreciative of this opportunity to appear here today to discuss the proper role of competition by banks and bank holding companies. We wish to commend Chairman Proxmire for again addressing a very serious problem which goes to the very heart of the idea of proper and fair competition in our economy. We shall confine our comments on S. 72 primarily to Section 301, Standards for Bank Holding Company Entry into Bank Related Activities and Section 401, Uniform Application of Standards Governing Entry into Bank Related Fields, as the balance of the provisions contained in this bill are beyond the direct concern and technical expertise of the members of this Association.

The 1970 amendments to the Bank Holding Company Act extended its coverage to one-bank holding companies rather than just multi-bank holding companies. It also authorized the Federal Reserve Board to exempt from the general prohibition against engagement in non-banking activities such "activities ... which the Board, after due notice and opportunity for hearing has determined to be so closely related to banking by managing or controlling banks as to be a proper incident thereto." The Act also directed the Board to permit only bank related activities which could reasonably be expected to produce benefits to the public -- greater convenience, increased competition or gains in efficiency -- that might outweigh possible adverse effect as undue concentration or unfair competition.

REALTORS® and other groups have become increasingly concerned that the continued expansion of bank holding company powers would make it impossible for the small independent company involved in many aspects of the real estate business to compete with holding company giants. In recent years, the Federal Reserve Board has been somewhat restrained in its approval of new activities. This restraint however, seems to be more directed at protecting the economic strength and solvency of the holding companies themselves, than in any acknowledgement that their activities should be curtailed because of the adverse effects on the industries into which they were making inroads.

REALTORS® believe that housing is one industry where competition is still a working reality. The industry is comprised of lenders, attorneys, title companies, insurance companies, REALTORS® and many others, both small and large. We believe that this diversity and scale of these market components creates true competition which serves the consumer by lowering costs, improving service, and offering a meaningful freedom of choice. This system, however, is made up of small and diverse parts and is therefore vulnerable to being absorbed by an industry with large resources such as the bank holding companies. There is a growing fear that our general economy will eventually be controlled by a few giant banking institutions. The commercial banks of this country have resources unequaled by any other sector of the economy and this vast economic force has been showing a clear and growing pattern of interest in housing activities such as mortgage guarantee insurance, real estate brokerage, appraisal, property management, savings and loan operations and others.

Currently, holding companies are permitted to engage in activities of finance companies, mortgage companies, and leasing of real or personal property, management consulting for banks, and advisory services for real estate and investment trusts. In the past, applications have been made for permission to engage in mortgage guarantee insurance and savings and loan associations. While acquisition of these activities by bank holding companies was disapproved by the Federal Reserve Board for technical reasons, the Board has stated that they deem these activities "closely related" to banking. It is clear therefore that this issue will be raised again.

We believe that such activities were not intended by Congress to be construed as "closely related" to banking when it enacted the Bank Holding Company Act Amendments in 1970. The legislative history of the 1970 Act reveals that the Congress did not define the precise boundries of "closely related" and, as a result, several interpretations have arisen. This Association supports S. 72 in its goal of narrowing the currently permissive Section 4(c)(8) (of the Bank Holding Company Act), activities from "closely related" to "directly related" and would impose more stringent public interest tests requiring that the activities be likely to benefit the public and increase competition.

In addition, the National Association of REALTORS® supports the extension of bank holding company regulation to national banks. Protection of the traditional roles of financial institutions' transactions dictates that a clear and unmistakable line be drawn between the lender of money and the user of money. Therefore, we strongly endorse a list that specifically prohibits activity similar to the one contained in the House passed version of the amendments of the Bank Holding Company Act of 1970.

While the Association supports amending the Bank Holding Company Act to change the emphasis of permitted bank holding activities from "closely" to "directly related" to banking, we also strongly feel that the inclusion of a list of specifically prohibited activities is in order. The Federal Reserve Board has consistently supported bank holding company activities into areas only peripherally related to banking, eroding the line between banking and commerce in the Nation. Therefore, this Association strongly suggests the inclusion of such a list of prohibited activities specifically directing the Board as to which activities are clearly not related to banking in view of the Congress.

In our opinion, the following activities, of which the first is now permitted and the others are now prohibited by the Federal Reserve Board, should be specifically prohibited by statute:

- Leasing of real or personal property (under existing law a bank holding company may act as agent, broker, or advisor in leasing such property)

- real estate brokerage
- management consulting (other than for banks)
- property management (except for properties owned or held by bank holding companies)
- land development
- real estate syndication
- operation of savings and loan associations
- underwriting of real estate mortgage guarantee insurance
- real estate appraisal

These specifically prohibited activities would clearly indicate the sense of the Congress that expansion of bank holding companies into independent real estate fields constitutes a long-range threat to competition.

This Association strongly supports the provision to make all Board proceedings under Section 4(c)(8) subject to the Administrative Procedures Act and on the record. The current practice of permitting the Board to decide on the level of formality during such hearings severely mitigates against parties opposing proposed Board actions, as opportunities for discovery, cross-examination, and similar safeguards are not present. Critics of this proposal argue against it on the grounds that it is time-consuming and unnecessary. However, the very formality and preciseness of a hearing of record makes this provision necessary. Relationships between the regulator and regulated will be much harder to conceal. Surely an industry as powerful and as important as banking requires the utmost in safeguards and protection in the public interest. Full public hearings on record will go a long way in providing this protection.

Mr. Chairman, as an example of the kind of unfair competition that we are talking about, which Section 401 (Uniform Application of Standards Governing Entry into Bank Related Fields) would rectify, I have with me and ask permission that it be made a part of the record, detailed documentation from REALTORS® in the State of Iowa concerning unfair competition in real estate brokerage by commercial banks, both state and nationally chartered. In summary, officers of these banke are in direct competition with independent real estate brokers. They frequently advertise real estate listings and give as a contact for its real estate brokerage business the banks' phone numbers. We also have documentation of undue pressure being exerted upon would-be borrowers and listers of property to deal with the banks. Insofar as these practices are committed by state chartered banks we realize it is most probably beyond the scope of this committee to legislate relief. Insofar, however, as these are practices committed by officers of national banks we would hope that the committee would look into this very clear conflict-of-interest and abuse of public trust and enact the appropriate legislation. I ask for permission for these documents to be accepted and made part of the hearing record.

Mr. Chairman, I would now like to take a few minutes to discuss my other experiences with this general problem of financial institutions engaging in non-financial areas. I realize that the scope of the legislation does not address itself to savings and loans service corporations, however, the experience of some of our members with savings and loan service corporations is perhaps instructive and indicative of this disturbing trend which we would like to see this committee stem. A few years ago, a savings and loan service corporation subsidiary of a savings and loan association purchased a mortgage banking company which had run a real estate brokerage operation. Under the terms of the Federal Home Loan Bank Board resolution permitting the acquisition, the mortgage company, now a subsidiary of the service corporation, was permitted to work out and complete whatever real estate contracts it currently had . The company, however, was supposedly enjoined from further soliciting any additional "third party" real estate brokerage listings, that is, a service corporation could continue as agent for its own properties but not act as agent for properties owned by others. We have had continued evidence that the service corporation is in violation of the Bank Board resolution, and has continued to pursue, sometimes by devious methods, the acquisition of third party listings. Our formal complaint to the Federal Home Loan Bank Board has resulted in no corrective action taken by that agency.

This Association's 1978 Statement of Policy states that REALTORS® are deeply concerned about the potential effects of the expansion of bank holding companies and savings and loan service corporations on the competitive structure of the real estate industry. Protection of the traditional roles in financial transactions dictates that a clear and unmistakable line be drawn between the lender of the money and the user of money. We oppose efforts by bank holding companies and savings and loan service corporations to participate in the business of real estate brokerage, leasing, management, and other real estate services not directly related to financing. We call upon the Federal Reserve Board, the Federal Home Loan Bank Board, the Congress, where appropriate, to deny permission for such real estate activities by bank holding companies and savings and loan service corporations.

Mr. Chairman, the REALTORS® in this country are not afraid of competition. Our industry as well as our country was built on competition. We welcome competition. We thrive on competition. As a matter of fact, our entire industry, to a large extent, represents almost a classic textbook definition of the elements required for perfect competition. First, we have a large number of participants -- over 208,000 brokers and almost 388,000 REALTOR® associates. Bear in mind that these numbers refer <u>only</u> to our members which represent some two-thirds of the real estate industry. Secondly, we operate on the concept of freedom of entry and exit. Next, the real estate industry exhibits a high degree of mobility of resources. Finally, within our industry there is substitutibility of services. Believe me, our members do indeed compete quite vigorously with each other. In terms of "competition", both quantitatively and qualitatively, of course, to compare our "free enterprise" industry with a regulated and protected industry such as banking or S&Ls, which really has no freedom of entry or exit, or other such "competitive" hallmarks, would be unfair to them.

But Mr. Chairman, I submit to you that it is not competition in the proper beat understood economic sense of the term, when the financial institution on whom all businessmen depend for lines of credit competes with its own customers. While this Association recognizes and sincerely appreciates the financial support for housing and real estate that comes from commercial banks and other bank holding companies' subsidiaries as well as savings and loan associations and service corporations, we strongly feel that permissible bank holding company activities should be specifically confined to financial matters directly related to banking. We also feel that non-banking activities by bank holding companies as well as service corporations should not be permitted in the field such as real estate, a field characterized by almost textbook description of competition by a large number of buyers and sellers.

We appreciate the opportunity to express our concerns about these matters and our support of S. 72.

Thank you.

The GRUNDY NATIONAL BANK OF GRUNDY CENTER

GRUNDY CENTER, IOWA

At the Call of the Comptroller of Currency at the Close of Business December 31, 1977

RESOURCES

U. S. Government Bonds and Securities	$ 3,242,966.92
U. S. Government Agencies	1,150,000.00
Other Bonds, County & Municipal	3,638,611.49
Cash in Vault and Due From Banks	1,635,419.14
Federal Funds Sold	600,000.00
CASH OR ITS EQUIVALENT	10,266,997.55
LOANS & DISCOUNTS	11,019,568.90
BANK PREMISES & EQUIPMENT	190,518.16
OTHER ASSETS	351,369.73
TOTAL RESOURCES	$21,828,454.34

LIABILITIES

Capital Stock (common)	$ 350,000.00
Surplus	450,000.00
Undivided Profits and Reserves	863,397.96
Total Capital Accounts and Reserves	1,663,397.96
DEPOSITS	19,935,696.39
OTHER LIABILITIES	229,359.99
TOTAL LIABILITIES	$21,828,454.34

Member Federal Deposit Insurance Corporation
$40,000.00 Maximum Insurance for Each Depositor
Member Federal Reserve System

DIRECTORS

DALE BEE
GERALD EHRIG
WARREN FELLER
CHARLES L. GOODMAN
DON KLIEBENSTEIN
A. EUGENE PLAGER
ARNOLD SCHULTZ
LEROY VANDERWICKEN
SARA LEE YODER

Honorary Directors

C. E. ENGELKES — WM. GROOTE
WESLEY T. HECKT — W. L. MOOTY

☆

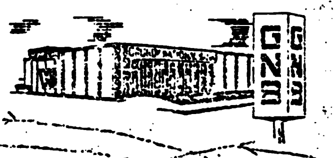
OFFICERS & EMPLOYEES

ARNOLD SCHULTZ, President
DALE BEE, Senior Vice President
ROGER ENGELKES, Vice President & Farm Rep.
SARA LEE YODER, Cashier
LARRY L. LEWIS, Mgr. Ag-Comm. Billing
Service & Installment Loan Officer
WM. L. HOFFMAN, Jr., Consumer Loans
MARY DOAK, Marketing
MARY ELLEN STOCK, ERMA HENZE,
JOY MULLER, Ass't Cashiers
LOIS VAN DEEST, PAT HITCHINGS, CINDY
HENRICKS, CAROLYN MAGOR, JOANN OLTMAN,
DOROTHY CLARK, Tellers & Bookkeepers
NANCY SHARP, Receptionist
BRENT WILSON, Ins. Agency Mgr. & Ass't V.P.
KAY SHAW, Ins. Office Mgr.
RUTH BLOOCH, Ins. Sec'y.

Complete (Bank Owned) Insurance Department

The Grundy National Bank

GRUNDY CENTER, IOWA



Each depositor insured to $40,000

FDIC

STATEMENT OF CONDITION

GRUNDY NATIONAL BANK:
a NATIONAL CHARTERED
BANK.

Real Estate For Sale

Just Listed

$3?,000. 2-3 br situated on three lots. Single garage. South Grundy Center.

CHOICE ACREAGE

Choice acreage located between Grundy Center & Dike. 7 acres with lg. well-kept home. Cut bldgs in top condition.

UNIQUE

An energy efficient home. One year warranty on defects on this newly constructed home. Buyer may choose on floor coverings. The newest in natural design.

READY FOR QUICK SALE

Possibly 4 bedroom home. New roof. Insulated. Large lot. Single garage. Many possibilities.

GREAT STARTER HOME

2 story, remodeled kitchen. Family room on first floor. 2 br up. Deck, economical utilities.

RANCH

3 br ranch, priced right. Deck. Double garage. Large basement with many possibilities. Appliances to remain. Call today.

MONEYMAKER

Quick food service business. Good opportunity. Call for details. Books are open.

GRUNDY 4/20/77
REAL ESTATE
JUST LISTED
CHOICE ACREAGE
3 BEDROOM RANCH
OFFICE PHONE 824-3432
GRUNDY CENTER, IOWA

All
Grundy National Bank
officers and employees

Cashier & Real Estate Sales Executive
manager of Agri Com-billing service & installment loan officer,
President Vice President & Insurance Agency Manager,
Vice President & Farm Representative
installment loan officer

have time for you

that's 240 reasons we're still the one.

Brent Wilson's a busy fellow . . . Grundy National Bank

. . . as assistant vice president at GNB, insurance agency manager, and real estate salesperson his days are pretty busy . . . but he always has time for you.

. . . as a husband and father of two children, his free time is pretty full . . . but he always has time for you.

. . . as a member of Kiwanis, church and park boards, he attends lots of meetings, but he always has time for you.

. . . a sportsman, he likes hunting, golf, tennis, volleyball, but he always has time for you.

so whenever you're considering purchasing a home, buying insurance, investing your money, or even just wanting to visit about those plans, hopes and dreams . . . Brent always has time for you.

grundy national bank

QUESTIONAIRE CONCERNING BANKS IN REAL ESTATE BUSINESS IN IOWA
(Fill out separate sheet for each bank)

Name of Bank: Merchants National Bank

Address: 2nd Avenue SE

City or Town & Zip Code: Cedar Rapids, Iowq 52401

Name of Officers: James E. Coquillette, President
F. Forbes Olberg, Exec. V. P.
Robert H. O'Meara, Sr. V. P. Loan Div.
Richard Ryan, Sr. V. P., Trust Div.
Ivan W. Reihmann, Farm Mgt. Off.

Name of Brokers and/or Salesmen licensed under bank or other connected business:

I believe - Ivan W. Reihmann

Is Real Estate Business directly or indirectly controled by Bank (Explain)

As far as the management department is directly controlled by the bank. Part of the farms that they manage are in trust with the bank trust dept. and the other are agency contracts.

Is Bank a locally owned bank or controlled by a Holding Company. If so what Holding Company.

Controlled by the Banks of Iowa holding co.

Type of Advertisement:
(Attach copy of publication with ad)

Type of Real Estate transactions handled by bank:

Agency contracts for professional farm management.

Major Source of Real Estate Business, if known:

Their source of business has been that the contacts are made through the bank.

Length of Time in Real Estate Business:

At least 10 years or more.

Number of Brokers & Salesmen:

Only one to my knowledge

	Yes	No
Attached is an Official Bank Publication such as a financial statement indicating names of officers who are also licensed brokers and/or salesmen		

IOWA BANK DIRECTORY

THE MERCHANTS NATL. BANK

LOAN DIVISION

CORRESPONDENT BANK DIVISION

OPERATIONS DIVISION

INTERNATIONAL DIVISION

TRUST DIVISION

FARM AND PROPERTY MANAGEMENT DEPARTMENT

Correspondents in all principal cities.

Yes No

Names and addresses of any people who you think may have been influenced, either directly or indirectly into doing business with a bank or their Real Estate entity, when they had wanted to do business with another (non bank associated) Real Estate Broker

Other Information

Your Name: Joel R. Hertz

Home Firm: Hertz Farm Management, Inc.

Address: 102 Palisades Road
Mt. Vernon, Iowa 52314

Phone Number: 319-895-8853

Date: March 15, 1978

QUESTIONNAIRE CONCERNING BANKS IN REAL ESTATE BUSINESS IN IOWA
(Fill out separate sheet for each bank)

Name of Bank: PEOPLES NATIONAL BANK.

Address: ALBIA & EDDYVILLE IOWA

City or Town & Zip Code: ALBIA 5253[illegible]

Name of Officers: [illegible] KING
LESTER POOLE
JOHN JUDGE

Name of Brokers and/or Salesmen licensed under bank or other connected [illegible]: LESTER POOLE & JOHN JUDGE

Is Real Estate Business directly or indirectly controled by Bank (Explain)

Lester Poole started Poole Real Estate while in bank then his wife took it [illegible] office [illegible] 105 S. Clinton. Lester Poole is an officer in the [illegible] for [illegible] years.
John [illegible] working in bank when he got his sales license, has since [illegible] officer.

Is bank a locally owned bank or controlled by a Holding Company. If so what Holding Company.
[illegible]

Type of Advertisement:
(Attach copy of publication with ad)

[illegible]

Page 2.

BANK: 1st. IOWA STATE BANK, ALBIA, IOWA 52531

Officers: RAY DAVIS, CLAUDE BEAN, ROBERT KALDENBERG.

REAL ESTATE CO. ALBIA REALTY. 301 Benton Ave. E. 0.

RAY DAVIS- BROKER, CARROLL [illegible] - SALESMAN.

This business was started by Mr. Davis in the bank then later was moved to the present address.

Bank is locally owned.

Advertisements in newspapers and phone books. (copy attached)

Farm and residential transactions.

Have in business app. [illegible] years.

Broker 1 Salesman 1.

attached page from phone book [illegible] and number are banks number. 932-2144

Sincerely
[illegible]
Southern Io Real Estate
[illegible], Ia

Printers

MERCER CO THE
LETTERPRESS AND
OFFSET PRINTING
OFFICE SUPPLIES
WE MAKE RUBBER STAMPS
REGISTER FORMS—CALCULATORS
226 E 2 Ottumwa..............682-6920

Public Utilities

See Bus Lines, Electric Companies, Railroads, Telephone Companies, also Gas Companies

Pumps

D & D PUMP INC
FAIRBANKS MORSE & GOULDS
Water Systems - Sales & Service
Specialists In Submersible Pumps
415 Franklin Pella Ia...........628-3585

GOULDS WATER SYSTEMS—
PROFESSIONAL DEALERS
DUER HARDWARE LTD
Melrose 726-3458

Pumps—Repairing

ELECTRIC MOTOR SERVICE
Repairs On All Makes
Electric Motors & Pumps
Jet & Piston
Submersible Pumps
Roto-Phase 3 Phase Convertors
Baldor Motors
Authorized Sales & Service
Myers Pumps
Sales & Service
Super B Grain Dryers
Service On All Makes
LEE A KRUSE - owner
504 S Market Oskaloosa Ia......673-6539

Quarries

DOUDS STONE INC
ROAD STONE
AGRICULTURAL LIMESTONE
611 Church Ottumwa Ia..........682-9661

KASER CONSTRUCTION CO
CRUSHED LIMESTONE PRODUCTS
AGRICULTURAL LIMESTONE
Eddyville Ia 969-4652

Radiators—Automotive

JOE'S RADIATOR SHOP
AUTO & INDUSTRIAL & TRUCKS
Complete Drive-In Radiator Service
NEW & REBUILT
Located ½ Blk North & ½ Blk East Of New Post Office
510 W 3rd Ottumwa Ia..........682-0314
If No Answer Call...............682-2572

WHEN ANSWERING
Always answer pleasantly. It may be your best friend. It may be someone who will get a lasting impression of you from a first call.

Radio Communication Equipment & Systems

MOTOROLA FM 2-WAY RADIO—
DIRECT FACTORY SALES
MOTOROLA COMMUNICATIONS & ELECTRONICS INC
666 Walnut Des Moines Ia.....244-4519

Railroads

Burlington Northern Inc North A Albia..932-2811

Ranges & Stoves—Dealers

WHIRLPOOL RANGES
BECAUSE QUALITY ALWAYS COSTS LESS IN THE LONG RUN
Whirlpool
"WHERE TO CALL"
DEALERS
Mick Furniture & Appliance
5 Clinton Albia.....................932-7135

Real Estate

ALBIA REALTY CO
FARM — HOMES — COMMERCIAL
13 S Clinton Albia......................932-7335
If No Ans Call ~~........................932-7[illegible]~~
After Hours ~~...........................932-[illegible]~~

Albia Realty Co 13 S Clinton Albia 932-7339

BELLES REALTY
Hwy 2 West Centerville Ia..........856-6220

CHAPPELL ROBERT REAL ESTATE
[illegible] Chariton Ia...........774-2531
Mobile Unit Chariton 774-4049
Or Call Melrose 726-3260

HARPER REAL ESTATE & AUCTION SERVICE
Residential • Commercial • Farms
Complete Auction Service
Eddyville Ia 969-4287
If No Answer Call Oskaloosa.......673-5990

Lowery Clifford A RFD 5 Albia Melrose 726-3260
Lowery Marge-Chappell Real Estate
RFD 5 Albia Melrose 726-3260

(Continued Next Page)

Now it's faster and easier than ever to call Long Distance. With Direct Distance Dialing you can dial your own station-to-station Long Distance calls. Be sure to use the area code.

PEOPLES National Bank

Peoples NATIONAL Bank

Peoples National BANK

ALBIA EDDYVILLE

FARM FOR SALE

JAMES MAHONEY FARM, 161 acres, Guilford township. Open except for a few scattered trees, some walnut. Completely

NEW LISTING—50 Acres with newly remodeled 2-bedroom home, 5 miles East of Moravia. 21 acres crop ground, 29 acres pasture.

Poole Real Estate

105 S. Clinton 932-2474

Lois and Lester Poole, Brokers

SALES ASSOCIATES

John & Patty Judge 938-2761 Greg Morehead 932-7805

E. F. Van Sickel 724-9[illegible] Howard VanZante 969-44[illegible]6

Type of Real Estate transactions handled by bank:

Farm, Residential,

Major Source of Real Estate Business, if known:

N.A.

Length of Time in Real Estate Business:

Appr. [illegible] years

Number of Brokers & Salesmen: Brokers 2. Sales associates 4.

	Yes	No
Attached is an Official Bank Publication such as a financial statement indicating names of officers who are also licensed brokers and/or salesmen		*

	Yes	No
Names and addresses of any people who you think may have been influenced, either directly or indirectly into doing business with a bank or their Real Estate Entity, when they had wanted to do business with another (non bank assiciated) Real Estate Broker		N.A.

Other Information

Your Name: [illegible] Crabtree

Home Firm: Southern Iowa Real Estate Ltd.

Address: 10[illegible] Chariton [illegible], Iowa 525[illegible]1

Phone Number: (515) 724-3005

Date:

TO U.S. SENATOR WM. PROXMIRE, CHAIRMAN AND ALL MEMBERS OF THE U. S. SENATE BANKING COMMITTEE

IN RE: SENATE BILL NO. 72

THIS IS AN AFFIDAVIT TO CERTIFY THAT I HAVE HAD THE FOLLOWING CIRCUMSTANCES UNFAIRLY THRUST UPON ME BY SMALL TOWN BANKERS WHO WERE ALSO REAL ESTATE BROKERS AND SALESMEN:

1. A REALTOR SHOWS A 240 ACRES FARM TO A FARMER, READY, WILLING AND ABLE TO PURCHASE A FARM. THIS PURCHASING FARMER WENT TO HIS "FRIENDLY" BANKER TO BORROW SOME OF THE DOWN PAYMENT OR EARNEST MONEY DEPOSIT. UPON LEARNING OF THIS BUYERS INTENTIONS OF PURCHASING THE ABOVE FARM WHILE ASKING TO BORROW SOME DOWN PAYMENT THE BANKER INFORMS THIS NEW FARMER PURCHASER THAT HE TOO HAS A LISTING ON THAT FARM AND HE, THE BANKER, IS GETTING THE SALE OF IT OR THE FARMER DOESN'T GET THE LOAN.

2. MANY PEOPLE WILL GO TO THEIR BANKER AND MAKE ARRANGEMENTS TO BORROW MONEY BEFORE CONTACTING ANY REALTOR OR REAL ESTATE AGENT. I HAVE BEEN INFORMED BY MANY LOYAL CLIENTEL OF THIS PROCEDURE USED BY BANKERS:

A. YOU HAVE ALWAYS BEEN A GOOD BANK CUSTOMER OF OURS.

B. REMEMBER THAT OVERDRAFT WE PAID FOR YOU LAST WEEK?

C. NOW IF YOU PURCHASE SOMETHING THROUGH OUR REAL ESTATE AGENCY ALL FINANCING WILL BE ARRANGED. IF NOT THROUGH OUR AGENCY PROBABLY NO FINANCING.

3. MR. JOHN DOE HAS A HOUSE LOAN AT THE BANK. HE IS BEHIND ON PAYMENTS AND DECIDES TO SELL, [illegible] EQUITY TO PURCHASE A SMALLER AND LOWER PRICED UNIT.

A. THE BANKER IS THE FIRST REAL ESTATE AGENT TO KNOW OF THIS CONDITION AND THUS HAS AN "INSIDE" OR "EDGE" OR FIRST KNOWLEDGE OF A SALE INTENT BY THE OWNER - "CONFLICT OF INTEREST"

B. HE, THE BANKER, SAYS NOW I WILL CARRY THE LOAN AND MAKE THE PAYMENTS AS LONG AS I HAVE THE LISTING, UNTIL I PERSONALLY CAN GET IT SOLD.

C. THE BANKER PROBABLY GETS TWO HOUSE SALES BY THIS PROCEDURE: THE CLIENT'S LISTING AND THE CLIENT'S OLDER PURCHASED HOME. - ANSWER - INSIDE INFORMATION AND UNFAIR COMPETITION.

4. I HAVE [illegible] HIGHLY UNETHICAL BANKERS WHO HAVE PRESSURED OR INTIMIDATED PROPERTY OWNERS WHOSE REAL ESTATE THEY HAVE LISTED AND HAVE BEEN UNSUCCESSFUL IN SELLING BY INFORMING THEM THAT IF THEY GIVE THE LISTING TO ANOTHER BROKER THEY, THE BANKER, WILL CALL AN OUTSTANDING LOAN - EITHER ON THE HOUSE, OR ANOTHER LOAN OR ANYTHING ELSE - UNFAIR COMPETITION AND "CONFLICT OF INTEREST"

5. [illegible] BANKERS FREQUENTLY ASK, EXPLAIN AND INFORM PEOPLE WHO HAVE A LARGE LOAN WITH THEM, [illegible] OF OTHER THINGS OTHER THAN REAL ESTATE THAT THEY WANT THEM TO DO ALL THEIR BUSINESS [illegible] THE BANKER, SO A CLOSE TOUCH OF THEIR, THE CUSTOMER'S FINANCIAL SITUATION WILL BE KNOWN.

6. I [illegible] MANY INSTANCES WHERE A BANKER WOULD LOAN THE SAME BUYER FROM $1,000 to $4,000 MORE MONEY ON A GIVEN PROPERTY WHEN HE, THE BANKER HAD THE LISTING, THAN WHEN A NON-BANKER [illegible] HAD THE LISTING.

John R. Currens

Subscribed and sworn to before me by John R. Currens this 10th day of April, 1973.

[signature]

Notary Public in and for the State of Iowa.

Directory of Bank Officers and Employees who are Real Estate Brokers and Salesmen
(Just a small area in Central Iowa)

Town	Bank	Position	Name of Banker in Real Estate	Title	With whom
Grundy Center	Grundy NATIONAL Bank	Marketing	Mary Doak	Salesman	Grundy Real Estate
G.Center	Grundy NATIONAL Bank	Mgr. Ag-Comm. Billing			
		Service and loan			
		officer	Larry Lewis	Salesman	Grundy Real Estate
G. Center	Grundy NATIONAL Bank	Ins. Agency mgr.			
		Real Estate salesman			
		Assistant Vice-Pres.	Brent Wilson	Salesman	Grundy Real Estate
G. Center	Grundy NATIONAL Bank	Vice-President and			
		Farm Representative	Roger Engelkes	Salesman	Grundy Real Estate
G. Center	Grundy NATIONAL Bank	Consumer Loans	Bill Hoffman	Salesman	Grundy Real Estate
G. Center	Grundy NATIONAL Bank	Owned by officers			
		and employees	Grundy Real		
			estate	Broker	for all bank li[illegible]
Grundy Center	Farmers Savings Bank	Assistant Vice-Pres.	Dave Fike	Salesman	Rick Briggs
G. Center	Farmers Savings Bank	Owned by officers and			
	Member of Hawkeye	employees	Center Ins. and		
	Bank Corporation		Real Estate Agcy.	Broker	for all bank li[illegible]
Tama	Tama State Bank	Chairman and			
		President	William Boehm	Broker	Self
Tama	Tama State Bank	Exec. Vice-President	Jerry Johnson	Salesman	William Boehm
Tama	Tama State Bank	Ins. Agency manager	Lowell Cooper	Salesman	William Boehm
Tama	Tama State Bank	Assistant Cashier	Keith Lasar	Salesman	William Boehm
Tama	Tama State Bank	Assistant Cashier			
		Ag Representative	Howard Poltovin	Salesman	William Boehm
Traer	Farmers Savings Bank	Vice-President and			
		g Representative	Fred Lineberry	Broker	Self
Traer	First Comm. Bank&Trust	President	Melvin Kupka	Broker	Self
Traer	First Comm. Bank&Trust	Exec. Vice-Pres. and			
		Cashier	Darrell Heaford	Salesman	Melvin Kupka
Traer	First Comm. Bank&Trust	Assistant Vice-Pres.	King Larson	Salesman	Melvin Kupka
Jesup	Jesup State Bank	Exec. Vice Pres.	Albert Duroe	Broker	Self
Jesup	Jesup State Bank	Vice-P[illegible], and			
		Inst. loan officer	Michael L. Frost	Salesman	Albert Duroe

Page 2

Town	Bank	Position	Name of Banker in Real Estate	Title	With Whom
Chelsea	Chelsea Savings Bank	Exec. Vice-Pres.	Richard Johnson	Broker	Self
Chelsea	Chelsea Savings Bank	Vice-Pres. and Cashier	John P. Cunningham	Broker	Self
Melbourne	Melbourne Savings Bank	Vice-Pres. Cashier and mgr. active farm land auctioneer	James Rhodes	Salesman	Active auctioneer auctions much farm Real Estate
Belle Plaine	Citizens State Bank	Exec. Vice-President	M.D. Dreibelbis	Broker	Self
Belle Plaine	Citizens State Bank	Director	C.P.Grozkruger	Broker	Self
Dike	Iowa Savings Bank	President	Marvin Graves	Broker	Self
Dike	Iowa Savings Bank	Vice-Pres. and cashier	Inez McCarville	Salesman	Marvin Graves
Dike	Iowa Savings Bank	Vice-President	Don Graves	Salesman	Marvin Graves
Clutier	Clutier State Bank	President	Melvin Kupka	Broker	Self
Toledo	Toledo State Bank	Vice-Pres. and General mgr.	Charles Cramer	Broker	Self (inactive)

As of February 1978, there are 12 banker licensees in Tama County and more vieing to be licensed. All sell homes, fa lots and a few businesses. Often bank clientele are their easiest prey. Melbourne, Iowa has a banker salesman who is a v active Auctioneer. He sells much farm land at auction. --IS THIS ETHICAL?????????

REAL ESTATE
INSURANCE
SECURITIES
LOANS

F. C. EARLEY AGENCY
912 Mill Street
Traer, Iowa 50675

PHONE: (319)
478-2696

AFFIDAVIT

STATE OF IOWA)
) SS:
COUNTY OF TAMA)

I, Franklin C. Earley, Realtor of Traer, Tama County, Iowa, do hereby state:

That my agency showed a prospective buyer a partial piece of farm land which he desired to purchase to add to his existing operation.

We had contacted all lending agencies including Federal Land Bank and three prominent insurance companies who make such loans, excepting the buyer's personal bank. Our client was able to obtain financial assistance from one of the above lending agencies except for a few thousand dollars in order to consumate the purchase. He then consulted his personal banker with his financial problems. The banker, who also had a real estate broker's license, assured him that he could assist him in making his purchase if he would sign a purchase agreement with his agency. This entitled the banker to a share of the commission even though the client was really ours and we haddone all of the preliminary work. The farmer later told us that the banker loaned him the money to make the initial down payment using personal collateral already secured by the bank.

This same banker was involved in another transaction as follows:

My client, Mr. A, who wished to purchase a 40 acre parcel of land to add to his existing farming operation went to his banker, being the above and same banker, and confided in his banker his intentions and asked his advice, stating the top dollar he would pay. The banker, upon learning of the offer, then wrote up a purchase agreement for one of his more prominent bank customers, Mr. B, offering slightly more then Mr. A intended to offer and consequently Mr. B purchased the land entitling the banker to a share of the commission which he would not otherwise have obtained and winning the esteem of Mr. B who was a

REAL ESTATE
INSURANCE
SECURITIES
LOANS

F. C. EARLEY AGENCY
912 Mill Street
Traer, Iowa 50675

PHONE: (319)
478-[illegible]

larger consistent borrower of the bank funds for his farming operation than Mr. A. Mr. A, upon learning of the deceit of his banker, immediately terminated his association with said bank.

Dated this 16th day of April, 1978.

F. C. EARLEY AGENCY

By Franklin C. Earley
Franklin C. Earley, Realtor

Subscribed and sworn to before me by Franklin C. Earley this 16th day of April, 1978.

[illegible]
Notary Public in and for the State of Iowa.

[illegible] CONCERNING BANKS IN REAL ESTATE BUSINESS IN [illegible]
(Fill out separate sheet for each bank)

Name of Bank: [illegible] STATE BANK

Address: [illegible] 3rd

City or Town & Zip Code: Tama, Iowa 52339

Name of Officers: William J. Boehm, Pres.
Jerald [illegible]. Johnson, Exec. Vice Pres.
John [illegible]. Bauch, Vice Pres.
[illegible] [illegible]. Harrison, Asst. Cashier
Howard L. [illegible]oltevin, Ag.Rep. and Asst Cashier
Keith [illegible], Asst. Cashier

Name of Brokers and/or Salesmen licensed under bank or other connected Business: [illegible]
[illegible]
[illegible]
[illegible]
[illegible] Cooner

Is Real Estate Business directly or indirectly controled by Bank (explain)
Wm J. Boehm, who is president of the bank, has sole ownership of [illegible] Realty so that direct control of the Real Estate operation is vested in the bank president. Each of the licensed real estate people are also officers of the Tama State Bank and their offices are adjacent to the public banking area. Lowell Cooner is [illegible] of the bank's insurance agency which is located in the [illegible] building.

Is Bank a locally owned bank or controlled by a Holding Company.
What Holding Company.
Locally [illegible]

Type of [illegible]
[illegible]

Tama State Bank

Tama, Iowa 52339

Member F.D.I.C.

DIRECTORS
WILLIAM J. BEOHM
JOHN S. BAUCH
A. J. HAVLIK, M.D.
FLOYD HEISHMAN
JERALD R. JOHNSON
BENJAMIN P. MCF[illegible] III

OFFICERS AND STAFF

WILLIAM J. BEOHM, President
JERALD R. JOHNSON, Executive Vice President
JOHN S. BAUCH, [illegible]
[illegible] HARRISON, Asst. Cashier
HOWARD L. PO[illegible], [illegible] Cashier
KEITH LAZAR, Asst. Cashier

LINDA BOSTIAN, Teller
LINDA ZHORNE, Teller
EMILY FURPO[illegible], Teller
CYNTHIA JOHN, Secretary
PATTY PRICE, Proof Operator
ANN SHILHANEK, Teller
CAROL SMITH, Secretary
BECKY CECAK, Teller
TERRI DUMBAULD, Teller
PAM FISH, Teller

statement of condition

At the close of business	December 31, 1977
ASSETS:	
Cash and due from banks	$ 1,101,000.00
U.S. Treas. and Fed. Agencies	1,018,000.00
Other Securities	6,764,000.00
Loans and Discounts	15,104,000.00
Bldg., Furn., and Fixtures	295,000.00
Other Assets	579,000.00
TOTAL ASSETS	$24,861,000.00
LIABILITIES:	
Capital Debentures	$ 750,000.00
Capital	600,000.00
Surplus	800,000.00
Undivided Profits and Reserves	571,000.00
Deposits	21,640,000.00
Fed. Funds Purchased	200,000.00
Other Liabilities	300,000.00
TOTAL LIABILITIES	$24,861,000.00

Type of Real Estate transactions handled by bank:

Commercial, residential and farm.

Major Source of Real Estate Business, if known:

Leads that are gained through information given by [illegible] clients when they [illegible] bank services.

Length of Time in Real Estate Business:

Approximately [illegible] years.

Number of Brokers & Salesmen:

One broker and [illegible] salespersons.

Attach [illegible] bank [illegible] such as a financial statement indicating names of officers who are also licensed brokers and/or salesmen

Yes

Names and addresses of any people who you think may have been influenced, either directly or indirectly into doing business with a bank or their Real Estate Entity, when they had wanted to do business with another (non bank assiciated) Real Estate Broker

I have had several people confide in me that they were unduly influenced (i.e. loan pressure) into doing their real estate business with the bank. However, when I asked them if I might use their names before an investigative committee, I was denied permission because of fear of repercussion and or indifference.

Other Information

Your Name: [illegible]

Home Phone: [illegible]

Address: [illegible], Ia 52342

Phone Number: [illegible]

Date: [illegible]

BEOHM Realty

NEW LISTING

NEWLY REMODELED HOME

with upstairs apt., 2 fireplaces, double garage, central air and many more extras. Reasonably priced. 311 East Seventh, Tama.

408 E. 12th ST.

3 bedroom home, insulated, very good condition, central air, lots of extras.

1312 SEYMOUR ST.

3-bedroom modern home, air conditioned, 2-car garage. Extras include fireplace.

507 McCLELLAN

Large comfortable 4 bedroom home, well located - priced to sell.

1001 SEYMOUR

Nice 2 bedroom home. Carpeted, reasonably priced.

TEN ACRES, SOUTH OF TAMA

A beautiful home site on highway 63.

1.3 ACRES

2-bedroom, 2-story home with fireplace. Completely insulated, 8 miles south west of Tama

8 to 10 ACRES WITH BUILDINGS

4-bedroom home with garage. 6 miles south of Montour. Excellent Condition.

PRICE REDUCED

Several good bldg. lots. Business opportunities, apartment building and other homes for sale.

WE NEED HOME LISTINGS

We are nearly sold out and have several interested buyers. If you are thinking of selling, call us.

PHONE 484-4620

Open 8:00 - 5:00 Monday thru Friday
8:00 to 12:00 noon Saturday (use east side entrance)
If no answer, call:

Wm. J. Beohm 484-3324 — Lowell Cooper 484-2847
Jerry Johnson 484-[illegible] — Keith Lazar 484-3393
Howard [illegible] 484-4409

Phone 484-4620
Tama State Bank Bldg.

BEOHM Realty

NEW LISTING

1312 SEYMOUR ST.

3-bedroom modern home, air conditioned, 2-car garage. Extras include fireplace.

507 McCLELLAN

Large comfortable 3 bedroom home, well located - priced to sell.

105 EAST 5TH ST.

4 Bedroom home, good condition, gas heat, air conditioning, 1 car garage, carpeted kitchen. Very reasonably priced.

1004 SEYMOUR

Nice 2 bedroom home. Carpeted, reasonably priced.

NEW ACREAGE LISTING — 1.3 ACRES

2 bedroom, 2-story home with fireplace. Completely insulated. 8 miles southwest of Tama.

NEW LISTING — 120 ACRES OF FARMLAND

80 acres tillable. South of Tama. No buildings.

TEN ACRES, SOUTH OF TAMA

A beautiful homesite on highway 63.
PRICE REDUCED

Several good bldg. lots. Business opportunities, apartment building and other homes for sale.

WE NEED HOME LISTINGS

We are nearly sold out and have several interested buyers. If you are thinking of selling, call us.

SALESMEN HOME PHONES:

Wm. J. Beohm 484-3324 — Lowell Cooper 484-2847
Jerry Johnson 484-4846 — Keith Lazar 484-3393
Howard Potterin 484-4409

Phone 484-4620
Tama State Bank Bldg.

BEOHM Realty

HOMES FOR SALE

Good 2 story, 2 BR Home

1½ Baths, Full Basement. Near schools and downtown. Priced to sell. 707 McClellan.

2 Story, 3 BR Home

New Siding & Carpet. 1006 State St., Tama.

1 Story, 2 BR Home

Near Country Club. Carpeted. Full basement. 1004 Seymour.

Near new 3 Bedroom Home

Central air, full basement, finished rec room, good location, 402 W. 13th.

ONE LOT - 711 Grant, Tama

OTHER LOTS AND APARTMENT BUILDINGS

All in Bank Bldg =

HOME PHONES:

Wm. J. Beohm 484-3324
Jerry Johnston 484-4846
Howard Poitevin 484-4409
Keith Lazar 484-3393
Lowell Cooper 484-2847
D.D. Potter 484-4508

Phone 484-4620

THE NEWSPAPERS OF BENTON COUNTY
811 13th Street
Belle Plaine, Iowa 52208
•Phone 319-444-2520

Publishers Of:
•THE BELLE PLAINE UNION
P.O. Box 208
Belle Plaine, Iowa 52208
•THE NORTH BENTON STAR PRESS
P.O. Box 129
Blairstown, Iowa 52209
Don E. Magdefrau
Editor-Publisher

The following news articles were taken from the Belle Plaine Union (Newspapers of Benton County)/Issues Feb. 15 and Jan. 13 of 1973.

[OVER]

Jan 11, 1978

444-2842 - Telephone number

STATEMENT OF CONDITION
CITIZENS STATE BANK
Belle Plaine, Iowa

State Bank No. 643

Consolidated Report of Condition of "Citizens State Bank" of Belle Plaine in the State of Iowa and Domestic Subsidiaries at the close of business on December 31, 1977.

ASSETS		
Cash and due from banks		$ 1,580,000
U.S. Treasury securities		1,749,000
Obligations of other U.S. Government agencies and corporations		1,661,000
Obligations of States and political subdivisions		3,621,000
Federal funds sold and securities purchased under agreements to resell		650,000
a. Loans, Total (excluding unearned income)	$14,897,000	
b. Less: Reserve for possible loan losses	102,000	
c. Loans, net		14,795,000
Bank premises, furniture and fixtures, and other assets representing bank premises		340,000
Other assets		19,000
TOTAL ASSETS		24,256,000
LIABILITIES		
Demand deposits of individuals, partnerships, and corporations		5,181,000
Time and savings deposits of individuals, partnerships, and corporations		16,775,000
Deposits of United States Government		104,000
Deposits of States and political subdivisions		394,000
Certified and officers' checks		73,000
TOTAL DEPOSITS		22,227,000
a. Total demand deposits	$ 5,490,000	
b. Total time and savings deposits	16,737,000	
Other liabilities		29,000
TOTAL LIABILITIES (excluding subordinated notes and debentures)		22,256,000
EQUITY CAPITAL		
Common stock		
a. No. shares authorized	32,000	
b. No. shares outstanding	4,000	400,000
Surplus		850,000
Undivided profits		728,000
Reserve for contingencies and other capital reserves		22,000
TOTAL EQUITY CAPITAL		2,000,000
TOTAL LIABILITIES AND EQUITY CAPITAL		24,256,000
MEMORANDA		
Average for 30 calendar days ending with call date:		
a. Cash and due from banks		1,493,000
b. Federal funds sold and securities purchased under agreements to resell		525,000
c. Total loans		14,775,000
d. Total deposits		22,168,000

We M.D. Dreibelbis, Exec. President, and Minnie Trimble, Cashier, of the above-named bank do solemnly swear that this report of condition is true and correct, to the best of our knowledge and belief.

M.D. Dreibelbis
Exec. Vice President
Minnie Trimble
Cashier

CORRECT—ATTEST:
Eugene A. Severson
C.P. Groszkruger
Wesley Mansfield
Directors

State of Iowa, County of Benton, ss:
Sworn to and subscribed before me this 4th day of January, 1978, and I hereby certify that I am not an officer or director of this bank.
My commission expires ... 1979.
... Notary Public

Expired Feb. 20, 1978

Evelyn T. ...
Notary Public

STATEMENT OF CONDITION
CHELSEA SAVINGS BANK
Chelsea, Iowa

State Bank No. 1086

Consolidated Report of Condition of "Chelsea Savings Bank" of Belle Plaine in the State of Iowa and Domestic Subsidiaries at the close of business on December 31, 1977.

ASSETS

Cash and due from banks		$ 548,000
U.S. Treasury securities		578,000
Obligations of other U.S. Government agencies and corporations		151,000
Obligations of States and political subdivisions		906,000
Federal funds sold and securities purchased under agreements to resell		50,000
a. Loans, Total (excluding unearned income)	$7,431,000	
b. Less: Reserve for possible loan losses	81,000	
c. Loans, Net		7,350,000
Bank premises, furniture and fixtures, and other assets representing bank premises		518,000
Other assets		15,000
TOTAL ASSETS		10,114,000

LIABILITIES

Demand deposits of individuals, partnerships, and corporations		1,896,000
Time and savings deposits of individuals, partnerships, and corporations		6,310,000
Deposits of United States Government		39,000
Deposits of States and political subdivisions		442,000
Certified and officers' checks		326,000
TOTAL DEPOSITS		9,013,000
a. Total demand deposits	$2,286,000	
b. Total time and savings deposits	6,727,000	
Mortgage indebtedness		241,000
Other liabilities		31,000
TOTAL LIABILITIES (excluding subordinated notes and debentures)		9,285,000

EQUITY CAPITAL

Common stock		
a. No. shares authorized	2,000	
b. No. shares outstanding	2,000	200,000
Surplus		200,000
Undivided profits		429,000
TOTAL EQUITY CAPITAL		829,000
TOTAL LIABILITIES AND EQUITY CAPITAL		10,114,000

MEMORANDA

Average for 30 calendar days ending with call date:	
a. Cash and due from banks	407,000
b. Federal funds sold and securities purchased under agreements to resell	95,000
c. Total loans	7,407,000
d. Time deposits of $100,000 or more	209,000
e. Total deposits	8,472,000
f. Federal funds purchased and securities sold under agreements to repurchase	18,000
Time deposits of $100,000 or more (as of call date):	
a. Time certificates of deposit in denominations of $100,000 or more	203,000

We Richard D. Johnson, Exec. Vice President, and John P. Cunningham, Vice-President and Cashier, of the above-named bank do solemnly swear that this report of condition is true and correct, to the best of our knowledge and belief.

Richard D. Johnson
Exec. Vice President
John P. Cunningham
Vice-President and Cashier

CORRECT—ATTEST:
[illegible]
[illegible]
Wayne [illegible]
Directors

State of Iowa, County of Benton, ss:
Sworn to and subscribed before me this 6th day of January, 1978, and I hereby certify that I am not an officer or director of this bank.
My commission expires September 30, 1978.
Mary Lou Van DeWalle, Notary Public
(SEAL)

Published in the Belle Plaine, Iowa Union in the issue of Wednesday, January 11, 1978.

—489- 2221 — PHONE
[illegible] HAS REAL ESTAT-
OFFICE.

LAND FOR SALE

87 acres in Columbia Township, 73 acres tillable. No buildings. Possession March 1, 1978.

Johnson & Cunningham
REAL ESTATE
Phone 489-2221 Chelsea

QUESTIONAIRE CONCERNING BANKS IN REAL ESTATE BUSINESS IN IOWA
(Fill out separate sheet for each bank)

Name of Bank: Lisbon Bank & Trust Co.

Address:

City or Town & Zip Code: Lisbon, Iowa 52253

Name of Officers:
H. W. Sizer, President
Albert Reid, Cashier
H. W. Sizer, Jr., V. P.
George L. Adams, Ass't Cashier

Name of Brokers and/or Salesmen licensed under bank or other connected business:

H. W. Sizer, Jr., known as 'Bud' Sizer

He does business as Bud Sizer Real Estate

Is Real Estate Business directly or indirectly controled by Bank (Explain)

Is Bank a locally owned bank or controlled by a Holding Company. If so what Holding Company.

Yes.

LIST your farm or residential property in the Lisbon area with Bud Sizer Real Estate. Dial 455-2652, Lisbon

Type of Advertisement:
(Attach copy of publication with ad)

the Record-Herald

Type of Real Estate transactions handled by bank:

Estates, houses, farms and businesses

Major Source of Real Estate Business, if known:

I assume he gets his real estate leads as all brokers do, as well as through the bank.

Length of Time in Real Estate Business:

At least 6-7 years

Number of Brokers & Salesmen:

Bud Sizer, Broker is only one

	Yes	No
Attached is an Official Bank Publication such as a financial statement indicating names of officers who are also licenced brokers and/or salesmen		

LISBON (Linn) Pop 1,316, Zip [illegible]
Lisbon Bank & Trust Co. [illegible] 72-1476
Tel. [illegible] Cap. [illegible]
Hrs. 9-12, 1-3 Sat. 9-12 Sur. 125,000
H. W. Sizer, Pres. H. W. Sizer, Jr., V.P.
Alberta [illegible], Cash. [illegible] L. Adams, A.C.
Deposits [illegible] Cash Resources $ [illegible]
L & D [illegible] Government Bonds $ 50,000
P & R [illegible] Other Securities $1,[illegible]
[illegible]
Northern Tr. Co., Chi[illegible] Mer. N. B., Cedar
[illegible], [illegible] Co., Davenport.

	Yes	No
Names and addresses of any people who you think may have been influenced, either directly or indirectly into doing business with a bank or their Real Estate Entity, when they had wanted to do business with another (non bank assiciated) Real Estate Broker		

Other Information

Your Name: Joel R. Hertz

Home Firm: Hertz Farm Management, Inc.

Address: 102 Palisades Road
Mt. Vernon, Iowa 52314

Phone Number: 319-895-8858

Date: March 15, 1978

IOWA ASSOCIATION OF REALTORS®

999 Oakridge Drive, Des Moines, Iowa 50314
Telephone 515 244-2294

REALTOR® REALTOR®

GOVERNMENTAL AFFAIRS DIVISION

June 12, 1978

Mr. Charles L. Marinaccio
Special Counsel
Committee on Banking
United States Senate
Washington, D.C. 20510

Dear Mr. Marinaccio:

We are forwarding with this letter 13 affidavitts concerning banks in real estate business. We hope these are in line with your request this past March when we visited you in your office.

Yours truly,

F. Harold Abernathey

F. Harold Abernathey, Director
Governmental Affairs Division

CC: Paul Preston
National Association of REALTORS
REALTOR I.L."Tommy" Tucker

AID

AID INSURANCE SERVICES

SCHMIDT REAL ESTATE AND INSURANCE INC.
DYSART, IOWA 52224

Senator Proxmire and other Members of the Senate Banking Committee

Re: Senate Banking Bill #72

As a real estate broker I have encountered the difficulties of selling properties when you have a banking institution also in the business of real estate sales and management.

In my instance the sale of a 120 acre farm was involved. The attorney did not want to give an exclusive listing so he contacted several real estate agents and told them he would accept offers on the farm and would pay the commission to the one with the offer which was accepted. I worked with a client who gave me a verbal offer pending while he contacted his banker to see if he could receive a loan. In a couple of days my client came back to my office and stated that he could receive the loan only if he would extend his written offer through the banker so that he would receive the sale and the commission for it. This client did obtain the loan and purchased the farm. I did all the work on this sale and the banker sat back and reaped the harvest. He received the commission on the sale of the property while I received nothing for all of my efforts. He took advantage of his position in the lending institution and I feel that this is taking undue advantage of another business person.

I feel very strongly that any person, officer or employee of a bank, should not be connected in any way with the sale or management of real estate.

I wonder how the banks would feel if the shoe were put on the other foot and anyone that wanted to could start a bank. I'm sure that they would not be too happy about that situation.

Respectfully yours,

Niels A. Schmidt

Niels A. Schmidt
Real Estate Broker

State of Iowa
County of Tama

On this 5 day of May, 1978 before me, the undersigned, a Notary Public in and for said County and State, personally appeared Niels A Schmidt To me known to be the identical person who executed and signed the foregoing instrument.

Delores M Schmidt

Delores M. Schmidt, Notary Public in and for said County and State

AID INSURANCE COMPANY (MUTUAL) • ALLIED LIFE INSURANCE COMPANY • AMCO INSURANCE COMPANY • AID FINANCE SERVICES, INC.
HOME OFFICE • DES MOINES, IOWA

Twin Cities Insurance & Real Estate

111 East High St. TOLEDO, IOWA 52342 Phone 484-2820

KEN CARSON
PAUL HUNTER
NELSON E. KING
P. HOPE OVERTURF

May 4, 1978

Iowa Association of REaltors

RE: Bankers in the Real Estate Business

Dear Sirs:

This is to inform you that our agency in 1968 had a relatively unfortunate happening. One of our real estate salesmen had a neighbor interested in a farm that we had listed, and he had pretty much of a committment from a young neighboring farmer to purchase this farm on a contract. When we're putting together a deal, we usually recommend they check with their financial advisor. In this case was bad news for our agency because he went in to talk to his banker at Traer Iowa and the banker said 'Let me sell you the farm. He called the seller who in turn cancelled his listing with us. He then sold the farm to this young farmer at the same price we had originally quoted. Therefore we lost the sale totally. as a Broker and a principal of this agency, Twin Cities Real Estate, did call this other broker and asked him if we could work a split on the commission. This fellow happened to be the Executive Vice-President of the bank and he told me under no circumstances--that he had sold the farm and we had nothing to do with the sale. He also said 'You guys don't furnish the money and therefore you have no reason to be selling farms because I control the money market too, you know. I thought this was a very arrogant attitude. At that time we did have a signed exclusive listing on the farm, however the seller cancelled this and we didn't really feel that we had enough to go to court in this case We certainly feel that our present exclusive listing contracts would give us the grounds to go to court and get the commission on a situation such as this.

I trust this is the information you requested.

Yours truly,

Kenneth E. Carson
Partner-Owner

KEC/lls

State of Iowa
County of Tama

On this 9 day of May, 1978
before me, a Notary Public, personally appeared the above named person (s), and they did sign the above at that time

Paul H Hunter
NOTARY PUBLIC

My commission expires 9/30/80

FULL SERVICE AGENCY — ALL LINES OF INSURANCE AND REAL ESTATE

THE McKinney AGENCY

515-473-2004 608 Garfield Street - - - - Gladbrook, Iowa 50635

May 9, 1978

Senator Proxmire and Other
Members of the Sehate Banking Committee
Washington, D.C.

I am very concerned with the unfair competition that occurs when banks are involved in the Real Estate and Insurance professions. I believe that banks should be prohibited from these businesses because of the pressure they exert on the clients, by implying that unless the insurance or real estate is handled through the bank, they will not make loans to the customer. More than the loss of business to me personally, I am concerned that the customer often pays a greater cost than is necessary because competition is suppressed.

Harold R. McKinney
Harold R. McKinney, CLU
The McKinney Agency
424 Second St.
Gladbrook, Iowa 50635

STATE OF IOWA, COUNTY OF TAMA, ss:

Subscribed and sworn to before me by Harold R. McKinney on this 9th day of May, 1978.

Marcia Weiss
Notary Public

KENSINGER REAL ESTATE
125 West Third Street
TAMA, IOWA 52339
Phone: 484-4441

April 19, 1978

Governmental Affairs Division
Harold Abernathy, Director

Re: Banks, Bankholding Companies

Concerning Conflict of interest, unfair competition in sale and listing of Real Estate.

I had a farm listed through our office. We had a young farmer and his wife as prospects, the man knew the farm well, having lived near it for some time. We talked to them several times concerning price, terms of sale, and contract.

The young wife came in to our office and said they were ready to make an offer on the farm, her husband had gone to the bank to see about financing. They didn't return that day so I called them and she said since the bank would loan them the money they had to buy the farm through the bank. They made the offerthrough the Vice - President of the bank, also a Real Estate Salesman, it was accepted and we lost the sale of the farm. Is that Fair Competion?

Very Truly,

Leo Steies

Leo Steies
Salesman
Kensinger Real Estate

Helen Greger
Commission Expires Sept. 30, 1979

KENSINGER REAL ESTATE
125 West Third Street
TAMA, IOWA 52339
Phone: 484-4441

April 10, 1978

Governmental Affairs Division
Harold Abernathey, Director

Re: State and National banks, bankholding companies.

Concerning conflict of interest and unfair competition with above in sale and listing of Real Estate, I have the following instances.

In 1976 my office sold a young couple an older home in Tama, Iowa. They had bought a new home in Tama and it was mortgaged through the bank. In order to sell their home and borrow money to purchase the older home the banker told them they would have to list their new home with the bank rather than our office, which they had planned to do, before they could secure the loan to completethe purchase of the older home.

Also I had a farmer who was more or less a friend of my late hsuband and we had carried his insurance on his car and farm for years, through hard times and good. He bought a house in Toledo, through our agency but said even though he wanted to list his farm with me and was very sorry he could not, for the bank told him he would have to list it with them in order to get his loan and clear his farm.

I have had young armers who would buy farm land through my office but are reluctant to even try because they know they will not be able to secure the financing through the bank.

Enclosed find the ad they run, week after week, using the bank as the place to buy property.

Very truly yours,

April 10, 1978

Trudie Kensinger
Realtor - Farm - Home

Leo H. Stites -
Expires Sept. 30, 1978

MEMO FROM
EUGENE A. ANDERSON

Honorable William S. Proxmire
Chairman Senate Banking Committee

Sir:

I have been asked if I had any problems with banks competing unfairly in real estate. I would have to say, yes, the most current example is that I have, is a local businessman who has a residence that he wants to sell and would like to list it with my office. He said that this could not be done openly (I could not advertising on it) but he would sign an listing agreement with my office. He informed me that the bank would put pressure on him through loans, etc. if they knew he listed it with me.

Notary Seal on Back

Eugene A. Anderson, Broker
Anderson Real Estate
125 West High
Toledo, Iowa 52342

DONNA L. ARRINGDALE

Subscribed and Sworn before me by Eugene A. Anderson
on this 17th day of April, 1978.

DONNA L. ARRINGDALE

Donna L. Arringdale
Notary Public in and for Tama County, Iowa

STATE OF IOWA, COUNTY OF TAMA: SS: AFFIDAVIT

TO U.S. SENATOR WM. PROXMIRE, CHAIRMAN AND ALL MEMBERS OF THE U. S. SENATE BANKING COMMITTEE

INRE: SENATE BILL NO. 72

THIS IS AN AFFIDAVIT TO CERTIFY THAT I HAVE HAD THE FOLLOWING CIRCUMSTANCES UNFAIRLY THRUST UPON ME BY SMALL TOWN BANKERS WHO WERE ALSO REAL ESTATE BROKERS AND SALESMEN:

1. A REALTOR SHOWS A 240 ACRES FARM TO A FARMER, READY, WILLING AND ABLE TO PURCHASE A FARM. THIS PURCHASING FARMER WENT TO HIS "FRIENDLY" BANKER TO BORROW SOME OF THE DOWN PAYMENT OR EARNEST MONEY DEPOSIT. UPON LEARNING OF THIS BUYERS INTENTIONS OF PURCHASING THE ABOVE FARM WHILE ASKING TO BORROW SOME DOWN PAYMENT THE BANKER INFORMS THIS NEW FARMER PURCHASER THAT HE TOO HAS A LISTING ON THAT FARM AND HE, THE BANKER, IS GETTING THE SALE OF IT OR THE FARMER DOESN'T GET THE LOAN.

2. MANY PEOPLE WILL GO TO THEIR BANKER AND MAKE ARRANGEMENTS TO BORROW MONEY BEFORE CONTACTING ANY REALTOR OR REAL ESTATE AGENT. I HAVE BEEN INFORMED BY MANY LOYAL CLIENTEL OF THIS PROCEDURE USED BY BANKERS:

A. YOU HAVE ALWAYS BEEN A GOOD BANK CUSTOMER OF OURS.

B. REMEMBER THAT OVERDRAFT WE PAID FOR YOU LAST WEEK?

C. NOW IF YOU PURCHASE SOMETHING THROUGH OUR REAL ESTATE AGENCY ALL FINANCING WILL BE ARRANGED. IF NOT THROUGH OUR AGENCY PROBABLY NO FINANCING.

3. MR. JOHN DOE HAS A HOUSE LOAN AT THE BANK. HE IS BEHIND ON PAYMENTS AND DECIDES TO SELL, USING HIS EQUITY TO PURCHASE A SMALLER AND LOWER PRICED UNIT.

A. THE BANKER IS THE FIRST REAL ESTATE AGENT TO KNOW OF THIS CONDITION AND THUS HAS AN "INSIDE" OR "EDGE" OR FIRST KNOWLEDGE OF A SALE INTENT BY THE OWNER - "CONFLICT OF INTEREST"

B. HE, THE BANKER, SAYS NOW I WILL CARRY THE LOAN AND MAKE THE PAYMENTS AS LONG AS I HAVE THE LISTING, UNTIL I PERSONALLY CAN GET IT SOLD.

C. THE BANKER PROBABLY GETS TWO HOUSE SALES BY THIS PROCEDURE: THE CLIENT'S EXISTING AND THE CLIENT'S OLDER PURCHASED HOME. - ANSWER - INSIDE INFORMATION AND UNFAIR COMPETITION.

4. HAVE KNOWN HIGHLY UNETHICAL BANKERS WHO HAVE PRESSURED OR INTIMIDATED PROPERTY OWNERS WHOSE REAL ESTATE THEY HAVE LISTED AND HAVE BEEN UNSUCCESSFUL IN SELLING BY INFORMING THEM THAT IF THEY GIVE THE LISTING TO ANOTHER BROKER THEY, THE BANKER, WILL CALL AN OUTSTANDING LOAN - EITHER ON THE HOUSE, OR ANOTHER LOAN OR ANYTHING ELSE - UNFAIR COMPETITION AND "CONFLICT OF INTEREST"

5. ALSO BANKERS FREQUENTLY ASK, EXPLAIN AND INFORM PEOPLE WHO HAVE A LARGE LOAN WITH THEM, PROBABLY ON OTHER THINGS OTHER THAN REAL ESTATE THAT THEY WANT THEM TO DO ALL THEIR BUSINESS WITH THEM, THE BANKER, SO A CLOSE TOUCH OF THEIR, THE CUSTOMER'S FINANCIAL SITUATION WILL BE KNOWN.

6. HAVE KNOWN MANY INSTANCES WHERE A BANKER WOULD LOAN THE ~~ONE~~ SAME BUYER FROM $1,000 to $4,000 MORE MONEY ON A GIVEN PROPERTY WHEN HE, THE BANKER HAD THE LISTING, THAN WHEN, A NON-BANKER AGENT HAD THE SAME LISTING.

John R. Currens

JOHN R. CURRENS, REALTOR
TRAER, IOWA 50675

Subscribed and sworn to before me by John R. Currens this 10th day of April, 1978.

Phyllis M. Early

Notary Public in and for the State of Iowa.

REAL ESTATE
INSURANCE
SECURITIES
LOANS

PHONE: (319) [illegible]

F. C. EARLEY AGENCY

912 Mill Street
Traer, Iowa 50675

AFFIDAVIT

STATE OF IOWA)
) SS:
COUNTY OF TAMA)

I, Franklin C. Earley, Realtor of Traer, Tama County, Iowa, do hereby state:

That a representative of a local State licensed bank who is also licensed by the State of Iowa to sell real estate told an eventual client of mine that the real estate agency of the bank could very likely find a buyer for her property more readily than I due to its having more access to the public through daily business in the bank. She, therefore, listed her property with the bank agency until her listing with it terminated (90 days), at which time she came to me.

The seller of the property felt that if she had not initially listed her property with the bank, she might have lost its good will toward her in future financial transactions.

Also the bank real estate agency recommended that she sell her property for cash rather than on an installment contract which was the method used in finally consumating the sale through my agency and approved by her attorney and income tax consultant. If the sale had been for cash as the bank advised, the bank would have received the cash from the seller as a deposit and also the bank would have been in a position to loan funds to a prospective buyer of the said property. Through the installment contract sale, the seller was the person who received the interest and we obtained an able and willing buyer within less than one week after listing the property with my agency.

Dated this 16th day of April, 1978.

F. C. EARLEY AGENCY

By Franklin C. Earley
Franklin C. Earley, Realtor

Subscribed and sworn to before by Franklin C. Earley this 16th day of April, 1978.

Phyllis M. Earley
Notary Public in and for the State of Iowa.

Pieper Real Estate and Insurance

123 West 13th Street, Tama, Iowa 52339
Telephone: office (515) 484-2906 Res. 484-4410

4-10-78

To Whom It May Concern:

In August 1976 I sold a young couple an older home in Tama, Iowa. They owned a smaller new home in Tama that was mortgaged to almost its total market value. When they made their offer to purchase the older home I suggested that they make their offer subject to selling their present home. They said "no" the bank had told them they would loan them the money. The offer was accepted by the seller and the young couple then stated they wanted to list their home for sale with me. I suggested they first go to their bank, which is in the real estate business, to get the loan for the house they would be buying. As I suspected would happen the banker told them in order to get the loan they should have purchased the house through the bank, but since they didn't they would have to list their present home with the bank's real estate agency.

Sincerely
Fred J. Pieper
Broker

Notary
Leo H. Stures April 10, 1978
Expires Sept. 30, 1978

April 11, 1978

U. S. Senator Proximire
Chairman of Banking Committee

Dear Senator Proximire:

As to the Banks, being in the Real Estate Business. I find my situation is that the Banks, will not cooperate in any way.

They also inform their Customers, not to do business with other Realtors, and indicate to them their needs for future financing could be jeopardized with them, being in a small town.

The Banks, work somewhat together, but they do not include anyone else. When the Customers asks the Banks, about listing their property, and do they (Banks) belong to Multiple, they say yes, which is incorrect (it being the two just work together). This being a small town the people knowing I too am in the Real Estate Business, they think that I too can show their property. Not until after it is listed with the Banks, and they talk to me about showing their property, do they find out that the Banks, do not belong to a multiple or that they do not cooperate with other Realtors.

I am well aware of the Banks proceedure in my town, as I formerly worked for one of them almost fifteen years. That being one of the reasons that I resigned and went into the Business myself.

Trusting something will be done about the monopoly the Banks have being in the Real Estate Business.

Sincerely,

Irene A. Stout

Irene A. Stout, Broker
101 E. Avenue
Grundy Center, Iowa 50638

On this 11 day of April A. D. 1978, before me, the undersigned, A Notary Public in and for said County, in said State, personally appeared Irene A. Stout to me known to be the identical person named in and who executed the foregoing instrument, and acknowledged that they executed the same as her voluntary act and deed.

Ronald C. Elkerkin
Notary Public in and for said County

To Whom it May Concern:

I own and operate a 240 acre farm near Hudson, Iowa.

A farmnear me was up for sale. The owner had made down payment on a farm near his father.

I knew his listing was expiring next day. He had it listed with a bank officer in the locality where his new farm was located. I asked him after listing expired to let my REALTOR list and present an offer from me to purchase. He stated that bank had advanced on note down payment on his new farm providing they could list and sell present farm.

I did not make offer and the bank sold the farm at a later date. This bank also after the sale loaned him balance on new farm.

Merlyn Boyken

On this 25 day of April A. D., 1978, before me the undersigned A Notary Public ~~in and~~ for said County, in said State,personally appeared [illegible] to me knownto be the identical person named in and who executed the foregoing instrument and acknowledged that they executed the same as his voluntary act and deed.

Gladys M. Michalski
Notary Public in and for Said County
Polk County

IOWA ASSOCIATION OF REALTORS®

999 Oakridge Drive, Des Moines, Iowa 50314
Telephone 515 244-2294

GOVERNMENTAL AFFAIRS DIVISION

July 17, 1978

Mr. Charles L. Marinaccio
Special Council
Committee on Banking
United State Senate
Washington, D. C. 20510

Dear Mr. Marinaccio:

We are forwarding you the following:

1. Four more affadavits.
2. Print-out furnished us by the Federal Reserve Bank of Chicago showing information on bank holding companies in Iowa.
3. Copy of a late ad from bank in Leon, Iowa.

We realize most of the material given you last March, and again by the National Association June, when they appeared before the Banking Committee concerned State of Iowa chartered banks. When you check the print-out on bank holding companies you will see that a very large percentage of these state chartered banks are members of some bank holding company.

We especially call your attention to three bank holding companies.

1. Brenton Banks Inc. - Des Moines, Iowa. Very active in farm management other than their trust accounts.
2. Centra Nationa Bankshares Inc. - Des Moines, Iowa. Very active n farm management and do take part in some real estate sales other than their trust accounts.
3. Hawkeye Bankcorporation - Des Moines, Iowa. Very active in all types real estate, listing, sales and management other than their trust accounts.

These are not the only ones involved, but probably the largest.

We hope the material will be of some help to you.

Yours truly,

Harold Abernathey

Harold Abernathey, Director
Governmental Affairs Division

HA:gm

cc: Mr. Paul Preston, NATIONAL ASSOCIATION OF REALTORS, Washington, D.C.
REALTOR I. L. (Tommy) Tucker, Cedar Rapids, Iowa

WAYNE N. CAREY
PHONE 237-5901

WALTER L. "BUD" VRZAK
PHONE (319) 776-6480

Carey-Vrzak, Inc.
REALTORS

REALTOR®

58 Combined Years of Service — 100's of Satisfied Clients

PAUL E. HASSMAN
SALESMAN
PHONE 394-2282

PHONES (AREA 515)
394-3126 - NEW HAMPTON, IOWA
237-5901 - FREDERICKSBURG, IOWA
(319) 776-6480 - WAUCOMA, IOWA

July 3, 1978

Iowa Association of Realtors
c/o Harold Abernathy
999 Oakridge Drive
Des Moines, Iowa 50314

Dear Mr. Abernathy:

We are enclosing (1) a copy of an original listing contract between our firm and Don & Doris Reicks, (2) a copy of a listing contract and a promissory note between Mr. and Mrs. Reicks and Volney Palmer, Real Estate Broker, who, to the best of our knowledge either wholly owns or at least controls the interest in the Hawkeye State Bank.

The circumstances that surround this matter are basically as follows: Mr. Reicks had contacted us to list the farm in view of his financial need, and had requested that every effort be put forth to make a sale for possession this spring. His attorney, Mr. Donohue, of West Union had advised us personally that since particularly Mr. Vrzak was most knowledgeable of the farm and with the experience of our firm,-that he felt we could do the best job in selling the farm for Reicks.

Reicks advised us that he was able to obtain short term operating capital from Mr. Palmer, but that Mr. Palmer wanted a listing contract on the farm. Therefore our original isting contract included the clause permitting Reicks to cancel the listing contract at his attorneys, Donohue's, request only

After several days had passed and this office had presented the farm to a number of prospective buyers, Reicks requested verbally that we cancel the listing. Further investigation revealed that Reicks had acquired the short term operating capital from Hawkeye State Bank and that he had signed a listing contract, a copy of which is enclosed.

Please note that the listing contract specifies that the farm would not be shown until August 15, 1978 and also that it was inserted that Reicks would accept $1700 while the listing price was $1800 per acre!

(Cont.)

Iowa Association of Realtors
c/o Harold Abernathy
July 3, 1978
Page 2

Wayne N. Carey of this office called Mr. Donohue and asked if he had advised Reicks to cancel the listing that he had originally given our firm and he stated 'that he had not',-in fact he reiterated that he still felt that because of Mr. Vrzak's knowledge of the farm and our experience as a firm that we could do the best job in selling the farm.

Carey requested a meeting with Donohue to discuss the matter and he stated that it would be useless because he could do nothing with Palmer' Shortly thereafter we received a letter from Mr. Donohue, a copy of which is enclosed, which in essence would comply with the cancellation clause in our original listing contract.

At a later date but shortly after the Donohue letter was received by us Reicks again came to Mr Vrzak and wanted to re-list hi farm, advising that he had changed attorneys and preferred to change banks. We might further advise that prior to that meeting we, Carey and Vrzak, visited Volney Palmer personally and received little or no encouragement only to be advised that he had the listing,-he had prospects, and the farm was not to be shown or sold prior to August 15, 1978, since then we have encountered at least one prospect who has looked at the farm and advised that Palmer presented the farm to him at either $1700/1750 per acre and encouraged him that he probably could trade his present farm for the Reicks property.

Don Reicks has employed Mr. Anderson of Cresco, as his attorney, and at his recommendation we have relisted the farm with the stipulation that all parties concerned are aware of the listing contract with Palmer but of its questionable validity according to Attorney Anderson.

We suggest that you take special note of the Palmer listing regarding 'no showing unti August 5th' and 'voids ts effectiveness until then'. The double figure which is not conducive to the best interests of the seller in our opinion. Also you might note the listing contract used by Mr. Palmer is a '1939 form'.

As Real Estate Brokers and as Realtors, we have no desire to create unjustified problems, but we feel that the approach that Mr. Palmer has taken in attempting to acquire this business does not compliment either the Real Estate profession or the banking industry.

We trust we will be advised by your office as to your feelings.

Sincerely,

WNC-WLV/hc

Wayne N. Carey - Walter L. Vrzak

STATE OF IOWA, CHICKASAW COUNTY, ss.
ON this 5 day of July, A.D. 1978, before me, the undersigned, a Notary Public in and for said County and State, personally appeared........................
Wayne N. Carey and Walter L. Vrzak
to me known to be the identical persons named in and who executed the foregoing instrument, and acknowledged that they executed the same as their voluntary act and deed.

Hazel C. Cochran
NOTARY PUBLIC IN AND FOR SAID COUNTY AND STATE
HAZEL C. COCHRAN

AGREEMENT

NOW, on this 26th day of June, 1978, this agreement is made by and between Carey - Vrzak, Inc., party of the first part, and Don Reicks and Doris Reicks, party of the second part, as follows:

Paragraph 1. Party of the second part agree that they will consider any other offers that party of the first part may present to them with regard to a Uniform Listing Contract on their farm entered into this day and date aforementioned.

Paragraph 2. It is further understood by all parties that there is in existence a Uniform Listing Contract between party of the second part and one Volney Palmer, which was dated May 11, 1978, and purports to be a Uniform Listing Contract on the same premises. It is further understood that that agreement provides that the farm in question will not be offered by said Volney Palmer before August 15, 1978.

Paragraph 3. Party of the first part agree to cooperate with any and all other real estate brokers who may present potential buyers for the farm owned by parties of the second part.

Paragraph 4. Parties of the second part acknowledge that they have entered into this agreement by their own voluntary action and deed and with no solicitations of any kind being made parties of the first part.

CAREY - VRZAK, INC.

BY Walter L. Vrzak

BY Wayne Carey

PARTIES OF THE FIRST PART

Don Reicks
DON REICKS

Doris Reicks
DORIS REICKS
PARTIES OF THE SECOND PART

UNIFORM LISTING CONTRACT

IOWA CHAPTER #2 – NATIONAL INSTITUTE OF FARM & LAND BROKERS

1. WE DO HEREBY LIST FOR SALE (OR EXCHANGE) WITH CAREY - VRZAK, INC. REALTOR, of New Hampton, Iowa, the following described property located in Winneshiek County, State of Iowa, containing 320 acres more less to wit:

The East Half (E½) of Section Seven (7), Township Ninety-six (96) North, Range Ten (10), West of the 5th P.M., Winneshiek County, Iowa;

2. IN CONSIDERATION of services which said REALTOR herein agrees to render, we give said REALTOR the exclusive right to sell said property, for a period of one and one-half MONTHS which will be until the 14 day of August A.D., 19 78, at the price of $ 688,000 for property: $ 1,000.00 to be paid when contract of sale is made and balances as follows:

Buyer is to make down payments on other farms to be specified by seller in an amount not to exceed $180,000.00, said interests in other farms to be traded to seller as part of the consideration. Difference between traded interests and sellers present contract obligation to be paid on or before possession date. Sellers will agree to pay all accrued interest. Buyer is to pay the principal payment in the amount of $10,000.00 on Cyril Jestrab contract on or before December 15, 1978. All principal and interest payments due after December 15, 1978, on present contract with Cyril Jestrab will be paid by purchaser according to the existing contract, and all other terms and conditions of the contract will be complied with by assignment. Further real estate contracts will be drawn between buyer and seller applicable to all property concerned.

6. Said REALTOR agrees to use his best efforts to sell said property by Personal Solicitation. [illegible]

Dated this 26 day of June, A.D., 1978, at ______, Iowa.

Signed Don Reicks

Signed Doris Reicks

ACCEPTED THIS 26 DAY OF June, A.D., 19 78

Signed Carey-Vrzak Inc. by Walter L Vrzak REALTOR

Address 3 E main New Hampton Ia 50659 Telephone 515-394-7126

Existing Mortgage:		Interest:		Due:	
Option Payment:		Gross Taxes:		Type of Road:	Black Top
Nearest Market:	Protivin	No. of Miles from Mkt:	4½ miles	Direction from Mkt:	South
Soil Type:		School Dist.	Turkey Valley	Creeks, Ditches or	Small
Acres Tillable:	304	Lay of Land:	Gentle Roll	Sloughs:	
Name of Owner:	Don Reicks	Acres Pasture:		Electricity:	R.E.C.
Type of House:	Frame	Tenant:	Owner	Modern:	Yes
Cellar or Basement:	Full	No. Rooms:	4 bedrooms	Hardwood Floors:	
Septic Tank:	Yes	Heat:	Gas forced air	Cribs:	
Barns:	Yes, Dairy	Water:	Well pressure		
Granary:		Hoghouse:		Henhouse:	
Cattle Shed:	yes	Machine Shed:	Yes	Garage:	
Fences:	Fair	Other Bldgs:			

REASON FOR SELLING:

REMARKS: Drying Bin plus other storage. Silo Unloader stays and Barn cleaner stays. Pipe line milker does not stay.

Approved by: Iowa Chapter No. 2, National Institute of Farm and Land Brokers.

Original Copy ☐
Duplicate Copy ☐

DONOHUE LAW OFFICE, P. C.

WEST UNION, IOWA

JAMES S. UPDEGRAFF

J. D. Villont

May 30, 1978

Carey, Vrzak and Associates
3 East Main
New Hampton, Iowa 50659

Re: Don Reicks

Gentlemen:

Pursuant to the listing agreement that you had with Don Reicks, I regret to inform you that it is necessary as previously discussed on the telephone, to terminate that listing agreement. Don advises me that due to the fact that this was only a one week tentative type listing, that in fact your listing did not particularly mean a great deal. However, be that as it may, it was signed, and therefore, I am required to give you this particular notice.

I am sure you fully realize that I feel that you could give a more than adequate representation to Don in selling the real estate, but I have no further control over this situation and therefore, as his attorney, must terminate that listing.

Yours very truly,

DONOHUE LAW OFFICE, P. C.

By: R. L. Donohue

RLD:ijc

NAME ... DUE Nov. 19, 1978 65,000.00

May 19, 1978 19 ... Six Months after the date hereof

[the] undersigned jointly and severally promise to pay to the order of

CITIZENS SAVINGS BANK, HAWKEYE, IOWA ... at its offices

[the] sum of Sixty five thousand and no/100 - - - - - - - - Dollars

[with] interest from date at ... at the rate of NINE

[per] cent per annum, payable Monthly at said bank. Interest will continue [at] the current NINE rate after maturity until paid.

The makers, sureties, endorsers and guarantors of this note hereby severally waive presentment for payment, notice [of] non-payment, protest and notice of protest, and diligence in bringing suit against any party thereto and consent [that the time] of payment may be extended without notice thereof to any of the sureties of this note All farm equipment, all farm products

[ ] This loan is secured by a Security Agreement dated 5-19-78 (including crops and livestock, all feed and [supplies] covering the following property: supplies used in farming operation) and additions, to and replace[ment] of, accessions, parts, and equipment now or hereafter affixed thereto or used [in] connection therewith. All accounts, consumer goods and fixtures. In claiming accounts and proceeds, the secured party does not [authorize] disposal of the collateral

[ ] The Security Agreement will secure future or other indebtedness and will cover after acquired property.

The bank has a right of set off or lien on any deposit in the bank which is the property of a debtor or co-debtor.

This loan is subject to the provisions of the Iowa Consumer Credit Code applying to consumer loans.

Purpose of Loan: Pay up bills etc. Consolidation of bills.

The unpaid balance of this loan may be prepaid in full at any time without penalty. Upon such prepayment, the creditor may collect a minimum **FINANCE CHARGE** [of] **$5** if the amount financed is **$75** or less or **$7.50** if the amount financed exceeds **$75**, if the **FINANCE CHARGE** earned at the time of prepayment is less [than] such minimum **FINANCE CHARGE.** If the **FINANCE CHARGE** contracted for is less than such minimums, upon such prepayment the **FINANCE CHARGE** contracted for may be retained or collected by creditor as the minimum **FINANCE CHARGE.**

Date	Int. Paid	Prin. Paid	Balance

PAYABLE FROM CREAM CHECK ASSIGNMENT $400.00 every 2 weeks.

PROCEEDS			AMOUNT FINANCED	FINANCE CHARGE	TOTAL OF PAYMENTS	ANNUAL PERCENTAGE RATE
65,000.00	$	$	$65,000.00	$ 2,925.00	$ 67,925.00	9 %

NOTICE TO CONSUMER:

1. DO NOT SIGN THIS AGREEMENT BEFORE YOU READ IT.
2. YOU ARE ENTITLED TO A COPY OF THIS AGREEMENT.
3. YOU MAY PREPAY THE UNPAID BALANCE AT ANY TIME WITHOUT PENALTY AND MAY BE ENTITLED TO RECEIVE A REFUND OF UNEARNED CHARGES IN ACCORDANCE WITH LAW.
4. BY SIGNING BELOW, YOU ALSO ACKNOWLEDGE RECEIPT OF A COPY OF THIS NOTE ON THE DATE HEREOF.

INSURANCE

PROPERTY INSURANCE, if written in connection with this loan, may be obtained by borrower through any person of his choice. If borrower desires property insurance to be obtained through the creditor, the cost will be $ ______ for the term of the credit.

CREDIT LIFE AND DISABILITY INSURANCE is not required to obtain this loan. No charge is made for credit insurance and no credit insurance is provided unless the borrower signs the appropriate statement below.

(a) The cost for Credit Life Insurance alone will be $ ______ for the term of the credit.

(b) The cost for Credit Life and Disability Insurance will be $ ______ for the term of the credit.

(c) The cost of Credit Life Insurance alone will be ______ per $100 per month, eligible to $ ______ limit. Debit my account as preauthorized by me.

I desire Credit Life Insurance only ______ (Date) ______ (Signature)

I desire Credit Life and Disability Insurance ______ (Date) ______ (Signature)

I DO NOT want Credit Life or Disability Insurance 5-19-78 (Date) Don Reicks (Signature)

5-19-78 (Date) Don Reicks (Signature)

CITIZENS SAVINGS BANK, HAWKEYE, IOWA 52147

[signature]

Don Reicks DEBTOR

[signature] CO-DEBTOR

THIS IS A CONSUMER CREDIT TRANSACTION

UNIFORM LISTING CONTRACT—Approved by Iowa Real Estate Commission, June 1, 1938.

Date ......May 11, 1978......

In consideration of the agreement herein contained, the undersigned Owner and Broker hereby agree as follows: The Owner hereby gives and grants to said Broker the sole and exclusive right to find a purchaser for, or to sell, the following described property located in Winneshiek County, Iowa, to wit: ....

..........East Half (E½) of Section seven (7) Township 96N, Range 10W ....

....

for the sum of $...[illegible],000.00...... on the following terms: 150,000.00 Down payment Mar 1, 1979 Balance $20,000.00 plus ... [illegible] ... Dec. 15th ... Mar. 1st

Balance due in full 12-15-19[illegible] or at any other terms that may be acceptable to the Owner.

The Broker agrees to use every proper effort to produce a buyer for or to sell said property on the terms specified, and in case of a sale, he is to receive as compensation therefor, in case said property is sold for the price specified or for any other price and terms accepted by the Owner, a commission of...... 5...... per centum, of the sale price or of the value of said property in case an exchange is made, but such consideration shall be not less than $.................. The commission shall be due in case the owner sells by himself or through the efforts of any other agent.

The Owner further agrees, in case a sale or exchange is made, to furnish an abstract of title showing a good and merchantable title in him to said property, subject only to such liens and encumbrances that the purchaser may agree to assume or take subject to. Said purchaser shall have a reasonable time to examine said abstract, and when deal is completed, to execute and deliver to purchaser a Warranty Deed for said premises, subject only to such liens and encumbrances, if any, that may be assumed, or taken subject to, by the purchaser.

To give possession of said premises at or within on or before March 1, 1979 ....days after deal is closed. Owner further agrees that Broker and prospective purchasers, shall have full and free access to said property at all reasonable times, to inspect said premises and the buildings thereon.

This contract shall continue in full force and effect until the ... 1st ... day of ...... March 19..79 and shall terminate on said date, without notice, except that if the owner makes a sale or exchange of said property to and with any person to whom the Broker has shown said property during the life of this contract within.............. months from and after the date of expiration, notice of such showing having been given him prior to such expiration, then said Broker shall be entitled to the full commission as herein agreed upon. In case said property is sold under a contract the owner agrees to execute such contract to and with the purchaser. In case of an exchange of said property the owner agrees that the Broker may also represent the other party and receive a commission therefor. In case the Owner leases said premises, or any part thereof, such lease shall be made subject to this. You are authorized to place a "For Sale" sign on said property and to remove all other signs.

Executed at.........[illegible], Iowa.........Iowa. It is understood that this farm will not offered before August 1, 1978

ACCEPTED:

It is understood that the sellers will sell for 1700.00 per acre if Broker can not get offer of 1800.00 per acre

[illegible] .... Owner.

[illegible] .... Wife or Husband.

Broker.

[illegible]

UNIFORM LISTING CONTRACT

IOWA CHAPTER #2 — NATIONAL INSTITUTE OF FARM & LAND BROKERS.

1. [illegible] HEREBY LIST FOR SALE (OR EXCHANGE) WITH Corey-Pegg Inc. , REALTOR, [illegible] , Iowa, the following described property located in [illegible] [illegible] Iowa , containing 320 acres more less to wit:
E½ of Sec 7 Twp 96 Range 10 West of the 5th PM [illegible] Co. Iowa.

2. IN CONSIDERATION of services which said REALTOR herein agrees to render, we give said REALTOR the exclusive right to sell said property, for a period of 3 MONTHS which will be until the 25 day of July A.D., 19 78 , at the price of $ 640,000 for property: $ ______ to be paid when contract of sale is made and balances as follows: $25,000 down, Bal of $615,000 [illegible] $115,000 on poss. Bal of 500,000 as follows $20,000 [illegible] annually plus 9½% int on the unpaid Bal. 1st payment Dec 15 78 and on [illegible] Bal due in full Dec. 15, 1990

3(a). FINAL SETTLEMENT to be given on ______ day of ______, A.D., 19 ______ as soon as possible

3(b) FINAL POSSESSION to be given on ~~[illegible]~~ day of ~~[illegible]~~ A.D., 19 ______ 30 days

4. We agree to pay said Listing Realtor Corey-Pegg Inc. at his office at New Hampton , a commission of 5 % of the sale price (a) if he finds a buyer who shall be ready, willing and able to purchase during said period upon the price and terms above stated or at any other price and terms that may be agreed upon, or (b) if said property is sold by the owner, or his authorized agent, or any other person or persons during said period, or (c) if said property is sold by the owner within 90 days after the termination of this contract to any person, firm, or corporation to whom this property has been presented by the Listing Realtor or any other persons representing him, providing Listing Realtor furnishes the owner in writing the names of persons to whom this property has been presented within ten days after the expiration of this contract.

5. We agree to furnish purchaser Warranty Deed and Abstract showing good merchantable title to said property.

6. Said REALTOR agrees to use his best efforts to sell said property ~~both by Multiple Listing and Personal Solicitation. It is further agreed that this listing is to be immediately forwarded to all members of the Iowa Farm Realtors Listing Exchange, National Institute of Farm and Land Brokers, at no additional cost to me.~~

Dated this 25 day of Apr. A.D., 19 78 , at [illegible] , Iowa.

Signed Don W. Reicks

Signed Doris Reicks

ACCEPTED THIS 25 DAY OF april A.D., 19 78

Signed Corey-Pegg Inc. By [illegible] REALTOR

Address [illegible] New Hampton [illegible] Telephone 515-394-[illegible]

Existing Mortgage:		Interest:		Due:	
Option Payment:		Gross Taxes:		Type of Road:	Black top
Nearest Market:	[illegible]	Miles from Mkt:	4 miles	Direction from Mkt:	South
Soil Type:		School Dist.	Turkey Valley	Creeks, Ditches or	small
Acres Tillable:	304	Lay of Land:	[illegible]	Sloughs:	
Name of Owner:	Don Reicks	Acres Pasture:		Electricity:	REC
Type of House:	[illegible]	Tenant:	[illegible]	Modern:	yes
Cellar or Basement:	[illegible]	No. Bed Rooms:	[illegible]	Crib:	
Septic Tank:	yes	Heat:	[illegible]	Garage:	
Barns:	[illegible]	Water:	well [illegible]	Corn Base:	
Granary:		Hoghouse:		Rate Yield:	
Cattle Shed:		Machine Shed:	[illegible]	Conserving Base:	
Fences:	[illegible]	Other Bldgs:		County Average:	

REASON FOR SELLING: ______

REMARKS:

[illegible]

[illegible]

[illegible]

Seller may cancel this listing if his Lawyer, Richard [illegible], recommends he do so. — Paragraph 4 above will apply in such case.

Approved by: Iowa Chapter No. 2, National Institute of Farm and Land Brokers, an affiliate of the Iowa Association of Realtors

Original Copy ☐
Duplicate Copy ☐
Triplicate Copy ☐

24-834 O - 78 - 12

HAROLD O. FISCHER
STATE REPRESENTATIVE
GRUNDY COUNTY

SERVICE – 58TH, 59TH, 60TH, 60TH Ex., 61ST, 62ND, 63RD, 64TH, AND 65TH GENERAL ASSEMBLIES

WELLSBURG, IOWA 50680
PHONE: (515) 869- 3724

House of Representatives
STATE OF IOWA
Sixty-Fifth General Assembly
STATE HOUSE
Des Moines, Iowa 50319

COMMITTEES

COMMERCE
APPROPRIATIONS
TRANSPORTATION

Wellsburg, Iowa
May 15, 1978

Senator William Proxmire
& Members of the Senate Banking Committee
Senate Office Building
Washington, D. C. 20515

RE: Senate Banking Bill #72

Gentlemen:

Although I have now retired from legislative service and have sold my general insurance agency, I have long been aware of the abuses by many independent banks and bank holding company member banks who have resorted to undue pressure and coercion in promoting the sale of various forms of insurance as well as tie-in transactions on real estate sales and loans through their respective insurance and real estate departments. During the time that I served in the Iowa Legislature, consideration was given many times to prohibiting banks from engaging in any non-banking services and activities. Because such a law would not apply to nationally chartered institutions, such a restriction or prohibition would then only apply to those state-chartered institutions which then could obtain a federal charter to avoid compliance. Efforts to change the laws were then dropped but the incidents of pressure and coercion still continue!

It is my confirmed belief and position, that given proper investigation and hearing by your Committee, the majority of your members will agree that strict legislation is not only badly needed but also desireable to eliminate the very existence of a temptation for those operators who use undue pressure and coercion in their business practices. It should be noted, however, that most victims of this type of pressure and coercion are generally most reluctant to testify because of fear of retaliation and retribution.

Respectfully yours,

Harold O. Fischer

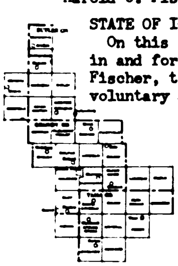
Harold O. Fischer.

STATE OF IOWA, COUNTY OF GRUNDY: SS

On this 15th day of May, 1978, before me, Darrell E. Breneman, a Notary Public in and for the County of Grundy, State of Iowa, personally appeared Harold O. Fischer, to me known to be the person named in and who executed the same as his voluntary act and deed.

Darrell E. Breneman

Darrell E. Breneman, Notary Public.



REPRESENTATIVE DISTRICT 38

BLACK HAWK COUNTY – ORANGE, LINCOLN, AND EAGLE TOWNSHIPS, AND THAT PORTION OF BLACK HAWK TOWNSHIP NOT INCLUDED IN REPRESENTATIVE DISTRICT THIRTY-THREE, AS DESCRIBED IN SUBSECTION THIRTY-THREE (33) OF THE APPENDIX

BUTLER COUNTY – BENNEZETTE, PITTSFORD, MADISON, RIPLEY, WASHINGTON, AND MONROE TOWNSHIPS

FRANKLIN COUNTY – GENEVA AND OSCEOLA TOWNSHIPS

GRUNDY COUNTY – GERMAN, PLEASANT VALLEY, BEAVER, FAIRFIELD, SHILOH, COLFAX, LINCOLN, GRANT, PALERMO, WASHINGTON, BLACK HAWK, AND CLAY TOWNSHIPS

MARSHALL COUNTY – VIENNA TOWNSHIP

TAMA COUNTY – LINCOLN, GRANT, BUCKINGHAM, GENESEO, SPRING CREEK, CRYSTAL, PERRY, CARLTON, AND HOWARD TOWNSHIPS

DIRKS REAL ESTATE & INSURANCE

[illegible] General Agent REINBECK, IOWA [illegible] 410 Main Street

June 21 1978.

Senator Proxmire & other members of the Comm.
Chairman of the Senate Banking Committee.
Washington D. C.

In re: of Senate Banking Bill # 72

Dear Sirs:

It is my opinion that banks which deal in real estate transactions are exercising a conflict of interest and should not be able to use their advantage in the real estate business.

Sincerely

Donald D. Dirks
Reinbeck, Iowa.

STATE OF IOWA)
COUNTY OF GRUNDY) ss.

Subscribed and sworn to before me by Donald D. Dirks this 21st day of June, 1978.

Arlene Wulf
Arlene Wulf
Notary Public - State of Iowa.

My Com. expires 9/30/78.

JOHN J. KALOUPEK INSURANCE AGENCY
Insurance - Real Estate
CHELSEA, IOWA 52215
PHONE [illegible]

insurance security • insurance security • insurance security • insurance security • insurance security • insura

May 10, 1978

TO: Senator Proxmire and Other Members of the Senate Banking Committee..
W/Reference to Senate Banking Bill #72.

I have been a real estate broker in the county of Tama for the past 40 years. During that period of time I have experienced many difficulties in connection with the sale of real estate (and insurance) due to the influence and power that can be wielded by bankers.

For Instance, I worked the sale of 604 acres. The buyer went to his banker for a promise that on possession date he could borrower "X" number of dollars. The banker advised he could have the money, but the banker also had this farm for sale, and advised if he wanted to be sure of the money, he would have to buy the farm thru him, which he did.

In another instance, I was selling 240 acres. The buyer went to his banker and advised he was going to write a check for "X" number of dollars as the down payment on a farm. He found who the seller was and wentto him, and advised this very elderly man, thatif he didn't get one-half the commission from the sale, he would no longer take care of his records and income tax returns. The banker had nothing to do with the sale of the farm, and I refused to give the banker one-half of the commission. The sale of the farm fell thru because of the banker.

We have other instances in which the banker willgo along with a young person by lending him the down payment to purchase a farm on contract, and also lend the young person to buy livestock and machinery. At the end of one year this person cannot meet his bank payments, so the banker has an auction and sells the personal property and then as a broker advertises the farm for sale, and in this particular case he bought one-half interest in the farm which is not told to the public, and the young farmer after selling the farm and his personal property is still indebted to the bank.

These are just a few of the many deals that bankers are able to maneuver, and have, in my community, because they have the bank's money to influence people. This practice should be stopped by not permitting any one in the lending business to sell real estate.

John J. Kaloupek

Subscribed and sworn to before me this 10th day of May, 1978.

Laura J. Pecenka Notary Public in and for Benton County, Iowa
Laura J. Pecenka

To The United States Senate Banking Committee, in William Proxmire Chairman, Wash.

TO THE STATE LEGISLATURE: — R. E. Senate Banking Bill No. 72

My opinion is that Bankers and their employees should not hold Real Estate Licenses and should not be permitted to sell insurance, such as mortgage insurance, etc., at least while they are working in a Bank.

I have lost several sales of real estate and mortgage insurance due to financing.

I also feel that Bankers should not be permitted to give legal advice in regard to real estate, insurance, etc.

I am hoping you will take some action in this repsect.

Noel H. Lenaburg

Noel H. Lenaburg, Real Estate Saleeman
333 Green Street,
Traer, Iowa 50675

Subscribed and sworn to before me by the said Noel H. Lenaburg, this 20th day of May, 1978.

[illegible] M. [illegible]

Notary Public

BANK HOLDING COMPANIES AND SUBSIDIARY BANKS AS OF DECEMBER 31, 1976

NOTE:

COMPANIES LISTED INCLUDE THOSE THAT HAVE REPORTED TO THE BOARD PURSUANT TO THE REQUIREMENTS OF THE BANK HOLDING COMPANY ACT AND INCLUDE SOME COMPANIES THAT HAVE FILED REGISTRATION STATEMENTS BUT WHOSE HOLDING COMPANY STATUS HAS NOT YET BEEN DETERMINED BY THE BOARD.

	NAME AND LOCATION OF BANK HOLDING COMPANY NAME AND LOCATION OF SUBSIDIARY BANK	FRB MEMBER-SHIP			NO. BANKS	NO. OF OFFICES	TOTAL ASSETS ($1000)	TOTAL DEPOSITS ($1000)
HC GROUP TOTAL					1	14	330,740	286,311
1146	FINA BANCORP, INC.		SOUTH BEND	IND				
	FIRST NB,VALPARAISO	NATIONAL	VALPARAISO	IND		5	93,875	80,629
HC GROUP TOTAL					1	5	93,875	80,629
1049	ST. JOSEPH AGENCY, INC.		SOUTH BEND	IND				
	CENTRAL ST BK OF LAKEVILLE	NON MEM	LAKEVILLE	IND		1	10,638	9,707
HC GROUP TOTAL					1	1	10,638	9,707
1059	ST. JOSEPH BANK & TRUST COMPANY		SOUTH BEND	IND				
	ST JOSEPH BANK AND TRUST CO	NON MEM	SOUTH BEND	IND		16	249,317	216,049
1049	ST. JOSEPH AGENCY, INC.		SOUTH BEND	IND				
	CENTRAL ST BK OF LAKEVILLE	NON MEM	LAKEVILLE	IND		1	10,638	9,707
NOTE:	1059 CONTROLS 1049							
HC GROUP TOTAL					2	11	259,955	225,756
0896	FIRST CHARTER FINANCIAL CORPORATION		SYRACUSE	IND				
	STATE BANK OF SYRACUSE	NON MEM	SYRACUSE	IND		3	24,342	22,341
HC GROUP TOTAL					1	3	24,342	22,341
0865	CLINTON CABLE TV COMPANY, INC.		TERRE HAUTE	IND				
	DULANEY NAT BK OF MARSHALL	NATIONAL	MARSHALL	ILL		1	18,972	16,904
HC GROUP TOTAL					1	1	18,972	16,904
0664	FARMERS STATE CORPORATION		ZIONSVILLE	IND				
	FARMERS STATE BANK	NON MEM	ZIONSVILLE	IND		2	18,853	17,011
HC GROUP TOTAL					1	2	18,853	17,011
0920	ACKLEY BANCORPORATION		ACKLEY	IOWA				
	ACKLEY STATE BANK	NON MEM	ACKLEY	IOWA		1	22,647	21,050
HC GROUP TOTAL					1	1	22,647	21,050
2399	ADAIR INSURANCE AGENCY, INC.		ADAIR	IOWA				
	EXCHANGE STATE BANK	NON MEM	ADAIR	IOWA		1	9,075	8,350
HC GROUP TOTAL					1	1	9,075	8,350

	NAME AND LOCATION OF BANK HOLDING COMPANY / NAME AND LOCATION OF SUBSIDIARY BANK	FRB MEMBER-SHIP			NO. BANKS	NO. OF OFFICES	TOTAL ASSETS ($1000)	TOTAL DEPOSITS ($1000)
2112	ALTON BANCORPORATION		ALTON	IOWA				
	ALTON SAVINGS BANK	NON MEM	ALTON	IOWA		1	7,799	7,145
HC GROUP TOTAL					1	1	7,799	7,145
2272	AMES NATIONAL CORPORATION		AMES	IOWA				
	FIRST NATIONAL BANK,AMES	NATIONAL	AMES	IOWA		3	52,847	47,735
HC GROUP TOTAL					1	3	52,847	47,735
2174	K-THREE ENTERPRISES, INC.		AMES	IOWA				
	UNIVERSITY BANK & TRUST CO	NON MEM	AMES	IOWA		3	25,866	23,386
HC GROUP TOTAL					1	3	25,866	23,386
2178	SBHC, LTD		ANAMOSA	IOWA				
	ONSLOW SAVINGS BANK	NON MEM	ONSLOW	IOWA		1	5,483	5,013
HC GROUP TOTAL					1	1	5,483	5,013
0970	LESERNAL CORPORATION		ANAMOSA	IOWA				
	CITIZENS SAVINGS BANK	NON MEM	ANAMOSA	IOWA		1	22,277	20,555
HC GROUP TOTAL					1	1	22,277	20,955
0820	APLINGTON INSURANCE, INC.		APLINGTON	IOWA				
	STATE SAVINGS BANK	NON MEM	APLINGTON	IOWA		2	7,908	7,208
HC GROUP TOTAL					1	2	7,908	7,208
0881	WHITNEY CORPORATION OF IOWA		ATLANTIC	IOWA				
	FIRST WHITNEY BANK AND TRUST	NON MEM	ATLANTIC	IOWA		1	34,979	33,727
HC GROUP TOTAL					1	1	34,979	33,727
2536	Audubon Investment Company		Audubon	Iowa				
	Audubon State Bank	Non mem	Audubon	Iowa				
1100	BAXTER INSURANCE AGENCY, INC.		BAXTER	IOWA				
	STATE SAVINGS BANK	NON MEM	BAXTER	IOWA		1	5,695	5,239
HC GROUP TOTAL					1	1	5,695	5,239
1046	BELLEVUE SERVICE COMPANY		BELLEVUE	IOWA				
	BELLEVUE STATE BANK	NON MEM	BELLEVUE	IOWA		1	10,402	9,671
HC GROUP TOTAL					1	1	10,402	9,671

	NAME AND LOCATION OF BANK HOLDING COMPANY / NAME AND LOCATION OF SUBSIDIARY BANK	FRS MEMBER-SHIP			NO. BANKS	NO. OF OFFICES	TOTAL ASSETS ($1000)	TOTAL DEPOSITS ($1000)
1070	INVESTMENT MANAGEMENT, INC.		BETTENDORF	IOWA				
	NORTHWEST BANK & TRUST CO	NON MEM	DAVENPORT	IOWA		3	85,177	73,889
HC GROUP TOTAL					1	3	85,177	73,889
1071	RIVER CITIES INVESTMENT CO.		BETTENDORF	IOWA				
1070	INVESTMENT MANAGEMENT, INC.		BETTENDORF	IOWA				
	NORTHWEST BANK & TRUST CO	MEM MEM	DAVENPORT	IOWA		3	85,177	73,889
NOTE:	1071 CONTROLS 1070							
HC GROUP TOTAL					1	3	85,177	73,889
2441	MONONA BANCORPORATION		BLENCOE	IOWA				
	BLENCOE STATE BANK	ST MEM	BLENCOE	IOWA		1	6,639	6,042
HC GROUP TOTAL					1	1	6,639	6,042
0434	BSB CORPORATION		BOONE	IOWA				
	BOONE STATE BK & TR CO	NON MEM	BOONE	IOWA		3	34,491	31,263
HC GROUP TOTAL					1	3	34,491	31,263
2606	Norris Bancor Ltd.		Cantril	Iowa				
	State Savings Bank		Cantril	Iowa				
0014	SECURITY INSURANCE, INC.		CASEY	IOWA				
	SECURITY STATE BANK	NON MEM	CASEY	IOWA		2	11,712	10,894
HC GROUP TOTAL					1	2	11,712	10,894
0436	CEDAR FALLS HOLDING COMPANY, LTD.		CEDAR FALLS	IOWA				
	CEDAR FALLS TR & SVGS BK	MEM MEM	CEDAR FALLS	IOWA		2	36,390	33,103
HC GROUP TOTAL					1	2	36,390	33,103
0823	BANKS OF IOWA, INC.		CEDAR RAPIDS	IOWA				
	FIRST NATIONAL BANK	NATIONAL	BURLINGTON	IOWA		2	63,819	57,786
	MERCHANTS NATIONAL BANK	NATIONAL	CEDAR RAPIDS	IOWA		4	304,883	247,753
	COUNCIL BLUFFS SAVINGS BANK	NON MEM	COUNCIL BLUFFS	IOWA		4	99,047	87,856
	VALLEY NATIONAL BANK	NATIONAL	DES MOINES	IOWA		5	132,086	116,705
	KEY CITY BANK & TRUST CO	NON MEM	DUBUQUE	IOWA		3	20,386	19,067
	UNION BANK AND TRUST CO	ST MEM	OTTUMWA	IOWA		6	84,216	75,843
	FIRST NB IN SIOUX CITY	NATIONAL	SIOUX CITY	IOWA		3	124,501	107,714
	First Trust & Savings Bank	Non Mem	Davenport	Iowa				
HC GROUP TOTAL					7	27	826,938	714,724
0925	NORAMERICA FINANCIAL CORPORATION		CEDAR RAPIDS	IOWA				

	NAME AND LOCATION OF BANK HOLDING COMPANY NAME AND LOCATION OF SUBSIDIARY BANK	FRS MEMBER- SHIP			NO. BANKS	NO. OF OFFICES	TOTAL ASSETS ($1000)	TOTAL DEPOSITS ($1000)
0925	JACKSON STATE BK & TR CO	NON MEM	MAQUOKETA	IOWA		4	49,073	43,907
	FIRST TRUST AND SAVINGS BANK	NON MEM	WHEATLAND	IOWA		3	16,555	14,919
HC GROUP TOTAL					2	7	65,628	58,826
2161	BRADLEY BANCORP., INC.		CENTERVILLE	IOWA				
	IOWA TRUST AND SAVINGS BANK	NON MEM	CENTERVILLE	IOWA		2	37,195	33,586
HC GROUP TOTAL					1	2	37,195	33,580
0976	CENTERVILLE NATIONAL INC.		CENTERVILLE	IOWA				
	CENTERVILLE NATIONAL BANK	NATIONAL	CENTERVILLE	IOWA		2	36,163	33,140
HC GROUP TOTAL					1	2	36,163	33,140
0915	HY-VEE EMPLOYEES' TRUST		CHARITON	IOWA				
	NAT BK AND TR CO OF CHARITON	NATIONAL	CHARITON	IOWA		1	29,290	26,702
HC GROUP TOTAL					1	1	29,290	26,702
0924	HY-VEE FOOD STORES, INC.		CHARITON	IOWA				
0915	HY-VEE EMPLOYEES' TRUST		CHARITON	IOWA				
	NAT BK AND TR CO OF CHARITON	NATIONAL	CHARITON	IOWA		1	29,290	26,702
NOTE:	0924 CONTROLS 0915							
HC GROUP TOTAL					1	1	29,290	26,702
0848	NORA SPRINGS INVESTMENT COMPANY		CHARLES CITY	IOWA				
	FIRST STATE BANK	NON MEM	NORA SPRINGS	IOWA		2	9,511	8,853
HC GROUP TOTAL					1	2	9,511	8,853
0833	RICEVILLE INVESTMENT COMPANY		CHARLES CITY	IOWA				
	FIRST NB OF RICEVILLE	NATIONAL	RICEVILLE	IOWA		1	9,738	8,982
HC GROUP TOTAL					1	1	9,738	8,982
2592	Panhandle Aviation, Inc.		Clarinda	Iowa				
	Citizens State Bank		Clarinda	Iowa				
1076	B. P. CORP.		CLINTON	IOWA				
	IOWA STATE SAVINGS BANK	NON MEM	CLINTON	IOWA		3	29,943	26,658
HC GROUP TOTAL					1	3	29,943	26,658
0858	W. J. YOUNG & CO.		CLINTON	IOWA				

	NAME AND LOCATION OF BANK HOLDING COMPANY NAME AND LOCATION OF SUBSIDIARY BANK	FRS MEMBER- SHIP			NO. BANKS	NO. OF OFFICES	TOTAL ASSETS ($1000)	TOTAL DEPOSITS ($1000)
0858	CLINTON NATIONAL BANK	NATIONAL	CLINTON	IOWA		2	50,796	45,989
HC GROUP TOTAL					1	2	50,796	45,989
0866	COMMUNITY GRAIN COMPANY		COON RAPIDS	IOWA				
	IOWA SAVINGS BANK	NON MEM	COON RAPIDS	IOWA		1	19,931	18,234
HC GROUP TOTAL					1	1	19,931	18,234
0824	DALLAS INVESTMENT COMPANY		COON RAPIDS	IOWA				
	RACCOON VALLEY STATE BANK	NON MEM	ADEL	IOWA		2	13,174	12,250
HC GROUP TOTAL					1	2	13,174	12,250
0837	PERRY INVESTMENT COMPANY		COON RAPIDS	IOWA				
	PERRY STATE BANK	NON MEM	PERRY	IOWA		4	33,721	31,151
HC GROUP TOTAL					1	4	33,721	31,151
0896	FRANK J. EICHER COMPANY, INC.		CORALVILLE	IOWA				
	UNIBANK & TRUST	NON MEM	CORALVILLE	IOWA		2	21,558	19,747
HC GROUP TOTAL					1	2	21,558	19,747
0588	WHITMORE BANCORPORATION, INC.		CORNING	IOWA				
	PAGE COUNTY STATE BANK	NON MEM	CLARINDA	IOWA		2	27,629	24,818
HC GROUP TOTAL					1	2	27,629	24,818
0803	WHITMORE COMPANY, INC.		CORNING	IOWA				
	OKEY VERNON FIRST NAT BK	NATIONAL	CORNING	IOWA		2	28,451	25,529
HC GROUP TOTAL					1	2	28,451	25,529
1031	CITIZENS CORPORATION		CORYDON	IOWA				
1030	HUMESTON CORPORATION		HUMESTON	IOWA				
	CITIZENS STATE BANK	NON MEM	CORYDON	IOWA		4	20,850	19,092
NOTE:	1031 CONTROLS 1030							
HC GROUP TOTAL					1	4	20,850	19,092
0863	MIDLANDS CORPORATION		COUNCIL BLUFFS	IOWA				
	FIRST NB OF COUNCIL BLUFFS	NATIONAL	COUNCIL BLUFFS	IOWA		3	72,712	67,737

NAME AND LOCATION OF BANK HOLDING COMPANY / NAME AND LOCATION OF SUBSIDIARY BANK		FRB MEMBER-SHIP			NO. BANKS	NO. OF OFFICES	TOTAL ASSETS ($1000)	TOTAL DEPOSITS ($1000)
HC GROUP TOTAL					1	3	72,712	67,737
0942	STATE COMPANY		COUNCIL BLUFFS	IOWA				
	STATE BANK & TRUST CO	NON MEM	COUNCIL BLUFFS	IOWA		6	53,295	48,545
HC GROUP TOTAL					1	6	53,295	46,545
0807	CRAWFORDSVILLE INSURANCE AGENCY, INC.		CRAWFORDSVILLE	IOWA				
	PEOPLES SAVINGS BANK	NON MEM	CRAWFORDSVILLE	IOWA		1	3,332	2,951
HC GROUP TOTAL					1	1	3,332	2,951
0871	HOW-WIN DEVELOPMENT CO.		CRESCO	IOWA				
	CRESCO UNION SAVINGS BANK	NON MEM	CRESCO	IOWA		1	22,778	21,254
HC GROUP TOTAL					1	1	22,778	21,254
2398	UNION-ADAMS BANCORP		CRESTON	IOWA				
	IOWA STATE SAVINGS BANK	NON MEM	CRESTON	IOWA		3	30,820	27,594
HC GROUP TOTAL					1	3	30,820	27,594
1113	AMERICAN HOME INVESTMENT COMPANY		DAVENPORT	IOWA				
	CITIZENS STATE BANK	NON MEM	DONNELLSON	IOWA		1	14,628	12,761
HC GROUP TOTAL					1	1	14,628	12,761
2020	HILLSDALE DEVELOPMENT CORPORATION		DAVENPORT	IOWA				
	OLD FRMERS & MERCNTS ST BK	NON MEM	HILLSDALE	ILL		1	7,916	6,933
HC GROUP TOTAL					1	1	7,916	6,933
0804	JOY DEVELOPMENT CORPORATION		DAVENPORT	IOWA				
	JOY STATE BANK	NON MEM	JOY	ILL		1	12,641	10,879
HC GROUP TOTAL					1	1	12,041	10,879
1102	SECURITY AGENCY, INC.		DECORAH	IOWA				
	SECURITY BANK AND TRUST CO	NON MEM	DECORAH	IOWA		1	27,185	24,932
HC GROUP TOTAL					1	1	27,185	24,932
0979	THE K[illegible] COMPANY		DENISON	IOWA				

	NAME AND LOCATION OF BANK HOLDING COMPANY / NAME AND LOCATION OF SUBSIDIARY BANK	FRB MEMBER-SHIP			NO. BANKS	NO. OF OFFICES	TOTAL ASSETS ($1000)	TOTAL DEPOSITS ($1000)
0979	KIRON STATE BANK	NON MEM	KIRON	IOWA		1	4,909	4,501
HC GROUP TOTAL					1	1	4,909	4,501
0809	BRENTON BANKS, INC.		DES MOINES	IOWA				
	DALLAS COUNTY STATE BANK	NON MEM	ADEL	IOWA		4	34,712	31,848
	BRENTON S&TC OF CEDAR RAPIDS	NON MEM	CEDAR RAPIDS	IOWA		1	12,893	11,810
	BRENTON BANK & TRUST CO	NON MEM	CLARION	IOWA		2	19,851	18,140
	BRENTON STATE BANK	NON MEM	DALLAS CENTER	IOWA		4	29,551	27,223
	FIRST NB OF DAVENPORT	NATIONAL	DAVENPORT	IOWA		4	40,641	37,428
	NATIONAL BANK OF DES MOINES	NATIONAL	DES MOINES	IOWA		4	52,311	48,011
	SOUTH DES MOINES NAT BANK	NATIONAL	DES MOINES	IOWA		3	25,997	23,915
	NORTHWEST BRENTON NB	NATIONAL	DES MOINES	IOWA		3	31,205	28,979
	BRENTON STATE BANK	NON MEM	EAGLE GROVE	IOWA		1	10,709	9,652
	PALO ALTO COUNTY STATE BANK	NON MEM	EMMETSBURG	IOWA		3	27,937	25,795
	POWESHIEK COUNTY NATIONAL BK	NATIONAL	GRINNELL	IOWA		2	37,221	34,491
	WARREN CTY BRENTON BK & TR	NON MEM	INDIANOLA	IOWA		2	15,951	14,397
	JEFFERSON STATE BANK	NON MEM	JEFFERSON	IOWA		2	32,262	29,603
	FIDELITY BRENTON BK & TC	NON MEM	MARSHALLTOWN	IOWA		2	52,468	48,317
	FIRST NAT BK OF PERRY	NATIONAL	PERRY	IOWA		1	30,013	27,667
	BRENTON BANK & TRUST COMPANY	NON MEM	URBANDALE	IOWA		2	11,263	10,313
	BENTON COUNTY BANK AND TRUST	NON MEM	VINTON	IOWA		1	18,405	16,921
HC GROUP TOTAL					17	41	483,390	444,510
0874	CENTRAL NATIONAL BANCSHARES, INC.		DES MOINES	IOWA				
	THE SECURITY STATE BANK	NON MEM	ALGONA	IOWA		2	22,872	20,841
	CENTRAL NAT BK & TR CO	NATIONAL	DES MOINES	IOWA		4	302,583	264,504
	ADAIR COUNTY STATE BANK	NON MEM	GREENFIELD	IOWA		1	16,140	14,460
0950	UNIBANK, INC.		MASON CITY	IOWA				
	UNITED HOME BANK & TRUST CO	ST MEM	MASON CITY	IOWA		3	77,205	68,885
NOTE:	0874 CONTROLS 0950							
HC GROUP TOTAL					4	10	418,800	368,690
2189	CENTRAL STATES BANCOR, INC.		DES MOINES	IOWA				
	CAPITAL CITY STATE BANK	ST MEM	DES MOINES	IOWA		3	80,752	67,536
HC GROUP TOTAL					1	3	80,752	67,538
0809	CHASE INVESTMENT CO.		DES MOINES	IOWA				
	W DES MOINES STATE BANK	NON MEM	WEST DES MOINES	IOWA		2	51,089	47,237
HC GROUP TOTAL					1	2	51,089	47,237
1087	DICO CORPORATION		DES MOINES	IOWA				

	NAME AND LOCATION OF BANK HOLDING COMPANY / NAME AND LOCATION OF SUBSIDIARY BANK	FRB MEMBER-SHIP			NO. BANKS	NO. OF OFFICES	TOTAL ASSETS ($1000)	TOTAL DEPOSITS ($1000)
1007	FIRST NAT BK,CEDAR FALLS,IA	NATIONAL	CEDAR FALLS	IOWA		2	34,640	31,132
HC GROUP TOTAL					1	2	34,640	31,132
0913	EASTER ENTERPRISES, INC.		DES MOINES	IOWA				
	FARMERS TRUST AND SAVINGS BK	NON MEM	SPENCER	IOWA		2	31,758	28,770
HC GROUP TOTAL					1	2	31,758	28,776
0083	HAWKEYE BANCORPORATION		DES MOINES	IOWA				
	CITIZENS NAT BK OF BOONE	NATIONAL	BOONE	IOWA		2	36,652	33,565
	HAWKEYE BANK AND TRUST	NON MEM	BURLINGTON	IOWA		6	66,832	61,361
	CAMANCHE STATE BANK	NON MEM	CAMANCHE	IOWA		1	6,269	5,613
	FIRST NATIONAL BANK	NATIONAL	CLINTON	IOWA		3	64,871	58,787
	FIRST FEDERAL STATE BANK	NON MEM	DES MOINES	IOWA		3	44,865	39,029
	ARMERS SAVINGS BANK	NON MEM	GRUNDY CENTER	IOWA		2	18,127	16,154
	FARMERS AND MERCHANTS STATE	NON MEM	LAKE MILLS	IOWA		1	16,026	14,601
	AMERICAN STATE BANK	NON MEM	MASON CITY	IOWA		3	14,354	13,297
	JASPER COUNTY SAVINGS BANK	ST MEM	NEWTON	IOWA		2	63,984	58,679
	PELLA NATIONAL BANK	NATIONAL	PELLA	IOWA		1	38,831	35,825
	HOUGHTON STATE BANK	NON MEM	RED OAK	IOWA		4	41,712	37,837
	LYON COUNTY STATE BANK	NON MEM	ROCK RAPIDS	IOWA		1	18,348	16,842
0938	SPENCER BANSHARES, INC.		DES MOINES	IOWA				
	CLAY COUNTY NB OF SPENCER	NATIONAL	SPENCER	IOWA		2	31,155	28,369
0942	STATE COMPANY		COUNCIL BLUFFS	IOWA				
	STATE BANK & TRUST CO	NON MEM	COUNCIL BLUFFS	IOWA		6	53,295	46,545
0976	CENTERVILLE NATIONAL INC.		CENTERVILLE	IOWA				
	CENTERVILLE NATIONAL BANK	NATIONAL	CENTERVILLE	IOWA		2	36,163	33,146
NOTE:	0083 CONTROLS 0938, 0942, 0976							
Morn. Dev. Co	Morningside State Bank							
	Commercial State Bank	Non Mem	Marshalltown	Iowa				
HC GROUP TOTAL					15	39	551,484	501,849
0818	IOWA BANCORPORATION		DES MOINES	IOWA				
	LA PORTE CITY STATE BANK	NON MEM	LA PORTE CITY	IOWA		1	9,721	8,657
HC GROUP TOTAL					1	1	9,721	8,657
2110	LONG BANCORPORATION		DES MOINES	IOWA				
	UNION WHITTEN STATE SAVINGS	NON MEM	UNION	IOWA		2	12,472	11,277
HC GROUP TOTAL					1	2	12,472	11,277
1088	RUAN FINANCIAL CORPORATION		DES MOINES	IOWA				
	BANKERS TRUST CO	ST MEM	DES MOINES	IOWA		7	294,136	245,386
HC GROUP TOTAL					1	7	294,136	245,386

	NAME AND LOCATION OF BANK HOLDING COMPANY / NAME AND LOCATION OF SUBSIDIARY BANK	FRS MEMBER-SHIP			NO. BANKS	NO. OF OFFICES	TOTAL ASSETS ($1000)	TOTAL DEPOSITS ($1000)
0938	SPENCER BANSHARES, INC.		DES MOINES	IOWA				
	CLAY COUNTY NB OF SPENCER	NATIONAL	SPENCER	IOWA		2	31,155	28,369
HC GROUP TOTAL					1	2	31,155	28,369
1090	DYERSVILLE NATIONAL INVESTMENT COMPANY		DYERSVILLE	IOWA				
	DYERSVILLE NATIONAL BANK	NATIONAL	DYERSVILLE	IOWA		1	27,560	25,217
HC GROUP TOTAL					1	1	27,560	25,217
2154	SECOND BANCORPORATION		ELDORA	IOWA				
	SECOND NATIONAL BANK	NATIONAL	ELDORA	IOWA		3	14,411	13,184
HC GROUP TOTAL					1	3	14,411	13,184
1069	BANKERS EQUITY CORPORATION		EVANSDALE	IOWA				
	PALO SAVINGS BANK	NON MEM	PALO	IOWA		1	3,864	3,280
HC GROUP TOTAL					1	1	3,864	3,286
0496	SCHROEDER-GOODENOW MANAGEMENT CO.		EXIRA	IOWA				
	EXCHANGE STATE BANK	NON MEM	EXIRA	IOWA		1	12,810	11,350
HC GROUP TOTAL					1	1	12,810	11,350
0825	STEGE INSURANCE AGENCY, INC.		FONDA	IOWA				
	FIRST NAT BK OF FONDA	NATIONAL	FONDA	IOWA		1	10,556	9,076
HC GROUP TOTAL					1	1	10,556	9,076
2672	Gilman Investment Co.		Gibson	Iowa				
	Citizens Savings Bank		Gilman	Iowa				
0809	GOOSE LAKE INVESTMENT, INC.		GOOSE LAKE	IOWA				
	GOOSE LAKE SAVINGS BANK	NON MEM	GOOSE LAKE	IOWA		2	5,669	5,113
HC GROUP TOTAL					1	2	5,669	5,113
1916	GRAETTINGER BANCORPORATION		GRAETTINGER	IOWA				
	GRAETTINGER STATE BANK	NON MEM	GRAETTINGER	IOWA		1	9,550	8,531
HC GROUP TOTAL					1	1	9,550	8,531
2194	GREENE BANCORPORATION		GREENE	IOWA				
	FIRST STATE BANK	ST MEM	GREENE	IOWA		1	14,645	13,344
HC GROUP TOTAL					1	1	14,645	13,344
2580	Hamburg Financial, Inc.		Hamburg	Iowa				
	Iowa State Bank	Non Mem	Hamburg	Iowa				

	NAME AND LOCATION OF BANK HOLDING COMPANY NAME AND LOCATION OF SUBSIDIARY BANK	FRS MEMBER-SHIP			NO. BANKS	NO. OF OFFICES	TOTAL ASSETS ($1000)	TOTAL DEPOSITS ($1000)
0816	A. M. SAYLOR, INCORPORATED		HAMPTON	IOWA				
	FIRST NAT BK OF HAMPTON	NATIONAL	HAMPTON	IOWA		1	25,700	23,625
HC GROUP TOTAL					1	1	25,700	23,625
0853	ALLISON CORPORATION		HAMPTON	IOWA				
	STATE BK OF ALLISON	NON MEM	ALLISON	IOWA		1	12,710	11,543
HC GROUP TOTAL					1	1	12,710	11,543
2253	PEOPLES BANCORPORATION		HAMPTON	IOWA				
	PEOPLES SAVINGS BANK	NON MEM	ELMA	IOWA		1	9,707	8,844
HC GROUP TOTAL					1	1	9,707	8,844
2216	THE HAMPTON BANCO, INC.		HAMPTON	IOWA				
	HAMPTON STATE BANK	NON MEM	HAMPTON	IOWA		2	20,496	18,826
HC GROUP TOTAL					1	2	20,496	18,826
2446	HARLAN NATIONAL COMPANY		HARLAN	IOWA				
	HARLAN NATIONAL BANK	NATIONAL	HARLAN	IOWA		2	30,600	26,860
HC GROUP TOTAL					1	2	30,600	26,860
0980	THE HAWARDEN BANKING COMPANY		HAWARDEN	IOWA				
	FIRST STATE BANK	NON MEM	HAWARDEN	IOWA		1	7,842	7,233
HC GROUP TOTAL					1	1	7,842	7,233
1099	HOSPERS AGENCY COMPANY		HOSPERS	IOWA				
	AMERICAN STATE BANK	NON MEM	SIOUX CENTER	IOWA		3	25,057	22,519
HC GROUP TOTAL					1	3	25,057	22,519
0875	D.W. HEINEKING, INC.		HUBBARD	IOWA				
	SECURITY STATE BANK	NON MEM	HUBBARD	IOWA		1	9,213	8,479
HC GROUP TOTAL					1	1	9,213	8,479
1016	FIRST INVESTORS SERVICES, INC.		HUMBOLDT	IOWA				
	FIRST NB IN HUMBOLDT	NATIONAL	HUMBOLDT	IOWA		1	31,537	29,162
HC GROUP TOTAL					1	1	31,537	29,162

	NAME AND LOCATION OF BANK HOLDING COMPANY / NAME AND LOCATION OF SUBSIDIARY BANK	FRS MEMBER-SHIP			NO. BANKS	NO. OF OFFICES	TOTAL ASSETS ($1000)	TOTAL DEPOSITS ($1000)
1030	HUMESTON CORPORATION		HUMESTON	IOWA				
	CITIZENS STATE BANK	NON MEM	CORYDON	IOWA		4	20,850	19,092
HC GROUP TOTAL					1	4	20,650	19,092
2120	MARDEN BANCORP.		IOWA FALLS	IOWA				
	CITIZENS STATE BANK	NON MEM	IOWA FALLS	IOWA		2	30,845	27,893
HC GROUP TOTAL					1	2	30,845	27,893
0817	HILL INVESTMENT CO.		JEWELL	IOWA				
	FARMERS STATE BANK	NON MEM	JEWELL	IOWA		2	12,822	11,896
HC GROUP TOTAL					1	2	12,822	11,896
0937	KANAWHA INVESTMENT CO.		KANAWHA	IOWA				
	FARMERS STATE BANK	NON MEM	KANAWHA	IOWA		1	11,655	10,714
HC GROUP TOTAL					1	1	11,655	10,714
2591	KSB Ltd.		Keokuk	Iowa				
	Keokuk Savings Bank and Trust Company		Keokuk	Iowa				
2252	THE LANDMANDS CORPORATION		KIMBALLTON	IOWA				
	LANDMANDS NB OF KIMBALLTON	NATIONAL	KIMBALLTON	IOWA		1	9,726	8,912
HC GROUP TOTAL					1	1	9,726	8,912
0882	COMMUNITY HOLDING COMPANY		KNOXVILLE	IOWA				
	CMTY NB & TRCO OF KNOXVILLE	NATIONAL	KNOXVILLE	IOWA		2	31,435	29,058
HC GROUP TOTAL					1	2	31,435	29,058
0847	DUCLARKEE, INC.		KNOXVILLE	IOWA				
	IOWA STATE SAVINGS BANK	NON MEM	KNOXVILLE	IOWA		4	25,243	23,023
HC GROUP TOTAL					1	4	25,243	23,023
0234	IOWA AGRICULTURAL DEVELOPMENT CORPORATION		KNOXVILLE	IOWA				
	BEDFORD NATIONAL BANK	NATIONAL	BEDFORD	IOWA		1	10,801	9,933
HC GROUP TOTAL					1	1	10,801	9,933
1116	JERS, INC.		LAKE VIEW	IOWA				
	FARMERS STATE BANK	ST MEM	LAKE VIEW	IOWA		1	9,786	9,006
HC GROUP TOTAL					1	1	9,786	9,006

	NAME AND LOCATION OF BANK HOLDING COMPANY NAME AND LOCATION OF SUBSIDIARY BANK	FRB MEMBER-SHIP			NO. BANKS	NO. OF OFFICES	TOTAL ASSETS ($1000)	TOTAL DEPOSITS ($1000)
2103	PLYMOUTH BANCORPORATION, INC.		LE MARS	IOWA				
	FIRST NB IN LE MARS	NATIONAL	LE MARS	IOWA		1	26,060	22,960
HC GROUP TOTAL					1	1	26,060	22,960
0482	NORTHWEST IOWA BANCORPORATION		LEMARS	IOWA				
	LAKES NATIONAL BANK	NATIONAL	ARNOLDS PARK	IOWA		1	6,609	6,077
HC GROUP TOTAL					1	1	6,609	6,077
0849	ZABEL ENTERPRISES, INC.		LENOX	IOWA				
	FIRST NB IN LENOX	NATIONAL	LENOX	IOWA		1	18,922	17,590
HC GROUP TOTAL					1	1	18,922	17,590
0981	DECATUR CORPORATION		LEON	IOWA				
	DECATUR COUNTY STATE BANK	NON MEM	LEON	IOWA		2	21,550	19,982
HC GROUP TOTAL					1	2	21,550	19,982
1009	LONE TREE SERVICE COMPANY		LONE TREE	IOWA				
	FARMERS & MERCHANTS SVGS BK	NON MEM	LONE TREE	IOWA		2	18,611	17,285
HC GROUP TOTAL					1	2	18,611	17,285
0864	DELAWARE SERVICE CO., INC.		MANCHESTER	IOWA				
	FIRST STATE BANK	ST MEM	MANCHESTER	IOWA		1	18,148	16,882
HC GROUP TOTAL					1	1	18,148	16,882
0902	THE MANNING COMPANY, INC.		MANNING	IOWA				
	MANNING TRUST AND SAVINGS BK	NON MEM	MANNING	IOWA		1	4,958	4,436
HC GROUP TOTAL					1	1	4,958	4,436
1127	YOWELL SALES DEPARTMENT, INC.		MANSON	IOWA				
	MANSON STATE BANK	NON MEM	MANSON	IOWA		1	9,407	7,675
HC GROUP TOTAL					1	1	9,407	7,675
0970	DANCO, INC.		MAPLETON	IOWA				
	FARMERS SAVINGS BANK	NON MEM	DANBURY	IOWA		1	5,190	4,663
HC GROUP TOTAL					1	1	5,190	4,663

	NAME AND LOCATION OF BANK HOLDING COMPANY NAME AND LOCATION OF SUBSIDIARY BANK	FRS MEMBER-SHIP			NO. BANKS	NO. OF OFFICES	TOTAL ASSETS ($1000)	TOTAL DEPOSITS ($1000)
0041	OHNWARD BANCSHARES, INC.		MAQUOKETA	IOWA				
	FIRST CENTRAL STATE BANK	NON MEM	DEWITT	IOWA		2	14,440	13,760
	MAQUOKETA STATE BANK	NON MEM	MAQUOKETA	IOWA		1	41,477	36,241
HC GROUP TOTAL					2	3	55,917	52,001
0013	M-V CO., INC.		MARION	IOWA				
	FIRST NAT BK OF MARION	NATIONAL	MARION	IOWA		2	39,116	35,796
HC GROUP TOTAL					1	2	39,116	35,796
0012	NEIGHBOR INSURANCE AGENCY, INC.		MARION	IOWA				
	FARMERS STATE BANK	NON MEM	MARION	IOWA		3	54,362	47,470
HC GROUP TOTAL					1	3	54,362	47,470
0193	ASSOCIATED BANK CORPORATION		MASON CITY	IOWA				
	COMMUNITY STATE BANK	NON MEM	CLEAR LAKE	IOWA		2	19,055	17,470
	IOWA TRUST AND SAVINGS BANK	NON MEM	ESTHERVILLE	IOWA		1	30,283	27,785
	HAWKEYE STATE BANK	NON MEM	IOWA CITY	IOWA		2	19,010	17,422
	KALONA SAVINGS BANK	NON MEM	KALONA	IOWA		1	16,976	15,510
	IOWA COUNTY SAVINGS BANK	NON MEM	MARENGO	IOWA		1	22,506	20,466
	FIRST TRUST AND UNION SAVING	NON MEM	SIGOURNEY	IOWA		3	16,776	17,080
	Cresco National Bank	National	Cresco (acq. 4-20-77)					
HC GROUP TOTAL					6	10	126,606	115,733
1415	MOWER AGENCY, INC.		MASON CITY	IOWA				
	STERLING STATE BANK	NON MEM	AUSTIN	MINN		1	11,830	10,845
HC GROUP TOTAL					1	1	11,830	10,845
0958	UNIBANK, INC.		MASON CITY	IOWA				
	UNITED HOME BANK & TRUST CO	ST MEM	MASON CITY	IOWA		3	77,205	68,885
HC GROUP TOTAL					1	3	77,205	68,885
0935	UNITED AMERICAN INVESTMENT CO.		MASON CITY	IOWA				
	FIRST STATE BANK	NON MEM	BRITT	IOWA		3	22,529	20,698
HC GROUP TOTAL					1	3	22,529	20,698
0939	UNITED IOWA BANCSHARES, INC.		MASON CITY	IOWA				
	NEWTON NATIONAL BANK	NATIONAL	NEWTON	IOWA		3	22,208	20,446
HC GROUP TOTAL					1	3	22,208	20,446

	NAME AND LOCATION OF BANK HOLDING COMPANY NAME AND LOCATION OF SUBSIDIARY BANK	FRS MEMBER-SHIP			NO. BANKS	NO. OF OFFICES	TOTAL ASSETS ($1000)	TOTAL DEPOSITS ($1000)
1913	CURRY BAN CORPORATION		MASSENA	IOWA				
	FARMERS SAVINGS BANK	NON MEM	MASSENA	IOWA		1	7,835	7,316
HC GROUP TOTAL					1	1	7,835	7,316
0932	DREAM, INC.		MELBOURNE	IOWA				
	MELBOURNE SAVINGS BANK	NON MEM	MELBOURNE	IOWA		1	13,148	11,440
HC GROUP TOTAL					1	1	13,148	11,440
0801	MILES SERVICE CORPORATION		MILES	IOWA				
	MILES SAVINGS BANK	NON MEM	MILES	IOWA		1	8,286	7,497
HC GROUP TOTAL					1	1	8,286	7,497
2016	MILFORD BANCORPORATION		MILFORD	IOWA				
	DICKINSON COUNTY SAVINGS BK	NON MEM	MILFORD	IOWA		1	12,122	10,918
HC GROUP TOTAL					1	1	12,122	10,918
2177	MINGO INSURANCE AGENCY, INC.		MINGO	IOWA				
	MINGO TRUST AND SAVINGS BANK	NON MEM	MINGO	IOWA		1	5,148	4,553
HC GROUP TOTAL					1	1	5,148	4,553
0472	FIRST NATIONAL COMPANY OF MISSOURI VALLEY, INC.		MISSOURI VALLEY	IOWA				
	FIRST NB OF MO VALLEY	NATIONAL	MISSOURI VALLEY	IOWA		1	19,361	17,669
HC GROUP TOTAL					1	1	19,361	17,669
2394	F. S. BANCOR, INC.		MITCHELLVILLE	IOWA				
	FRM SVGS BK OF MTCHELVLE	NON MEM	MITCHELLVILLE	IOWA		2	9,268	8,651
HC GROUP TOTAL					1	2	9,268	8,651
0888	LEROY C. DARBY, INC.		MONONA	IOWA				
	UNION STATE BANK	NON MEM	MONONA	IOWA		1	9,542	8,799
HC GROUP TOTAL					1	1	9,542	8,799
0805	ARENDTS, INC., OF MONTEZUMA, IOWA		MONTEZUMA	IOWA				
	PEOPLES SAVINGS BANK	NON MEM	MONTEZUMA	IOWA		1	7,862	7,353
HC GROUP TOTAL					1	1	7,862	7,353

	NAME AND LOCATION OF BANK HOLDING COMPANY / NAME AND LOCATION OF SUBSIDIARY BANK	FRB MEMBER-SHIP			NO. BANKS	NO. OF OFFICES	TOTAL ASSETS ($1000)	TOTAL DEPOSITS ($1000)
0856	M.S.B. CORPORATION		MONTICELLO	IOWA				
	CITY STATE BANK	NON MEM	CENTRAL CITY	IOWA		1	9,164	8,285
HC GROUP TOTAL					1	1	9,164	8,285
0972	NEVADA BRICK & TILE COMPANY		NEVADA	IOWA				
	NEVADA NATIONAL BANK	NATIONAL	NEVADA	IOWA		1	34,189	28,851
HC GROUP TOTAL					1	1	34,189	28,851
2302	HANSEN BANCORPORATION		NEW HAMPTON	IOWA				
	STATE BANK OF LAWLER	NON MEM	LAWLER	IOWA		2	11,226	10,200
HC GROUP TOTAL					1	2	11,226	10,200
0973	SHAW INVESTMENT COMPANY		NEW HAMPTON	IOWA				
	FIRST NB IN NEW HAMPTON	NATIONAL	NEW HAMPTON	IOWA		1	25,036	21,943
HC GROUP TOTAL					1	1	25,036	21,943
2636	Anita Bancorporation		Newton	Iowa				
	Anita State Bank		ANITA	Iowa				
0484	OAKLAND BANSHARES, INC.		OAKLAND	IOWA				
	OAKLAND SAVINGS BANK	NON MEM	OAKLAND	IOWA		2	13,543	12,457
HC GROUP TOTAL					1	2	13,543	12,457
1077	OELWEIN BANCORPORATION		OELWEIN	IOWA				
	FIRST NB OF OELWEIN	NATIONAL	OELWEIN	IOWA		3	32,605	29,486
HC GROUP TOTAL					1	3	32,605	29,486
0948	BANKO, INC.		OSCEOLA	IOWA				
	OSCEOLA STATE BANK & TRUST	NON MEM	OSCEOLA	IOWA		2	6,048	5,509
HC GROUP TOTAL					1	2	6,048	5,509
2599	Packwood Financial, Inc.		Packwood	Iowa				
	Farmers Savings Bank of Packwood, Iowa (NM)		Packwood	Iowa				
0800	MID IOWA, INC.		PANORA	IOWA				
	PANORA STATE BANK	NON MEM	PANORA	IOWA		1	6,897	6,342
HC GROUP TOTAL					1	1	6,897	6,342
2219	EMS, INC.		PARKERSBURG	IOWA				
	PARKERSBURG STATE BANK	NON MEM	PARKERSBURG	IOWA		2	18,227	16,208
HC GROUP TOTAL					1	2	18,227	16,208

	NAME AND LOCATION OF BANK HOLDING COMPANY NAME AND LOCATION OF SUBSIDIARY BANK	FRS MEMBER-SHIP			NO. BANKS	NO. OF OFFICES	TOTAL ASSETS ($1000)	TOTAL DEPOSITS ($1000)
0801	VERMEER INVESTMENT COMPANY		PELLA	IOWA				
	MARION COUNTY STATE BANK	NON MEM	PELLA	IOWA		2	26,637	24,480
HC GROUP TOTAL					1	2	26,637	24,480
0901	NEBO CORPORATION		PISGAH	IOWA				
	PISGAH SAVINGS BANK	NON MEM	PISGAH	IOWA		1	3,962	3,615
HC GROUP TOTAL					1	1	3,962	3,615
0829	CHEVALIER, INC.		POSTVILLE	IOWA				
	CITIZENS STATE BANK	NON MEM	POSTVILLE	IOWA		1	14,227	13,088
HC GROUP TOTAL					1	1	14,227	13,088
1103	ASCO, INC.		ROCK RAPIDS	IOWA				
1114	ROCK RAPIDS STATE BANK		ROCK RAPIDS	IOWA				
	ROCK RAPIDS STATE BANK	NON MEM	ROCK RAPIDS	IOWA		2	19,140	16,825
0998	MIDWEST AGRICULTURAL CREDIT CORPORATION		ROCK RAPIDS	IOWA				
	LESTER STATE BANK	NON MEM	LESTER	IOWA		1	4,248	3,911
NOTE:	1103 CONTROLS 1114, 0998							
HC GROUP TOTAL					2	3	23,388	20,736
0999	ASHTON INVESTMENT COMPANY		ROCK RAPIDS	IOWA				
	ASHTON STATE BANK	NON MEM	ASHTON	IOWA		1	12,046	10,400
HC GROUP TOTAL					1	1	12,046	10,400
0998	MIDWEST AGRICULTURAL CREDIT CORPORATION		ROCK RAPIDS	IOWA				
	LESTER STATE BANK	NON MEM	LESTER	IOWA		1	4,248	3,911
HC GROUP TOTAL					1	1	4,248	3,911
2412	PARKWAY DEVELOPMENT, INC.		ROCK RAPIDS	IOWA				
1103	ASCO, INC.		ROCK RAPIDS	IOWA				
1114	ROCK RAPIDS STATE BANK		ROCK RAPIDS	IOWA				
	ROCK RAPIDS STATE BANK	NON MEM	ROCK RAPIDS	IOWA		2	19,140	16,825
0998	MIDWEST AGRICULTURAL CREDIT CORPORATION		ROCK RAPIDS	IOWA				
	LESTER STATE BANK	NON MEM	LESTER	IOWA		1	4,248	3,911
NOTE:	2412 CONTROLS 1103, 1114, 0998							
HC GROUP TOTAL					2	3	23,388	20,736
1114	ROCK RAPIDS STATE BANK		ROCK RAPIDS	IOWA				

	NAME AND LOCATION OF BANK HOLDING COMPANY / NAME AND LOCATION OF SUBSIDIARY BANK	FRB MEMBER-SHIP			NO. BANKS	NO. OF OFFICES	TOTAL ASSETS ($1000)	TOTAL DEPOSITS ($1000)
1114	ROCK RAPIDS STATE BANK	NON MEM	ROCK RAPIDS	IOWA		2	19,140	16,825
0998	MIDWEST AGRICULTURAL CREDIT CORPORATION		ROCK RAPIDS	IOWA				
	LESTER STATE BANK	NON MEM	LESTER	IOWA		1	4,248	3,911
NOTE:	1114 CONTROLS 0998							
HC GROUP TOTAL					2	3	23,388	20,736
1095	SHIELDS AGENCY, INC.		ROWLEY	IOWA				
	ROWLEY SAVINGS BANK	NON MEM	ROWLEY	IOWA		1	6,707	6,198
HC GROUP TOTAL					1	1	6,707	6,198
0895	PIONEER DEVELOPMENT COMPANY		SERGEANT BLUFF	IOWA				
	PIONEER VALLEY SAVINGS BANK	NON MEM	SERGEANT BLUFF	IOWA		1	7,426	6,415
HC GROUP TOTAL					1	1	7,426	6,415
2579	Security Bancshares, Inc.		Shenandoah	Iowa				
	The Security Trust and Savings Bank	Member	Shenandoah	Iowa				
0423	K.S.J. ENTERPRISES, INC.		SIBLEY	IOWA				
	SIBLEY STATE BANK	NON MEM	SIBLEY	IOWA		1	15,197	13,974
HC GROUP TOTAL					1	1	15,197	13,974
0583	SOUTHWEST COMPANY		SIDNEY	IOWA				
	FREMONT COUNTY SAVINGS BANK	NON MEM	SIDNEY	IOWA		1	13,702	12,399
HC GROUP TOTAL					1	1	13,702	12,399
	Keokuk County Bankshares, Inc.		Sigourney	Iowa				
	Keokuk County State Bank		Sigourney	Iowa				
0857	MIDCO INCORPORATED		SIOUX CITY	IOWA				
	AKRON SAVINGS BANK	NON MEM	AKRON	IOWA		1	6,268	9,849
HC GROUP TOTAL					1	1	6,268	9,849
0892	MORNINGSIDE DEVELOPMENT COMPANY		SIOUX CITY	IOWA				
	MORNINGSIDE STATE BANK	NON MEM	SIOUX CITY	IOWA		1	15,804	14,595
HC GROUP TOTAL					1	1	15,804	14,595
0844	PERRY DEVELOPMENT COMPANY		SIOUX CITY	IOWA				
	VALLEY STATE BANK	NON MEM	SIOUX CITY	IOWA		2	9,612	8,711
HC GROUP TOTAL					1	2	9,612	8,711
0846	SECURITY NATIONAL CORPORATION		SIOUX CITY	IOWA				

	NAME AND LOCATION OF BANK HOLDING COMPANY / NAME AND LOCATION OF SUBSIDIARY BANK	FRS MEMBER-SHIP			NO. BANKS	NO. OF OFFICES	TOTAL ASSETS ($1000)	TOTAL DEPOSITS ($1000)
0846	NWN SB OF ORANGE CITY	NON MEM	ORANGE CITY	IOWA		3	32,305	29,896
	SECURITY NB OF SIOUX CITY	NATIONAL	SIOUX CITY	IOWA		3	195,710	168,350
HC GROUP TOTAL					2	6	228,015	198,246
1036	SLOAN STATE CORPORATION		SLOAN	IOWA				
	SLOAN STATE BANK	NON MEM	SLOAN	IOWA		1	8,375	7,467
HC GROUP TOTAL					1	1	8,375	7,467
1086	SPENCER NATIONAL BANK TRUST		SPENCER	IOWA				
	SPENCER NATIONAL BANK	NATIONAL	SPENCER	IOWA		2	24,124	21,867
HC GROUP TOTAL					1	2	24,124	21,867
0215	THE FIRST NATIONAL COMPANY		STORM LAKE	IOWA				
	CITIZENS FIRST NATIONAL BANK	NATIONAL	STORM LAKE	IOWA		2	63,089	56,401
HC GROUP TOTAL					1	2	63,089	56,401
0899	HUNTER AGENCY, INC.		STRAWBERRY POINT	IOWA				
	UNION BANK AND TRUST COMPANY	NON MEM	STRAWBERRY POINT	IOWA		1	15,135	13,724
HC GROUP TOTAL					1	1	15,135	13,724
0822	BANK SERVICE DEPARTMENT, INC.		SWEA CITY	IOWA				
	SWEA CITY STATE BANK	NON MEM	SWEA CITY	IOWA		1	6,557	6,091
HC GROUP TOTAL					1	1	6,557	6,091
1110	BEDMM'S INC.		TAMA	IOWA				
	FIRST COMMUNITY BANK & TRUST	NON MEM	TRAER	IOWA		1	15,025	13,695
HC GROUP TOTAL					1	1	15,025	13,695
0974	HANS, INC.		TAMA	IOWA				
	TAMA STATE BANK	NON MEM	TAMA	IOWA		3	22,936	20,233
HC GROUP TOTAL					1	3	22,936	20,233
0810	BANK SALES DEPARTMENT, INC.		TERRIL	IOWA				
	STATE BANK	NON MEM	SPIRIT LAKE	IOWA		2	8,574	7,647
HC GROUP TOTAL					1	2	8,574	7,647

	NAME AND LOCATION OF BANK HOLDING COMPANY / NAME AND LOCATION OF SUBSIDIARY BANK	FRS MEMBER-SHIP			NO. BANKS	NO. OF OFFICES	TOTAL ASSETS ($1000)	TOTAL DEPOSITS ($1000)
0911	CARL G. RIGGS AGENCY, INC.		TINGLEY	IOWA				
	TINGLEY STATE SAVINGS BANK	NON MEM	TINGLEY	IOWA		1	7,602	7,064
HC GROUP TOTAL					1	1	7,602	7,064
0850	MILLER CO.		TIPTON	IOWA				
	FIRST NB OF TIPTON	NATIONAL	TIPTON	IOWA		1	14,494	13,538
HC GROUP TOTAL					1	1	14,494	13,538
1058	TIPTON CO., INC.		TIPTON	IOWA				
	TIPTON STATE BANK	NON MEM	TIPTON	IOWA		1	24,261	22,228
HC GROUP TOTAL					1	1	24,261	22,228
0819	TAMA COUNTY ABSTRACT COMPANY		TOLEDO	IOWA				
	STATE BK OF TOLEDO	NON MEM	TOLEDO	IOWA		1	22,110	20,407
HC GROUP TOTAL					1	1	22,110	20,407
1089	JFBS, INC.		TRAER	IOWA				
	FIRST COMMUNITY BANK & TRUST	NON MEM	TRAER	IOWA		1	15,025	13,695
HC GROUP TOTAL					1	1	15,025	13,695
1066	KUPKA'S, INC.		TRAER	IOWA				
	CLUTIER STATE BANK	NON MEM	CLUTIER	IOWA		2	6,592	5,906
HC GROUP TOTAL					1	2	6,592	5,906
2332	TRAER SHARES, INCORPORATED		TRAER	IOWA				
	FARMERS SAVINGS BANK	NON MEM	TRAER	IOWA		1	23,526	21,633
HC GROUP TOTAL					1	1	23,526	21,633
	Washington Bancorporation		Washington	Iowa				
	The National Bank of Washington	National	Washington	Iowa				
2450	PEOPLES BANKSHARES, LTD.		WATERLOO	IOWA				
	PEOPLES BANK AND TRUST CO	NON MEM	WATERLOO	IOWA		3	70,196	64,354
HC GROUP TOTAL					1	3	70,196	64,354
0995	CEDAR INVESTMENT COMPANY		WAVERLY	IOWA				
	STATE BANK OF WAVERLY	NON MEM	WAVERLY	IOWA		3	31,511	28,609
HC GROUP TOTAL					1	3	31,511	28,609

	NAME AND LOCATION OF BANK HOLDING COMPANY / NAME AND LOCATION OF SUBSIDIARY BANK	FRB MEMBER-SHIP			NO. BANKS	NO. OF OFFICES	TOTAL ASSETS ($1000)	TOTAL DEPOSITS ($1000)
2457	AGRI-BANK CORPORATION		WEBSTER CITY	IOWA				
	FARMERS NB OF WEBSTER CITY	NATIONAL	WEBSTER CITY	IOWA		2	37,655	34,153
HC GROUP TOTAL					1	2	37,655	34,153
2372	VAN DIEST FINANCIAL, LTD		WEBSTER CITY	IOWA				
	FIRST STATE BANK	NON MEM	WEBSTER CITY	IOWA		1	24,146	21,889
HC GROUP TOTAL					1	1	24,146	21,889
2700	Wellman Investment Company		Wellman	Iowa				
	Wellman Savings Bank	Non Mem	Wellman	Iowa				
0893	WISCO, INC.		WEST DES MOINES	IOWA				
	FIRST STATE BANK	NON MEM	DIAGONAL	IOWA		2	5,226	4,801
HC GROUP TOTAL					1	2	5,226	4,801
1446	WEST LIBERTY HOLDING COMPANY		WEST LIBERTY	IOWA				
	WEST LIBERTY STATE BANK	NON MEM	WEST LIBERTY	IOWA		1	21,060	19,376
HC GROUP TOTAL					1	1	21,060	19,376
0843	WILLIAMS SECURITY INSURANCE AGENCY, INC.		WILLIAMS	IOWA				
	WILLIAMS SAVINGS BANK	NON MEM	WILLIAMS	IOWA		1	7,975	6,776
HC GROUP TOTAL					1	1	7,975	6,776
1038	C-B-G, INC.		WILTON	IOWA				
	WILTON SAVINGS BANK	NON MEM	WILTON	IOWA		2	21,547	19,543
HC GROUP TOTAL					1	2	21,547	19,543
2195	WOODBINE BANCORP, INC.		WOODBINE	IOWA				
	FIRST NB OF WOODBINE	NATIONAL	WOODBINE	IOWA		1	14,866	13,212
HC GROUP TOTAL					1	1	14,866	13,212
1017	TRI COUNTY INSURANCE AGENCY, INC.		ZEARING	IOWA				
	TRI COUNTY STATE BANK	NON MEM	ZEARING	IOWA		2	5,474	4,895
HC GROUP TOTAL					1	2	5,474	4,895
2127	FARMERS ENTERPRISES, INC.		ALBERT	KAN				
	FARMERS STATE BANK	NON MEM	ALBERT	KAN		1	12,157	10,601
HC GROUP TOTAL					1	1	12,157	10,601

IOWA ASSOCIATION OF REALTORS®

999 Oakridge Drive, Des Moines, Iowa 50314
Telephone 515 244-2294

GOVERNMENTAL AFFAIRS DIVISION

July 31, 1978

Charles L. Marinaccio
Special Committee
Committee on Banking
United States Senate
Washington, D.C. 20510

Dear Mr. Marinaccio:

We are enclosing a letter from one of our REALTORS along with a brochure from the Grundy Saving Bank, Grundy Center, Iowa.

His letter is self-explanatory. We wish to point out that the office of Center Insurance and Real Estate is in the lobby of this bank and that all members of this Insurance and Real Estate firm are employees of this bank. Also that this bank is a member of a bank holding Company, Hawkeye Bancorporation Des Moines, Iowa, and that they so state in the last page of the brochure.

Yours truly,

Harold Abernathey

Harold Abernathey, Director
Governmental Affairs

HA:dm

CC: Mr. Paul Preston, NATIONAL ASSOCIATION OF REALTORS, Washington, D.C.
REALTOR I.L."Tommy" Tucker. Cedar Rapids, Iowa

REALTOR

KAMBER-VAN DORN CO.

4921 DOUGLAS AVENUE, DES MOINES, IOWA 50310 PHONE: 276-8241

Tom Seibel
Dubuque, Ia

May 15 78

Dear Tom:

Enclosed is a sample Prospectus of a Commercial Bldg in Grundy Center Iowa. Notice the information comparison between the Front cover and Rear Cover. L. E. Pike Broker ? I believe (License on office wall) and L. E. Pike Bank President! Center Real Estate office is within the Bank Building.

I sought this listing - Known in advance of the forming of the Corp. I told They had both an interest (Possibly financial) and a lower commission Rate and giving listing I Believe they listed at 4% - 6% normal 10% After two trys they have agreed to co-operate with me only at 40% of 4%.

[illegible]

They now have this site at
1,250,000.00 - at a total 50,000.00 Commis-
x40%
20,000 to color seller.

Since I have interested parties I
am working it even at low commission.

If my information is of any help
or you need a notorized letter on the
subject, please advise as to needed
content within the letter,

R. M. Shane
P.O. Box 1106
Iowa Falls, Iowa
50126

RESIDENTIAL · COMMERCIAL · FARMS
Member Multiple Listing

ROBERT M. SHANE

REALTOR®

KAMBER - VAN DORN CO.

4921 DOUGLAS - DES MOINES, IOWA 50310
Off. 515/278-9241 Res. 515/648-9855

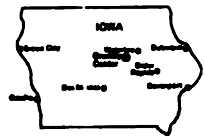
This Plant Is Priced To Sell

This is an outstanding industrial facility with all the utilities available and in use. The Main Production Building, a 200 x 400 steel building built in 1971-72, is one of the finest industrial buildings in the State of Iowa.

Among the many items included in the sale of this plant are:

- 2 automotive spray paint booths (1 with hydraulic hoist, 1 with crane rail through)
- 4 overhead cranes
- Machine tool area
- Metal fabrication facility

The buildings are located on 28.59 acres of land. 11 buildings, including office space, are located on the plant site.



Brief Facts

LOCATION: Along Highways 14-175, 1 mile West of Grundy Center, Iowa, and located 30 miles either way from Marshalltown and Waterloo and 38 miles East of Interstate Highway 35.

NATURAL GAS: Supplied by Peoples Natural Gas, a division of Northern Natural Gas. An 18,000 gallon LP tank provides back-up fuel.

WATER SUPPLY: City of Grundy Center provides a direct 12" water line to plant property connected directly to the City's 500,000 gallon water tower.

SEWAGE TREATMENT: Plant has their own sewage treatment system consisting of a two cell lagoon designed for 600 employees.

ELECTRICITY: Provided by Iowa Electric Light & Power Co. with industrial rates.

TELEPHONE SERVICE: Provided by United Telephone Service of Iowa with home offices in Newton, Iowa.

MAIL SERVICE: Provided through local Pcst Office Box in Grundy Center or through Rural Free Delivery.

TAX INFORMATION: Property is located in a rural area and benefits from a lower millage rate as opposed to city tax rates. Current rate 17.75911.

SCHOOLS: The plant is located in the Grundy Center Community School District. Grundy Center is 30 miles from the University of Northern Iowa at Cedar Falls, 60 miles from Iowa State University at Ames, and 30 miles from Hawkeye Institute of Technology in Waterloo.

LABOR FORCE: Good supply of skilled and unskilled workers available. 100-150 available from the closing of Mid Equipment, Inc.

TRANSPORTATION: Several large trucking firms are available for contract hiring within a 30 mile radius. A half mile long grass strip for small airplanes is located 1 mile from the plant, hard surfaced runways north of Marshalltown are 25 miles away and commercial airline service is 30 miles away in Waterloo.

FINANCE: Industrial Revenue Bond with 6 figure balance could be assigned. Present owners will consider a contract sale with a favorable interest rate.

Priced to Sell in a Community That Wants You

Grundy Center, Iowa

Where Industry and Agriculture Are Partners in Progress.

IOWA
A Place to Grow

For Further Information Contact:

L.C. Pike, President
Farmers Savings Bank
Grundy Center, Iowa
(319) 824-5226

or

Richard M. Briggs, Broker
Center Insurance & Real Estate Agency
Grundy Center, Iowa
(319) 824-3414

Member Hawkeye Bancorporation

34-934 O - 78 - 14

The CHAIRMAN. Thank you very much, Mr. Farrer.

We are going to ask Mr. Hemphill, of the Mortgage Insurance Cos. of America, if you would recognize when you start the green light will go on and it will be on for 9 minutes and then the yellow light for 1 minute and then the red light comes on and that means to stop.

If you would like to abbreviate your statement, the entire statement will be printed in full in the record.

STATEMENT OF WILLIAM L. HEMPHILL, PRESIDENT, MORTGAGE INSURANCE COS. OF AMERICA, ACCOMPANIED BY JOHN WILLIAMSON, EXECUTIVE VICE PRESIDENT

Mr. HEMPHILL. Mr. Chairman, I am William L. Hemphill and I'm president of United Guaranty Corp., whose home office is in Greensboro, N.C. I am also president of the Mortgage Insurance Cos. of America, on whose behalf I appear today. I am accompanied by John Williamson, our executive vice president, who is based here in Washington.

I have already filed a detailed statement setting out the reasons why we support S. 72 to restrict further the entry of bank holding companies into activities which are not directly related to banking and which are not necessary incident thereto.

[Complete statement follows:]

STATEMENT OF WILLIAM L. HEMPHILL, PRESIDENT, MORTGAGE INSURANCE COMPANIES OF AMERICA, BEFORE THE SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS IN REGARD TO S. 72 RELATING TO BANK HOLDING COMPANIES

June 16, 1978

Mr. Chairman and Members of the Committee:

*I am William L. Hemphill of Greensboro, North Carolina, and am President of United Guaranty Corporation, a private mortgage insurance company . I appear before you as President of the Mortgage Insurance Companies of America.**

I am pleased to present this statement in support of proposed amendments to section 4(c) of the Bank Holding Company Act, as set forth in Section 301 of S. 72, which would provide stronger and more restrictive tests in determining whether a bank holding company may engage in certain non-banking activities.

The mortgage insurance industry is directly involved in the issues presented by the legislation. On May 23, 1973 the Federal Reserve Board issued a notice of proposed rulemaking that the underwriting of real estate mortgage guaranty insurance was a permissible non-banking activity of bank holding companies. Subsequently, in January 1974 public hearings were held on the applications of the three bank holding companies for de novo entry in the mortgage guaranty insurance business. On September 11, 1974 the Board

---

**The Mortgage Insurance Companies of America is a trade association consisting of fourteen private mortgage insurance companies whose insurance in force on June 1, 1978 was in excess of $68 billion. The national officers of the Association are William L. Hemphill (President of United Guaranty Corporation, Greensboro, NC), President; Preston Martin (President of PMI Mortgage Insurance Company, San Francisco), Vice President; Leon T. Kendall (President of Mortgage Guaranty Insurance Corporation, Milwaukee), Secretary; John E. Horne (Chairman, Tiger Investors Mortgage Insurance Company, Boston), Treasurer; and John C. Williamson, Washington, DC, Executive Vice President.*

denied the applications "at the present time" although concluding that underwriting mortgage guaranty insurance "is closely related to banking" and therefore in principle a logical and legal activity for bank holding companies.

It is our considered opinion that the Federal Reserve Board having ruled that mortgage guaranty insurance is "closely related to banking or managing or controlling banks as to be a proper incident thereto" that this is sufficient and eloquent testimony that the test, quoted above, requires the amendments proposed by section 301 of S. 72, that the activity sought be "closely and directly" related to banking, and that the activity be "a proper and necessary incident thereto."

If the "closely related" test makes mortgage insurance a permissible activity, then the test must be revised to require that the activity be "closely and directly related to banking" as provided in S. 72.

Our arguments as herein set forth will point out the reasons why bank holding companies should not be permitted to engage in mortgage insurance. This will underscore our argument why Section 301 of S. 72 should be approved so as to avert such a ruling by the Federal Reserve Board.

The underwriting of mortgage guaranty insurance may be "related" to banking in the sense that banks originate mortgages on real estate. At that point the interest of the bank as lender, and that of the mortgage insurer, move off at divergent angles.

First a little history. The private mortgage insurance industry which flourished in the early decades of this century went broke in the early 1930's. A New York State Commission investigated the debacle and concluded:

> "The business of guaranteeing mortgages is not an ordinary banking function and the public would have been better off if none of the companies had owned or been affiliated with banking institutions, or in turn had not been owned by them." (Alger Report, P. 86)

If the present tests for acquisition or *de novo* entry by bank holding companies in mortgage guaranty insurance were to result in approval by the Board, the following conflicts of interest with inevitable detriment to the public interest would result:

1. Elimination of Reciprocal Policing

The relationship between mortgage insurers and lenders today is subject to the discipline imposed by the competing interests of independent businesses with differing viewpoints. Where the mortgage lender and mortgage insurer are unrelated, there is a salutary incentive for reciprocal policing of both lending and insuring practices. The mortgage lender will seek an insurer whose rates and services are competitive and who possesses sufficient financial strength and risk dispersion to assure its ability to satisfy its insurance obligations. At the same time, the insurer will seek to avoid underwriting lenders whose practices expose it to high risks of loss. Affiliation of the lender and insured would relax or eliminate entirely the incentive for such mutual policing. This result seems obvious in cases of providing coverage for the credit risks of lending affiliates.

Conflicts may also exist whenever an insurance subsidiary underwrites mortgage loans originated or held by a mortgage lender with significant business contacts elsewhere in the holding company system. Thus, a mortgage banker or a commercial bank which borrows from or has significant deposits in a banking subsidiary within the holding company may be in a position to command special treatment from the holding company's insurance subsidiary. The opposite could, of course, also be the case — that is, such a customer might feel constrained to purchase the holding company's mortgage insurance because of favorable credit relationships. It is the malign influence such relationships may have on underwriting practices and standards which are cause for greatest concern.

2. Adverse Risk Selection

A favorite banking customer of the holding company system may be granted insurance on mortgage loans which, but for the banking relationship, would have been rejected by the mortgage insurer. The ubiquitous hazard of adverse risk selection always prevalent in the mortgage insurance business, and indeed any insurance business, will be greatly exacerbated by the presence of extraneous incentives for an insurer to accept (or fail to investigate adequately) risks proposed by a preferred customer of its banking affiliate.

3. Appraisal Practices

Faulty appraisal practices pose an even graver potential problem than adverse credit risk selection. Mortgage guaranty insurers generally rely upon the property appraisals submitted by their lenders (spot checking by means of independent appraisals). Inflated appraisals expose the mortgage insurer not only to normal fluctuations in property values but also to an initial inadequacy of security which virtually assures loss in the event of default.

4. Hidden Rebates

To persons unfamiliar with the insurance industry, it may not be self-evident how damaging hidden rebates can be. State insurance regulations generally prohibit rebating of premiums; and the Federal Home Loan Mortgage Corporation's eligibility requirements for mortgage insurers expressly prohibit paying commissions or other compensation to insured lenders or persons related to them (FHLMC, Eligibility Requirements s. 150). The principal objective of these regulatory prohibitions is to prevent unfair discrimination between insureds and provide assurance that premiums are sufficient to cover the insured risks. Allowing affiliation of banks and insurers will greatly facilitate circumvention of these salutary state and federal regulations.

5. Financial Relationships

The existence of other financial relationships within the same holding company would create an excellent vehicle for covert premium rebates. A bank holding company might indirectly compensate a customer of its mortgage insurance subsidiary by having its banking affiliate make deposits in or reduce correspondent service charges to such customer. Even more obvious opportunities for premium rebating exist whenever the insurance customer is also a borrower from the banking system, e.g., interest rate reductions or more favorable loan terms. There are times that the mere availability of credit when it would not otherwise be available could be considered a rebate.

The intricate web of reciprocal relationships which exist in the correspondent banking area would make rebates almost impossible to discover or police.

The crucial point is that there is no conceivable way to prevent, much less police, such rebating if significant financial relationships with non-insurance subsidiaries of the holding company are allowed to exist. It would not be feasible to determine that excessive deposits are being made by a holding company bank with correspondent banks which are also customers of its mortgage insurance affiliate or that the interest rates on loans to a mortgage banker have been slightly reduced to compensate the mortgage banker for using the holding company's mortgage insurance.

6. Reinsurance

Another danger is the possibility that the mortgage insurance affiliate of a bank holding company will reinsure its risks with a thinly capitalized reinsurance affiliate of a banking customer of a holding company. Reinsurance can easily be used to disguise premium rebating.

If the lender who controls the flow of insurance business also owns a reinsurer, the lender can require the primary insurer to reinsure with the lender's affiliated reinsurer. Since reinsurance premium rates are not regulated, the reinsurer can charge any price it wants. If the primary insurer wants to keep that lender's business, it will have to pay the price. This type of rebating through the reinsurance mechanism has existed in the credit life and credit accident and health field for several years. It has proved to be almost impossible to regulate or control this type of rebating activity. Such rebating has potentially disastrous consequences because the primary insurer has fewer funds because of the high reinsurance premium and, since the reinsurer is usually distributing its profits, it may not have the funds available to meet its obligations.

7. Inadequate Geographic Dispersion of Risks

Another danger inherent in allowing mortgage insurers affiliated with bank holding companies to insure customers of the holding company banks is the adverse impact on geographic dispersion of mortgage insurance risks. Because even the largest bank holding company banks are essentially regional in their operations, it will be natural for bank holding companies to place greatest emphasis on marketing mortgage insurance in the regions where their banks have established markets — that is, where their reciprocal leverage to sell mortgage insurance derived from the banking relationships will be the greatest. Confining risk dispersion to a limited geographic area is extremely undesirable from an insurance standpoint, because it makes the insurer peculiarly vulnerable to economic reversals affecting only that region.

8. Unnecessary Insurance

The decision to purchase or require mortgage insurance (like credit life and credit health and accident insurance) is made by the lender, not the borrower who in one form or another pays for it. In a normal arm's length situation, competitive interplay among lenders may prevent their requiring borrowers to maintain mortgage insurance except where it is clearly needed from a credit standpoint. The existence of other relationships, such as correspondent banking or a mortgage lender's own borrowings from the banking affiliate of a mortgage insurer, may, however, cause the mortgage lender to insist on mortgage insurance for reasons which have no connection with the mortgage loan transaction. Particularly in the case of commercial banks (which tend to treat residential mortgage lending as an "off-again, on-again" proposition), it is likely that there will be a strong tendency to require mortgage insurance whenever it would be of advantage to the bank for other reasons.

9. Reverse Competition

The premiums charged for credit life and credit accident and health insurance are not subject to normal competitive disciplines. Indeed a reverse competition prevails with credit insurance: The stronger the competition for such insurance, the higher the premiums become because larger "experience" rebates, dividends, commissions or other means are offered as a means of compensating lenders who dictate the purchase of such insurance but do not pay for it. In the case of credit life and credit accident *and health insurance, however, a lender may not explicitly require a consumer-borrower to purchase such insurance from an affiliated company, even though this is often what happens as a practical matter. Even this minimal safeguard against unnecessary and unduly expensive insurance may not exist in the case of mortgage insurance.*

10. The "Increased Competition" Argument

It has been alleged that the mortgage guaranty insurance industry is a single-company dominated industry and needs the competition that would be afforded by lender entry. As was noted above, the mortgage guaranty insurance industry as it exists today is a relatively new phenomenon. After its formation in 1957, Mortgage Guaranty Insurance Corporation had 100 percent of the market written by private companies until competitors began surfacing in the early 60's. As competitors entered the market, including my own company, United Guaranty Corporation, MGIC's share dropped to 82 percent in 1963, to 57 percent in 1973 and below 50 percent in 1975 and about 40 percent in 1978. Obviously, competition in the industry is a fact and is increasing with fifteen companies now writing mortgage insurance. No state is served by less than four mortgage insurers and about 20 are served by more than ten.

11. The "Additional Capital" Argument

It has been alleged by the bank holding companies that their entry into the mortgage guaranty insurance field would bring increased capital into a business that is very capital intensive. Since the existence of the mortgage guaranty insurance business, it has succeeded in raising capital of several hundred million dollars. Total assets of our member companies on December 31, 1977 exceeded $1 billion dollars. Thus, while mortgage guaranty insurance is a capital intensive industry, the companies that are in the field have been able to raise funds in the money market when that was necessary.

12. The Credit Function Analogy

Another allegation of the bank holding companies is that mortgage guaranty insurance is so analogous to the credit function of lending money, that it is well within their existing scope of expertise to engage in this activity. This assertion misses the point entirely that the expertise needed for insuring is substantially different from the expertise needed to write insurance even though there are some similar criteria involved.

A lending institution does not make loans on the theory that those loans are going to go into default. Credit is extended only to those individuals or corporations that they believe will pay off the debt. Contrariwise, mortgage guaranty insurance is written on the assumption that there will be losses and that the mortgage guaranty insurance company will have to be able to pay off loans which have defaulted. Therefore, it is important in the insuring function to have an actuarially sound reserving system and a geographically spread book of business. While most lending institutions concentrate in one particular area of geographic expertise, an insurance company must spread its risks geographically so that it cannot be decimated by the economic conditions in one particular area. Consequently, the function of extending credit is a very different one from the function of insuring against default of credit.

To summarize, there is no need for entry of bank holding companies into the private mortgage insurance field to assure competition or to contribute capital for expansion. Nor do bank holding companies possess any special expertise or other assets peculiarly adapted or adaptable to mortgage insurance underwriting. Hence, no gain in efficiency or convenience to the public could be expected to ensue. Indeed, as pointed out above, the relationship would give rise to a strong incentive to foist unnecessary mortgage insurance upon the borrowing public and would invite insoluble conflict of interest situations to the detriment of the mortgage insurance industry. The mistakes of the past indicate that it is important to retain the checks and balances which exist today and which preserve the integrity of the industry.

Furthermore, it clearly would be a mistake to superimpose a capital demanding activity such as mortgage insurance in a banking system which already has demonstrated extreme trauma from capital shortages.

I want to reiterate in the strongest terms that under existing law, the Federal Reserve Board has concluded that mortgage guaranty insurance is closely related to banking and presumably a permissible activity of bank holding companies. In this statement I have pointed out the disadvantages to the public of such an entry. The amendments set forth in section 301 of S. 72 would bar such entry. We therefore strongly recommend its approval by the Committee and the Congress to avert any final ruling by the Board which would generate conflicts of interest and have such an adverse impact on the home-buying public and the banking industry.

Mr. HEMPHILL. Concluding, it's my understanding that the House Subcommittee on Financial Institutions last week rejected language similar to that proposed in S. 72. However, I have had an opportunity to examine substitute language which was approved and which would sharply limit insurance activities of bank holding companies, both as principal, agent or broker, to credit life and credit disability.

My initial reaction to this change is it accomplishes our objective. However, we prefer the language of section 301 of S. 72 which is more general but unmistakable in its principal thrust of barring bank holding companies from the insurance business. I recommend, should the House bill find its way into conference on S. 71, the banking bill approved by the Senate last year, that whatever language is adopted to curb activities of bank holding companies into nonbanking fields should also be applicable to other supervised lenders who may be tempted to extend their activities into nonlending areas. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Mr. Hemphill.

The last witness on the panel will be Mr. Robert Masterton, chairman of the Committee on Federal Legislation, National Association of Mutual Savings Banks.

STATEMENT OF ROBERT R. MASTERTON, CHAIRMAN, COMMITTEE ON FEDERAL LEGISLATION, NATIONAL ASSOCIATION OF MUTUAL SAVINGS BANKS, ACCOMPANIED BY JAMES J. BUTERA

Mr. MASTERTON. Thank you, Mr. Chairman.

Statement of the
National Association of Mutual Savings Banks
on
S. 72, The Competition in Banking Act
Before the
Committee on Banking, Housing and Urban Affairs
United States Senate
June 16, 1978

Mr. Chairman and members of the Committee, my name is Robert R. Masterton. I am president of the Maine Savings Bank in Portland, Maine and chairman of the Committee on Federal Legislation of the National Association of Mutual Savings Banks. I am accompanied today by James J. Butera, the Associate Director of our Washington Office. This Association commends the Committee Chairman, Senator Proxmire, for introducing S. 72, the Competition in Banking Act, which serves as a focal point for these important hearings on the impact of the bank holding company movement on the nation's banking industry and related lines of commerce.

A mere glance at the raw data on the rapid growth of bank holding companies clearly establishes the need for a reexamination of the federal laws regulating this form of banking organization. According to statistics compiled by the Federal Reserve Board, the number of registered bank holding companies increased from 65 to 1,912 during the period 1966 to 1976; the number of banks and branches operated increased almost ten times from 2,363 to 22,990, and their total deposits multiplied over thirteen times from $41 billion to $554 billion during this same 10-year period.1/ According to the latest available data, the bank holding company share of domestic commercial bank deposits has risen to 70.8 percent.2/ Clearly the bank holding company is the dominant form of financial institution in the country today.

In the savings bank industry, we are particularly concerned about the recent attempts by several bank holding companies in Maine and New Hampshire to acquire a savings bank subsidiary. We will be discussing this issue in more detail in the course of our testimony.

BACKGROUND AND OBJECTIVES OF FEDERAL REGULATION OF BANK HOLDING COMPANIES

Although the federal regulation of bank holding companies was a matter of legislation as early as 1933, it was not until the Bank Holding Company Act of 1956 that the Congress first established the principal public policy considerations which should pertain in this area. A review of the relevant legislative history indicates that the major concerns were with:

1) concentration of resources within the banking industry, and

2) separation between banks and other types of commerce.3/

To deal with these problems, the 1956 Act required registration of multi-bank holding companies and provided that no such company could acquire another bank without the prior approval of the Federal Reserve Board. It further provided that, as a practical matter, no holding company could make a bank acquisition outside the home state of its principal banking subsidiary.4/ With respect to nonbanking activities holding companies were limited to those companies of a "financial, fiduciary, or insurance nature ... so closely related to the business of banking or of managing or controlling banks as to be a proper incident thereto."5/

During the period 1956 to 1966 the holding company share of total deposits did not show any significant amount of growth. After reviewing the experience gained to date, the Congress did decide in 1966 to make certain changes to the initial Bank Holding Company Act. Insofar as competition in banking was concerned, the 1966 amendments made future bank acquisitions by holding companies subject to the same standards applicable to bank mergers under the Bank Merger Act of 1960.6/ These standards are, in turn, essentially a restatement of Section 2 of the Sherman Act7/ and Section 7 of the Clayton Act.8/ The 1966 amendments did not readdress the question of permissible nonbanking activities since at that point such activities were still quite limited.

Over the next few years, however, there occurred a marked proliferation of holding company formations with those involving the conversion of the nation's major banks to one-bank holding company status particularly arousing the concern of Congress. From 1966 to June 1968, 201 new one-bank holding companies were formed, and from June 1968 to the end of 1970, an additional 690 were created.9/ One reason for the growth was the fact that one-bank holding companies were at this time under no statutory limitations regarding the types of nonbanking activities which could be undertaken on an interstate basis. Another major reason cited by a Federal Reserve staff study for the rapid growth of one-bank holding companies was the "ability to use the holding company as a means of raising funds free from constraint of Regulation Q interest rate ceilings."10/

To rectify this situation the Congress acted first in 1969 to grant the Federal Reserve and the FDIC flexible authority to define the obligations of bank affiliates, including those of a parent holding company, as deposits for purposes of interest rate ceilings and reserve requirements.11/ With regard to the nonbanking activities of one-bank holding companies, the Congress addressed this in 1970 by ending the exemption to the Bank Holding Company Act that one-bank holding companies had enjoyed since 1956.12/

There was another major change brought about by the 1970 amendments in the area of nonbanking activities, and this action has generally been interpreted as liberalizing the range of closely related activities which the Federal Reserve Board could authorize bank holding companies to engage in. Specifically, the 1970 amendments amplified the standards for determining that a particular activity is so "closely related to banking as to be a proper incident thereto," by deleting the limitation to companies of a "financial, fiduciary or insurance nature," while at the same time providing that any such activity must "reasonably be expected to produce benefits to the public."13/

The 1970 amendments were the last major change to the Bank Holding Company Act, although Congress was forced once again in 1974 to deal with the related problem of bank holding companies issuing debt obligations in excess of federal interest rate controls applicable to their banking subsidiaries. Specific legislation was necessitated by the Federal Reserve Board's stated inability to regulate the floating rate notes of Citicorp and other bank holding companies because the proceeds of the note sales were purportedly being used outside their banking subsidiaries.14/ To resolve this, the Congress acted in 1974 to broaden the authority of the agencies to classify obligations of bank affiliates as deposits "regardless of the use of the proceeds."15/

We have chronicled these bank holding company developments to demonstrate that notwithstanding several amendments over the years, the basic thrust and overall objective of the federal regulation of bank holding companies has not changed. Each time the Act has been reviewed and modified the Congress has reinforced the commitment to the two principal goals of preserving competition in banking and promoting competition in related nonbanking areas.

FAILURE OF THE FEDERAL RESERVE TO ACCOMPLISH CONGRESSIONAL GOALS FOR THE BANK HOLDING COMPANY ACT

We respectfully submit that in administering the Bank Holding Company Act, the Federal Reserve Board has in many instances taken action inconsistent with the Congressional goals which we have just outlined. The result has been that bank holding companies have been permitted to engage in both banking and nonbanking activities which have not served the best public interest. I would now like to discuss certain of these areas in detail before recommending specific aspects of the present statute which should be tightened up so as to reduce or eliminate the prospect of continued pro-holding company implementation by the administering agency in the years ahead.

1. Acquisition of Savings Banks by Holding Companies

Turning first to the question of competition in banking, the bulk of the studies completed thus far suggest that bank holding company activity has had little systematic effect on market concentration and hence no measurable impact on banking competition pro or con.[16/] But as was pointed out by the Federal Reserve Chairman G. William Miller in testimony before this Committee on May 25, 1978, the banking environment has become considerably more competitive in recent years.[17/] We would contend that most of this increased competition at the retail level has come about as the result of the participation by financial institutions other than commercial banks. Here we are referring, for example, to NOW accounts, which were inaugurated by savings banks in New England; off-premise electronic banking, which was started by a savings and loan association in the Midwest; telephone bill paying services, which were first successfully marketed by savings banks; credit union share drafts; and variable rate mortgages.

Thus, we are suggesting that while retail banking has become more competitive, it has not been the result of holding company activity but, rather, it has been increased participation by thrift institutions in such areas as consumer lending, third party transfers, etc. On this particular point we have attached to our testimony, as Exhibit A, a Wall Street Journal article indicating the consumer benefits brought about by increased competition in my own state of Maine as a result of the revision to our Banking Code granting consumer lending powers to savings banks and savings and loan associations.

For the very reason that competition in banking is coming in large part from the thrift industry, we submit that this Committee and the Congress should share our concern over the fact that bank holding companies are evidencing increased interest in acquiring their thrift competitors and in certain other ways attempting to utilize the holding company device to gain unfair market advantages over those institutions specializing in home mortgage finance.

Although the great majority of savings banks are mutual (nonstock) institutions, there exists authority in the states of Maine and New Hampshire for similar institutions to be organized in stock form. Six such institutions are now and have for some time been operating in New Hampshire. Under current FDIC interest rate control regulations, stock savings banks operate under the same rate structure permitted mutual savings banks, i.e., they offer a one-quarter percent differential on most deposit accounts.[18] Because a stock savings bank can offer the interest rate differential, there have been several attempts by bank holding companies in Maine and New Hampshire to obtain stock savings bank charters and operate the savings bank subsidiaries on the same banking premises as their commercial subsidiaries.[19]

These applications were opposed by this industry and several other interested parties during the hearings held before the state banking departments last year. While the test cases were turned down by the banking departments in both states, there is no indication that the ardor of the holding company activists to move in on the thrift industry has abated. The decisions reached in these two particular cases are by no means the final disposition of the many important public policy questions involved. The Maine Superintendent of Banking recently stated that, "My decision on Casco's application doesn't mean that I would reject a bank holding company's application for a stock thrift in another community..."[20] and the New Hampshire decision is being appealed. Moreover, a similar application for a stock thrift institution has been filed and is currently being heard in the state of Rhode Island.

Should an application for a thrift institution subsidiary be approved at the state level, it would then be up to the Federal Reserve Board to grant final approval by determining whether operating a thrift institution is a permissible holding company activity. Since the Board has already determined that operating a savings bank[21/] and, in a separate action, that operating a savings and loan association[22/] are "closely related to banking," the sole remaining question to be decided is the so-called "public benefits" test.

In our view, this question is of such overriding importance that the Congress and not the Federal Reserve should make the determination. Looking over the record, the Federal Reserve Board has never seriously enforced the statutory requirement that the acquisition of nonbanking companies must result, in all cases, in public benefits, but has instead appeared willing to accept the pro forma recitation of anticipated public benefits. For example, in connection with applications by bank holding companies to engage in both mortgage banking and consumer finance, claims have been made that granting the applications would yield a variety of public benefits. Sufficient time has elapsed since mortgage banking and consumer financing were added to the list of permissible nonbanking activities so as to permit these claims to be evaluated on the basis of actual experience. According to studies prepared by the staff of the Board of Governors, the "public benefits" claims of the bank holding companies have not been substantiated in either case.

Mortgage banking was first placed on the list of permissible bank holding company activities in 1971,[23/] and since that time bank holding companies have acquired numerous mortgage banking firms, including many of the nation's largest. The study conducted by Stephen A. Rhoades, a staff economist with the Board, compared the performance of certain mortgage banking firms which had affiliated with bank holding companies with ones which had not. The summary and conclusions of the study were as follows:

> The two sets of regression results presented in this paper indicate that mortgage bankers affiliated with a bank holding company do not grow faster than nonaffiliated mortgage bankers and that affiliated commercial banks do not increase or decrease their mortgage lending activity as a result of affiliation with a mortgage banker These results taken together suggest that bank holding company acquisitions of mortgage bankers do not increase the flow of funds to the mortgage market and, therefore, should not generally be viewed as a public benefit.24/

An even more detailed study was conducted of the consumer finance business, which the Board also included on the initial list of permissible nonbanking activities for bank holding companies in 1971.25/ This study analyzed a sample of affiliated and independent consumer finance companies and compared them to one another as well as comparing the performance of the affiliated companies before and after their acquisition by holding companies. The results indicated that prior to their affiliation, the consumer finance companies performed no differently than independent companies; after affiliation, however, the testing revealed that these companies had higher interest and debt expense, lower profits, greater leverage and did not even benefit from lower operating expenses than independent companies. The authors' summary of their study is particularly pointed:

> It must be concluded that this study does not confirm the arguments of /bank holding companies/ that their entry into the consumer finance industry will yield numerous public benefits To the contrary, results indicate poorer performance by affiliates with respect to profits, leverage, and interest expenses.26/

Given the Board's accommodating attitude over the years toward the expansion of holding company activities, we urge the Congress in the strongest possible terms not to leave the question of whether a bank holding company should be permitted to own a savings bank in the hands of the administering agency. Indeed, on the related question of whether operating a savings and loan association is a permissible activity, the Board itself has asked the Congress for precisely such guidance.27/

Of course, it would be our position that commercial bank holding companies should not be permitted to own or operate a thrift institution of any kind on the grounds that acquisitions of this sort would eventually erode the competitive environment in which depository institutions do business today. Another potential problem is that opening up the thrift industry to bank holding company acquisition would give additional impetus to the trend already developing of mutual-to-stock conversions of such institutions.

2. Evasion of Regulation Q

Notwithstanding the fact that bank holding companies have been thwarted thus far in their efforts to move in on the thrift industry directly, the holding company device has allowed them to indirectly undercut their competitors by issuing deposit-like instruments at interest rates exceeding that which can be paid by thrift institutions. As noted at the outset of our testimony, the ability to issue a so-called "thrift certificate" with an interest rate and other terms more liberal than that permitted member banks under Regulation Q, was one of the prime factors behind the rapid growth of bank holding companies in the late 1960's. In 1969 and 1973/4, during periods of high interest rates, numerous bank holding companies resorted to this form of raising funds and recently, as open market rates have risen again to a level exceeding the ceilings authorized for deposits under federal interest rate controls for similar maturities, these types of note issues have begun to reappear.28/ Although

Congress has twice attempted to put an end to Regulation Q evasions of this sort, the problem persists to this day for the basic reason that the statute involved grants discretionary enforcement authority to the Federal Reserve Board, and the Board has never exercised its authority.

In order to understand the manner in which bank holding companies and their nonbank subsidiaries are evading Regulation Q, it is first necessary to review briefly the regulations applicable to the deposits and nondeposit obligations of commercial banks. Deposits in amounts of less than $100,000 are, of course, subject to Regulation Q insofar as member banks are concerned and, for nonmember insured banks, the FDIC has an identical regulation.29/ Deposits in excess of $100,000 are not regulated as is also the case with short-term borrowings by banks in denominations of $100,000 or more -- commonly referred to as commercial paper.

However, banks are subject to certain regulatory restraints when it comes to raising capital through longer term notes and other nondeposit obligations undertaken for the purpose of obtaining funds to be used in the banking business. These obligations generally take the form of debentures subordinate to the claims of depositors and, when issued in amounts of less than $100,000, must meet the following conditions in order to avoid being treated as deposits for purposes of interest rate ceilings:

1) an original maturity of at least 7 years;

2) a minimum denomination of $500;

3) advance approval by the appropriate federal bank supervisory agency; and

4) a statement in bold face type that it is not an insured deposit.30/

Returning now to the authority of bank holding companies and their nonbank subsidiaries to issue debt obligations, it should first be noted that Section 4 of the Bank Holding Company Act provides that a holding company may engage in the activity of:

> "... banking or of managing or controlling banks or other subsidiaries authorized under this chapter."31/

The sale of securities to obtain funds for doing business is clearly a basic function of managing a subsidiary company and thus it follows that a bank holding company may borrow funds on either a long-term or short-term basis in the same manner permitted any nonbanking subsidiary. The issuance of thrift type notes by finance companies, industrial (Morris Plan) banks, etc., is a fairly common practice, and since operating such companies is a permissible activity for bank holding companies,32/ there can be little question, at least insofar as the Bank Holding Company Act is concerned, that a holding company is permitted to solicit funds through small denomination certificates. Nonbanking subsidiaries of bank holding companies likewise operate under no statutory or any current regulatory impediments as to their short-term borrowing authority.

As noted, the Congress has attempted to plug this loophole by granting the Federal Reserve Board and the FDIC authority to classify the obligations of holding companies and their nonbank subsidiaries as bank deposits for purposes of interest rate ceilings and reserve requirements. But neither the Board nor the FDIC have deemed it necessary to amend their regulations to implement this authority on a formal basis. On balance, one must, therefore, conclude that the current state of the law is inadequate to prevent bank holding companies from issuing "thrift certificates" in excess of Regulation Q ceilings. The problem is best summed up in the supplemental remarks of Congressman James M. Hanley set forth in the House

Report accompanying the 1974 legislation:

> "H.R. 15928, as reported by the Committee on Banking and Currency, obviously does not resolve the question confronting the Committee about what to do to check the circumvention of Regulation Q by major bank holding companies.
>
> "The amendment adds more discretion to the discretion already possessed by the Federal Reserve Board...."33/

In November of last year when Citicorp proposed its latest issuance of "thrift certificates," this Association filed a formal protest with the Federal Reserve Board. In addition to seeking to have this particular note issue restrained, NAMSB requested the Board to establish a regulatory scheme for handling similar type issues in the future. Although the Federal Reserve Board declined to stop the note issue, it did finally agree, in a letter dated December 27, 1977, to undertake formal rulemaking on this long-standing problem with a view toward establishing regulatory procedures to be followed by bank holding companies proposing to sell small denomination debt obligations to the public. Thus we were very disappointed to learn that the Board of Governors reversed this decision on Wednesday, May 31, 1978, by voting to reject a staff proposal to solicit public comment on guidelines for the issuance of thrift notes by bank holding companies.

3. Evasion of Interstate Branching Prohibitions

The use of the bank holding company form of organization to evade restrictions on branch banking within a given state is, of course, a well established practice. In certain savings bank states, such as New Hampshire and Minnesota, the ability of commercial bank holding companies to establish new banking subsidiaries does give them a competitive advantage, but what has us particularly concerned is the recent use of the holding company device by a Rhode Island banking institution to establish an FDIC-insured depository institution in the state of Massachusetts. This has come about as a result of a quirk in the law which defines a "bank" for purposes of the Federal Deposit Insurance Act[34/] differently and more broadly than the term is defined in the Bank Holding Company Act.[35/]

As alluded to at the outset of our testimony, a bank holding company is precluded from making a bank acquisition in another state unless there is a reciprocal branching arrangement, which does not exist between any states at this time.[36/] The acquisition of two Morris Plan banks in Massachusetts by a Rhode Island based bank holding company was initiated by filing an application to engage in a nonbanking activity, namely, operating an industrial loan company, which is already on the permissible list of holding company activities. After the application was approved by the Federal Reserve Board as a nonbank acquisition,[37/] the holding company then turned around and applied to the FDIC for deposit insurance for the institutions involved on the grounds that they were banks. Not only was deposit insurance granted to these institutions,[38/] but the FDIC bestowed a further windfall by classifying the Morris Plan banks as thrift institutions for purposes of establishing their maximum interest rate ceilings.[39/] We are of the view that bank holding companies should not be permitted to exploit the current state of the law to establish interstate branching networks of this sort.

CONCLUSION

In the course of this testimony, we have attempted to highlight the major problems for the thrift industry caused by bank holding companies. Our industry has consistently opposed the past practices of holding companies to utilize their form of corporate organization to evade federal interest rate control authority, and we are especially concerned about the latest artifice which is being employed to achieve this goal, i.e., the acquisition of a savings bank or other thrift institution subsidiary. On contested issues the Federal Reserve Board, as the administering agency of the Bank Holding Company Act, has repeatedly failed to give adequate consideration to the views presented by this industry and other competitors of the bank holding companies. For this reason, it is our conclusion that the Congress must reduce the amount of discretion accorded the Federal Reserve by the Bank Holding Company Act and related banking statutes. Specifically, we support changes which would:

1. prohibit bank holding companies and their nonbank subsidiary from issuing thrift certificates with interest rates in excess of those permitted member banks under Regulation Q;

2. prohibit bank holding companies from operating a savings bank; and

3. redefine the term "bank" to achieve a uniformity between the Federal Deposit Insurance Act and the Bank Holding Company Act.

As a final matter we would like to suggest a procedural change to that section of the Bank Holding Company Act which limits the right of a party to intervene in a holding company application and request a public hearing to those who would be "a competitor of the applicant." The effect of this language is to preclude trade associations and other interested parties who are not actual competitors from participating fully in administrative procedures conducted by the Federal Reserve Board. In a Board action taken just last month, for example, a nonprofit, public interest law firm attempted to intervene in an application by a bank holding company to engage in the consumer finance business, and the Board rejected the request for lack of standing even though this firm represented many low-income persons who would be affected if the application were granted.[40/] We would simply suggest that this limiting language be deleted from the Act.

This concludes our testimony on S. 72, I would be pleased to answer any questions which the Committee members may have.

EXHIBIT A

Auto Loan Fees Plunge in 2 Maine Towns As Small Savings Bank Sparks Rate War

By DAVID GUMPERT
Staff Reporter of THE WALL STREET JOURNAL

Where's the best place to be shopping for an auto loan these days?

If you guessed Los Angeles, Detroit, New York, or any other large metropolitan area, you guessed wrong. The cheapest auto loans have in recent months become available in two towns far removed from the mainstream of the auto trade and the money markets – the neighboring central Maine towns of Augusta and Gardiner.

Thanks to what a Maine consumer official refers to as a loan-rate "gas war," new-car loan rates at a number of Augusta-Gardiner banks have dipped to between 7¾% and 8%. In contrast, commercial banks in Los Angeles are typically charging 11½%; in Detroit, 12%; and in New York, 13.4%, according to Federal Reserve Board statistics. And the average charge in a national sampling of commercial banks for the most common 36-month auto loans is 10.8%, says the Fed.

"We're having a real fight," says Richard Gilcreast, who heads Augusta's Econo Bank. That bank is offering a 7¾% rate on 24-month auto loans taken out by its checking account customers. Other customers must pay 8%.

Furthermore, the rate war threatens to spread. "The rates are coming down around the state," says John Quinn, director of Maine's Bureau of Consumer Protection. "There's nobody paying 11% for a car loan in Maine," he says; many banks are already down to 9%, he adds.

Publicizing Rates

In the Augusta area, at least, the rate war has led to a departure from the way banks typically market their loans, says Mr. Quinn. He says that banks usually have an aversion to publicizing their actual loan rates.

"Banks will talk about how quick they are, about how friendly they are and about the freebies they offer," but won't mention rates, he says. In the Augusta area, though, "you'll be shaving in the morning and you'll hear an ad on the radio promoting a (auto loan) rate of 7.95% and then right away you'll hear another for 8¼%."

Central Maine's rate war was apparently sparked by the aggressive marketing tactics of a small Augusta savings bank, First Consumer Savings. Last March, the bank reduced its rate for 36-month auto loans to 7.95% from an already comparatively low 9.98%. As a further incentive to attract customers, the bank promised that most loans could be processed within an hour.

First Consumer Savings didn't attach strings to its promotion, but the idea behind the low-cost loans was to "cross sell" other types of loans and services like checking and savings accounts, says John Gwazdosky, a vice president. (Maine's savings banks can legally offer commercial loans and checking accounts under legislation that became effective in late 1975.)

"When we close an auto loan we say (to a customer) we'd like to have your other business," says Mr. Gwazdosky. "It just mushrooms because people like to help people."

Jump in Loans

First Consumer's business has certainly mushroomed. Customers have been flocking to it from all parts of the state; some have traveled hundreds of miles to take out auto loans, he says. First Consumer boosted its total loans outstanding last year by about 80%, the bulk of the increase coming from auto loans, Mr. Gwazdosky adds.

Because First Consumer Savings charges more conventional rates on some other types of loans as home improvement and mobile homes, the bank's average yield on all loans has been 10½%, he says.

The one-hour processing time promised on most auto loans hasn't presented a problem, he says. Mr. Gwazdosky simply tries to do his credit checks more quickly than other banks and relies also on his familiarity with employers in the area. Consequently, the bank's delinquency rate has been lower than the state average, he says.

Mr. Quinn of the Bureau of Consumer Protection also credits a booklet published by his department, known as the Downeaster Pocket credit guide, with helping spur the rate war. The booklet (fifty cents to out-of-staters) shows the total cost of loans at different interest rates; in a little over a year more than 90,000 of the guides have been requested by Maine residents, says Mr. Quinn.

The booklet shows "it's worth looking around," he says, because on a three-year, $6,000 loan, each percentage point of interest costs about $100.

Other banks that have joined the competition aren't as enthusiastic about the effects as Augusta's First Consumer Savings, though. Customers "aren't stampeding in," says Robert B. Davis, president of Gardiner Savings Institution, which, since last November, has been offering a rate of 7¾% on all auto loans up to four years.

Mr. Davis contends that "there's still a good deal of customer loyalty left" in Maine and thus "it takes dynamite" to get Mainers to switch banks. Also, he says, there is "a lot of resistance to new-car prices." Nonetheless, since last November, Gardiner Savings has given more auto loans than during the year-earlier period, he says.

There are signs, though, that as the prime, or minimum, lending rate increases, so will the Augusta-Gardiner auto loan interest rates. National Bank of Gardiner has already boosted its rates to 9% from 7.69% before Christmas. And Gardiner Savings may be raising its rate in another month or two, says Mr. Davis. "It's the same as a store offering a sale," he says. "Sales don't last forever."

Wall Street Journal
Monday, January 23
1978

EXHIBIT B

AMERICAN BANKER
July 13, 1977

Consumer Finance Firms Beginning to Offer More High Rate Certificates to Individuals

By MICHAEL QUINT

NEW YORK.—Treasurers of consumer finance companies say that direct offerings to individuals of high rate thrift certificates are becoming increasingly used and talked about. Recently the $64.2 billion-asset Citicorp's consumer finance company announced plans to sell "consumer debentures" that resemble other issues being sold by other bank-affiliated consumer finance companies.

Rates on notes offered by these companies are a point and more above legal maximums for new, insured savings certificates, but some treasurers add that the notes are valuable as a marketing tool and as another source of funds to be tapped when credit conditions tighten.

Even though other borrowings might be cheaper, one observer says the new certificates are cheaper than some loans arranged in 1974 which are still on the books of some companies.

Citing the direct sales as "a trend within the industry," Martin Starr, vice president and treasurer at Liberty Loan Corp., St. Louis, notes that many companies are finding "ready clients" for a shopping list of certificates with maturities out to 10 years.

The Citicorp notes registered with the Securities and Exchange Commission on June 29, mature in five years, but the interest rate depends on how long the notes have been outstanding. Citicorp has not yet set the initial rates for each of the five years, but it has dubbed the certificates "rising rate notes."

The certificates being offered by other bank-affiliated consumer finance companies have a fixed rate for each of the various maturities. For example, First Pennsylvania Financial Services, Inc., a subsidiary of the $7.2 billion-asset First Pennsylvania Corp., is offering 6¼% for demand certificates, 7¾% for two years, 8¾% for four years, and 9¼% for six years. A subsidiary of Signal Finance Corp., itself a subsidiary of the $4.3 billion-asset Philadelphia National Corp., is offering 7½% certificates due in one year and 8½% certificates due in five years, according to a Signal official.

Another wrinkle to the Citicorp notes is that they are obligations of the bank holding company. The notes sold by subsidiaries of First Pennsylvania and Philadelphia National do not carry the backing of the holding company. The prospectus for the issues not backed by the holding company focuses on the operations of the consumer finance companies, while the Citicorp prospectus presents financial data of the holding company and its consolidated subsidiaries.

The Citicorp notes are to be sold by Person-to-Person Investments, Inc., through Person-to-Person Financial Center offices in Arizona and Colorado. They are also registered for offering in California and Missouri, but as yet there are no Person-to-Person offices in those states. Proceeds will be used for consumer finance operations of Nationwide Financial Services Corp., a consumer finance subsidiary of Citicorp; and Advance Mortgage Crop., a mortgage banking susidiary.

Citicorp says it may change rates of the notes., but this would not affect outstanding notes. Also, the notes are not callable by Citicorp, but may be redeemed by the holder on any anniversary of the date of prchase.

At First Pennsylvania Financial Services, an official says that by offering the notes they have "learned how to handle sales" and "developed a customer base that could be used in the future." He commented on the good experience in advertising techniques and following up initial sales contacts.

The FPFS official said that about 1,000 customers have bought the $8.9 million of notes outstanding. He says that the company will probably stop advertising the notes when sales reach $10 million, but will begin advertising again if interest rates move up. It has registered up to $30 million with the Securities and Exchange Commission.

Sales of the FPFS notes started in February, 1976, from three states, but now are offered from nine states and the District of Columbia. The notes are offered on a continuous basis in New York and Connecticut, even though First Pennsylvania's finance company subsidiaries do not have offices in those states.

The FPFS certificates are obligations of that company, without insurance or the guarantee of the holding company.

At Signal, an official said that sales were started in November, 1974. He notes that besides being a marketing tool, the notes are cheaper than some borrowings made in 1974. Signal is considering selling more of the notes when sales are completed on the $20 million of notes already registered with the SEC he added. By the end of the first quarter, about $6 million of the 7½% one-year certificates and over $4 million of then 8½%, five-year certificates had been sold, he added.

Signal sells the notes from offices in Pennsylvania, New York, Massachusetts, New Hampshire, Vermont, and Ohio. State securities laws make sales unattractive in other states where Signal has offices, a company official observes.

Industry observers say that small finance companies with only a few offices have traditionally sold certificates on an intrastate basis. The interstate offerings registered with the SEC were encouraged by the impact of high interest rates in 1974 on consumer finance companies, they note.

Two of the most aggressive sellers of thrift notes to the public have been the consumer finance affiliates of Associates Corp. of North America, Dallas, and Commercial Credit Corp., Baltimore.

Associates Corp. of North America, has used about 300 of its local offices in 18 to 20 states to sell investment notes directly to the public, making it one of the most active companies in this activity.

Since sales started, in 1970, the notes outstanding have risen to a peak of $155 million, and they currently total $130 million, Associates officials say. The investment notes are obligations of Associates First Capital Corp., a subsidiary of Gulf + Western Industries Inc. and also the owner of Associates Corp. of North America.

James F. Leary, executive vice president-finance at Associates, said the notes are useful for financial and marketing reasons, and added that employees like the sales commissions.

The notes may be expensive, compared with short-term borrowing alternatives, Mr. Leary said, but they are "quasicapital" with a longer term to maturity. He explained they are sometimes used to fund consumer-finance-related acquisitions, "and for that purpose they are not expensive."

Associates' notes are aimed at the savings market dominated by banks and thrifts, Mr. Leary said. The minimum denomination is $500, and the average size of noteholdings is $3,000 to $4,000, he added. The notes are not insured.

The issue currently in registration offers one-, three-, five- and 10-year maturities, with rates rising from 6% in one year to 8½% in 10 years. Mr. Leary said the company tries to regulate the new sales by adjusting terms and advertising, but there is usually some issue in registration.

At Commerical Credit Corp., Baltimore, subsidiary companies in eight states have sold a total of about $225 million in notes at rates ranging from 6% for passbook-like savings to 8% for two- and three-year notes. The notes are not registered with the Securities and Exchange Commission, since they are intrastate offerings, and they are obligations of the local company selling them.

A Commercial Credit official explained that in Ohio, California and Rhode Island, the local companies are fully funded by their note sales. In Ohio the activity has been traditional, and that state accounts for $190 million of the total outstanding. The activity was started in California in 1970 and Colorado in 1974. Since 1975, note sales have been started in Rhode Island, Iowa, Utah, and Kentucky. A West Virginia-based acquisition also sells notes.

Excluding Ohio, the note holdings average about $3,700, Commercial Credit officials said. When the local company is fully funded, the effort to sell notes is slackened, but in other states they are marketed more aggressively, a Commercial Credit official said.

As intermediate-term debt, the notes are one of the first nonlending services offered at finance offices, an official said.

Notes issued in Colorado, Rhode Island and Utah are insured by a near-government agent that is funded by private companies selling the certificates, according to Commercial Credit.

NATIONAL ASSOCIATION OF MUTUAL SAVINGS BANKS
Footnotes to Statement before the
Committee on Banking, Housing and Urban Affairs
United State Senate
June 16, 1978

1/ Banking and Monetary Statistics 1941-1970, Federal Reserve Board, p. 454; Annual Statistical Digest, Federal Reserve Board, 1976, p. 311.

2/ Cynthia A. Glassman and Robert A. Eisenbeis, "Bank Holding Companies and Concentration of Banking and Financial Resources: A Review," Federal Reserve Staff Study, April, 1978.

3/ See, e.g., H. Rept. 84-609, 84th Cong., 1st Sess., p. 11.

4/ 70 Stat. 134, 12 U.S.C. §1842(d).

5/ 70 Stat. 135, 12 U.S.C. §1843(c)(8).

6/ 80 Stat. 237, 12 U.S.C. §1842(c).

7/ 15 U.S.C. §2.

8/ 15 U.S.C. §18.

9/ Donald T. Savage, "A History of the Bank Holding Company Movement 1900-1978," Federal Reserve Staff Study, April, 1978.

10/ Id.

11/ 83 Stat. 371; 12 U.S.C. §§461,1828(g).

12/ 84 Stat. 1760; 12 U.S.C. §1841(a).

13/ 84 Stat. 1760; 12 U.S.C. §1843(c)(8)

14/ Letter of George W. Mitchell to Chairman of the Securities Exchange Commission (July 2, 1974).

15/ 88 Stat. 1557, 12 U.S.C. §§461, 1828(g).

16/ "A Review of the Evidence on the Bank Holding Company Movement; Summary," Federal Reserve Staff Study, April, 1978.

17/ Statement of G. William Miller, Chairman of the Federal Reserve Board, before the Committee on Banking, Housing and Urban Affairs, 95th Cong., 2nd Sess., May 25, 1978.

18/ FDIC Reg. 329.7(a).

19/ E.g. Application of Casco-Northern Corporation before the Bureau of Banking, Department of Business Regulation of the State of Maine, filed June 13, 1977.

20/ 59 Savings Bank Journal No. 3, p. 14 (May, 1978).

21/ Application of Profile Bankshare 61 FR Bull. 901 (1975).

22/ Application of American Fletcher Corporation 60 FR Bull. 868 (1974); Application of Memphis Trust Co., 61 FR Bull. 327 (1975).

23/ 36 F.R. 10777; FRB Reg. Y, §225.4(a)(1).

24/ Stephen A. Rhoades, "The Effect of Bank-Holding Company Acquisitions of Mortgage Bankers on Mortgage Lending Activity," 48 Journ. of Bus. 344, 348 (July, 1975).

25/ 36 F.R. 10777; FRB Reg. Y, §225.4(a)(1).

26/ Stephen A. Rhoades and Gregory E. Boczar, "The Performance of Bank Holding Company Affiliated Finance Companies (summarized in 63 FR Bull. 715 (1977)).

27/ Application of D.H. Baldwin Co., 63 FR Bull. 280 (1976).

28/ Exhibit B.

29/ FDIC Reg. §329.6.

30/ FRB, Reg. Q, §217.1(f); see also FDIC Reg. §329.10 for an identical regulation applicable to insured nonmember banks including mutual savings banks.

31/ 12 U.S.C. §1843(a)(2)(A); (emphasis added).

32/ FRB Reg. Y, §225.4(a)(2).

33/ H. Rept. 93-1259, 93rd Cong., 2nd Sess., p. 19.

34/ 12 U.S.C. §1813(a).

35/ 12 U.S.C. 1841(c).

36/ Supra n.4.

37/ Application of Old Stone Corporation, 41 FR 52531 (Nov. 30, 1976).

38/ FDIC PR-49-77.

39/ 42 FR 21101 (April 25, 1977).

40/ FRB Order Approving Application of Manufacturers Hanover Corp., May, 1, 1978.

The CHAIRMAN. Thank you very much. As I say, your statements will be printed in full in the record.

Mr. Hemphill, in your statement you say that it is argued that the holding company entry into the private mortgage or insurance business would bring increased capitalization to that industry.

Now I'm curious about that argument. The facts appear to be just exactly the opposite. Chairman Burns and Chairman Miller, the former and present chairmen of the Federal Reserve Board, both said that the banking industry is undercapitalized and I think the evidence is overwhelming that it is undercapitalized, particularly the big banks.

If the rule of thumb is that they ought to have $8 in capital for every $100 in assets, they average in the big banks less than $5; the biggest bank in the country has only $3, and even the smaller banks have less than that rule of thumb.

Now there's been a reluctance to go to the market for capital in that industry, in contrast to your industry. We know that bank holding company, mortgage banking and finance subsidiaries are more poorly capitalized, less capitalized than their competitors. So how in the world can you argue that at this time banks are in a position to fortify the capital of other industries?

Mr. HEMPHILL. Mr. Chairman, I did not intend for this statement to suggest that. The additional capital argument is one which has been advanced by bank holding companies for years. This was one of their principal arguments in the 1974 case and I attempted in my statement simply to refute the argument.

The CHAIRMAN. So you say their argument is they will improve the capitalization and you disagree with that?

Mr. HEMPHILL. I disagree with it. I say it is alleged by the bank holding companies. It is not my suggestion.

The CHAIRMAN. I thought that might be the case but I wanted to be sure because I think this is one of the strong arguments in favor of the bill and in favor of preventing this kind of entry, that they are already undercapitalized and there's no way they can improve their capitalization elsewhere.

Mr. HEMPHILL. I said that in 1974 to the Federal Reserve Board and I'm saying it recently to the Home Loan Bank Board, that the mortgage insurance industry is very capital intensive and that permitting an institutional——

The CHAIRMAN. Let me just interrupt. What was the Federal Reserve's response in 1974?

Mr. HEMPHILL. In 1974, they said, "No; not at this time," but they found it——

The CHAIRMAN. "No" what?

Mr. HEMPHILL. No; they could not enter at that time—"at this time" was the finding in 1974. The door was not closed forever. It was slammed shut at the time but it was not locked at that time.

The CHAIRMAN. Now, Mr. Farrer, incidentally, I'm delighted with your excellent documentation of the competition in your industry. You point out the ease of entry and exit, and an enormous number of competitors. I think everybody who's got eyes to see knows that your industry is tremendously competitive at the present time. Any additional competition from the banks would be a position in my view of unfair competition because they have advantages that you don't have.

In your statement you say that you have documentation of undue pressure being exerted upon would-be borrowers and listers of property to deal with banks. Can you give us some details on this? Are banks tying the use of their credit facilities to the sale of real estate activities and, if so, how widespread is this practice?

Mr. FARRER. Well, we specifically are documenting it in the State of Iowa because there they seem to be very blatant about it. To approach it from the standpoint of the real estate commissioner himself, if the banker wants a real estate license, certainly his character and quality and references would be such that the Division of Real Estate would have to issue him a license. So he's got an ease of entry into my business.

The CHAIRMAN. Can you give us that documentation for the record?

Mr. FARRER. Yes.

The CHAIRMAN. That Iowa documentation would be very helpful.

Mr. FARRER. The problem arises that then there comes a time for extension of credit to one of my customers because he then at that point can either directly or in an implied innuendo say, "I have a real estate license and therefore as a requirement to extend this credit I desire that you purchase this piece of property from me."

We have some specific cases, affidavits signed by people that this actually happened to them in the State of Iowa.

Now the problem is, of course, without the presence of the credit making it impossible for the buyer to buy, he had no alternative but to accept the services of the bank, not only as a real estate agent but also as a lender in advance of credit.

The other concern on the part of the industry is that to extend that favor at that time that it might be to the detriment of the public because at some future time if that loan were ever to get into default that I, as the borrower, would also want to get back and get another favor from that same banker because after all he's the one that helped me to get into trouble.

The CHAIRMAN. Mr. Hemphill and Mr. Masterton, both of you make, I think, a very good point in saying that the Fed has denied acquisition of bank holding companies of mortgage insurers, savings banks, and savings and loan associations in a way that leaves it open to the Fed to permit such acquisitions in the future. The Fed has essentially said their activities are closely related to banking, but they are not convinced that sufficient public benefits would result at this time.

Now, my question—and I'll ask Mr. Masterton first and then Mr. Hemphill to comment—in my view, the Fed has put itself in a position to make decisions that properly belong with the Congress. To my knowledge, Congress has never sanctioned the takeover of the thrift industry by the commercial banks.

Is it correct to characterize your position as favoring S. 72 because it would merely give the particular current Fed rulings a force of law?

Mr. MASTERTON. Yes, Senator, it is, and we would request that the final legislation include the specific exemption prohibiting the acquisition of thrift institutions by the bank holding companies. I believe that the Federal Reserve in 1976, in the *Baldwin* case, stated that it also felt that had the Congress intended the acquisition, it would have specifically directed it, and we feel that the *Baldwin* case specifically seeks from the Congress direction on the acquisition question.

The CHAIRMAN. Mr. Hemphill.

Mr. HEMPHILL. Mr. Chairman, let me comment briefly. Just as mortgage insurers are not permitted to make loans—and we think that is proper—the mortgage insurers take the position that the obvious conflict of interest should preclude permission of lenders to become mortgage insurers. I don't think it's in anybody's interest—the public interest or in the interest of the banks or the savings and loans.

The CHAIRMAN. Now, assuming the Fed would change its mind and permit bank holding company entry into the thrift industry, which I don't believe even the present bank holding company law sanctions, could you, Mr. Hemphill, give us the dimensions of the outcome in terms of the relative size of the industries, who would acquire whom and the resulting effect on our economy?

Mr. HEMPHILL. You might better address that question to someone representing the thrift industry. I can respond to you on mortgage insurers if you want me to do that.

The CHAIRMAN. All right.

Mr. HEMPHILL. I should say that only the very large bank holding companies would attempt to enter the mortgage insurance field on a national basis. It is capital intensive, and I think a bank holding company which moves into the national field would be that group. I should think that there perhaps would be acquisitions attempted rather than de novo entry. It would take a large accumulation of capital then and in the future to operate effectively on a national basis. So I think that there would not be a mass movement by all bank holding companies to enter the national market, but I think you would see some initially in the large ones. Following that, I think you would then see creation of captive mortgage insurers by regional bank holding companies. Those would be small, very small, insurance companies, and they would receive both the business coming off paper originated by the particular bank holding system and from other lenders. I think it would take a number of years for this to happen; I would think on the order of 5 years perhaps.

If it is permitted by the Fed, just as if the Home Loan Bank Board permits S. & L.'s, I think we would eventually see a number of small capitive companies, insurance companied, owned by large units or by combinations of units.

The CHAIRMAN. Let me ask you, Mr. Masterton, as far as the mutual savings banks are concerned. I'll state the question quickly again. Assuming the Fed would change its mind and permit bank holding company entry into the thrift industry, give us the dimensions of the outcome in terms of the relative size of the industries and who would acquire whom and so forth.

Mr. MASTERTON. Senator, I cannot, and we have not studied the impact on the national level, but there are two specific States in which attempts have occurred in the last 12 months, and if they had been successful or if they are sucessful in their appeals at the State court level and upheld by the Federal Reserve, it would be the beginning of a very major shift in acquiring of those assets. The specifics of the two cases may give you some perspective for projecting nationally.

In Maine, the largest single banking entity, the Casco Northern Bank and Holding Company, was the applicant to form and acquire a stock savings bank. Another banking holding company testified they were opposed to the move, but if Casco were approved it would be necessary for them to also take such a move, the reason being that Casco then would have circumvented Regulation Q and be in very commanding positions with 56 branches statewide vis a vis other commercial banks. This would have forced literally the six largest commercial banking entities which control 90 percent of the State's commericial banking resources into the business and since they have already circumvented the State branching law over the past decade and have a statewide distribution they would be in a very commanding position vis a vis other financial institutions because of the convenience of the services the consumer requires.

In the State of New Hampshire, the final decision of the regulatory authorities there came down on the point that it would not be possible for all of the commercial banks to acquire or form stock thrifts subsidiaries. Therefore, the circumvention of interest regulation would be uneven and inequitable. The net result, if the application had been granted, would be a major structural change within that State of total banking resources.

So I think that both of those cases—and we would be very happy to furnish both decisions to your staff—clearly outline the kinds of problems and the scenario that could occur on the national level. If it does occur, we hold that there would probably be a major shift in banking resources.

The CHAIRMAN. That's a very helpful response.

Mr. Farrer, you say that the Federal Reserve is permitting bank holding companies to engage in leasing of real and personal property. I'm familiar with the banks and bank holding companies auto leasing activities. I have met with the auto people in Milwaukee.

Can you give the committee a better idea of bank holding company involvement in leasing real estate? Which banking holding companies are involved and the activity they engage in and the ultimate effect on the market?

Mr. FARRER. I didn't bring that information with me, but we would be happy to provide it. We are not talking just about the leasing of real estate. They have computer service leasing and automobile leasing and these other kinds of activity.

The CHAIRMAN. I'd like to have that detailed as thoroughly as possible because that's an excellent point. That would greatly strengthen our bill.

Mr. Hemphill, you make a very convincing case for prohibiting bank holding company entry into the private mortgage business. Nevertheless, bank holding companies and even the Justice Department, to some extent, argue that bank holding company entry into nonbank fields would have a procompetitive effect. All of us are procompetition. Everybody argues that his position would favor competition.

How do you answer the argument that allowing bank holding companies into private mortgage insurance would have a procompetitive effect? What's your answer? After all, all of us are really interested in serving the public and having, especially these days with inflation what it is, having competition the great regulator of pricing in our free enterprise system effective. So what is your response?

Mr. HEMPHILL. Obviously, nobody can oppose competition on principle and certainly we have no objection to the keenest possible competition. That already exists in this business.

The argument made years ago and the argument which was bantered back and forth in the Fed case in 1974 was the industry was pretty much a one-company dominated industry and that permitting and encouraging entrance would increase competition. Since that time the industry has become much more competitive. At one time one company, 20 years ago, had 100 percent of the business; there was only one company. Now there are 15 companies in this very specialized part of the insurance business. It would be difficult to see how it could be any more competitive than it is.

The one company which at one time had 100 percent is now writing 38 percent. Companies such as the one I have come from, nothing 15 years ago and we are writing 12 percent of the national market. In my company we have strong competition in all 50 States.

The CHAIRMAN. Do you go along with—I'm sure that there are differences, but Mr. Farrer made the very helpful statement that in his industry, *a*, there were very large numbers; *b*, there was ease of entry and ease of exit, particularly ease of entry, which is imperative to competition. Now you're making that point with respect to your own experience. You say in 15 years you came from nothing to a very big competitive factor.

Can you give us a little more documentation on that as to the numbers and as to the number of firms coming in and leaving and so forth so we know it is a dynamic industry?

Mr. HEMPHILL. Yes; we shall be pleased to submit that. I cannot give it to you off the top of my head, but I can assure you that it is a very competitive industry now. Entrance is relatively easy. Anyone who can accumulate money to start a small insurance company can get into this business. Companies have done that. Companies have sprung up and have become factors in a regional sense and some have moved into the national scene. We have seen that particularly in the last 5 years. Other companies coming in and capturing 7 or 8 percent of the national market over a 5- or 6-year period of time. We shall be glad to submit that.

[The following table was received for the record:]

PRIVATE MORTGAGE INSURANCE COMPANIES, 1978

Name	Year of initial certificate authority	Number of mortgages insured 1st quarter 1978	Share of market (percent)
Mortgage Guaranty Insurance Corp	1957	50,657	37.59
American Mortgage Insurance Co	1961	11,261	8.36
Verex Assurance, Inc	1961	16,041	11.91
United Guaranty Corp	1963	16,852	12.52
Tiger Investors Mortgage Insurance Co	1968	8,635	6.40
Foremost Guaranty Corp	1972	2,161	1.60
Integon Mortgege Guaranty Corp	1972	NA	(1)
Home Guaranty Corp	1973	NA	(1)
PMI Mortgage Insurance Co	1973	12,706	9.43
Republic Mortgage Insurance Corp	1973	3,482	2.58
Ticor Mortgage Insurance Co	1973	12,942	9.60
Commercial Credit Mortgage Insurance Co	1974	NA	(1)
Commonwealth Mortgage Assurance Co	1977	NA	(1)
Total		134,737	100.00

[1] Less than 1/10 of 1 percent.

The CHAIRMAN. Very good. Mr. Masterton, your example of the Fed allowing a holding company to acquire an alleged nonbank across State lines and thereafter the FDIC insurance company insuring the alleged nonbank as a bank is another good example of the confused regulatory structure. There's a provision in S. 72 which would prohibit national banks from engaging in activities prohibited to their bank holding companies. Would you support a provision requiring a consistent definition of the term "bank" for the purposes of the holding company and deposit insurance loss?

Mr. MASTERTON. Yes; we would.

The CHAIRMAN. You might submit for the record your notion of how that definition should be constructed (see p. 241).

Mr. MASTERTON. I would be delighted to do so.

The CHAIRMAN. Mr. Farrer, in your statement, you argue for prohibiting bank holding companies from operating savings and loan institutions. What would be the effect on the housing industry, in your judgment, if bank holding companies were permitted to acquire S. & L.'s.

Mr. FARRER. I think there would be a significant shift of credit from the long-term market to the short-term market and the fact that the savings and loan associations virtually having an exclusive power to lend only on real estate, which tends to mean there are longer term loans, I think you'd see those funds would then shift to the holding company where they could be used on the short-term kind of basis. So I think there would be a definite shift either way from money for the housing industry.

The CHAIRMAN. Mr. Masterton, you say that the Federal Reserve has refused to use its authority to classify the obligations of bank holding companies and the nonbank subsidiaries as bank deposits for the purpose of interest rate ceilings and reserve requirements. Can you tell us exactly how this hurts thrifts and what the size of the problem is?

Mr. MASTERTON. Senator, our concern is in times of disintermediation, when it is very advantageous to circumvent interest rate ceilings, that the holding companies will issue their so-called thrift certificates and easily acquire funds in the capital market. Those funds are purported to be for their finance company or other nonbank affiliates, but we suggest that those funds are in essence transferable within the holding company system. It is an easy matter, rather than lending from the banking subsidiary to its finance company's subsidiary, to simply raise those funds in the public market through their small certificates and use the residual funds elsewhere in the banking system. The net result is that the holding company is directly competing, making an end run around the interest rate regulation. We brought this to the attention of the Federal Reserve most recently in 1977 on the Citicorp note issue which I believe was a $25 million issue as I recall it through their finance company subsidiaries. We would be most pleased to—I believe we already have done so in previous testimony, but to furnish some summary of the extent of those notes and certificates on this historical basis.

The CHAIRMAN. Are you saying that all obligations of a mortgage banking subsidiary of a bank holding company should be considered bank deposits and, if so, wouldn't that put the nonbank mortgage subsidiaries at a competitive disadvantage?

Mr. MASTERTON. I don't think we're coming down that hard on it, Senator. I think we are specifically referring to the thrift certificates or whatever other name they are given that are generally competing for consumer dollars. They are in general the specific ones of the Citicorp notes sold through their subsidiaries on a multistate basis.

Mr. BUTERA. Senator, what we are suggesting is a regulatory approach in this area which would treat the obligations of finance companies, mortgage subsidiaries, and other nonbank affiliates of the bank holding companies as deposits when they come take on the characteristics of a bank certificate of deposit. We currently have both the FDIC and the Federal Reserve regulating this area when it comes to banks themselves, so that if you have a nondeposit obligation of a bank that begins to look in terms of its denomination, maturity, and interest rate much like a deposit, then these instruments can be classified as deposits for purposes of interest rates and reserve requirements.

[The following letter was received for the record:]

NATIONAL ASSOCIATION OF MUTUAL SAVINGS BANKS,
New York, N.Y., July 14, 1978.

Hon. WILLIAM PROXMIRE,
Chairman, Committee on Banking, Housing and Urban Affairs, U.S. Senate, Washington, D.C.

DEAR SENATOR PROXMIRE: This letter is in response to the two questions which you posed to our National Association's witness, Robert R. Masterton, during the recent Committee hearings on S. 72, the Competition in Banking Act. Specifically, you requested that we furnish a suggested definition of the term "bank" that would reconcile the inconsistency between the Federal Deposit Insurance Act and the Bank Holding Company Act (transcript p. 18), as well as a summary of the extent to which bank holding companies have been issuing "thrift certificates" as a means of evading federal interest rate controls applicable to bank deposits (transcript pp. 19, 20).

First with regard to the issuance of thrift certificates by bank holding companies, our research reveals that during the last period of high interest rates in 1974, numerous bank holding companies resorted to this form of debt financing. Our information, which was developed primarily from reports appearing in the financial press, indicates that the amount of such note issues was approximately $1.25 billion. The breakdown by issuer was as follows:

Issuer:	*Amount of issue (millions)*
Citicorp	$650
Chase Manhattan Corp	200
Continental Illinois Corp	125
Mellon National Corp	100
Crocker National Corp	75
Philadelphia National Corp	50
First Piedmont Corp	10
Alabama Bancorp	25
First Security Corp	20

This list is not necessarily an exhaustive compilation, and in addition to the bank holding companies listed, it should be noted that certain industrial firms also sold similar small denomination variable rate notes. For example, Standard Oil Company of Indiana offered $150 million of such notes for public sale.

Our research has not been able to turn up similarly detailed data for the period 1968–69 when the issuance of thrift certificates by bank holding companies first became a large-scale problem. However, according to the documentation supporting the 1969 legislation dealing with the issuance of short-term notes by bank holding company affiliates, over $2.9 billion was raised through this particular financing device.[1]

[1] S. Rept. 91–516, 91st Cong., 1st Sess., (Nov. 5, 1969), at p. 9; H. Rept. 91–755, 91st Cong., 1st Sess., (Dec. 15, 1969) at p. 8.

Turning now to the question of defining the term "bank," the problem as pointed out in our testimony is that the Federal Deposit Insurance Act contains a definition broader than that utilized in the Bank Holding Company Act. This makes it possible for an institution to qualify for federal deposit insurance coverage but not be considered a bank for purposes of the holding company act. It would be our suggestion that the inconsistency between the two statutes can best be reconciled by modifying the Bank Holding Company Act to include within its definition of the term bank (12 U.S.C. § 1841(c)) any institution which could be insured by the FDIC. Specific language might take the following form:

> The term "bank" includes, for purposes of Section 1842(d), an insured bank as defined in Section 1813(h) of this Title or any institution eligible to become an insured bank.

This definition would expand the definition of the term bank only for the purpose of bringing it within the proscription on the interstate acquisition of banking subsidiaries. This limitation is designed to accomplish the needed result without disrupting the differing regulatory scheme erected by the Bank Holding Company Act of 1956, as amended, for prior approval of applications to engage in banking and nonbanking activities.

I trust that you will find the foregoing to be responsive to your requests; we look forward to working with you in the subsequent progress of this legislation.

Sincerely yours,

JAMES J. BUTERA,
Associate Director.

The CHAIRMAN. Well, I want to thank you very much. I think you have made an excellent record. We deeply appreciate your testimony. And I might say that Senator Lugar may have some questions that he would appreciate your responding to in writing when you correct your remarks for the record. Thank you very, very much.

Our other panel is Mr. Edward I. O'Brien, president of the Securities Industry Association; and Mr. David Silver, president of the Investment Company Institute.

Mr. O'Brien, we have the same ruling. When you start the green light will go on, and that will be on for 9 minutes, and then a minute for the yellow light and then the red light goes on.

We are delighted to have you back, and go right ahead, sir.

STATEMENT OF EDWARD I. O'BRIEN, PRESIDENT, SECURITIES INDUSTRY ASSOCIATION; ACCOMPANIED BY DONALD CRAWFORD, VICE PRESIDENT

Written Statement of Securities Industry Association
Hearings on The Competition in Banking Act of 1977 (S. 72)
before the
Committee on Banking, Housing and Urban Affairs
United States Senate

June 16, 1978

Mr. Chairman, my name is Edward I. O'Brien, and I am President of the Securities Industry Association, a national trade association representing approximately 500 organizations responsible for over 90% of the securities brokerage and investment banking business of the nation. With me today is Donald J. Crawford, Vice President in charge of our Washington office. Our membership represents a cross section of many different facets of the securities business and is comprised of members of national securities exchanges and firms which are not members of such exchanges. The business of our members includes retail and institutional brokerage, over-the-counter market making, underwriting and other investment banking activities, and various exchange floor functions. Many of our members perform these services in municipal and government, as well as corporate securities. Geographically, the firms which comprise our membership are located all across the nation and provide services to investors of every size and type.

We appreciate the opportunity to appear before you today to offer our comments on a piece of legislation which we believe is essential to the continued stability of the banking system and to the vitality of our economy, "The Competition in Banking Act of 1977." The provisions of this bill are responsive to many of our concerns about the increasing domination by commercial banks of the nation's financial resources.

For example, the bill would limit the further concentration of banking resources among the major commercial banks. Such a limitation is essential because banks and their holding companies already wield an overwhelming degree of control, not only over bank resources, but also over other financial resources, such as trust assets. Encroachment by banks into the securities industry further exacerbates this concentration.

The bill also would limit the incursions of banks and their holding companies into "commerce" -- i.e., into non-banking activities. This tendency to expand into other businesses not only increases the concentration of economic power in the major commercial banks, but also be a breeding ground for other problems, such as misallocation of credit, unfair competition, and conflicts of interest. Such problems have been particularly acute in the case of bank-sponsored securities activities. It may also divert banks management's attentions from their primary and essential banking function of proper credit allocation.

Moreover, as the major banks have attempted to utilize their ready access to deposits in offering an ever-widening range of services, their capital structure in many cases has become seriously impaired. In recognition of this problem, the bill would require the Federal Reserve Board to carefully supervise the capital structure of bank holding companies and their subsidiaries. We believe such supervision is especially necessary to guard against liquidity problems associated with the long-term bank loans which are extended to many corporations as a substitute for equity capital.

In sum, we strongly endorse the underlying principles and basic approach of this bill; however, we would like to suggest several minor amendments. First, to avoid the "competition in laxity" at which Section 401 of the bill is aimed, we suggest that the Board be given power to limit the non-bank activities not only of national banks, which the present language confers, but of all federally insured banks, or, alternatively, all member banks of the Federal Reserve System. Secondly, to assure that banks and bank holding companies are prohibited from engaging in those activities which are not closely and directly related to banking, we believe that Section 301 should be amended expressly to proscribe certain specific activities to banks. Also, although it may be unambiguous, we suggest that the bill's legislative history make clear that the "concentration of financial resources" standard set forth in Section 301, as one of the factors to be considered in determining permissible non-banking activities, include those resources owned or controlled by mutual funds, insurance companies, securities underwriters and other financial intermediaries as well as by banks. Finally, we believe that the mandate to the Federal Reserve Board Section 501(f)(1) to supervise the adequacy of bank holding company capitalization should be amended to require that supervision take account of the illiquidity associated with excessive long-term loans and to extend such supervision to all insured banks (or all member banks), to insure against continuation of a "competition in laxity." The need for these amendments to a bill which clearly is a long overdue step toward restoring better balance and more efficiency to our financial markets is discussed more fully below.

Securities Activities of the Commercial Banks

We believe bank expansion into the securities business provides an excellent example of the excesses toward which this legislation is directed. As the trade association for the securities industry, we, through our members, are particularly aware of the many securities activities in which banks are engaged. The securities activities of banks may be divided into three general areas: (1) investment advisory services, (2) brokerage related services, and (3) investment banking services.

Investment Advisory Services

Apart from their own assets, banks are responsible for the management of more funds than any other type of financial institution.* In their fiduciary capacity, banks manage the assets of pension and other employee benefit plans and of trusts and estates of individuals. In their agency capacity, they manage the portfolios of a variety of individual and corporate customers. In addition, banks serve as investment advisers to both open-end and closed-end investment companies and also act as investment advisers to Real Estate Investment Trusts (REITs), which they sponsor in many cases.

Brokerage Related Services

In recent years, many banks have begun to offer several brokerage related services to their customers. One of the more common of these is the automatic investment service (AIS). Through AIS plans, banks offer customers the opportunity to have a specified amount deducted automatically each month from their checking accounts and invested by the bank in the common stock of one or more issuers included on a list supplied by the bank. The list typically includes the twenty-five largest corporations in the Standard and Poor's 425 Industrial Index, based on the market value of the corporation's outstanding common stock. The bank pools the monthly deductions from the account of each participating customer and directs a broker to

---

* The Treasury Department has estimated that commercial banks manage approximately $400 billion in trust assets alone. Public Policy Aspects of Bank Securities Activities, An Issues Paper, Department of the Treasury, November, 1975, p. 7.

execute transactions for the pooled accounts. Each AIS customer receives a monthly statement indicating, among other things, the number of shares purchased and their price.

Banks also offer dividend reinvestment plans (DRP) under which investors may have the dividends they receive from a participating corporation automatically reinvested in the securities of that corporation. Through these plans, shareholders of a participating corporation may request that their dividends be paid directly to a bank, which pools the dividends received and purchases additional shares of the corporation's stock in the open market.

Besides pooling funds and acting as a conduit between brokers and customers, some banks perform a more traditional type of brokerage by executing agency transactions for their trust and other managed accounts, either through a registered broker, in the case of listed securities, or, directly in the over-the-counter market. In the fall of 1976, one major money city bank introduced a retail brokerage service. The services provided were execution of orders in listed securities and portfolio valuation services. The experimental service was discontinued in December of 1976.*

---

* For a complete description of this plan, see The Wall Street Journal, 9/17/76, p. 4; Securities Week, 10/11/76, p. 1.

Investment Banking Services

The investment banking activities of the major commercial banks generally take two forms: the rendering of financial advice to corporations and the finding or furnishing (or both) of funds for the long-term capital needs of corporations. Financial counseling may be provided for a fee either on a long-term basis or for specific projects (e.g., the financing of a new plant) and generally encompasses the customer's total need for financing, ranging from short-term borrowings to permanent capital. Banks also furnish financial advice in connection with corporate reorganizations, including mergers and acquisitions, and sometimes perform appraisal services for such transactions.

Banks also serve directly as a source of long-term funds, either through their own lending facilities or by arranging private placements of securities with other lenders. Frequently, loans are made through syndicates of banks, which range in size from a handful to a substantial number of domestic, and sometimes foreign, banks.

In addition to providing long-term funds themselves, banks have become quite active in arranging, for a fee, private placements of securities of all types, from long-term bonds to equities, with a variety of institutional lenders. In some instances, banks participate in private placements they have arranged by purchasing for portfolios under their management a portion of the securities to be sold, and on occasion a bank will assemble for a customer a financing package consisting of a medium-term loan from the bank itself, together with a private placement to provide the ultimate long-term financing.*

Relationship of Bank Securities Activities to Concerns Reflected in Proposed Legislation

The provision of securities services by the major commercial banks raises concerns among our members similar to those to which the bill is addressed. These amendments discussed below would help assure that the bill will achieve its stated objectives.

"Adverse Effects" of Bank Securities Activities

The proposed amendment to section 4(c)(8) of the Bank Holding Company Act of 1956 contained in section 301(a) of the bill would require the Fed to consider certain specified "adverse effects" in determining whether an activity it finds to be closely and directly related to banking is to be a permissible activity for bank holding companies. Bank participation in the securities business can result in a number of such adverse effects, including unfair competition, conflicts of interest, undue concentration of financial resources, as well as the misallocation of credit.

---

* The Final Report on Bank Securities Activities, prepared by the Securities and Exchange Commission dated 6/30/77, fully describes bank corporate financing services beginning at p. 51. "Commercial Bank Private Placement Activities," a staff study of the Federal Reserve Board, dated June 1977, also describes these activities.

Unfair Competition

Under existing law, banks enjoy numerous advantages not available to commercial entities such as the members of the securities industry. These advantages give banks an almost insurmountable, and wholly unfair, edge in competing with our members.

The principal such advantage possessed by banks is their unique ability to accept deposits coupled with the unrestrained freedom to allocate such deposits to borrowers. This enables them to obtain funds at comparatively low cost -- and in some cases at no cost -- without the expensive and time-consuming disclosure process which commercial entities must follow. Banks also have primary and direct access to a reliable and extensive source of funds through their ability to borrow from the Federal Reserve System at low interest rates, even when they may be suffering from financial difficulties which would prevent a non-bank entity from obtaining credit. Moreover, banks possess substantial tax advantages, such as their ability to deduct the interest cost of carrying or purchasing tax-exempt securities and their ability to set up reserves for losses. In fact, in 1977 major commercial banks paid federal taxes at rates substantially lower than those paid by the securities industry.*

Banks also have unfair advantages over members of the securities industry in the operation and promotion of their securities services. For example, bank borrowers and depositors

* The February 9, 1978 American Banker, p. 2, reported that the average large banking organizations paid 6% on their world-wide income. For the same period, broker/dealers paid approximately 49%.

provide a convenient and favorable market for the promotion of any additional services a bank may choose to offer. In addition, the sheer size of the major commercial banks and the diversity of their financial and managerial resources enable them to utilize economies of scale unavailable to other competitors in performing securities services.

Furthermore, banks are in a position to use the economic leverage inherent in their ability to extend short-term credit to establish explicit or implied tying arrangements -- i.e., according preferential lending treatment to users of their securities services.* Even if a bank has no explicit policy of so using this economic power, the probable expectation of its customers or prospective customers that such a connection exists suggests that fair competition may not be possible when a bank offers services in competition with non-bank entities. Lastly, the comparative regulatory framework places burdens upon the broker/dealer not found in banks.**

---

* The Conference Committee that reported the Bank Holding Company Act amendments of 1970 specifically noted the possibility of this occuring

> Such tie-ins may result from actual coercion by a seller or from a customer's realization that he stands a better chance of securing a scarce and important commodity (such as credit) by "volunteering" to accept other products or services rather than seeking them in the competitive market place. In either case, competition is adversely affected, as customers no longer purchase a product or service on its own economic merit.

H.R. Rep. No. 1747, 91st Cong., 2nd Sess., p. 18 (1970).

** See Final Report on Bank Securities Activities, prepared by the SEC, dated 6/30/77, pp. 101-120.

These competitive advantages make it relatively apparent that banks would dominate the securities industry were they to compete directly in offering securities services.

Conflicts of Interest

A bank's performance of various securities services may result in conflicts of interest adverse to: (1) its trust customers and other managed accounts, (2) its commercial customers, and (3) users of its securities services.

One of the more egregious conflicts between a bank's interest in a securities service and its duty to its managed accounts exists in the case where a bank trust department causes an account to purchase securities from a private placement bank for a corporate client of the bank or securities distributed by the bank as underwriter, as in the case of municipal bonds. Even where restrictions in private trust agreements or legal proscriptions prevent this conflict from occuring directly, two or more banks may have a tacit understanding that the trust department of each will participate in the private placement or underwritings of the other. Further, if a private placement proves a disappointment, the bank's trust department may be tempted to cause accounts that it manages to make investments in, or to lend money to, a corporation for which the bank has effected the placement in an attempt to assuage the dissatisfaction of the placement participants.

The relationship of a banker to corporate borrower may create another more subtle conflict situation, especially when substantial loans are in questionable condition. Disinterested credit decisions become impossible, and the banker in effect begins to run the corporation. A recent example is the Bank of America-Memorex situation. After unsuccessfully trying to arrange a purchaser for the company, Bank of America deposed its then current management and hired a new president and guaranteed his employment package, while extending additional credit to the corporation.*

The charges reported in the Microdot-Irving Trust episode is one of the more dramatic examples of potential conflict between a bank's securities services and its commercial customers. In that case, it was alleged that Irving Trust used its confidential knowledge of the financial condition of its credit customer, Microdot, in the course of providing advisory services to General Cable -- also a credit customer -- in its bid to capture control of Microdot through a tender offer. Although the facts must await adjudication of that dispute, it is obvious that, in the course of providing financial advisory services, there are many opportunities for a bank to make improper use of confidential financial information obtained from its credit customers.

---

* Fortune, "The Loneliness of the Master Turnaround Man," February 1976, pp. 118-128.

In providing an AIS or DRP to customers, a bank is in a position to delay placing orders for its pooled accounts in order to enjoy the use of the funds without interest. On some occasions such a delay may result in a less favorable execution for such accounts. Similarly, the bank trust department is in a position to take advantage of its knowledge of when an order for an AIS or DRP will be executed in placing orders for accounts it manages.*

A bank also may have a conflict between the interests of its financial advisory customers in giving objective advice and its own business interests in extending loans. For example, when a corporation consults a bank for financial advice, the bank may be tempted to advise the corporation to meet at least some of its capital needs through bank borrowings, even where the terms of such borrowings may not be as favorable as those obtainable in the public market.

In summary, we believe, whatever the fact situation, the prudent course of action is to limit the potential conflicts arising when banks invade new areas of commerce.

Concentration of Financial Resources

As the Chairman suggested in his remarks introducing this bill, its main purpose is to prevent the concentration of economic power in the major commercial banks and their holding companies. By way of example, those remarks cite the concentration of bank assets in the major commercial banks. The Asso-

* A more detailed analysis can be found in the Second Report & the Final Report on Bank Securities Activities, prepared by the SEC.

ciation believes that even more serious than this concentration of bank resources is the concentration of financial resources in general that may result from the continued offering of securities services by such banks.

There are six principal kinds of institutions in the American economy that act as financial intermediaries, channelling idle funds and savings to those with commercial and investment needs for such funds: (1) insurance companies; (2) thrift institutions; (3) commercial banks; (4) trust companies (or trust departments of commercial banks); (5) mutual funds; and (6) broker/dealers. Commercial banks already dominate the two largest and fastest growing of these, categories (3) and (4).

The trust departments of commercial banks manage over $400 billion in assets of personal trusts, estates, and employee benefit and pension plans.* In addition to these enormous trust assets, commercial banks have available for lending or other investment approximately $900 billion of their own assets. Thus, commercial banks control over $1,300 billion of assets. This concentration of control over financial assets is in itself shocking, but what is far more worrisome, in our opinion, is the fact that control of over 70 percent of the trust assets is held by less than 2 percent of the commercial banks.

---

* The next largest category of asset management institution, insurance companies, manage only an estimated $300 billion in assets.

Two recent studies, "Disclosure of Corporate Ownership"* and "Interlocking Directorate Among the Major U.S. Corporations"** demonstrate the enormous economic power exercised by commercial banks. For example, four major commercial banks own approximately and voted 25% of the outstanding shares of Burlington Northern.*** There is considerable evidence that unlike broker/dealers, banks vote shares in their registered name, and quite often vote with management. Large bank trust departments control large portions of the common stock of the insurance industry. In the case of one major insurance company, the 50 largest bank trust departments held in excess of 35% of its common stock,**** and the ten major financial institutions had two direct interlocking directorates and 25 indirect interlocking directorates with that company.***** Additional, and perhaps most persuasive, are the direct and indirect interlocks between financial institutions and industrial utilities, transportation companies and retailers, the heavy users of financial services.******

---

* Study prepared by the Subcommittees on Intergovernmental Relations and Budgeting, Management and Expenditures of the Committee on Government Operations, U.S. Senate, 3/4/74.

** A staff study prepared by the Subcommittee on Reports, Accounting and Management of the Committee on Governmental Affairs, U.S. Senate, January 1978.

*** OP. CIT., p. 5.

**** OP. CIT., p. 365.

***** Ibid., p. 120.

****** Ibid., p. 7.

The same large money-center banks also happen to be those most active in offering securities services in competition with broker/dealers. Their sheer size, in relation to the securities industry, is illustrated by the fact that the shareholders' equity of Citicorp, Inc., the parent holding company of First National City Bank, was $2.922 billion at the end of the first quarter of 1978. This amount is almost as large as the $3.180 billion which was the aggregate shareholders' equity and proprietors' capital at that time of members of the New York Stock Exchange. Because of their disproportionate size, as well as the other decided competitive advantages mentioned above, it seems probable that banks will also come to dominate the securities industry, giving them control of four of the above six categories. If banks succeed in dominating the securities industry, virtually every source of investment capital -- save insurance companies and mutual funds -- would be controlled by these few giant banks, a situation which presently prevails in Europe.

Bank Expansion Into Commerce

Whenever a bank has a financial interest in a commercial enterprise, it is possible that credit determinations with respect to that enterprise will not be made solely on the basis of disinterested banking judgment. The experiences of the members of the Association would suggest that banking judgment is equally subject to distortion when banks participate in securities activities.

Such bank involvement raises many conflicts between a bank's interest in its various securities services and its duty to make prudent and disinterested loans solely on the basis of banking and credit judgments. For example, a bank may extend credit to a corporation as an inducement for that corporation to patronize financial advisory services of the bank. Also, a bank may be tempted to make loans to a corporation in which some of the bank's AIS customers have invested in order to prevent that corporation's financial difficulties from reflecting adversely on the bank. A bank may also extend credit to a corporation for which it effected a private placement of securities to maintain its "credibility" with those who participated in the private placement. Recent history provides a vivid example of the potentially serious consequences of the conflict between a bank's interest in furnishing investment advisory services and sound banking practices: the substantial loans which many commercial banks have extended to (or purchased from) the REITs sponsored and managed by them or one of their subsidiaries appear in many cases to have been effected in less than a prudent and disinterested manner.*

Apart from producing a distorted allocation of credit, the conflicts between a bank's interest in its securities

* "Disclosure and Bank Soundness: Non-Bank Activities of Bank Holding Companies," a study prepared by Ralph Nader and Jonathan Brown, dated 6/30/76, detailed this problem.

activities and its duty to observe sound banking principles may also seriously jeopardize the stability of the banking system. For example, many of the banks which recently have been revealed as "problem banks" possess loan portfolios laden with loans to their REITs.

Suggested Amendments

Because the potential abuses which may be associated with the securities activities of banks are reflected in the list of "adverse impacts" in Section 301(a) of the bill, we strongly endorse the scope of that list. However, the Association would suggest several amendments to strengthen and clarify that section.

To prevent the major commercial banks from gaining further control over sources of investment capital, we suggest that the reference in Section 301(a) to "concentration of . . . financial resources" be clarified. We feel that, either through language in the bill or in its legislative history, it should be made clear that no bank may engage in non-banking activities -- even if directly related to banking -- if such involvement would cause any further concentration of resources among any type of financial intermediary, such as securities underwriters, insurance companies and mutual funds. The Association believes that such a clarification is necessary to assure that the major commercial banks do not further their control over our nation's capital resources.

Furthermore, to preclude most of the potential abuses discussed above, we strongly support the approach taken by Section 301(a) of the bill in placing greater limitations on non-banking activities. However, we suggest a minor amendment to that section. We believe banks should be expressly prohibited, in a new clause of Section 301(a) (which amends Section 4(c)(8) of the Bank Holding Company Act of 1956), from engaging in those activities enumerated in Section 2(c). The new clause, to be inserted in subparagraph (B), would read as follows:

> ( ) the term "closely and directly related to banking or managing or controlling banks" does not include (1) offering insurance agency and underwriting services, (2) offering leasing, accounting travel or courier services, (3) offering management and data processing services, or (4) soliciting purchases or sales of securities (except investment securities to the extend permitted to national banking associations by the provisions of section 24 of this title),*

Competition in Laxity

Both past and recent history bear out the proposition that when banks are able to choose among several regulators a "competition in laxity" may occur, and banks may switch charters in order to avoid restrictive regulatory policies of a particular agency. The result often can be the frustration of critical national polciy objectives. In the second and third decades of the twentieth

* We assume that the phrase "marketing of securities" in Section 2(c)(iv) is intended to refer to the solicitation of purchases or sales of securities.

century, so many state chartered banks had securities affiliates that the Comptroller at first ignored his duty to prevent national banks from engaging in such activities and, then, successfully lobbied Congress to permit them to engage in those activities.

The end of that competition among regulators was prompted by the failure of many banks in 1933 due to the losses incurred by their securities affiliates. More recent history has seen banks converting to one-bank holding companies during the 1960's in an attempt to employ their competitive advantages in areas outside of banking. Also, as the Chairman mentioned in his remarks when he introduced this legislation in 1975, bank holding companies which have been denied permission to engage in certain activities by the Federal Reserve Board have succeeded in obtaining approval by the Comptroller of the Currency for the very same activities.

Since most of the securities activities of banks are provided by banks themselves, rather than by subsidiaries of bank holding companies, those activities are subject to the more permissive regulation of the Comptroller of the Currency and of various state banking authorities, rather than the stringent controls imposed by the Federal Reserve Board. For that reason, the Association strongly endorses the intent, expressed in Section 401, of having the Board determine permissible non-banking activities of national banks. However, we would urge that a uniform and coherent national policy with respect to competition in the banking industry -- which this bill seeks to enact into law -- requires that competing state and national banks be treated equally in this critical regard. In the absence of such uniformity, attainment of national policy objectives may be frustrated. Thus, we believe Section 401 should be extended to apply to all insured banks, or at the very least, all member banks.

Undercapitalization of Banks

A quick analysis of the current financial situation for many bank holding companies leads one to the conclusion that bank holding companies should return to the business of banking. On the average, their equity to asset ratio is approximately 4.5% for the major bank holding companies, and their holding company debt to an equity ratio approaches the one-to-one limit imposed by the Federal Reserve. The major bank holding companies asset growth cannot exceed their equity growth because of this situation. How can bank holding companies raise equity capital with their current financial structures and business conditions. For example, Citicorp debt to equity ratio is one-to-one, and Citicorp is looking at an $80 billion capital need in the next five years. How it will raise its equity capital should be a major concern, and it is clear that invading the small and cyclical securities industry will be of no assistance.

Expansion of banks into non-banking areas may seriously compound the problem of inadequate bank capital. To the extent banks devote their capital resources to investment in other activities, they are deprived of the use of those funds to support their lending activities. In addition, the tendency over the past decade has been for banks to steadily increase the maturity of the loans they extend. Such loans may be said to have equity attributes in that the terms of the accompanying loan agreements may give the lender virtual control over the corporate borrower. Consequently, repayment of the loans may depend more on the long run success of the borrowing enterprise than on normal considerations of solvency.

Such long-term loans may affect bank liquidity adversely in two respects. The probability of such loans being repaid at maturity generally is somewhat lower than with short-term borrowings. Moreover, because of the extended maturity of these loans, banks may lose some of their flexibility to adjust to unanticipated declines in their deposits, many of which are subject to withdrawal on demand or short notice.

To preclude such risks to bank liquidity, we suggest two minor amendments to Section 501. First, the section should be revised specifically to require bank regulators to consider, in determining the adequacy of a bank's capitalization, the relationship between long-term loans and other illiquid assets on the one hand and long-term sources of funds, such as time deposits and shareholders' equity, on the other. Secondly, to avoid the problems of competition in laxity discussed above, we suggest that the provisions of section 501 be made applicable to all member banks or all insured banks.

Conclusion

We are concerned with many of the issues addressed by this bill and strongly endorse the thrust of this proposed legislation. Indeed, the concentration of economic power in the major commercial banks poses a serious threat which calls for legislative action. Banks' control over financial resources, if not our entire economy, suggests the need for strict limitations on both their size and their activities. We believe that this legislation, modified in accordance with our suggestions, will go a long way toward solving the problem as we perceive it.

We appreciate this opportunity to offer our comments and suggestions on this important piece of legislation and will be happy to try to respond to any questions.

The CHAIRMAN. Thank you very much, Mr. O'Brien.
Mr. SILVER. I understand that you want to have 10 minutes on your statement and 5 minutes on another matter. Will you proceed in that way?
Mr. SILVER. Yes.
The CHAIRMAN. All right. Go right ahead.

STATEMENT OF DAVID SILVER, PRESIDENT, INVESTMENT COMPANY INSTITUTE; ACCOMPANIED BY MATTHEW P. FINK, GENERAL COUNSEL

16 June 1978

ORAL STATEMENT OF THE

INVESTMENT COMPANY INSTITUTE

ON S. 72

(Before the Senate Committee on Banking, Housing and Urban Affairs)

My name is David Silver. I am President of the Investment Company Institute, the national association of the mutual fund industry. With me today is Matthew P. Fink, the Institute's General Counsel. Mr. Chairman, we have a statement which is too long to read and I ask that it be included in the Record.

I would like to open with a few general observations and then proceed to a summary of our written testimony. I should state at the outset, however, that we endorse the purposes and provisions of S. 72.

Unique Role of Banks

From time to time, objective observers raise the question as to why the nation's banks should not be freed to join the competitive race in the securities field and other areas of commerce. In a society built on competition, this is a reasonable inquiry. Yet, for over 100 years there has been chronic tension as the banking industry, often aided by bank regulatory authorities, has tried to expand into other businesses, while the Congress has time and time again attempted to confine banks to the business of banking. What is it that has given rise to the tension between free competition and the recurrent legislative efforts? What hazards exist when banks enter other lines of commerce and more particularly the securities business? An answer to the latter question may be found in the form of a study of bank sponsored real estate investment trusts which I will discuss later. However, the competitive issue is not developed in our written statement and I would like to offer a few words with respect to it.

Banks are unique. Most business depends on a satisfactory banking relationship. While a good relationship with a bank does not insure commercial success, its absence can be crippling. I do not have to detail for this Committee the valuable and useful services provided to business by the nation's banks.

But the importance of banks is not restricted to business services. A banking relationship is important in the personal lives of millions of Americans. A bank may hold the mortgage on our home, and be the source of loans for the college education of our children or to meet such crises as illness and death. A bank may participate in the administration of our estates. And this is without considering that the savings of our citizens are entrusted to banks. To quantify some of this, the statistics on page 8 of our statement indicate that commercial bank assets now stand at about one trillion dollars, while trust assets of these banks are now at $500 billion or more. These assets exceed those of <u>all other financial institutions combined</u>.

The awesome economic power of the banks and the web of relationships created with users of bank services make it logical, indeed inevitable, that banks, especially the major commercial banks, would seek to use their financial power and leverage to expand into other lines of commerce.

History reveals two major concerns with bank entry into businesses other than banking.

First, the unique relationships between banks and customers, coupled with their economic power, give banks an enormous competitive advantage in whatever business they enter, increasing the already high degree of economic concentration in the major banks. Bank customers know that the totality of their use of bank offered services will be considered by bank officers passing on their loan applications.

Second, are the effects on the economy as a whole when banks, particularly the large banks, divert their assets and energies from providing banking services to enter other businesses. Of even greater significance are the drastic consequences when major banks encounter trouble and bank assets are placed in jeopardy. Then, all who are dependent on bank services suffer and the basis is laid for widespread economic disaster. The legislative efforts culminating in the Glass-Steagall Act were in response to such financial debacles.

Our written statement illustrates some of these points. We show that for over 100 years, in the face of recurrent financial crises, Congress has sought to prevent commercial banks and their affiliates from engaging in the general securities business. Yet, the banks and the bank regulatory authorities have repeatedly sought to subvert Congress' intent, for example: by banks forming securities affiliates in the early 1900's in order to circumvent The National Banking Act; by the Comptroller's lobbying in the 1920's to permit banks to underwrite securities; by the Comptroller's efforts in the 1960's to authorize banks to sponsor mutual funds; by bank sponsorship of REITs in the early 1970's; by the present mass-merchandising of interests in bank collective pension funds; and by the current efforts to repeal the Glass-Steagall Act and return to the dangerous pattern of the 1920's. It is to these matters which we now turn.

The Glass-Steagall Act

In 1927 as a result of banking industry pressures and the efforts of the Comptroller, Congress enacted legislation relaxing previous restrictions to permit national banks to underwrite securities. By the early 1930's a national consensus emerged that commercial bank entry into the securities business had been a major contributor to the Great Crash. In the Glass-Steagall Act of 1933 Congress restored the historic separation between commercial banking and the general securities business.

While commercial banks have achieved phenomenal success and gigantic growth since the Great Crash and the enactment of the Glass-Steagall Act, the banking industry now seeks to expand into areas prohibited by the Act. As to the wisdom of these efforts I might note the recent statement of Federal Reserve

Board Governor Henry C. Wallich that in view of the adverse experience of bank holding companies due to the 1974 recession, "...the banks were fortunate not to have been burdened, at the same time, with securities affiliates. In 1974, Glass-Steagall stood the banks in good stead."

The banking industry, however, has continued its efforts to use the Holding Company device to erode the Glass-Steagall Act and then to repeal it so that once again banks would be permitted to operate securities affiliates in the form of open-end and closed-end investment companies.

Sponsorship of Investment Companies

In 1962 the Comptroller authorized banks to sponsor and operate open-end investment companies, commonly known as mutual funds. This attempt was struck down by the United States Supreme Court in 1971 in its landmark decision in Investment Company Institute v. Camp. The Court found that "the same basic hazards and abuses that Congress intended to eliminate about forty years ago..." still existed.

One might have expected that the Supreme Court's decision in Camp would have put the issue to rest. However, scarcely four months after the Supreme Court's decision in Camp the Federal Reserve Board proposed, under the Bank Holding Company Act, to permit banks to serve as investment advisers to investment companies. In its final ruling, the Board reinterpreted the law to permit a component in a bank holding company to organize, sponsor and advise a closed-end investment company, and to advise an open-end company, i.e., a mutual fund. As a result, bank holding companies now manage at least twenty-five investment companies with total assets in excess of $2 billion.

Despite the actions of the federal banking agencies in undercutting the Glass-Steagall Act, the banking industry has decided to seek its complete repeal. The banking industry would have Congress believe that the Glass-Steagall Act was an exercise in public relations which has now outlived its usefulness. The Glass-Steagall Act, however, simply restored the historic separation between commercial banking and securities activities which was unwisely abandoned in the 1920's. Moreover, the Glass-Steagall Act not only helped restore public confidence in the banking system but has generally prevented the recurrence of the abuses of the 1920's.

Recent experience indicates that the problem is not that the Glass-Steagall Act went too far, but that it has been evaded.

Sponsorship of REITs

The story of bank managed real estate investment trusts is as current as today's newspaper. It shows the historic wisdom of the efforts of the Congress to confine banks to the business of banking.

After the Bank Holding Company Act Amendments of 1970, the Federal Reserve Board adopted regulations permitting a bank holding company to act as investment adviser to a REIT. Commercial banks promptly proceeded to form REITs and provide REITs with more than $11 billion of loans. Between 1972 and 1974, while overall REIT assets more than doubled, those of bank-sponsored

REITs increased about ten-fold to constitute approximately one-third of industry assets.

From their very inception, banks sponsoring REITs engaged in practices which do not seem consistent with principles of sound banking. First, their promotional activities were questionable. Since the sponsoring bank and its REIT often had the same officers, it was no surprise that investors were induced to purchase REIT securities in reliance on the sponsoring bank itself. Indeed in promoting their REITs, bankers stressed the real estate expertise of their banks.

Second, banks used their ability to manipulate the financial affairs of the REIT to the advantage of the bank. The bank's advisory fee was ordinarily based on the amount of the REIT's assets. Banks, therefore, had every incentive to swell the size of their REITs by causing them to borrow excessively and to make loans without adequate review. At least one major bank's failure to make adequate reserve provisions for losses in its REIT was allegedly due to its desire not to lower the advisory fee it received.

Third, there were major conflicts between the business interests of banks and that of their REITs. Loans that were judged too risky for a bank were simply passed on to its REIT. Similarly, loans which a bank itself could not make could lawfully be passed on to the REIT, thereby complementing the bank's own real estate activities by not refusing a loan to a good bank customer.

There were subtle conflicts of interest. Banks profited from the use of the "float" created by the REITs' loans to developers who were bank customers. In addition, banks earned commissions on the placement of REIT loans and received fees as the REITs' transfer agents, registrars and dividend agents. They also lent immense sums to their captive REITs, which had the triple effect of producing interest income, compensating deposits in the bank, and expansion of the REIT asset base enhancing the bank's advisory fee. Finally, there apparently were preferential loans to REITs controlled by the banks' own officers and directors, which in turn gave loans to these same insiders.

When the speculative real estate bubble of the early 1970's inevitably burst, bank-sponsored REITs and their shareholders suffered the consequences. Although we cannot distinguish between bank-sponsored REITs and others, at least seven REITs have gone into bankruptcy -- another 11 have failed to pay interest on their subordinated debt, much of which was sold to public investors; over 40 REITs have nominal or negative net worth; and another 19 apparently have been kept afloat by interest rate concessions from their banks. REITs owe over $8.8 billion, $7 billion of it to the banks.

The rescue operations which banks mounted to bail out their REITs have diverted needed monies which would have been available to other borrowers. For example, Chase Manhattan Bank has taken over about $160 million of its REIT's loans. At least two smaller bank holding companies have failed because of the drain of real estate affiliates. Investment advisers warned investors against purchasing bank stocks.

The banks had little choice but to attempt rescue missions. As major REIT creditors, the banks obviously wished to avoid bankruptcy proceedings. Further, since the original promotion of bank REITs had intentionally blurred the distinction between the bank and the REIT, the banks had to protect their own names and reputations. On top of all this, the Federal Reserve Board pressured the banks to "bail out" their REITs for fear that REIT failures would lead to a "financial panic" and would endanger "the stability of the financial system." At the same time, bank regulatory authorities sought to shield the public from the facts.

After reviewing the banks' rescue attempts, one observer warned that examination of: "America's last experience...[of] a pattern of banks coming to the aid of troubled affiliates revealed such abuses as to lead to the Glass-Steagall Act of 1933, separating commercial from investment banking."

In short, the REIT story is graphic and current confirmation of the Supreme Court's analysis of the hazards which led to the enactment of the Glass-Steagall Act. By interpreting the Glass-Steagall Act narrowly and giving a broad interpretation to the Holding Company Act, the bank regulatory agencies produced the very evils which the Supreme Court enumerated in the Camp case.

<u>Sponsorship of Common Trust Funds and Collective Pension Funds</u>

We also believe that these hearings offer the opportunity for the Congress to take needed measures regarding the current attempts of the banks and bank regulatory authorities to convert bank common trust funds and collective pension funds into mass-marketed investment vehicles. The decision in <u>Camp</u>, though directly in point, has not deterred the banks from this effort.

For example, we have with us today copies of ads currently being published by banks in newspapers and magazines aimed at hundreds of thousands of small pension plans. These ads do little more than trumpet the collective funds' investment performance. The Fifth Third Bank of Cincinnati's headline is "Entering our Second Decade of Outperforming the Dow Jones." Hibernia National Bank's headline states that it is "#1." The National Bank of Detroit's ad consists of a 10-year chart comparing the performance of its commingled equity funds with the Becker Median.

What must be emphasized is that these sales materials are aimed at small, unsophisticated employee benefit plans. There are over 800,000 employee benefit plans in the country with less than 100 participants. When one views advertisements aimed at hundreds of thousands of small plans, and which tout investment performance with scarcely a word about fiduciary expertise, it seems difficult to believe that the banks are not merchandising interests in these funds in violation of the Glass-Steagall Act.

We believe that these hearings afford Congress the opportunity to reaffirm the historic national policy that prohibits commercial banks and bank holding companies from engaging in the general securities business. Over 100 years of experience indicates that this matter is far too important to be left to the business judgment of the banks or to the administrative discretion of the bank regulatory authorities.

STATEMENT OF THE

INVESTMENT COMPANY INSTITUTE

BEFORE THE

SENATE COMMITTEE ON BANKING

HOUSING AND URBAN AFFAIRS ON S. 72

June 16, 1978

My name is David Silver. I am President of the Investment Company Institute. With me today is Matthew P. Fink, the Institute's General Counsel.

The Investment Company Institute is the national association of the American mutual fund industry. Its membership includes 454 open-end investment companies ("mutual funds"), their investment advisers and principal underwriters. Its mutual fund members account for over 90% of industry assets and have approximately seven million shareholders.

We greatly appreciate the opportunity to testify before you in connection with S. 72, A Bill to Amend the Bank Holding Company Act and The Bank Merger Act. We have testified before you in the past in connection with similar legislation, and on March 21st of this year we submitted a written statement relating to S. 72.

We strongly support enactment of S. 72. In particular, we support enactment of Section 301(a) which would tighten up the tests contained in Section 4(c)(8) of the Bank Holding Company Act relating to the permissible non-banking activities of components in bank holding companies. In addition, we support the enactment of

Section 401 of the bill which provides that an activity found by the Federal Reserve Board to be improper for a bank holding company is improper for a national bank itself, and which further explicitly denies a national bank the right to engage in any activity prohibited to it under any other provision of law.

Our testimony today will focus on the increasing activities of banks and bank holding companies in the general securities business. For over 100 years, the federal banking laws have sought to prevent commercial banks and their affiliates from engaging in these activities. This long-standing position has been based on Congress' concern that bank involvement in the securities business inevitably will result in disaster for banks engaging in these activities, and hence cause severe problems for the entire American economic system. Congress' concerns have been amply justified by events, most recently by the crises which resulted from bank sponsorship of securities affiliates in the 1920's and from bank sponsorship of real estate investment trusts in the early 1970's. In our testimony today we will demonstrate that a wide number of existing bank securities activities, including bank-managed mutual funds and closed-end investment companies, bank-operated automatic investment plans, bank-sponsored REITs, and mass-merchandizing of bank collective pension funds, are contrary to the basic intent of the federal banking laws, and indeed violate specific provisions of those laws, including the Bank Holding Company Act as amended in 1970.*

* The legislative history of the 1970 Act makes it absolutely clear that Congress did not intend to permit non-bank components in bank holding companies to engage in securities activities prohibited to banks themselves. See the floor colloquy between Senators Williams and Sparkman, quoted in full on page 3 of our earlier statement to this Committee, dated March 21, 1978.

We believe that the introduction of S. 72 affords Congress the opportunity to make it clear that banks and bank holding companies are prohibited from engaging in these activities, which, if left unchecked, could threaten our national financial system. Specifically, we recommend that Congress make it plain that banks and bank holding companies are prohibited from:

- sponsoring or advising open-end investment companies ("mutual funds")
- sponsoring or advising closed-end investment companies
- operating automatic investment plans
- sponsoring or advising real estate investment trusts
- selling interests in common trust funds other than to true personal trust accounts
- selling interests in collective pension funds other than to large and medium-size corporate pension plans (and not to individual retirement accounts, Keogh plans and small corporate plans)
- advertising and mass-merchandizing interests in common trust funds and collective pension funds

We believe that it would be useful to begin by briefly summarizing the history of the federal banking laws which, for over 100 years, have sought to prevent commercial banks and their affiliates from engaging in the general securities business.

THE FEDERAL BANKING LAWS

At its origins in the nineteenth century, the modern American banking system was based on a complete separation of commercial banking and securities activities. This was modeled on the English system which "considered investment banking an inherently risky and speculative venture and, for that reason, considered any dealings in stocks and bonds an improper business pursuit" for commercial banks.* The National Banking Act of 1864, which granted national banks certain limited powers, was interpreted to totally prohibit national banks from underwriting or dealing in non-Government securities.** In the early 1900's, the Comptroller of the Currency began reinterpreting the Act to permit national banks to deal in and underwrite debt securities. However, in 1902 the Comptroller still ruled that The National Banking Act did not permit national banks to participate in the underwriting and distribution of equity securities.***

In order to avoid these legal prohibitions on the securities activities of national banks, the banks resorted to the now-familiar device of creating non-bank affiliates. In the words of the Treasury Department's 1975 Issues Paper:

> "...In the face of the Comptroller of the Currency ruling that national banks cease their underwriting of stocks, the major national banks, commencing in 1908, created securities affiliates chartered under state law. The affiliates were free of Federal regulation and thus able to engage in the wide range of securities activities permitted under state law, including the underwriting of corporate stocks."****

---

* Perkins, "The Divorce of Commercial and Investment Banking: A History", 88 Banking Law Journal 483, 485 (1971).

** Department of the Treasury Issues Paper "Public Policy Aspects of Bank Securities Activities" Appendix, at 2 (1975).

*** Redlich, The Molding of American Banking - Men and Ideas, Volume 2 at 389 and 393 (1951).

**** Treasury Issues Paper Appendix, supra, at 5. (Footnote omitted).

These developments, which were directly contrary to the historic separation of commercial banking and securities activities, did not go unnoticed. In 1911 the Solicitor General and Attorney General of the United States were of the opinion that bank securities affiliate arrangements, which permitted national banks to do indirectly what they could not do directly, constituted an "usurpation of Federal authority and [were] in violation of Federal law." However, for reasons never explained, the Taft Administration did not take any action.* In addition, in 1912 the Pujo Committee recommended legislation to clearly prohibit national banks from participating in the underwriting of corporate securities, based on concerns over undue concentration of economic power and the belief that securities activities were not a proper function of banking. However, for a variety of unrelated reasons, Congress failed to enact the recommended legislation.**

There now followed the familiar pattern of the bank regulatory authorities lobbying on behalf of the commercial banking industry to completely break down the historic separation of commercial banking and the securities business:

> "...[T]he Comptroller did not enforce the existing restrictions on the powers of national banks and suggested greater leniency in the national banking laws. From 1923 to 1927 the Office of the Comptroller was the driving force behind the legislation which conferred on national banks the power to engage in a modified securities business."***

---

* Perkins, supra, at 517.

** Treasury Issues Paper Appendix, supra, at 10-12.

*** Peach, The Security Affiliates of National Banks, at 150 (1941). (Footnote omitted).

The Comptroller's efforts on behalf of the banking industry resulted in the passage of the McFadden Act in 1927 which permitted national banks to underwrite securities as authorized by the Comptroller. The Comptroller soon permitted national banks to underwrite both debt and equity securities.* Following passage of the McFadden Act, "Commercial banks became increasingly more active in the securities markets; their market share of new bond issue participations was boosted from 37 per cent in 1927 to 61 per cent in 1930.... By the end of the decade commercial banks and their affiliates had become the dominant force in the investment banking field."**

Thus, on the eve of the Great Crash, commercial banks, through the device of securities affiliates and with the active assistance of the federal banking agencies, had completely smashed the traditional barrier between commercial banking and the securities business. The national banking system and the nation as a whole were to suffer the consequences.

Time does not permit us to fully describe the myriad abuses which resulted from commercial bank entry into the securities business in the 1920's, other than to note that they included: causing bank securities affiliates to make investments considered too "risky" for the bank itself; dumping bad bank loans and investments into securities affiliates' portfolios; the purchase by banks and controlled trust accounts of unsuccessful issues underwritten by securities affiliates; imprudent and excessive bank loans to prevent the collapse of securities affiliates; bank loans to purchasers of

---

* Perkins, supra, n. 27 at 494.

** Ibid, at 495. (Footnote omitted).

24-934 O - 78 - 19

securities underwritten by affiliates; bank loans to corporations using securities affiliates as underwriters; abuses of relationships with correspondent banks to help distribute securities affiliates' underwritings; and personal self-dealing by bank officers and directors in the operation of securities affiliates. *

By the early 1930's there was a general national consensus that commercial bank entry into the securities business had been a major contributor to the Great Crash and the ensuing depression:

> "...Members of the Glass Committee and the general public believed at the time that the securities activities of banks contributed to and accentuated the economic collapse. They believed that the banking community, as the depository of individual savings and the institution which created credit, bore higher standards of responsibility as a result of its crucial position of influence over the state of the economy."**

As a result, Congress enacted the Banking Act of 1933 (the Glass-Steagall Act) which restored the historic separation between commercial banking and the general securities business. For example, Section 16 of Glass-Steagall provided that a national bank "shall not underwrite any issue of securities or stock" and shall not purchase "for its own account...any shares of stock of any corporation", and Section 21 prohibited a national bank from engaging in "the business of issuing, underwriting, selling or distributing, at wholesale or retail, or through syndicate participation, bonds, debentures, notes, or other securities...."***

In the 45 years since the enactment of the Glass-Steagall Act, Congress has steadfastly refused to tamper with the separation of commercial banking and the

* Hearings Before a Subcommittee of the Senate Committee on Banking and Currency, 71st Congress, 3d Session, Part 7, at 1063-64 (1931).

** Treasury Issues Paper Appendix, supra, at 17.

*** Banking Act of 1933, Pub. L. 73-66, Ch. 89, 48 Stat. 162 (1933).

securities business, despite repeated attempts by the banking industry and the bank regulatory authorities to repeal Glass-Steagall and return to the dangerous pattern of the 1920's. As we shall demonstrate later in our testimony, events over the ensuing decades have reemphasized the need to maintain and reinforce the separation between commercial banking and the general securities business.

Since the enactment of Glass-Steagall, commercial banks have become far, far larger, so that the dangers inherent in bank involvement in the securities business are even greater today than they were 45 years ago. In 1933, commercial banks had non-trust assets of $46.1 billion and trust assets of $25 billion.* At the end of 1976, these amounts had grown to $966 billion and $486.6 billion, respectively.** These combined commercial bank assets of $1452.6 billion exceed the aggregate assets of <u>all</u> other financial institutions, such as mutual savings banks, savings and loan associations, credit unions, private and government pension funds, insurance companies and mutual funds. Moreover, there is concentration within concentration. In 1976, the total non-trust assets of the top 10 commercial banks amounted to 36.7% of all commercial bank non-trust assets.*** Moreover, the assets of just these 10 banks alone exceeded the total assets of <u>all</u> other major types of financial institutions combined, other than savings and loan associations. There are 4 banks which individually have combined commercial and trust assets which are larger than the total assets of the <u>entire</u> mutual fund industry.

* Goldsmith, <u>Financial Intermediaries in the American Economy Since 1900</u>, National Bureau of Economic Research Studies in Capital Formation and Finance, No. 3 (1958).

** Data compiled from the December 1977 Federal Reserve's "Flow Of Funds Accounts: Assets and Liabilities Outstanding 1965-1976", and the 1976 joint report of the federal banking agencies "Trust Assets of Insured Commercial Banks 1976".

*** "The Fifty Largest Commercial-Banking Companies", Fortune, July, 1977, at 162.

The potential of banks to dominate American industry is startling. At the end of 1977, federally-chartered banks with assets in excess of $75 million held the following percentages of voting stock of the following major companies: 19.5% of General Motors; 20.6% of Exxon; 20.9% of Dow Chemical; 22.9% of IBM; 27.6% of Standard Oil of Indiana; and over 30% of Ford, Caterpillar Tractor, K Mart and Kelloggs. These banks owned 20.9% of the bituminous coal mining industry; 23.3% of the chemical and drug industry; 25.6% of the food product-grain mill industry; and 27.4% of the furniture and fixture industry.* It must be emphasized that these figures omit the stockholdings of state-chartered banks which are almost equal to those of federally-chartered banks. It is thus fair to assume that these percentages substantially understate the stockholdings of all banks.

Superimposed on this dominant stock ownership is a pervasive system of interlocking directorates between banks and non-financial corporations. This system of interlocking directorates was highlighted in a recent Senate Staff Study.** The Study found 182 separate director interlocks alone just between the five largest banks and the five largest non-financial corporations.*** In addition, the banks interlock indirectly among themselves by having directors on the boards of the same corporations. For

* Data compiled from Spectrum 3, Bank Stock Holdings Survey, December 31, 1977.

** "Interlocking Directorates Among the Major U. S. Corporations", Staff Study Prepared by the Subcommittee on Reports, Accounting and Management of the Senate Committee on Governmental Affairs, 95th Cong., 2d Sess. (January 1978).

*** Ibid, at 29.

example, Manufacturers Hanover had 121 indirect interlocks with five other New York banks alone.*

While commercial banks have achieved phenomenal success and gigantic growth since the Great Crash and the enactment of the Glass-Steagall Act, in recent years banks and bank holding companies have become more and more aggressive both in banking and non-banking activities. In the banking area:

> "... [T]hey devised new techniques--many highly ingenious--for gathering deposits and making loans. They opened offices at a rate much more rapid than the growth of the Nation's population, and increasingly extended their operations to new geographic areas and functions. Banks that previously served only local markets sought to become regional in scope; regional banks moved to establish a national presence; and our Nation's largest banks looked more and more to opportunities abroad."**

In the non-banking area, the Federal Reserve Board has approved 17 types of non-bank activities, and in 1971-1976 approved 2,753 individual applications to engage in these activities.*** The banks' aggressive push for growth was accompanied by a sharp drop in the capital ratios of insured commercial banks. Between 1961 and 1977, capital

* Ibid, at 120.

** Testimony of Federal Reserve Board Chairman Arthur F. Burns Before the Senate Committee on Banking, Housing and Urban Affairs, March 10, 1977.

*** Savage, "A History of the Bank Holding Company Movement 1900-1978", printed as Section II of "The Bank Holding Company Movement to 1978: A Compendium", at 35, Study by the staff of the Board of Governors of the Federal Reserve System (April 1978).

as a percent of risk assets fell from 14% to 9.1%.* This naturally has led to widespread concern over the stability of the national banking system. Federal Reserve Board Governor Henry C. Wallich recently stated that it was fortunate in view of these developments and the 1974 recession that banks and bank holding companies were precluded by the Glass-Steagall Act from engaging in the general securities business.**

Despite these facts, the banking industry is engaged in an all-out effort to repeal the Glass-Steagall Act and to once again permit banks to operate securities affiliates -- this time in the form of open-end and closed-end investment companies.

BANK INVESTMENT COMPANIES

While the Glass-Steagall Act prohibited commercial banks from engaging in the general securities business, commercial banks have been permitted to pool small trust accounts in bank-managed common trust funds. In 1937 the Federal Reserve

* Updated data based on Pierson, "Bank Holding Company Capital", in Compendium of Major Issues of Bank Regulation, Print No. 2, Printed for the Use of the Senate Committee on Banking, Housing and Urban Affairs, 94th Cong., 1st Sess., at 458 (1975).

** "Then came the recession of 1974, which brought serious losses. At that time, newly established bank holding companies had been extending their operations into new areas of financial activity, such as mortgage banking, consumer finance, and advising and financial real estate investment trusts. The holding companies' experience in many cases was sufficiently adverse to justify the conclusion that the banks were fortunate not to have been burdened, at the same time, with securities affiliates. In 1974, Glass-Steagall stood the banks in good stead". Wallich and Harvey, "Reflections on Glass-Steagall", Bankers Magazine, March-April 1978, at p. 9.

Board first adopted rules permitting national banks to operate collective investment funds in furtherance of "bona fide fiduciary purpose" and not solely as vehicles for investment purposes.* The Board repeatedly warned banks against using common trust funds as investment vehicles, presumably to avoid violations of the Glass-Steagall Act.** In 1960, the Federal Reserve Board proposed further limitations to prevent the use of common trust funds for revocable inter vivos trusts which in reality were simply managing agency accounts.*** For this and other reasons, the banking industry prevailed upon Congress in 1962 to transfer control over national bank trust powers from the Federal Reserve Board to the Comptroller of the Currency.****

---

* Fed. Res. Bd. Reg. F. §17, 2 Fed. Reg. 2976 (1937).

** See, e.g., 26 Fed. Reserve Bull. 390, at 393 (1940): [In permitting] the operation of Common Trust Funds, the Board intended that a Common Trust Fund should be used merely to aid in the administration of trusts by a trust institution through the commingled investment of funds of various trusts...it was contemplated that [the] trust guise or form should not be used to enable a trust institution to operate a Common Trust Fund as an investment trust attracting money seeking investment alone and to embark upon what would be in effect the sale of participations in a Common Trust Fund to the public as investments."

*** 25 Fed. Reg. 12479 (1960).

**** Lybecker, "Bank-Sponsored Investment Management Services: A Legal History and Statutory Interpretative Analysis - Part 1", 5 Securities Regulation Law Journal, at 151-52 (Summer 1977).

The Comptroller acted quickly to permit banks to sponsor commingled managing agency accounts and deleted the requirement that a "bona fide fiduciary purpose" exist for establishing the investment advisory relationship.* In short, the Comptroller authorized banks to sponsor and operate open-end investment companies, commonly known as mutual funds.

The Comptroller's bald attempt to permit commercial banks to reenter the general securities business on a wholesale basis, was of course struck down by the United States Supreme Court in 1971 in its landmark decision in Investment Company Institute v. Camp.** The Court did not base its decision on a technical reading of the Glass-Steagall Act, but found that "the potential hazards and abuses that flow from a bank's entry into the mutual investment business are the same basic hazards and abuses that Congress intended to eliminate about forty years ago...." Time does not permit us to do more than quote a representative excerpt from the Supreme Court's decision:

* Reg. 9 §9.18, 28 Fed. Reg. 3311 (1963).

** 401 U. S. 617 (1971).

"And there are other potential hazards of the kind Congress sought to eliminate with the passage of the Glass-Steagall Act. The bank's stake in the investment fund might distort its credit decisions or lead to unsound loans to the companies in which the fund had invested. The bank might exploit its confidential relationship with its commercial and industrial creditors for the benefit of the fund. The bank might undertake, directly or indirectly, to make its credit facilities available to the fund or to render other aid to the fund inconsistent with the best interests of the bank's depositors. The bank might make loans to facilitate the purchase of interests in the fund.. The bank might divert talent and resources from its commercial banking operation to the promotion of the fund. Moreover, because the bank would have a stake in a customer's making a particular investment decision -- the decision to invest in the bank's investment fund -- the customer might doubt the motivation behind the bank's recommendation that he make such an investment. If the fund investment should turn out badly there would be a danger that the bank would lose the good will of those customers who had invested in the fund. It might be unlikely that disenchantment would go so far as to threaten the solvency of the bank. But because banks are dependent on the confidence of their customers, the risk would not be unreal."

One might have expected that the Supreme Court's decision in Camp would have finally put to rest the question of bank entry into the securities business in general, or at a minimum, into the mutual fund business in particular. Subsequent events, however, have demonstrated that the banking industry and the bank regulatory authorities view Camp not as a barrier, but merely as an obstacle to be avoided as banks aggressively seek to engage in more and more aspects of the securities business. For example, the Comptroller of the Currency has authorized banks to establish and operate automatic stock investment plans.* Moreover, only four months after the Supreme Court's decision in Camp, the Federal Reserve Board issued a notice proposing that the list of permissible nonbanking activities in Regulation Y be expanded to include serving as an investment adviser to an investment company.** After hearings the Board adopted final regulations permitting a component in a bank holding company to serve "as investment adviser, as defined in §2(a)(20) of the Investment Company Act of 1940, to an investment company registered under that Act".*** In its accompanying ruling, the Board reinterpreted the Glass-Steagall Act and the Camp case to permit a component in a bank holding company to organize, sponsor and advise a closed-end investment company, and to advise, but not "sponsor, organize or control", a mutual fund. The Board's decision has resulted in components in bank holding companies serving as investment advisers to at least sixteen mutual funds with total assets in excess of $1.33 billion, and in bank sponsorship of at least nine closed-end investment companies with total assets in excess of $780 million.

* The New York Stock Exchange and the Investment Company Institute jointly brought an action in the federal district court for the District of Columbia against the Comptroller of the Currency seeking a judicial declaration that the Comptroller's regulation permitting such activity violates the Glass-Steagall Act. Summary judgment held that the case was not ripe for judicial review. A petition for a writ of certiorari has been denied by the Supreme Court. New York Stock Exchange, Inc. v. Smith, 404 F. Supp. 1091 (D.D.C. 1975); aff'd on other grounds sub nom., New York Stock Exchange, Inc. v. Bloom, 562 F. 2d 736 (D.C. Cir. 1977); cert. denied, 46 USLW 3599 (1978).

** 36 Fed. Reg. 16695 (1971).

*** 37 Fed. Reg. 1463 (1972).

In our view, the Board's actions represent a flagrant attempt to circumvent the Supreme Court's decision in Camp. Bank sponsorship of closed-end funds violates the Glass-Steagall Act as much as does bank sponsorship of mutual funds. Closed-end funds actively engage in issuing and selling their securities to the general public. Indeed, the success of their original securities offerings is critical to closed-end funds. In addition, closed-end funds can and do sell their securities to the public after their first distribution is completed. In this context, the only relevant difference between closed-end funds and mutual funds is that bank holding company sponsorship of closed-end funds results in a limited number of violations of law while in the case of mutual funds there would be continuous violations.

As to mutual funds, the apparent difference between organizing and sponsoring a mutual fund and "merely" advising it is illusory. In either case the bank has a "salesman's stake" in the success of the fund and bank involvement raises the potential for the same types of hazards and abuses which the Supreme Court recited in the Camp case. The bank obviously profits from the sales of new shares of the fund since the bank's advisory fee is based on the size of the fund. Further, since a mutual fund shareholder may redeem his interest in the fund at any time, new sales are needed simply in order to prevent the fund from continuously contracting and thereby continuously reducing the fee paid to the bank.

For these reasons, we have challenged the Board's regulations in a suit which is presently pending before the U. S. Court of Appeals for the District of Colubmia. *

---

* Investment Company Institute v. Board of Governors of the Federal Reserve System, Civil Action No. 77-1862, September 23, 1977.

Despite the friendly actions by the federal banking agencies, the banking industry has announced its intention to seek legislation to completely overturn the *Camp* case. * Successive Comptrollers of the Currency state and restate support for permitting banks to enter the mutual fund business. **

The banking industry argues that the prohibitions contained in the Glass-Steagall Act, though perhaps relevant in the years of the Great Depression, are irrelevant in the modern world of the 1970's. Hans A. Angermueller, the Senior Vice President and General Counsel of Citicorp and its principal subsidiary, Citibank, N. A., the nation's second largest commercial bank, stated last year:

> "The basic needs in 1933 were to strengthen the commercial banking system and restore depositors' confidence so that banks could resume their intermediary function of helping to convert the nation's savings into productive investments for economic growth. The Glass-Steagall Act was remarkably successful in meeting those public needs.
>
> "Today, however, the commercial banking system has shaken off a series of economic and financial crises and has emerged stronger and more capable than ever. Depositors feel no loss of confidence."***

---

* As recently as February of this year, the Chairman of the Trust Counsel Committee of the American Bankers Association reiterated that organization's intention to seek legislation authorizing commingled managing agency accounts (mutual funds). "ABA Seeks Commingled Agency Accts: Confrontation With Sec. Industry Seen", American Banker, Feb. 8, 1978, p. 1.

** See, e.g., Transcript of Hearings on Securities Activities of Commercial Banks before Subcommittee on Securities of Senate Committee on Banking, Housing and Urban Affairs, December 9-10, 1975, Vol. 1, 70-71, Vol. 2, 124-125.

*** Angermueller and Taylor, "Commercial vs. Investment Bankers", September-October 1977 Harvard Business Review, 132 at 137.

The views of the present Comptroller of the Currency are contained in a speech delivered only two months ago:

> "...[T]he primary thrust of these remarks, [is that] attention must be paid to the role of commercial banking vis-a-vis investment banking and securities industry. In this connection, however, no attempt should be made to rejustify the lines of demarcation Congress may, or may not, have intended to draw in 1933 through the Glass-Steagall Act. Rather, any review should focus on those lines which make sense in light of the financial needs and regulatory environment of today.
>
> "What were the circumstances that so alarmed the nation in 1933 as to demand the enactment of Glass-Steagall? Did these circumstances really necessitate a divorce of commercial banking from investment banking?
>
> "First and foremost, the legislation was debated when the nation was in the depths of its greatest depression. This was a time when the standard of living of most Americans was being shattered. The stock market, long the public symbol of economic well-being, was in shambles. In this setting, neither the Administration nor the Congress had any reason to provide for a world where inflation presents the most serious economic threat and competition is accepted as a force for the public good."*

The banking industry would have Congress believe that the Glass-Steagall Act was an exercise in public relations which has outlived its usefulness. This conveniently ignores the fact that the Glass-Steagall Act simply restored the historic separation between commercial banking and securities activities which was unwisely abandoned in the 1920's. Moreover, the banks' line of reasoning could be applied to all of the economic reform legislation enacted in the 1930's, including the creation of the Federal

* Remarks of John G. Heimann, Comptroller of the Currency, Before the Institutional Investor Conference, New York Hilton Hotel, New York City, April 17, 1978.

Deposit Insurance Corporation and the enactment of the various federal securities laws. Most importantly, this reasoning ignores the real possibility that the Glass-Steagall Act was one of the measures which returned stability to the national banking system after the abuses of the 1920's, not only restoring public confidence in the banking system and helping to lead the nation out of the depression, but preventing the reoccurrence of these abuses.

Further, recent experience indicates that the problem is not that the Glass-Steagall Act went too far, but that the banks and bank regulatory authorities have again reinterpreted the federal banking laws to permit commercial banks and bank holding companies to reenter the securities business.

It is to one of these areas, bank-managed REITs, that we now turn.

BANK REAL ESTATE INVESTMENT TRUSTS*

After the enactment of the Bank Holding Company Act Amendments of 1970, the Federal Reserve Board adopted regulations permitting a component in a bank holding company to act "as investment adviser or financial adviser, including (1) serving as

* In preparing our testimony on REITs we reviewed unpublished material by Roy A. Schotland, Professor of Law, Georgetown Law School, and J. G. Taylor, III, a student at Duke University Law School. However, neither Professor Schotland nor Mr. Taylor have been retained by the Institute and the positions set forth in this testimony are our own.

the advisory company for a mortgage or real estate investment trust...."* In a time of relatively easy money and real estate speculation, commercial banks proceeded to provide more and more credit to REITs, finally totalling more than $11 billion.** In the words of one observer: "Scores of REITs began a competitive scramble to put to work the easy money, made primarily possible by the commercial banks, flowing into their coffers."*** By the end of 1974, REIT assets amounted to over $21 billion.**** The stampede was led by bank-sponsored REITs. Between 1972 and 1974, while overall REIT assets more than doubled, bank-sponsored REITs increased about ten-fold to constitute approximately one-third of industry assets. During that period there were some 24 public offerings of bank-sponsored REITs involving over $25 million each.***** By 1975, 39 of the 100 largest REITs were advised by components of bank holding companies.******

* 12 C.F.R. §222.4(a)(5)(i).

** Schotland, "Bank Holding Companies and Public Policy Today", Compendium of Papers Prepared for the FINE Study, 94th Cong., 2d Sess., 233 at 246 (1976).

*** Zucker, "A Current and Future Assessment of the Real Estate Investment Trust Industry," Wharton School Studies in Entrepreneurship, Report No. 2, at 11 (1975). (Footnote omitted).

**** 1977 REIT Fact Book, at 24.

***** SEC Economic Staff Paper 75-1, "REITs: A Background Analysis and Recent Industry Developments, 1961-1974" (1975), at 56-61.

****** "Bank Loans to REITs: How Serious the Problem?", Keefe, Bruyette & Woods, Inc. (1975) at 62.

From their very inception, bank-sponsored REITs were characterized by conflicts of interest. Typically, the bank and its REIT had the same officers and personnel.* Therefore, it is hardly surprising that investors purchased REIT securities in reliance on the sponsoring bank itself.** Indeed in promoting their REITs to the public, bankers stressed the real estate expertise of the bank.*** Since the advisory fee received by the bank was based on the amount of the REIT's assets, banks sought to swell the size of their REITs by causing them to borrow excessively and to make loans without

---

* "The REITs sponsored by banks were usually merely a transfer of the bank's real estate people and activities to a separate corporate entity, which proceeded with common officers, often common facilities, and often common clientele and ventures." Schotland, supra, at 271.

** "Stockholder reaction at the meeting was typified by the observation of a Milwaukee attorney who invested in the trust's stock when all signs pointed up. 'I got in,' he said 'because this was being run by First Wisconsin and I felt they were a good, orderly investor-minded organization.'" "Banks are Declared Key to Relief for 'Very Sick' First Wisconsin REIT", American Banker, April 22, 1975, p. 1, col. 2.

"And justified or not, the feeling may also exist that if a REIT runs into difficulties, the bank will stand behind it, rather than jeopardizing the bank's name." Schulein, "Recent Developments in the REIT Industry", Federal Reserve Board Bank of Boston, New England Economic Review, September-October 1972, at 10.

*** "Becoming an advisor to Chase Manhattan Mortgage and Realty Trust was the logical extension of our current activities. Chase is the largest national originator of construction and development loans and has considerable experience in making equity real estate investments." Stephen R. Downes, Assistant Treasurer, The Chase Manhattan Bank, N.A., "Why Chase Manhattan Sponsored a Real Estate Investment Trust", Trust and Estates (1970) p. 1026 at p. 1027.

adequate review.* Ironically, these practices endangered banks which had made unwise loans to their REITs.** At least one major bank's failure to make adequate reserve provisions for write-downs and losses was allegedly due to its desire not to lower the advisory fee paid by its REIT.*** However, the conflicts of interest between banks and their REITs went well beyond the area of advisory fees. Loans that were too risky for a bank were simply passed on to its captive REIT.**** It has been alleged that banks dumped bad loans on their REITs.***** Similarly, loans which the bank itself

* "With fees based on the gross amount of money loaned, advisers had every incentive to encourage trusts to leverage their assets by borrowing." Robertson, "How the Bankers Got Trapped in the REIT Disaster", Fortune, March 1975, 113 at 168.

"During this period of rapid growth, most trust advisers were compensated according to the asset size of their REIT. The greater the level of mortgage investments, the greater the fee." G. N. Buffington, Executive Vice President and General Counsel of the National Association of Real Estate Investment Trusts, address to the Association of Reserve City Bankers, March 20, 1975.

"But in its haste to grow, sources at First Wisconsin say, an inexperienced staff often made loans with only cursory examination of such things as developers' financial status and project plans.
'The trust would throw some kid into the room with a big-time developer like (Walter J.) Kassuba, who knew exactly what he wanted, and the kid would be overwhelmed,' one source says." "Too Much Too Soon: How 2 Realty Trusts Gave Backers Big Gains - And Then Big Losses", Wall Street Journal, March 14, 1975, p. 1, col. 6.

** "Bankers Gain From Insider Deals", Washington Post, February 15, 1976, p. 1, col. 1.

*** "Falling Out: Real Estate Trusts Feud With Advisers Over Their Obligations", Wall Street Journal, March 13, 1975, p. 1, col. 6.

**** "The problem was aggravated when bankers connected with REITs received loan requests from developers. 'You come in with a loan, and where is it going to go?' says Joseph W. Barr, former chairman of American Security. 'If it's a good loan, it goes to the bank. If it's not, it goes to the trust.'" "Bankers Gain from Insider Deals", Washington Post, February 15, 1976, p. 1, col. 1.

"Bankers, who might have injected an element of prudence along the way, didn't. Indirectly, through the REIT mechanism, they made loans for projects they would never have financed directly...." Robertson, supra, at p. 113.

***** American Banker, supra, at p. 1, col. 2.

was precluded from making were passed on to the REIT, thereby complementing the bank's own real estate activities and keeping the bank's customers happy.* A recently settled SEC proceeding alleged that a REIT had extended loans in which its bank adviser had a pre-existing interest.** Banks also profited from the use of the "float" created by the REITs' loans to developers.*** In addition, banks earned commissions on the placement of REIT loans, received fees as the REITs' transfer agents, registrars and dividend agents, and lent immense sums to their captive REITs, thereby producing

---

* "Last year was real evidence of things to come regarding the future, when without curtailing any of our Real Estate and Mortgage Loan Department lending activities, we had to turn down over one billion dollars in prime construction and development loan opportunities because the funds were not available." Downes, supra, at p. 1027.

"Sponsoring a REIT enables a commercial bank to bypass indirectly a number of restrictions which may hamper its acquisition and lending of funds. For example, during the past tight money period a REIT could sell commercial paper without an interest-rate ceiling, while banks were subject to ceilings. Thus, a bank may want to sponsor a REIT in order to assure its customers of a source of real estate funds." Schulein, supra, at 10.

** SEC v. Southern Realty Investors, BNA Daily Report for Executives, April 24, 1978 at p. A-8.

*** "For example, if a trust was lending $20 million to a contractor, and a check was issued by the adviser's bank on Friday, the check mightn't clear until the following Wednesday, giving the bank six days of interest on the check's 'float'". "Falling Out: Real Estate Trusts Feud With Advisers Over Their Obligations", Wall Street Journal, March 13, 1975, p. 1, col. 6.

interest income and compensating deposits for the bank, and expanding the REIT asset base used to calculate the bank's advisory fee. When banks reached their own lending limits, additional money was lent by the parent holding company, a practice apparently permitted under banking law.* Banks made preferential loans to REITs controlled by the banks' own officers and directors; the REITs in turn gave fees and loans to the insiders, and postponed payments on their delinquent loans.** Ironically, practically all of these abuses had been predicted in advance by the Chairman of the House

---

* Keefe, Bruyette & Woods, supra, at p. 65.

** "Riggs National Bank and Madison National Bank have loaned more than $9 million, often at preferential interest rates, to a real estate investment company controlled by the two banks' key officers and directors.

"The money from the banks has been used in part by the Riggs and Madison officers and directors to give themselves millions of dollars in fees and loans from the real estate investment firm, Mortgage Investors of Washington.

"Some of the loans have not been repaid on time and, rather than foreclosing on themselves, the Riggs and Madison officers and directors have postponed dates when the loan payments are due. In some instances, they have reduced the interest charges on the loans." "Bankers Gain from Insider Deals", Washington Post, February 16, 1976, p. 1, col. 1.

Banking and Currency Committee, * but neither the banks nor the bank regulatory agencies took any steps to prevent their occurrence.

When the speculative real estate bubble of the early 1970's inevitably burst, bank-sponsored REITs and their shareholders suffered the consequences of these abuses. As one observer concluded: "Unfortunately, all too often the REIT for a variety of reasons became uncommonly venturesome, and as is hardly surprising when bankers become uncommonly venturesome, disaster ensued."** Although we cannot distinguish between bank-sponsored REITs and others, at least seven REITs have gone into bankruptcy; another 11 have failed to pay interest on their subordinated debt, much of which was sold to public investors; over 40 REITs have nominal or negative net worth; and another 19 apparently have been kept afloat by interest rate concessions from their banks. The "deeply troubled" REITs owe over $8.8 billion, $7 billion of it to the banks.*** More importantly, the bank REIT debacle became a disaster for the banks themselves. At least two banks failed when they sought to bail out REITs.**** "We have seen banks across the nation suffering declines in their holding companies' earnings, and almost certainly disproportionate declines in their stock prices and their ability to raise sorely needed capital for the banks, because of the REIT disaster."***** Chase Manhattan

* Patman, "Banks and Real Estate Trusts: New and Dangerous Extension of Banking Power", Congressional Record, July 15, 1970, p. 24532.

** Schotland, supra, at 271.

*** Kenneth D. Campbell, "Background of the REIT Industry", Practicing Law Institute, REIT Restructuring, at pp. 11, 15 (May-June 1977); Glatt and Miller, "The Real Estate Debtor or REIT and the Bankruptcy Act," id. at pp. 99, 147-152; and "Rise in Property Aiding Recovery of Real Estate Investment Trusts", New York Times, January 23, 1978, at pp. D1, D3.

**** Schotland, supra, at 273.

***** Ibid, at 271-72.

Bank was placed on the Comptroller's secret list of problem banks, largely due to loans to its REIT. * The holding company for Chemical Bank was forced to call off a proposed public offering of its securities due to investor concern over the bank's loans to REITs. ** Investment bankers warned investors against purchasing bank stocks generally as a result of the REIT problem, *** and particularly warned against purchasing stock in banks who sponsored REITs. ****

When their REITs began to founder, the banks had little choice other than to attempt rescue missions. As major lenders to REITs the banks obviously wished to avoid bankruptcy proceedings. Further, since the original promotion of bank REITs had intentionally blurred the distinction between the bank and the REIT, the banks had to act to protect their own names and reputations. ***** The banks had also entered into so many questionable transactions with their captive REITs that there was the

---

* "[O]ne of the largest loans classified by examiners early last year at Chase was $140 million to Chase Mortgage and Realty Trust." "Citibank, Chase Manhattan on U. S. 'Problem' List", Washington Post, January 11, 1976, p. 1, col. 1.

** "Chemical Bank Parent Cancels Debt Sale Due to Investor Concern Over REIT Loans", Wall Street Journal, March 31, 1975, p. 3, col. 2.

*** See, e.g., "Bank Loans to REITs: Problems and Prospects", Drexel Burnham & Co. (1975) at p. 1: "Accordingly, we maintain our very cautious approach to bank stock investing. We would, likewise, refrain from purchasing any bank stocks until the threat from the REIT situation appears to be dissipating; and further, if heavily invested in the bank group, we would advise lightening positions."

**** Keefe, Bruyette & Woods, supra, at p. 64.

***** "Concurring in this view is William Bateman, an executive vice president of Chase Bank, 'We're not anxious to see anything with the name Chase Manhattan in bankruptcy anywhere,' he says." "Too Much Too Soon: How 2 Realty Trusts Gave Backers Big Gains - And Then Big Losses", Wall Street Journal, March 14, 1975, p. 1, col. 6.

"'[I]t is hard to imagine the world's third largest bank [Chase Manhattan] letting a REIT that shares its name go down the drain.' [quoting Business Week] Kinship is a strong bond, and so the Chase lent its wayward child nearly the maximum amount allowed by law." "Bad Investments", New Republic, April 19, 1975, p. 8.

likelihood that a REIT bankruptcy would result in REIT shareholders suing the bank.* One expert referred to this problem as the "virtual open-ended liability for those holding companies who have sponsored REITs."** On top of all this, the Federal Reserve Board pressured the banks to "bail out" their REITs out of fear that REIT failures would lead to a "financial panic"*** and would endanger "the stability of the financial system."**** The big banks, which had the greatest exposure, in turn put heavy pressure on smaller banks to go along.*****

* Keefe, Bruyette & Woods, supra, at p. 69.

"Also, industry observers said, if the bank didn't act and the trust's problems worsened, the bank as the trust's adviser could be exposed to lawsuits by the trust's noteholders and shareholders accusing it of mismanaging the trust's affairs." "Chase Manhattan REIT to Propose Plan for Dealing With May 1 Default on Notes", Wall Street Journal, May 22, 1978, p. 8, col. 2.

** Keefe, Bruyette & Woods, supra, at p. 70.

*** "Another reason the banks helped out the REITs is that they were told to do so by the government. Former member of the Federal Reserve Board Andrew Brimmer testified to this fact in February. He told the House Banking Committee that the Fed asked banks to lend money to the REITs last summer. Brimmer said that he and other Fed members felt that was a necessary action. At the time, the real estate investment trusts were in a great deal of trouble. The Fed's directors thought a series of REIT failures might start a financial panic, and to prevent that from happening, they engineered a rescue of the REITs. Now the banks are stuck with the consequences." New Republic, supra.

**** Statement of Former Federal Reserve Board Chairman Arthur F. Burns, quoted in Robertson, supra, at p. 113.

***** Ibid, at p. 172. Despite these statements by members of the Federal Reserve Board, the banks state "[W]e are aware of no evidence that public confidence in banks is significantly adversely affected by the present condition of bank-advised REITs." Response of the American Bankers Association to "The Securities Activities of Commercial Banks Study Outline" of the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs, May 1976, at p. 62.

However, the banks' efforts to bail out their REITs through such devices as increased lines of credit, revolving credit agreements by bank syndicates, interest rate reductions or total forbearance, and particularly bank acquisition of REIT loans and properties, imperiled the banks themselves. In one expert's words: "[T]he extent to which some bank holding companies have already gone to aid their REITs is far beyond the normal bounds of the traditionally conservative American Banking Industry.... Thus, we as bank shareholders may be in the position of absorbing some of the risks originally intended to be borne by REIT shareholders."* At least two bank holding companies failed when they sought to rescue their REITs.** In an attempt to save its REIT from bankruptcy, Chase Bank purchased from its REIT $160 million of loans, which "nobody else would buy on the terms the Chase Bank gave."*** The holding company and affiliated subsidiaries of First Wisconsin National Bank entered into similar transactions with its REIT.**** This has led to concern that the banks are exposed to suit by their own shareholders.***** In the midst of this crisis, the bank

* Keefe, Bruyette & Woods, supra, at p. i.

** "[A] small BHC in Florida and a major one in Tennessee failed during that period as a result of exposure to bad real estate loans which had been held originally by mortgage banking affiliates but which at the end, in unsuccessful 'work-out' efforts, were loaded into the affiliated banks." Schotland, supra, at 247.

*** Ibid, at 272.

**** "The holding company and two of its subsidiaries agreed to purchase $18.8-million in loans from the REIT at face value, despite the belief that these loans included principle losses of as much as $4.5-million. In addition, the corporate group agreed to reimburse the REIT, up to $5.5-million, for all principle losses above $7-million." "First Wisconsin's Gloomy Outlook", Business Week, August 3, 1974, at 43.

***** "If the banks did go to the trust's rescue, asked a REIT industry observer, 'to what extent could it be held liable by its shareholders' if the trust didn't recover and the bank lost its investment?", "Chase Manhattan REIT to Propose Plan For Dealing With May 1 Default on Notes", Wall Street Journal, May 22, 1978, p. 8, col. 2.

regulatory authorities sought to shield the public from the facts.* After reviewing the banks' rescue attempts, one observer warned: "[I]t is certain, however, that America's last experience with a pattern of banks coming to the aid of troubled affiliates revealed such abuses as to lead to the Glass-Steagall Act of 1933, separating commercial from investment banking."**

It cannot be emphasized too strongly that the bank REIT disaster occurred despite the fact that the Glass-Steagall Act prevented the banks from distributing shares of their REITs to the public. The debacle occurred because, even as mere "investment advisers" to REITs, banks had a "salesman's stake" in the success of the enterprise. Simply put, the banks had myriad incentives to swell the size of their REITs - in order to earn higher advisory fees; in order to receive greater interest payments and compensating balances; in order to generate placement commissions; in order to receive greater transfer agent, registrar and dividend agent fees; in order to increase the size of the "float"; and in order to meet the demands of borrowers who were judged too "risky"

* "The prospect of bank losses on loans to REITs and on property being taken over unnerves federal banking regulators. They fear that too much disclosure of the dangers would touch off runs on banks and shake the nation's financial structure. "'To overemphasize disclosure of (bank) losses could jeopardize... investor confidence... and thus bring on sizeable deposit outflows, especially of impersonal money-market funds', Federal Reserve Board member Philip E. Coldwell warned the Senate banking committee last year." "Discarding Losers: Realty Trusts Raise Cash, Repay Bankers by Giving Up Assets", Wall Street Journal, January 5, 1976, p. 1, col. 8.

** Schotland, _supra_, at p. 273. Despite these facts, the banks still maintain that "Banks, for the most part, have treated REIT loans just as all other loans, and it is merely a happenstance of the economy that a number of these loans have become problems". Response of the American Bankers Association, _supra_, at p. 57.

for the bank itself. While the bank REIT disaster originally only threatened the captive bank REITs and their shareholders, it inevitably spread to the banks themselves, thereby shaking the entire national banking system to a degree which has not occurred since the early 1930's. The bank REIT debacle has made it clear that interpreting the Glass-Steagall Act to permit banks to serve as "mere" advisers to REITs produces the very types of hazards which the Supreme Court enumerated in the Camp case. *

We believe that these hearings afford the opportunity to prevent a reoccurrence of the bank REIT debacle. Specifically, we urge this Committee to report out legislation which will make it absolutely clear that bank holding companies and commercial banks are precluded, not only from distributing REIT securities to the public, but from serving as "investment advisers" or "financial advisers" to REITs.

Further, we urge the enactment of legislation which will make it absolutely clear that bank holding companies and commercial banks cannot sponsor, organize or advise either closed-end investment companies or mutual funds. As set forth in the earlier part of our testimony, the Federal Reserve Board's regulations permitting these activities are a clear attempt to circumvent the Glass-Steagall Act and the Supreme Court's decision in Camp. These activities present the very same

* The banks take the view that "The effect of the Glass-Steagall Act in this area is to prevent banks from selling a REIT's shares to the public.... Banks and bank affiliates that serve as advisers to REITs do not publicize, distribute or sell shares in the REIT." Response of the American Bankers Association, supra, at p. 55.

dangers that the Supreme Court recited in connection with bank sponsorship of mutual funds, and which have recently occurred in connection with bank sponsorship of REITs. Indeed, we believe that the only reason that bank managed investment companies have not produced a disaster similar to that generated by bank REITs is the fact that, to date, most bank-advised investment companies have invested in debt securities. We submit that if the banks had operated equity funds over the last decade, we might very well have witnessed a financial crisis far eclipsing the bank REIT debacle. *

Finally, we believe that these hearings offer the opportunity for the Congress to take measures regarding bank-sponsored common trust funds and collective pension funds.

BANK COMMON TRUST FUNDS AND COLLECTIVE PENSION FUNDS

We previously discussed bank common trust funds, which were first authorized by the Federal Reserve Board in 1937. Since 1962 they have been under the jurisdiction of the Comptroller of the Currency, whose regulations provide that funds held by a national bank as fiduciary may be invested collectively "in a common trust fund maintained by the bank exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank in its capacity as trustee, executor, administrator,

* In a recent article, Federal Reserve Board Governor Henry R. Wallich stated: "Then came the recession of 1974, which brought serious losses. At that time, newly established bank holding companies had been extending their operations into new areas of financial activity, such as mortgage banking, consumer finance, and advising and financing real estate investment trusts. The holding companies' experience in many cases was sufficiently adverse to justify the conclusion that the banks were fortunate not to have been burdened, at the same time, with securities affiliates. In 1974, Glass-Steagall stood the banks in good stead". Wallich and Harvey, "Reflections on Glass-Steagall", Bankers Magazine, March-April 1978, at p. 9.

guardian or custodian under a uniform gifts to minors act".* The Comptroller's regulations prohibit all advertising, other than providing that the fact of the availability of the common trust fund's annual financial report "may be given publicity solely in connection with the promotion of the fiduciary services of the bank".** At the end of 1975, 805 banks operated 1,915 common trust funds with assets of $17.8 billion.***

In addition to operating common trust funds, banks also manage another form of collective fund -- pooled pension funds. They were first permitted by the Federal Reserve Board in 1955.**** The Comptroller's present regulations provide that funds held by a national bank as fiduciary may be invested "[i]n a fund consisting solely of assets of retirement, pension, profit-sharing, stock bonus or other trusts which are exempt from Federal income taxation under the Internal Revenue Code".***** Whereas the Comptroller's regulations do not permit banks to advertise the investment performance of bank common trust funds, this ban does not apply to pooled employee benefit funds.******

* 12 C.F.R. §9.18(a)(1) (1977).

** 12 C.F.R. §9.18(b)(5)(iv) and (v) (1977).

*** SEC Final Report on Bank Securities Activities, at 149 (1977).

**** 30 Fed. Reg. 3305 (1955).

***** 12 C.F.R. §9.18(a)(2) (1977).

****** 12 C.F.R. §9.18(b)(5)(iii) (1977).

Indeed, as we will demonstrate later in our testimony, banks and bank holding companies advertise the investment performance of their pooled pension funds with a vengeance. At the end of 1975, the top 115 banks operated 465 pooled pension funds with assets of $21.5 billion.* Bank pooled pension funds can be expected to grow at a rapid rate as banks manage more and more pension assets.**

The Comptroller of the Currency has stated that the purpose of both bank common trust funds and bank collective employee benefit funds is to provide diversification of investments for small trusts and pension plans and to reduce costs and fees to the various participants.*** Indeed, common trust funds and collective employee benefit funds are used by smaller trusts and employee benefit plans. For example, whereas the average separately managed employee benefit plan at the top 115 banks had

* SEC Report, supra, at 154.

** Bank-managed pension assets have grown from perhaps $5 billion in 1950 to $134.5 billion in 1972. In 1972, the ten largest banks held twice as many assets in pension funds as in personal trust accounts. Herman, "Conflicts of Interest: Commercial Bank Trust Departments", at 17 (1975). Employee benefit plans are the fastest growing component of bank trust department assets. Loomis, "How the Terrible Two-Tier Market Came to Wall Street", Fortune, July 2, 1973, at 126.

*** "The Federal Reserve Board, which administered this statute from 1913 until 1962, allowed national banks holding trust funds or pension, profit-sharing, or stock bonus plan funds to pool such funds together when authorized to do so by the governing instrument or by local laws. The commingling of such funds allowed sharing of administration expenses among the funds so pooled, thus reducing the service and management fees charged by the bank to each individual fund, and also allowed the diversification of assets required for a sound investment program." Brief for the Comptroller of Currency in Opposition to a Petition for a Writ of Certiorari, in Investment Company Institute v. Camp, at p. 3 (December 1969). (Footnotes omitted).

assets of $2,796,585 at year-end 1975, the average employee benefit plan in these same bank's pooled funds had assets of only $254,631.*

Recent studies indicate that many of the abuses which occurred in the 1920's in connection with bank-sponsored investment companies and in the 1970's in connection with bank-sponsored REITs, are taking place today with respect to bank common trust funds and collective pension funds.** More importantly, in recent years, the banks and bank regulatory authorities have repeatedly sought to convert bank common trust funds and collective pension funds into mass-marketed investment vehicles offered to the general public. Indeed, the Supreme Court's decision in Camp arose out of the Comptroller's attempt to convert common trust funds into publicly-offered mutual funds. However, the decision in Camp has not deterred either the banks or the bank regulators from seeking to convert both common trust funds and pooled pension funds into general investment vehicles. For example, The First National Bank of Chicago currently proposes to establish a "common trust fund" which will be sold to credit unions. There are approximately 22,600 credit unions in the country. The Deputy Comptroller of the Currency has advised the bank that the proposed fund will be in compliance with the

* SEC Report, supra, at pp. 145 and 154.

** For example, there is evidence that banks accede to demands of important commercial customers for priority positions in the allocation of investment opportunities. Herman, supra, at 61. There is also evidence that undesirable securities issued by favored bank customers are placed in pooled funds. Ibid, at 62-63. An investment officer of a national bank recently alleged that the bank's common trust fund had purchased securities which increased in value and which were then transferred at their original cost to other accounts. "Hamar Case: Did the Bank Regulators Fail in Their Duties", New York Times, April 10, 1978, p. D1, col. 2. The recent SEC Report on Bank Securities Activities indicates that these are not isolated cases. SEC Report, supra, at 198-99.

Comptroller's regulations relating to common trust funds.* The Comptroller did this despite the fact that the credit unions have no traditional trust relationship, in fact no relationship at all, with the bank.** The Comptroller has taken similar action with respect to bank collective pension funds. The Deputy Comptroller has advised Continental Illinois Bank that Regulation § 9.18(a)(2) will be available for a bank fund to be offered to potential participants in Individual Retirement Accounts ("IRAs").*** IRAs are intended for the 40 million Americans who are not covered by employer-sponsored retirement plans and annual contributions are limited to $1,500 a year ($1,750 in the case of an eligible participant and a non-working spouse). Since the Comptroller's regulations relating to collective pension plans do not prohibit advertising of performance, the Comptroller's action would permit the aggressive mass-merchandizing of interests in bank pooled IRA funds to millions of small individual investors.****

*Letter dated June 16, 1976 from Deputy Comptroller Dean E. Miller to Helen J. Hahne, Vice President Legal of The First National Bank of Chicago.

** The bank has submitted an application to the Securities and Exchange Commission requesting a complete exemption for the fund from the Investment Company Act of 1940 on the basis that it is a common trust fund and hence exempt from that Act by reason of Section 3(c)(3). The SEC has ordered a hearing on the matter and the Institute is participating in opposition to the requested exemption.

*** Letter dated February 20, 1975, from Deputy Comptroller Dean E. Miller to Charles W. Petty, Jr., of Mayer, Brown & Platt.

**** The bank filed an application with the SEC seeking an exemption of its proposed IRA fund from the Investment Company Act. (Inv. Co. Act Rel. No. 9462, September 29, 1976). However, the bank withdrew its application after the Institute requested a formal hearing. (Inv. Co. Act Rel. No. 9611, January 17, 1977). Earlier this year the Colorado State Bank of Denver filed a similar application with the SEC and the Institute has requested a hearing.

However, these developments relating to specific banks are far eclipsed by the efforts of banks and bank holding companies all across the country to aggressively mass merchandise interests in their collective pension funds to hundreds of thousands of investors. We have with us today copies of ads currently being published by banks in newspapers and magazines which reach hundreds of thousands of small plans. As you will note, the ads do little more than trumpet the collective funds' investment performance, and make practically no mention whatsoever of the banks' fiduciary expertise. The Fifth Third Bank of Cincinnati's headline is "Entering Our Second Decade of Outperforming the Dow Jones." Hibernia National Bank's headline states that it is "#1". The National Bank of Detroit's ad consists of a 10-year chart comparing the performance of its commingled equity funds with the Becker Median. (We note that mutual funds are totally precluded under the federal securities laws from advertising their investment performance in newspaper ads: a mutual fund can only set forth its performance in material which is accompanied or preceded by a full statutory prospectus).

What is more, the banks have carefully selected the time periods used in their ads, presumably so that they can select the periods of their best performance. The Fifth Third Bank of Cincinnati uses one year and unabashedly speaks of "our consistency of performance". The National City Bank of Cleveland uses 1, 2 and 3 years. Marine Midland uses 1, 3 and 5 years. The First National Bank of Birmingham uses 1 and 5 years. Hibernia and Continental use 5 years. The First National Bank & Trust Company of Tulsa uses 7 years, and the National Bank of Detroit uses 10 years. On top of all this, the banks have selected the particular market index which best suits their needs. The

National Bank of Detroit, The First National Bank & Trust Company of Tulsa and the National City Bank of Cleveland use Becker. Marine Midland uses Pensions & Investments' Performance Evaluation Report. The Fifth Third Bank of Cincinnati uses the Dow Jones and Standard & Poor's. The First National Bank of Birmingham only uses Standard & Poor's. Hibernia uses three yardsticks not used in any other ad.

What must be emphasized is that these aggressive ads are aimed at small unsophisticated employee benefit plans. There are over 800,000 employee benefit plans in the country with fewer than 100 participants.* As the recent SEC Bank Report demonstrates, interests in bank collective employee benefit funds are purchased by the smaller, less sophisticated plans. The SEC Report found that at the end of 1975, over 84,000 plans were invested in pooled funds operated by the top 115 banks. The average account size was only $254,000. In the smaller 550 banks the average account size was less than $40,000.**

*There are fewer than 27,000 plans with over 100 participants. Figures based on information provided to us by the Internal Revenue Service Employee Plans Operations Branch.

** SEC Report, supra, at 154.

We believe that the mass-merchandizing of interests in bank collective employee benefit funds through aggressive advertising campaigns aimed at smaller, unsophisticated, employee benefit plans constitutes a clear violation of the Glass-Steagall Act. In the Camp case, when the Supreme Court struck down the attempt by banks to operate commingled agency accounts, it repeatedly stressed the promotional and merchandising nature of the venture as contrasted with the simple commingling of assets which the bank "has received for a true fiduciary purpose rather than for investment":

> "These activities, unlike the operation of an investment fund, do not give rise to a promotional or salesman's stake in a particular investment; they do not involve an enterprise in direct competition with aggressively promoted funds offered by other investment companies; they do not entail a threat to public confidence in the bank itself; and they do not impair the bank's ability to give disinterested service as a fiduciary or managing agent. In short, there is a plain difference between the sale of fiduciary services and the sale of investments." *

When one views bank and bank holding company advertisements for collective employee benefit funds which are aimed at hundreds of thousands of small plans, and which tout investment performance with scarcely a word about fiduciary expertise, it is not difficult to believe that the banks are merchandising interests in these funds in violation of the Glass-Steagall Act.

---

* ICI v. Camp, 401 U.S. 617 (1971). The leading commentators on the Camp case emphasize the fact that the decision turned on the promotional and merchandizing nature of commingled agency accounts, as opposed to traditional trust activities. "Whatever might be said about the factual validity of the Supreme Court's distinction in Camp between commingled agency accounts and other bank-sponsored investment management arrangements, the Court did attempt to tie security status to concern over the methods of promotion banks might adopt." (Footnote omitted). Bines, The Law of Investment Management ¶3.03[2][b] at p. 3-65 (1978). "[T]he key difference under the Glass-Steagall Act, as interpreted by the U. S. Supreme Court, between traditional trust department advisory activities, and other investment management services must thus be the manner of offering advisory services." Lybecker, "Bank-Sponsored Investment Management Services: A Legal History and Statutory Interpretative Analysis-Part 2", 5 Securities Regulation Law Journal 195, at 223 (Autumn 1977).

However, a determination of this issue could only be achieved through protracted and costly litigation. We believe that the introduction of S. 72 provides Congress with the opportunity to end the very real possibility that bank promotion of collective pension funds will eventually result in a financial crises similar to that created by bank sponsorship of investment companies in the 1920's and bank sponsorship of REITs in the 1970's.

In recent years there have been numerous studies relating to the conflicts of interest which inevitably arise from the combination in one bank or in one bank holding company complex of both commercial lending activities and general trust activities. * Some experts have concluded that the conflicts are so great as to call for a complete separation of these two functions. ** If Congress decides not to require

---

* See, e.g., Herman, "Conflicts of Interest: Commercial Bank Trust Departments" (1975); Herman and Safanda, "The Commercial Bank Trust Department and the 'Wall'", 14 Boston College Industrial and Commercial Law Review 21 (1972); Hunsicker, "Conflicts of Interest, Economic Distortions, and the Separation of Trust and Commercial Banking Functions", 50 Southern California Law Review 611 (1977); Lybecker "Regulation of Bank Trust Department Investment Activities", 82 Yale Law Journal 977 (1973); Lybecker, "Regulation of Bank Trust Department Activities: Seven Gaps, Eight Remedies", 90 Banking Law Journal 912 (1973); SEC Final Report on Bank Securities Activities (1977); and "Financial Institutions: Reform and the Public Interest", Staff of the Subcommittee on Domestic Finance of the House Committee on Banking and Currency, 93d Cong., 1st Sess. (Committee Print 1973).

** See, e.g., Hunsicker, supra.

a complete separation of commercial bank activities and trust activities, there will still remain the question of whether commercial banks and bank holding companies should continue to be permitted to operate common trust funds and collective employee benefit funds. There may well be valid reasons for the continued existence of these vehicles, provided they are only used for their original purpose -- in the words of the Comptroller -- to allow "sharing of administration expenses among the funds so pooled, thus reducing the service and management fees charged by the bank to each individual fund, and also... [to allow] the diversification of assets required for a sound investment program."*

However, banks and bank holding companies should not be permitted to mass-merchandise interests in common trust funds and collective pension funds to the public as a whole or to vast categories of public investors, such as employee benefit plans, credit unions and participants in individual retirement accounts. Specifically, we request this Committee to report out legislation which makes it absolutely clear than banks and bank holding companies may only sell interests in common trust funds to traditional personal trust accounts and may only sell interests in collective pension funds to large and medium-size corporate plans (and not to individual retirement accounts, Keogh plans and small corporate plans). In addition, the legislation should make it clear that banks and bank holding companies are absolutely prohibited from merchandizing

* Comptroller's Brief, supra, at p. 3.

and advertising these vehicles. It is clear that these matters cannot be left to the bank regulatory authorities. As we have demonstrated, they have not limited the use of common trust funds and collective pension funds to their original legitimate purposes, but rather have encouraged their expansion into publicly-offered investment vehicles and have sanctioned the crudest types of mass advertising campaigns aimed at unsophisticated investors. We fear that if Congress fails to act in this area, bank sponsorship of common trust funds and collective pension funds ultimately will result in a financial crisis similar to that caused by bank sponsorship of securities affiliates in the 1920's and bank sponsorship of REITs in the early part of this decade.

CONCLUSION

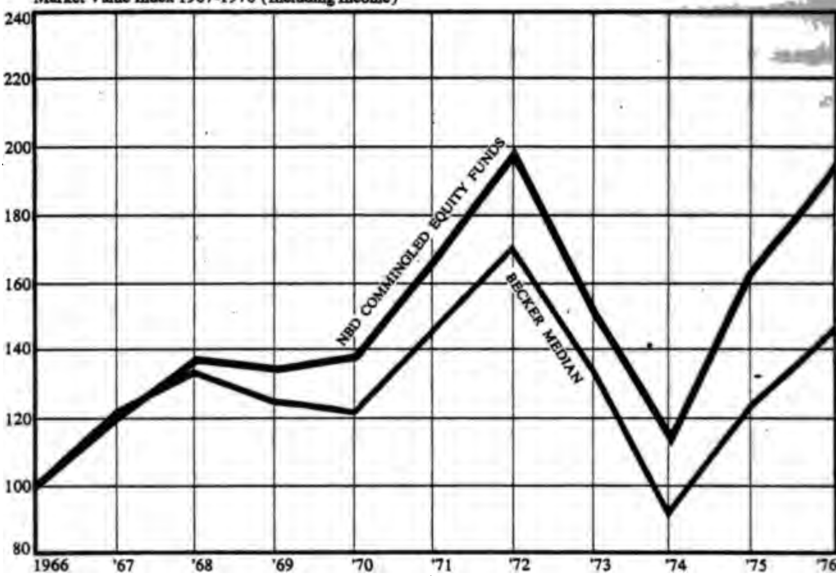
For over 100 years, Congress has sought to prevent commercial banks and their affiliates from engaging in the general securities business out of concern that such activities inevitably will result in economic disaster for the banks and the nation as a whole. Congress' concerns have been amply justified by events, most recently by the crises which resulted from bank sponsorship of securities affiliates in the 1920's and from bank sponsorship of REITs in the early 1970's. Yet, the banks and the bank regulatory authorities have repeatedly sought to subvert Congress' intent, for example: by banks forming securities affiliates in the early 1900's in order to circumvent The National Banking Act; by the Comptroller's lobbying in the 1920's to permit banks to underwrite securities; by the Comptroller's efforts in the 1960's to authorize banks to sponsor mutual funds; by bank sponsorship of REITs in the early

1970's; by the present mass-merchandizing of interests in bank collective pension funds; and by the current efforts to repeal the Glass-Steagall Act and return to the dangerous pattern of the 1920's.

We believe that these hearings afford Congress the opportunity to categorically reaffirm the historic national policy that prohibits commercial banks and bank holding companies from engaging in the general securities business. Over 100 years of experience indicates that this matter is far too important to be left to the business judgment of the banks or to the administrative discretion of the bank regulatory authorities.

Read between the lines.

Market Value Index 1967-1976 (Including Income)



OVER THE LAST DECADE, THE NATIONAL BANK OF DETROIT COMMINGLED EQUITY FUNDS HAVE OUTPERFORMED 97% OF THE BECKER UNIVERSE.

THIS RECORD IS A RESULT OF:

- Consistently superior performance from peak to peak, trough to trough, and over full market cycles.
- A uniquely disciplined approach to investment research and portfolio construction, utilizing modern asset valuation technology.

For some fascinating details on this process, and how it can benefit you, please contact RICHARD L. FOERSTERLING, Vice President, Trust Investment Department, National Bank of Detroit (313) 225-2820.

NBD Trust Division
National Bank
of Detroit

INSTITUTIONAL INVESTOR, NOVEMBER 1977

Active investing in the fixed-income market makes sense and money.

Becker

FUNDS EVALUATION SERVICE

INTERIM REPORT

NATIONAL CITY BANK • CLEVELAND, OHIO
NATIONAL CITY BANK INVESTMENT FUND FOR RETIREMENT TRUST – FIXED INCOME

TIME-WEIGHTED RATES OF RETURN AND RANKINGS
PERIODS ENDED JUNE 30, 1977

YOUR FUND W1298	12 MONTHS PERCENT		24 MONTHS PERCENT		36 MONTHS PERCENT	
FIXED INCOME	RATE	RANK	RATE	RANK	RATE	RANK
YOUR FUND	13.2	12	12.5	10	11.9	11
MEDIAN	10.4		9.8		9.7	

This rate of return was accomplished through efficient management of our $129 million Fixed Income Collective Fund for Retirement Trusts without impairing the quality of the portfolio. 98.45% of the market value is in Governments, Agencies and AAA Corporate Bonds. We feel this is the type of bond management you should be looking for. For further information or to arrange for a fact finding presentation, call (216) 861-4900 or write the Trust Group, New Business Division, National City Bank, 623 Euclid Avenue, Cleveland, Ohio 44114.

National City Bank
Cleveland • Ohio

INSTITUTIONAL INVESTOR, APRIL 1978

Hibernia National Bank

#1

Bank Equity Fund Manager for the five years ended December 31, 1977 as measured by Frank Russell Co., Inc.; Computer Directions Advisors, Inc.; and Rogers, Casey, & Barksdale, Inc.

For Information Contact:
Gregory N. Schedler, Trust Officer,
(504) 586-5767, Hibernia National Bank,
Post Office Box 61540, New Orleans, Louisiana 70161

HIBERNIA
NATIONAL BANK
Member FDIC

PENSIONS AND INVESTMENTS, APRIL 24, 1978

Entering our second decade of outperforming the Dow Jones.

Why move your money to one of the larger investment centers for long-term investment performance? You can stay close to home and receive the superior performance and administrative services you require!

Where? At The Fifth Third Bank in Cincinnati. While we don't have an address in the heart of a major money center, we do outperform the industry, year in and year out.

Again in 1977, The Fifth Third Bank Trust Department has outperformed the Dow Jones and Standard and Poor's 500 averages!

Our consistency of performance has a lot more to do with philosophy than geography. And our philosophy can work anywhere. For anyone.

We maintain the flexibility needed to anticipate the market. Our size makes it easier to be responsive to the needs of customers, and we provide personal attention on an ongoing basis.

Are your funds performing as well as ours? If not, you may want to find a new home for your pension and profit sharing investment within the Trust Management Division of The Fifth Third Bank in Cincinnati.

Get complete performance information from Bob Mitchell, Trust Officer at (513) 579-5684.

FIFTH THIRD BANK

Cincinnati, Ohio

© The Fifth Third Bank, 1978

Better things happen with Fifth Third Trust.

Member FDIC/
Federal Reserve System

Your fixed-income fund has got to deliver superior results.

Year. After year. After year.

We'll find a way.

It's a matter of record.

Each $1000 invested in our Fixed-Income Employee Benefit Fund just five years ago has a compounded value of $1461 today. Check our performance over any time period. With any evaluation service.

This is no guarantee of future success. It's an indicator that sound investment strategies and decisions can deliver outstanding results.

We specialize in fine tuning fixed-income employee benefit accounts for consistent performance, with low volatility through market cycles, to produce the superior results you're looking for.

Put our fund to work for you. Or let us tailor an actively managed fixed-income portfolio to your individual goals and objectives.

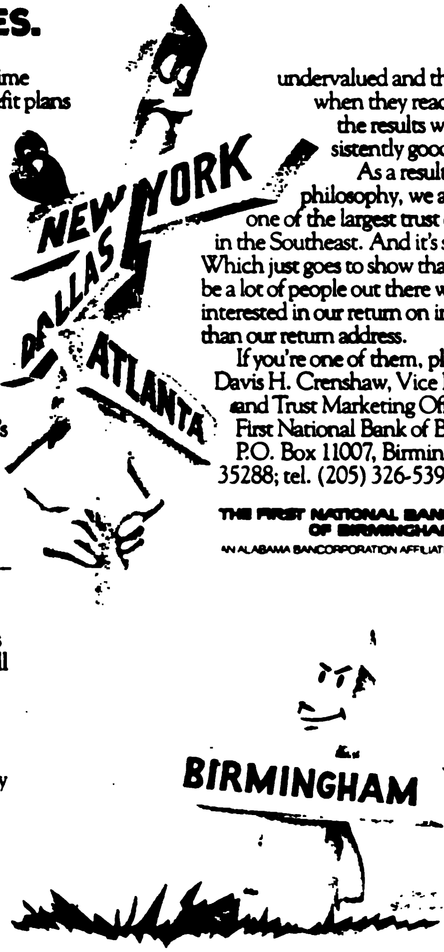
Call Tom Patterson, Vice-President, at 312/828-7001. We'll find a way.

CONTINENTAL BANK
TRUST AND INVESTMENT SERVICES

Continental Illinois National Bank and Trust Company of Chicago · 231 South La Salle Street, Chicago, Illinois 60693

PENSIONS & INVESTMENTS, APRIL 25, 1977

IT'S ABOUT TIME INVESTMENT MANAGERS WERE JUDGED ON THEIR SUCCESSES INSTEAD OF THEIR ADDRESSES.



In other words, it's about time that managers of employee benefit plans realized that you don't have to be located in one of the great investment centers to have a great investment record.

Take us, for example. The First National Bank of Birmingham. We're certainly not at the hub of the investment industry, yet our Trust Division has been outperforming the industry standards for years.

1972-76 is a good example. During that time, our Corporate commingled equity fund's rate of return was 7.9 percent versus only 4.9 percent for the Standard & Poor's 500. And for 1976 itself, our overall return was more than 14 points higher than the S&P–a hefty 38.5 percent.

How can a bank from Birmingham get this kind of results for its clients? Because despite all the myths and misunderstandings, it's still philosophy that determines investment success. Not geography.

And we have a philosophy that would be just as sound no matter where we had our office. Which is simply that if you consistently buy stocks that are undervalued and then sell them when they reach full value, the results will be consistently good.

As a result of this philosophy, we already have one of the largest trust departments in the Southeast. And it's still growing. Which just goes to show that there must be a lot of people out there who are more interested in our return on investment than our return address.

If you're one of them, please contact Davis H. Crenshaw, Vice President and Trust Marketing Officer, The First National Bank of Birmingham, P.O. Box 11007, Birmingham, Ala. 35288; tel. (205) 326-5397.

THE FIRST NATIONAL BANK OF BIRMINGHAM

AN ALABAMA BANCORPORATION AFFILIATE MEMBER FDIC

PENSION WORLD, NOVEMBER 1977

Your company's employee benefit plan can't profit from a bad fit.

Most money managers prefer that your company's pension or profit sharing plan be designed to fit one of their standardized investment programs.

At First of Tulsa, we don't think that's in your best interest. That's why we design our investment and administrative programs to fit your individual plan.

We're specialists in stocks, bonds, oil, real estate, and the complexities of ERISA. And regardless of the size of your trust, we analyze your particular requirements then tailor an investment and administrative program to meet the performance goals of your plan.

This flexibility has enabled First of Tulsa's investment record to rank in the top 12% of those money managers surveyed nationwide by the Becker Securities Corporation.*

For more information about how our administrative and investment capabilities can help your company (and you), call collect for John Heard at (918) 586-5384. Or write First of Tulsa today.

*Pooled equity fund for employee benefit accounts, equities only, 1-1-70 thru 12-31-76

TRUST FIRST TULSA

Your First Resource

First National Bank & Trust Company of Tulsa • Box One Tulsa, Oklahoma 74193 • 918/586-5384

PENSIONS AND INVESTMENTS, APRIL 24, 1978

EVEN IF YOUR PENSION FUND HAD A GOOD YEAR,

TELL IT TO THE MARINE

As good as our performance is, Marine Midland doesn't believe that performance is the only way to judge management. We believe there are other important issues to consider in addition.

That's why you should ask yourself these questions—even if your pension fund had a good year.

Does the performance run hot and cold as the market runs hot and cold?

Will the investment philosophy that worked in the past be flexible enough to work tomorrow?

Do you feel comfortable with the long-term goals set up for you?

Understanding this total picture is the way we approach pension funds. And it's paid off.

Marine Midland had the highest rate of return on a 5-year basis for collective equity funds among the largest 25 U.S. bank trust departments.[1]

We also ranked first in 1-year performance. And number seven in the 3-year category. (All periods ending 12/31/77.)[2]

In fact, Marine Midland is one of the few major investment managers whose collective equity fund has beaten the Standard & Poor's average over the last 5 years.

If you want the kind of performance that goes deeper than just a good rate of return, tell it to the Marine. Contact Mr. Robert L. Kuney, Vice President, Marine Midland Bank, 250 Park Avenue, N.Y., N.Y. 10017, telephone (212) 949-6511.

[1]*Trust Assets of Insured Commercial Banks*, Joint Publication of Comptroller of the Currency, FDIC, and Federal Reserve Board, latest issue.

[2]Pensions and Investments' Performance Evaluation Report (P.I.P.E.R.)—Comparative Data through 12/31/1977.

MARINE MIDLAND BANK

Buffalo, New York City ([illegible]), Beirut, Bogotá, Buenos Aires, Caracas, Frankfurt, Hong Kong, Jakarta, London ([illegible]), Madrid, Manila, Mexico City, Nassau, Panama, Paris, Rio de Janeiro, Rome, São Paulo, Seoul, Singapore, Sydney, Tehran, Tokyo, Toronto.

Investment Company Institute
1775 K STREET N. W., WASHINGTON, D C 20006
(202) 293-7700

March 21, 1978

The Honorable William Proxmire, Chairman
Committee on Banking, Housing and Urban Affairs
United States Senate, Suite 5300
Washington, D. C. 20510

Re: S. 72 - A Bill To Amend The Bank Holding Company Act and The Bank Merger Act

Dear Senator Proxmire:

Thank you for the opportunity to submit our comments on S. 72. The Investment Company Institute is the national association of the American mutual fund industry. Its membership includes 446 open-end investment companies ("mutual funds"), their investment advisers and principal underwriters. Its mutual fund members account for over 90% of industry assets and have approximately eight million shareholders.

Our comments are primarily directed to the desirability of Section 301(a) of S. 72 which tightens up both the existing "closely related" and "public benefits" tests with respect to non-banking activities made permissible to a bank holding company component by Section 4(c)(8) of the Bank Holding Company Act (the "Act"), and also to the desirability of Section 401 of the bill which provides that an activity found by the Federal Reserve Board to be improper for a bank holding company is improper for a national bank and further explicitly denies a national bank the right to engage in any activity prohibited to it under any other provision of law.

We support Section 301(a) and Section 401 of the bill.

Present Section 4(c)(8) of the Act enables a bank holding company to acquire a company the activities of which are determined by the Federal Reserve Board to be "so closely" related to banking or managing or controlling banks as to be a "proper" incident thereto. We endorse the provisions of Section 301(a) of the bill which would require that the non-banking activities be not only "closely" but also "directly" related to banking so as to be not only a "proper" but also a "necessary" incident. The additional public benefits test is also tightened by the bill in a number of ways that, we believe, place desirable restrictions on non-banking activities.

In recent years banks, largely through the device of bank holding company complexes, have expanded or tried to expand their activities into new fields not traditionally related to banking. Banks lease equipment; they sell insurance; they render accounting and tax services; they issued credit cards; they market securities; and they offer investment management services. They also want to expand into furnishing armored car services and travel agency services.

Bank expansion into such commercial fields has raised serious questions with respect to the permissible scope of bank activities under existing law. These activities have been or are being contested in the courts by competitiors who would be directly harmed by such activities.*

The focus of our testimony is on the increasing activities of banks in the securities business. This relates to the finding in Section 2 of the bill that, among other activities, "in marketing securities" and "in offering management and data processing service" bank holding companies "have extended their services into product markets beyond those directly related to banking, thereby eroding the line between banking and commerce in the Nation."

---

* It should be noted that the Supreme Court and other federal courts have in recent years struck down a number of attempts by the Office of the Comptroller of the Currency to permit banks to engage in activities not normally associated with the banking business. For example, the Comptroller's rulings were overturned in the following cases: Saxon v. Georgia Association of Independent Insurance Agents, Inc., 399 F. 2d 1010 (5th Cir. 1968) (selling life insurance); First National Bank v. Dickinson, 396 U.S.122 (1969) (setting up armored car service and deposit receptables); Arnold Tours, Inc. v. Camp and South Shore National Bank, 472 F. 2d 427 (1st Cir. 1972), aff'g 338 F. Supp. 721 (D.C. Mass. 1972) (acting as travel agent); and involving interpretation of Glass-Steagall, Investment Company Institute v. Camp, 401 U.S. 617 (1971) (sponsoring and operating a mutual fund); Baker, Watts & Co. v. Saxon, 261 F. Supp. 247 (D.C.D.C. 1966), aff'd. 392 F. 2d 497 (D.C. Cir. 1968) (sale of municipal revenue bonds); National Retailers Corporation of America v. Valley National Bank, et al., U.S.Dist. Ct. Ariz., Feb. 2, 1976 (offering data processing services).

At the outset we wish to refer to what should be obvious. Banking interests should not be permitted to do indirectly what they are forbidden to do directly The Bank Holding Company Act was never intended and cannot be used as an excuse to permit banking interests to avoid prohibitions elsewhere contained in the law -- such as the provisions of the Glass-Steagall Act of 1933 which divorced the banking business from most aspects of the securities business.*

---

* Any possible thought that the 1970 amendments to the Bank Holding Company Act might be interpreted to dilute the application of the Glass-Steagall Act to a component of a bank holding company was dispelled by the following colloquy between Senators Williams and Sparkman on the Senate floor in connection with the passage of such amendments

"Mr. WILLIAMS of New Jersey. I have one question I should like to ask the chairman of the committee.

Both the Senate and House bills contained, in section 4(c)(8), substantially similar language reiterating the existing law embodied in the Glass-Steagall Act which provides essentially, for separation of commercial banking and the securities business. This language does not appear in the bill agreed to by the conferees. I wonder whether there was any intention to imply that the very securities-related activities forbidden to banks directly may nevertheless be engaged in by bank-holding companies or their nonbanking affiliates.

Mr. SPARKMAN. The answer to the Senator's question is that there clearly was not. As it now stands the Glass-Steagall Act broadly prohibits both banks and their affiliates from engaging in what we commonly understand to be the securities business. There are some specific exceptions, of course, but I can assure you that we did not mean to enlarge or contract them here. We regarded that general prohibition as being so clearly applicable to the subjects of this bill as to make a restatement of it unnecessary... If Congress is to change that longstanding, fundamental statement of public policy, we will have to do so in other legislation. I hope there is no longer any misconception on that point.

Mr. WILLIAMS of New Jersey: It is reassuring, indeed, to know that the Glass-Steagall Act has not been disturbed in any way and that there is no intention at all here to do so." [116 Cong. Rec. 42430 (1970)]

The expanded activity by banks in the securities industry raises two fundamental questions:

First, are the reasons that give rise to the Glass-Steagall Act still valid today, or should the Glass-Steagall Act be amended so as to make it clear that banks may or may not engage in some or all of these securities activities?

Second, is it in the public interest to sanction the increased concentration of economic power in banks by permitting them to enter the securities business and would this create unfair competition?

Among the securities activities which the banks are engaging in, have tried to engage in, or would like to engage in, are the following:

(1) Bank sponsorship and operation of open-end investment companies (mutual funds). This involves the creation and merchandising by banks of pooled funds for managing agency accounts -- found by the courts to be the functional equivalent of mutual funds. In a suit instituted by the Investment Company Institute against the Comptroller of the Currency this activity was held by the Supreme Court of the United States in 1971 to violate the Glass-Steagall Act (Investment Company Institute, et al v. Camp, 401 U.S. 617). Nevertheless, the American Bankers Association has announced its intention to seek legislation to overturn the Camp case and the Comptroller of the Currency has announced his support for permitting banks to enter the mutual fund business.* As recently as February of this year, the Chairman of the Trust Counsel Committee of the ABA reiterated that organization's intention to seek legislation authorizing commingled managing agency accounts.**

(2) Bank sponsorship of closed-end investment companies. In the last few years, banks have created and sponsored closed-end

---

* Transcript of Hearing on Securities Activities of Commercial Banks before Subcommittee on Securities of Senate Committee on Banking, Housing and Urban Affairs, December 9-10, 1975, Vol. 1, pages 70-71, Vol. 2, pages 124-125.

** American Banker, February 8, 1978, p. 1.

investment companies having hundreds of millions of dollars. This activity is presently being challenged in a suit brought in the U. S. Court of Appeals for the District of Columbia by the Investment Company Institute against the Board of Governors of the Federal Reserve System (Investment Company Institute v. Board of Governors of the Federal Reserve System, et al, Civil Action No. 77-1862 (September 23, 1977)). The suit seeks a judicial declaration that the Regulation of the Federal Reserve Board permitting such sponsorship violates the Glass-Steagall Act.

(3) Bank automatic stock investment plans. Banks have attempted to aggressively market these plans under which a depositor directs the bank to withdraw monthly an amount (usually a minimum of $20 and a maximum of $500 per company) from his checking account to purchase shares of one or more of the 25 companies with the largest capitalization appearing in the Standard & Poor's 425 Industrial Index. The bank receives a fee for its service. The New York Stock Exchange and the Investment Company Institute have jointly brought an action in the federal district court for the District of Columbia against the Comptroller of the Currency seeking a judicial declaration that the Comptroller's regulation permitting such activity violates the Glass-Steagall Act. Summary judgment* was awarded to the Comptroller. On appeal, the Court of Appeals held that the case was not ripe for judicial review.** A petition for a writ of certiorari is presently pending before the Supreme Court.

(4) Dividend reinvestment plans. Banks are aggressively merchandising these plans under which the banks for a fee will reinvest dividends of a particular corporation in the stock of the corporation and often will permit the stockholder to add up to an additional $1,000 monthly for reinvestment by the banks in such stock.

(5) Sponsorship of REITs. Banks have in recent years sustained huge losses in connection with real estate investment trusts because of the banks' involvement as sponsors and lenders.

(6) Underwriting municipal revenue bonds. Banks are attempting to have the Glass-Steagall Act amended to permit this activity,

---

* New York Stock Exchange, Inc. et al v. Smith, 404 F. Supp. 1091 (D.C.D.C. Dec. 5, 1975).

** 562 F.2d 736 (D.C.Cir. 1977).

in view of a court decision* holding such activity illegal under Glass-Steagall.

It may be expected that such activities by banks in the securities business are only the beginning, if they are permitted to go on unchecked. It may not be unreasonable to anticipate that U. S. Banks will ultimately seek the right to conduct a regular broker-dealer securities business and thus dominate such business as in the case of many European countries.

1. The Glass-Steagall Act

After the Congressional study as to reasons for the stock market debacle of 1929 and ensuing depression years, Congress in 1933 passed the Glass-Steagall Act which was in large part designed to divorce the banking business from the general securities business.**

While the securities activities of banks described above will present dangers to the public and involve conflicts of interest which are likely to differ in degree depending on the type of activity involved, a crucial fact is that these dangers and conflicts exist because banks have a "salesman's stake" in these activities.

In considering the issue of Glass-Steagall, we take as a focal point the hazards to the public which the Supreme Court of the United States found to exist in 1971 if a bank were permitted to sponsor and merchandise its own mutual fund -- hazards which

---

* See Baker, Watts & Co. v. Saxon, 261 F. Supp. 247 (D.C.D.C.1966), Aff'd sub. nom., Port of New York Authority v. Baker, Watts & Co., 392 F. 2d 497 (D.C. Cir. 1968).

** To explain in more detail the intent of the Glass-Steagall Act in this respect, we offer to submit for the record a copy of the plaintiff s Memorandum in opposition to the defendant s motion to dismiss or for Summary Judgment, in the pending case which the New York Stock Exchange and the Investment Company Institute have brought against the Comptroller of the Currency with regard to bank automatic stock investment plans. In particular, we call the Committee's attention to pages 23 to 32 of the memorandum on the question of the intent of Glass-Steagall, as interpreted by banking authorities, with respect to banks offering brokerage services.

permeate the other bank securities activities in varying degrees of intensity.

The potential dangers to the public which result from these activities are highlighted in the Supreme Court's decision in the Camp case referred to above. In finding that "the potential hazards and abuses that flow from a bank's entry into the mutual fund business are the same basic hazards and abuses that Congress intended to eliminate almost forty years ago," the court pointed to specific hazards as follows:

> "And there are other potential hazards of the kind Congress sought to eliminate with the passage of the Glass-Steagall Act. The bank's stake in the investment fund might distort its credit decisions or lead to unsound loans to the companies in which the fund had invested. The bank might exploit its confidential relationship with its commercial and industrial creditors for the benefit of the fund. The bank might undertake, directly or indirectly, to make its credit facilities available to the fund or to render other aid to the fund inconsistent with the best interests of the bank's depositors. The bank might make loans to facilitate the purchase of interests in the fund. The bank might divert talent and resources from its commercial banking operation to the promotion of the fund. Moreover, because the bank would have a stake in a customer's making a particular investment decision -- the decision to invest in the bank's investment fund -- the customer might doubt the motivation behind the bank's recommendation that he make such an investment. If the fund investment should turn out badly there would be a danger that the bank would lose the good will of those customers who had invested in the fund. It might be unlikely that disenchantment would go so far as to threaten the solvency of the bank. But because banks are dependent on the confidence of their customers, the risk would not be unreal."

Many of the same or substantially the same conflicts of interest that led to the decision in the Camp case involving bank-sponsored mutual funds are involved in bank automatic stock investment plans. For example, there is the temptation to lend moneys to bolster the 25 companies on the investment list or to withhold credit from competing companies; to have the bank's trust or other departments invest in such stocks to stabilize or improve their prices; and to merchandise the plan to anyone and everyone without regard to suitability to the investor, all in order to make a profit out of the service. There is the further temptation to profit from a "float" by utilizing the full 30-day "acquisition interval" permitted for buying securities after the cut-off date established by the bank.

There is also a serious question of disclosure involved in the potential conflict between the activities of a bank in purchasing securities under its widely advertised automatic investment plan and the activities of the bank's trust department in dealing in the same securities. For example, if bank customers are in the process of giving the bank millions of dollars to buy certain securities under the automatic investment plan, and at the same time the bank, having decided the outlook for those issues is not good, is in the process of selling off millions of dollars of the same securities from its trust funds and other investments, does not the bank have a fiduciary duty to advise its automatic investment customers that it is buying for them securities which the bank's trust department believes are not a good investment? The banks apparently deny that such a fiduciary duty exists.

In recent years, we have read press reports which indicate that some banks do not hesitate to plunge into conflicts of interest situations when they sponsor or rescue their real estate investment trusts. We do not know how valid the criticism may or may not be. However, the relationship of banks to their REITs appears to have striking similarities to the relationship before 1933 between banks and their securities affiliates, which was instrumental in bringing about the Glass-Steagall separation of banking and securities functions. If so, this is another reason for maintaining the prophylactic provisions of Glass-Steagall.

2. Undue concentration of economic power in banks and unfair competition

Commercial banks have acquired huge assets which carry with them a powerful capacity to dominate our nation's business and to influence our securities markets.*

It is a truism that banks are far and away the largest of private financial institutions. At the end of 1976, commercial banks had non-trust assets of $966 billion and trust assets of $487 billion These combined commercial bank assets of $1,453 billion exceeded the aggregate assets of all other major financial institutions, such as, mutual savings banks, savings and loan associations, credit unions, insurance companies and mutual funds. Of these bank assets of $1,453 billion, $270 billion were accounted for by ownership of common stocks.

Moreover, there is concentration within concentration. During 1976, a relatively small number of banks with assets of $1.0 billion or more controlled 45.8% of the assets of all insured commercial banks.

As for potential capacity to dominate U. S. industry, it is interesting to note, for example, that at the end of 1973 New York banks alone held the following percentages of total voting stock of the following companies, to mention just a few examples: 17% of Mobil Oil, 11% of Ford Motor 19% of Xerox, 30% of American Airlines 30% of the Burlington & Northern Railroad, 17% of Western Union and 18% of Safeway Stores And superimposed on such dominant stock ownership is a pervasive system of interlocking directorates between industrial corporations and banks.

This vast concentration of economic wealth and influence increases the probability that bank equity investments will flow to large corporations, creating artificial pressures for higher stock prices of the favored large corporations. The smaller firms are not big enough to satisfy the huge appetite of bank needs to invest.

---

* See, for example, Staff Report on Financial Institution Reform, House Committee on Banking and Currency, attached to memorandum dated August 15, 1973 from Chairman Patman to all Committee members; The Role of Institutional Investors in the Stock Market -- staff briefing material dated July 24, 1973, prepared for use of Subcommittee on Financial Markets of Senate Committee on Finance; Disclosure of Corporate Ownership, prepared by the Subcommittees on Intergovernmental Relations, and Budgeting, Management, and Expenditures of the Senate Committee on Government Operations, December 27, 1973.

One of the arguments that banks make in favor of being permitted to compete in the securities business is that they can do it better and cheaper. Even if this were true -- which is doubtful -- the justification for permitting banks to enter the securities business must also be measured in terms of the fairness or unfairness of the competition which would be represented by bank entry into the business. Moreover there is no lack of competition in the securities industry today For example, there are over 600 mutual funds being offered today to the public.

It seems clear that, apart from other impacts on the U. S. economy, if banks are permitted to compete in the securities business their concentration of economic power will produce unfair competition favoring the banks as against their competitors.

Some of the reasons for this conclusion are as follows:

(1) Banks would have a tremendous competitive advantage because of their built-in customers and their leverage over financial decisions made by these customers National banks have approximately 14 000 branches and over 18,000 offices throughout the country and there are many additional branches and offices maintained by state banks. Every day thousands of customers stream across the threshold of banks for the purpose of making deposits, making loans, paying off loans and taking advantage of many other banking services. The financial health even the financial existence of many ot these customers depends upon a satisfactory relationship with the bank. Under these circumstances, pressure from a bank does not have to be very direct to enable it to capture all of a customer's financial business.

(2) Not only are the customers physically present in the bank, but banks are permitted to, and do advertise their services in a much more aggressive and liberal fashion than is permitted to financial institutions such as mutual funds that are subject to regulation by the Securities and Exchange Commission and state securities administrators. For example, when the Chase Manhattan Bank in New York began in 1973 to merchandise its automatic stock investment plan its multi-colored promotional brochure referred to the plan as a "fantastic new way" to establish a stock investment program..."Just fill out the attached form...and you're on your way to Wall Street." Moreover, the regular monthly statements sent by Chase Manhattan to its checking account depositors were used to promote the plan by being accompanied by the same brochure

and having a legend on the statement itself "CHASE'S AUTOMATIC STOCK INVESTMENT PLAN EACH MONTH ALLOWS YOU TO INVEST IN A SELECTION OF STOCKS. ENROLL NOW."

The merchandising of securities services by institutions other than banks is closely regulated under federal and state law. Banks, however, are generally exempt from the provisions of the federal securities laws and probably from most state securities laws.

National banks usually argue that regulation by the Comptroller of the Currenty is equivalent to regulation by the Securities and Exchange Commission. But the fact is that banking regulation is designed to protect the solvency of banks and not to protect the public investor who accepts investment advice from banks. To be sure, the activities of bank trust departments are subject to inspection by the banking authorities, but the thrust of such trust department inspection is not to protect the investor but rather to see to it that trust department activities are not mismanaged in a way that will cause the bank to be surcharged so as adversely to affect its solvency and therefore its depositors.

(3) The trust department of a bank has access to inside information not available to competitors in the investment business. Although the banks like to talk of a "Chinese Wall" between the trust department and the commercial department, there is far too much danger that the wall will be perforated -- that the trust department, in choosing to make or change investments for its customers, will have the advantage of inside knowledge possessed by the commercial department concerning companies that are customers of the commercial department.

When pressure is applied the wall can obligingly disappear. For example, following the institution of fully competitive stock exchange commission rates on May 1, 1975, the extreme price cutting of commission rates raised questions as to the financial stability of brokers with whom the banks deal. According to the June 9, 1975 issue of the Wall Street Letter, the trust departments of large commercial banks were "discreetly" asking their commercial department to notify them about the checking and lending accounts of brokers. No such inside information is available to other financial institutions who also rely heavily on the solvency of the broker-dealers they employ.

(4) Many banks hold themselves out as investment advisers and thousands of people go to them for impartial investment advice.

The inherent conflict of interest which is present when a profit-oriented bank has a salesman's stake in merchandising its own investment services will not only jeopardize the bank's ability to give impartial advice but will also produce an unfair competitive advantage. If a bank is permitted to operate and make a profit out of its own mutual fund, is it likely that the bank will recommend a competitive mutual fund to a customer seeking impartial investment advice?

Looking beyond the question of competitive advantage, there is a serious question as to what will happen to public confidence in banks if they are permitted to enter the securities business on a broad scale. For example, as the Supreme Court of the United States pointed out in the Camp case, if the bank is permitted to operate its own mutual fund and recommends such an investment, will customer losses in the bank's mutual fund tend to affect the customers' confidence in his bank and thus its solvency? Or what effect on a customer's confidence in his bank will there be if the customer were to discover that at the same time he is investing his money in one of the stocks offered under the bank's automatic investment plan, the bank is in the process of unloading the stock of the same corporation from its trust funds and other investments?

In conclusion, we emphasize that it is essential to preserve the integrity, and not to permit the dilution, of the Glass-Steagall Act. Moreover, the strengthening of the public benefits test, as proposed in the bill, is a distinct improvement on the standards presently applicable to the legitimacy of non-banking activities within a bank holding company structure.

We also suggest that it might be well for Congress to give some guidance to the Federal Reserve Board to assist it in determining what is or is not so "closely and directly" related to banking as to be "a proper and necessary" incident thereto. There has been too much costly litigation already with respect to the non-legitimacy of many banking activities. We think Congress should make it plain that, among other activities, the sponsorship, management and promotion by banks of their own mutual funds and of automatic stock investment plans do not meet the bill's criteria for legitimate activity by a component in a bank holding company complex.

For the foregoing reasons, we support Section 301(a) and Section 401 of S. 72.

Sincerely,

David Silver
President

cc: Honorable Edward W. Brooke
Ranking Minority Member
Committee on Banking, Housing and Urban Affairs
United States Senate, Suite 5300
Washington, D. C. 20510

Investment Company Institute
1775 K STREET N. W., WASHINGTON, D. C. 20006
(202) 293-7700

DAVID SILVER
PRESIDENT

June 26, 1978

Honorable William Proxmire
United States Senate
Washington, D.C. 20510

Dear Senator Proxmire:

On June 16, 1978 we testified on S. 72 before the Senate Committee on Banking, Housing and Urban Affairs. We were encouraged by your understanding and evident concern with respect to the specific issues of bank securities activities which we discussed. At the conclusion of our testimony you asked that we provide additional information regarding our fear that unrestricted bank sponsorship of common trust funds and collective pension funds ultimately would result in a financial crisis. Our statement is based, first, on the experience of history and, second, on certain early warning signals pointing to the existence of current problems.

At the outset, however, we might simply note the dimensions of potential problems involving bank collective funds. The last available figures indicate that at year end 1975 the assets of bank common trust funds and collective pension funds amounted to $39.3 billion. At that time, the assets of the entire mutual fund industry were $42.2 billion. As you are aware, collective funds which mingle the monies of a number of investors, pose different regulatory problems than occur when an investment manager deals on a one-to-one basis with a large, sophisticated customer.

Throughout this century the operation of pooled investment vehicles by banks and the mass merchandising of the interests in their collective funds have proved to be a sure recipe for financial disaster. Indeed, it was for this very reason that Congress enacted the Glass-Steagall Act in 1933 separating commercial banking and the general securities business. As Federal Reserve Board Governor Henry C. Wallich recently pointed out, the Glass-Steagall Act was probably responsible for the avoidance of serious problems in the banking industry in the mid-1970s:

> "Then came the recession of 1974, which brought serious losses. At that time, newly established bank holding companies had been extending their operations into new areas of financial activity, such as mortgage banking, consumer finance, and advising and financing real estate investment trusts. The holding companies' experience in many cases was sufficiently adverse to justify the conclusion that the banks were fortunate not to have been burdened, at the same time, with securities affiliates. In 1974, Glass-Steagall stood the banks in good stead". 1/

The intense promotional efforts connected with the merchandising of bank collective funds and the types of abuses which apparently have emerged bear an uncanny resemblance to the pattern of bank securities affiliates in the 1920s and bank REITs in the 1970s, and to the dangers which the Supreme Court pointed to in ICI v. Camp with respect to bank-sponsored mutual funds.

Bank securities affiliates in the 1920s and bank REITs in the 1970s were built on aggressive merchandising. In the Camp case the Supreme Court warned that "[p]romotional incentives might also be created by the circumstance that the bank's mutual fund would be in direct competition with mutual funds.... The bank would want to be in a position to show to the prospective customer that its fund was more attractive than the mutual funds offered by others." The enclosed ads indicate that banks all across the country presently are engaged in advertising campaigns stressing the investment performance of their collective pension funds with scarcely a word about the bank's fiduciary expertise. The Fifth Third Bank of Cincinnati's headline is "Entering Our Second Decade of Outperforming the Dow Jones." Hibernia National Bank's headline states that it is "# 1". The National Bank of Detroit's ad consists of a 10-year chart comparing the performance of its commingled equity funds with the Becker Median.

These ads seek to trade on the expertise and reputation of the bank itself. The ad run by the First National Bank & Trust Company of Tulsa announces: "We're specialists in stocks, bonds, oil, real estate, and the complexities of ERISA." The First National Bank of Birmingham's ad asks: "How can a bank from Birmingham get this kind of results for its clients?" This type of advertising naturally induces the public to invest in reliance on the sponsoring bank -- this is precisely what occurred in connection with bank securities affiliates in the 1920s and bank REITs

---

1/ Wallich and Harvey, "Reflections on Glass-Steagall", Bankers Magazine, March-April 1978, at p. 9.

in the 1970s.[2/] Promotional tactics which seek to exploit the bank's reputation create the obvious danger of a backlash against the bank itself when bank-sponsored investment vehicles perform badly, whether or not through any fault of the bank. The Supreme Court warned: "Imprudent or unsuccessful management of the bank's investment fund could bring about a perhaps unjustified loss of public confidence in the bank itself." This very phenomenon actually occurred when bank securities and REITs entered into periods of poor performance.

Further, whenever bank-sponsored investment vehicles encounter difficulty, banks find themselves forced to use their own assets to attempt to rescue their pooled funds, thereby placing the banks themselves in jeopardy. In the Supreme Court's words: "If imprudent management should place the fund in distress, a bank might find itself under pressure to rescue the fund through measures inconsistent with sound banking." Pages 26-29 of our testimony detailed the banks' attempts to rescue their REITs and the crisis which this produced for the banks themselves. If bank sponsored collective pension funds, which are being aggressively marketed to hundreds of thousands of small investors, encounter difficulties, the banks will inevitably mount similar rescue missions.

While promotional excesses may cause their own problems, various abuses of fiduciary responsibilities can also occur in the management of these funds. Here too it appears that certain abuses which took place when banks sponsored securities affiliates in the 1920s and REITs in the 1970s are occurring today. In some cases

---

2/ "Stockholder reaction at the meeting was typified by the observation of a Milwaukee attorney who invested in the trust's stock when all signs pointed up. 'I got in,' he said 'because this was being run by First Wisconsin and I felt they were a good, orderly investor-minded organization.'" "Banks are Declared Key to Relief for 'Very Sick' First Wisconsin REIT", American Banker, April 22, 1975, p. 1, col. 2.

"And justified or not, the feeling may also exist that if a REIT runs into difficulties, the bank will stand behind it, rather than jeopardizing the bank's name." Schulein, "Recent Developments in the REIT Industry", Federal Reserve Board Bank of Boston, New England Economic Review, September-October 1972, at 10.

bank trust departments purchase securities issued by good commercial customers of the bank, despite the fact that such investments may be imprudent. 3/ The evidence indicates that banks use their pooled investment funds as dumping grounds for undesirable securities issued by good commercial customers:

> "For example, one bank trust department a few years ago bought a large block of bonds of a director-interlocked customer, whose common stock was not on the trust department's approved list. The bond specialist of the bank informed the author that this purchase of bonds was 'expected of the bank' as a quid pro quo for the board directorship, the bank's award of the role of collection agent on the bond issue, and the generally good customer relationship. A large fraction of these bonds was put into one of the bank's common trust funds and into a nonprofit trust account managed by the bank; that is, into relatively weak and insensitive accounts. An examination made by the author of fourteen trust portfolios held in this bank in mid-1967, revealed that 'special notes' of the bank's own customers tended to show up regularly in the common trust fund and in nine of ten randomly selected portfolios of small nonprofit accounts, but in only one of three portfolios of major companies."4/

3/ See, e.g., Herman, "Conflicts of Interest: Commercial Bank Trust Departments" (The Twentieth Century Fund 1975), at 49-50:

> "The company then approached a large trust bank with which it had a director interlock and a major customer relationship and asked it to take some or all of the bonds. According to two employees of the bond department, the customer applied pressure on the commercial arm, including a threat of withdrawal of deposits and shift of other business. Pressure was then put on the trust department, which had not been interested in private placements and ordinarily only bought bonds of a higher quality. After some resistance, the trust department succumbed, and after some haggling over the price, it eventually absorbed half of this large private placement."

4/ Ibid, at 62-63.

Similarly, there are indications that bank trust departments do not sell securities issued by good commercial customers, despite adverse financial information concerning the companies.5/

There is also evidence that banks give preferential treatment to large individually-managed accounts over their pooled investment vehicles. This occurs in the allocation of investment opportunities:

> "For example, the largest and most important commercial customer of one bank did not want its pension fund participating in a pooled fund, but did want a portion of its investment portfolio in the same kind of 'hot' issues. An officer of the bank described the situation as follows: 'When the research department came up with an idea that would be useful for the pooled fund, there was a problem with regard to allocating investment opportunities between the pooled fund and the customer's account. Although pro rata division between these two accounts was not the general rule, there was some exceptions. On occasion we could favor the customer's account, because it was the bank's largest customer and had tough investment people who were very performance oriented.'"6/

But favored treatment to good customers can also be given after the fact. An investment officer of a national bank recently alleged that the bank's common trust fund had purchased securities which increased in value and which were then transferred at original cost to other accounts. 7/

It also appears that banks have pressured commercial customers to retain the bank to manage their pension assets:

5/ See the discussions of the Air Line Pilots Association suit against Continental Illinois Bank and the Penn Central case in Herman, supra, at 54-55; and in Hunsicker, "Conflicts of Interest, Economic Distortions, and the Separation of Trust and Commercial Banking Functions", 50 Southern California Law Review 611, at 655-56 (1977).

6/ Herman, supra, at 61.

7/ "Hamar Case: Did the Bank Regulators Fail in Their Duties", New York Times, April 10, 1978, p. D1, col. 2.

> "A former Continental Illinois National Bank employee told the Wall Street Journal that pressure is commonly applied to commercial customers. The commercial lending officer tells the potential commercial customer how their full service bank would 'love' to manage his pension fund, and '[t]he executives get the message pretty quickly.'"8/

Commercial bank customers are not only pressured to retain the bank for pension management, but many then find that the bank uses their pension portfolio as a dumping ground for weak issues of other bank customers:

> "In one such case described to the author by an investment banker, one customer, highly dependent on credit from a powerful trust institution, was virtually forced to place its pension fund with the bank. Approximately 10 percent of the assets of this fund were shortly thereafter placed in the stock of a financially stricken customer with whom the bank was deeply involved and whose stock was of less than investment grade. Almost immediately after acquisition, this issue fell to a small fraction of its original price. The investment banker believes that a very strong and alert pension fund customer of the bank learned of the coming debacle and insisted that the shares of the sagging company be removed from its portfolio. Because the market was thin, the shares were placed in weaker portfolios. The investment banker claims that the customer knew this but was too dependent on bank credit to withdraw, sue or even complain."9/

Recent studies point to a variety of other problems reminiscent of those uncovered in connection with bank-sponsored securities affiliates in the 1920s and bank-sponsored REITs in the early 1970s. These include use of inside information obtained from the bank's commercial activities;10/ use by the bank of uninvested cash of trust and pension accounts;11/ and banks using trust and pension accounts

8/ Hunsicker, supra at 650-651, quoting from Wall Street Journal of January 7, 1975, p. 1, col. 6, at p. 31, col. 2.

9/ Herman, supra, at 63.

10/ See, e.g., Herman, supra, at 73-87; and Hunsicker, supra, at 630-647.

11/ See, Herman, supra, at 107-121; and Hunsicker, supra, at 619-630.

to assist commercial customers in takeover battles.[12/] Citibank's pooled equity fund apparently invests in certificates of deposit issued by the bank, a self-dealing practice which is prohibited by the Investment Company Act for a mutual fund registered under that Act.

Full-scale investigations tend not to occur until abuses finally result in a major crisis. However, the existing evidence indicates that bank common trust funds and collective pension funds are embarking on the same road as prior pooled vehicles sponsored by banks. An early indication are the aggressive advertisements aimed at small unsophisticated investors -- advertisements which purposely induce investors to rely on the expertise and reputation of the bank itself. Then there are studies which present instances of the use of bank pooled funds as dumping grounds for securities issued by favored bank commercial customers and by the banks themselves; of banks favoring large individually-managed accounts over pooled vehicles offered to small investors; of commercial bank customers being pressured to entrust their pension assets to banks who then proceed to unload imprudent investments into their portfolios; and of banks profiting by using customers' uninvested cash, and by using trust and pension assets to assist favored commercial clients of the bank.

We believe that Congress should act to curb the use of bank common trust funds and collective pension funds as mass-merchandised investment vehicles for the general public. We therefore urge the enactment of the type of legislation set forth in our testimony.

We would be pleased to furnish any additional information you may request.

Sincerely yours,

David Silver

12/ See, e.g., Herman, *supra*, at 50:

> "One major trust bank, which managed the pension funds and held about 5 percent of the stock of a good commercial customer, was faced with the attempt of a conglomerate to take over the customer. The bank bought the customer's stock for the customer's own pension fund accounts, even though the trust department did not like the stock."

The CHAIRMAN. Thank you very much, Mr. Silver.

These are two very, very interesting and helpful statements and I think your last point on the advertising and your examples here are very, very interesting indeed.

I haven't had a chance to think about this very carefully, but you may well be correct that this does constitute a violation of Glass-Steagall. At any rate, it certainly doesn't seem to be banking in the usual sense by any means.

Mr. SILVER. It is not the offer of fiduciary services, Mr. Chairman.

The CHAIRMAN. That's right. Will you pick out one of these advertisements and show us how the banks can do more than the securities industry can do?

Mr. SILVER. Mr. Chairman, if I can start as a whole, no mutual fund registered with the SEC could use any one of these ads at all because we are totally prohibited from advertising any performance whatsoever in newspapers. So that each and every one of these ads, were they to be run by a mutual fund, would be illegal under the Securities Act of 1933.

Now as far as supplemental sales literature is concerned, once an investor has received a prospectus on the fund and you want to provide an investor with some performance information, there are problems with these ads. First, the time periods. Some of these ads use 1 year. One uses 1, 3, 5, and 7 years. They are odd periods of time. SEC rules provide that when you're illustrating performance you must use 10 years, plus increments of no less than 5 years or the life of the fund itself. So that you're not free to select your own periods.

Second, there must be disclosures as to how the index you are using may differ or is relevant to your fund.

Third, you have to talk in terms of markets which go both ways, et cetera. You have to tell everything, disclose anything which is peculiar about the period which you may be illustrating. There are some other points which will occur to me, but these ads under no circumstances would comply with either SEC or NYSE rules. At best, they would be woefully incomplete but as I said the major point is we couldn't use them at all.

The CHAIRMAN. Has the SEC indicated any interest in this because they seem to be so blatant and so conspicuous, as you say: "entering our second decade of outperforming the Dow Jones," "Your fixed-income fund has got to deliver superior results," "It's about time investment managers were judged on their successes instead of their addresses," in the Birmingham bank with a crow sitting on a directions sign, New York to Dallas, Atlanta and Birmingham, which is a great place. "Your company's employee benefit plan can't profit from a bad fit."

These are all banks that have fine conservative reputations. It's astonishing that they can do this and the SEC has no authority, no jurisdiction, and they can do that in competition of course with your industry. It just doesn't seem to be logical at all. Either what the SEC is doing in restraining the industry is wrong, which I think it is not—I think it's right—or the banks should be restrained on the same basis.

Mr. SILVER. I fully agree, Mr. Chairman.

The CHAIRMAN. When you talk about competition, that obviously isn't fair competition.

Mr. SILVER. On its face, it is not.

The CHAIRMAN. Mr. O'Brien, would you comment?

Mr. O'BRIEN. I'd like to add one thing to that. There is of course the exemption which the banks have under the 1934 act. That's point No. 1. Therefore, this is just not under the oversight of the SEC in this area and while Mr. Silver has far more experience than I in this area, I can tell you that from my own experience of 20 years with one of the firms that the mutual fund industry—and we have been selling mutual funds for years—has been trying to get the SEC to somewhat make their regulations more flexible, basically to little or no avail. There may be a slight movement within the recent past, but basically it has not been a successful one.

So the competition is clearly unequal on that score.

The CHAIRMAN. Now, Mr. O'Brien, in your statement you speak of the capital shortage in the banking industry. You argue that banks should not be allowed to invade, as you put it, the smaller securities industry in order to augment their capital. I certainly agree with you on that.

As a man of wide experience in the equities market, what can you suggest to help the bank capital problem? Chairman Burns and Chairman Miller both termed, as we pointed out earlier, that the banking industry is undercapitalized, and we went into a little detail on that. The banks are reluctant to go to market during periods of depressed prices for fear of diluting ownership. Comptroller Heimann speaks of a serious capital shortfall in the 1980's, more serious than it is now. What can the securities industry suggest as a solution to that?

Mr. O'BRIEN. That's a very tall order, Senator, but the first thing that occurs to me—and I don't mean to be impertinent in suggesting it, but it may be sticking to their business would be of particularly good help; in other words, sticking to the banking business would immediately take some pressure off the capital needs of the banks. If you're going to get into leasing or mutual fund business or private placements or a host of other areas, you're immediately going to put greater demands on the capital requirements of the bank. So that's the first and I think most fundamental one—get back to the principles of Glass-Steagall.

The CHAIRMAN. Now, Mr. Silver, bank holding companies were allowed to advise REIT's by the Federal Reserve. In your judgment, would Glass-Steagall have prohibited bank holding companies from engaging directly in the REIT business?

Mr. SILVER. Yes, I have no doubt about that. I think that certainly if the bank holding company was trying to distribute shares of REIT's to the public the Glass-Steagall Act would have prohibited that.

The CHAIRMAN. Now do the Federal Reserve regulations with respect to investment advisory services pose the same potential difficulties to the banking business as the REIT experience?

Mr. SILVER. I think so, Mr. Chairman. I think that the distinctions that the Federal Reserve Board and the Comptroller have tried to draw between pure investment advice on the one hand and distributing securities on the other hand, and thus giving a very narrow interpretation to the Glass-Steagall Act, was in fact proved fallacious by the REIT experience.

The banks acted not only as investment advisers. They acted as promoters and sponsors of the REIT's and, as the Supreme Court pointed out in *Camp*, they had a salesman's stake in the distribution of REIT securities to the public. So to expand on Mr. O'Brien's answer, certainly REIT activity has inhibited the ability of banks not only to use their capital but to raise new capital.

As you know, Mr. Chairman, the holding company parent of Chemical Bank had to withdraw its securities offering because of the disclosures which they had to make with respect to the difficulties with their REIT loans.

The CHAIRMAN. Mr. O'Brien, in your statement you say that banks are in a position to accord preferential treatment to users of their securities service. I know there's a tremendous temptation for credit customers to favor banks voluntarily with their nonborrowing business because they think it might give them a leg up when times get tough and money gets tight and there's a credit crunch. Are there any specific instances of coercive practices on the part of banks to your knowledge?

Mr. O'BRIEN. Senator, I remember being asked this question one other time. I don't know if it was here, but I remember answering it then, and I thought about it since then and I still think it's true. I don't wish to evade the question. I think that the banks themselves are the most qualified people to answer that question. I'm sure there are instances which could be set forth.

The CHAIRMAN. It's pretty hard to get them to answer it and a frank and full answer would be against their interest.

Mr. O'BRIEN. Almost impossible to get an answer. You may be able to find a better way than I, but I can assure you it is very, very difficult.

The CHAIRMAN. Also you say that the comparative regulatory framework places burdens on broker-dealers not found in banks. Can you detail the unequal treatment accorded banks?

Mr. O'BRIEN. Yes. I refer in the statement to the final report of the SEC where they lay out some of the points having to do with such matters as sales literature, having to do with qualification for getting into the business, the questions—in other words, the training which is required, the disclosure which is required with respect to the issuance of securities, the overall regulatory framework which has been clearly set forth in the SEC report shows that the climate for banks is on one end of the spectrum and the climate for the securities industry is quite on the other end of the spectrum. The attitude of the SEC is one of enforcement and disclosure which of course is coupled with tight regulation every step of the way, entry into the business, capital requirements, training which is required, and then down to the actual distribution of the securities. The attitude in general of banking regulators has been I think pretty much acknowledged to be an accommodative one, if I could put it that way. There is relatively little or no regulation of security activities of banks today.

The CHAIRMAN. Now, Mr. Silver, in your statement you say:

> We fear that if Congress fails to act in this area banks sponsorship of common trust funds and collective pension funds ultimately will result in a financial crisis similar to that caused by bank sponsorship of REIT's in the early part of this decade.

Now if your conclusion is correct, it should cause this committee grave concern. What is the evidence to support this? I didn't find it in your statement.

Mr. SILVER. OK, Mr. Chairman. I think that the REIT story which we detailed in the statement is indeed an analog to the securities area. In our written statement, you will find what the hearings conducted by this committee back in 1932 uncovered with respect to the activities of bank securities affiliates in the 1920's.

Now we have heard since then—and I have been hearing this since 1962 from the bank regulatory authorities—that that kind of thing could never happen again because of the vigilance of the bank regulatory agencies. Yet if you compare those misdeeds of the 1920's with what the Supreme Court talked about in the long paragraph which we quote on page 14 from the *Camp* case, as to the purpose of Glass-Steagall, and the evils that Glass-Steagall was designed to prevent, you will find that things haven't changed at all when you come to the REIT's. Every problem that characterized the banks with respect to securities affiliates back in the 1920's emerged in the REIT story. Human nature hasn't changed in 50 years. So there's no reason to believe that if the securities affiliates simply take the form of collective funds of one kind of another rather than the form they took in the 1920's, that the same problems would not occur again.

The CHAIRMAN. Well, I think that sounds very logical. What I'd like you to do for the record, if you would, when you go over your remarks, is to give us whatever evidence you can in addition to this. I don't mean what you have given us isn't very persuasive, but I think you could make it even stronger and it would be very helpful for the record.

Mr. SILVER. We certainly will.

The CHAIRMAN. In your statement, Mr. O'Brien, you say:

> Banks possess substantial tax advantages, such as their ability to deduct the interest cost of carrying or purchasing tax-exempt securities and their ability to set up reserves for losses. In fact, in 1977 major commercial banks paid Federal taxes at rates substantially lower than those paid by the securities industry.

What are the tax rates paid by banks versus the tax rates paid by securities firms? Do you have that evidence?

Mr. O'BRIEN. Yes. I have some reactions on that. I have seen various tax rates paid by banks and I have seen them as low as 10 percent and lower—12 percent, 14 percent—but generally in that lower range, whereas the average tax rate which would be paid by a partnership would of course depend upon the rate of the partners and it could be whatever the top rate is, but let's just say a publicly held brokerage firm, the rate would be close to 45 or 50 percent, so there's enormous disparity between the rates paid by the banking community and by the investment banking community.

The CHAIRMAN. Now what's the effect on the competition of the banks' special treatment on municipal securities and is it one that should be corrected by legislation?

Mr. O'BRIEN. Are you talking about the question of the revenue bond question, Senator? Can you help me out on that question again?

The CHAIRMAN. I am just talking about your statement with respect to the favorable tax advantages that banks have compared to nonbanks.

Mr. O'BRIEN. Well, I think I understand what you mean then. The ability to deduct on the tax return the amount of the carry of the municipal bonds gives an outright advantage to the bank side.

The CHAIRMAN. Do you see any legislative remedy possible for that?

Mr. O'BRIEN. One obvious one is, I suppose, to take away the advantage or to give it on the other side. The disparity in treatment here is the disadvantage on the one side and the advantage on the other side. That's the essence of the problem.

The CHAIRMAN. You see how hard it is to correct that by legislation. One way you could do it, I suppose, would be by—it's been proposed by a number of us at times in the past that we substitute for tax exempt a subsidy to the municipality of 35 to 40 percent and then make it taxable and give them the option of using whatever they wish, but with the recognition that the advantage by going the taxable way and eventually the tax exempts would dry up.

Mr. O'BRIEN. I know. I'm famliar with that and, Senator, I think you and I may disagree on that option in that area.

The CHAIRMAN. You may, but at least that's one remedy that eventually would get you where you want to be as far as this particular point is concerned.

Mr. O'BRIEN. As far as this particular point is concerned. That could be quite diplomatic. There is a problem here and we don't really know the answer to it, but we know for sure what the tax rate is on the one side and the tax rate on the other side. We also know the disparity as far as the carry on municipals is concerned. It's a terrific problem area.

The CHAIRMAN. Mr. Silver, you point out the unfair advantage banks have in advertising their investment services. We discussed that to some extent. Is it your position that all the bank advertisements attached to your statement would be illegal if published by a mutual fund? I think you said that before.

Mr. SILVER. Yes, sir.

The CHAIRMAN. Mr. O'Brien, also in your statement you discuss the private placement activities of banks. In your view, do these activities violate the Glass-Steagall Act and, if so, how?

Mr. O'BRIEN. Yes, it is, Senator. I believe that the private placement activities is nothing more than the sale of securities. As such, I believe it is a direct contribution to the——

The CHAIRMAN. Has the Justice Department ever looked into this? I understand the Glass-Steagall has a criminal statute.

Mr. O'BRIEN. I don't know if the Justice Department has.

The CHAIRMAN. Have you complained to the Justice Department, anybody in your industry?

Mr. O'BRIEN. I have not. Mr. Crawford may know more about it, but I can say the attitude of the Federal Reserve has been one of complete support on the private placement activities as being nonviolative of the Glass-Steagall Act and we are just in direct disagreement with them.

The CHAIRMAN. Mr. Crawford.

Mr. CRAWFORD. We have held some discussions with the Justice Department on an informal level and in a situation where they see two very opposing interpretations of the same statute they have been unwilling to take any direct action.

The CHAIRMAN. Well, gentlemen, I want to thank you very much. I think, again, you have made a very, very good record, a very helpful record, and I'm hopeful on the basis of this record we can make some progress. We can try very hard.

[Whereupon, at 11:45 a.m., the hearing was adjourned.]

COMPETITION IN BANKING ACT OF 1977

FRIDAY, JUNE 23, 1978

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING,
AND URBAN AFFAIRS,
Washington, D.C.

The committee met at 10:05 a.m. in room 5302, Dirksen Senate Office Building, Senator William Proxmire (chairman of the committee), presiding.

Present: Senators Proxmire and Schmitt.

STATEMENT OF CHAIRMAN PROXMIRE

The CHAIRMAN. The committee will come to order.

Today we continue hearings on S. 72, legislation designed to control the growth of bank holding companies by restricting bank acquisition by bank holding companies already in the market and by restricting their nonbank activity under section 4(c)(8) of the Bank Holding Company Act to those activities that are directly related to banks.

A recent study of bank holding companies by the staff of the Federal Reserve Board revealed the bank holding company, mortgage banking, and consumer finance subsidiaries operated with lower capital ratios than their nonbank competitors. Moreover, data submitted by the Independent Insurance Agents show that when bank holding companies enter into mortgage banking, consumer finance, and factoring they tend toward substantial dominance in these fields. Banks may come to dominate nonbank industries that are characterized as small businesses if bank holding companies are allowed to go outside of banking and into commercial enterprises. The banks dispense a scarce commodity—credit. They have a unique monopoly over vital forms of credit. When banks go into nonbanking fields their control of this critical credit dispensing mechanism may give them at times a serious leverage advantage over their competitors. In such a circumstance the market may get unfair competition. Credit judgments may become distorted by the lure of nonbank income. In part, the REIT experience may demonstrate the unfortunate consequences that could result.

One question before the committee is whether or not those unfortunate consequences may be made less likely if we confine bank holding companies more directly to banking.

The committee will hear testimony from representatives of the insurance industry, the accounting profession and spokesmen for independent small business this morning.

Our first witness is a panel which will consist of Mr. Wayne Naugle, CPCU, president of the National Associaton of Professonal Insurance

Agents; Mr. Joel Shapiro, cochairman, Committee on Federal Law and Legislation, National Association of Life Underwriters; and Mr. Thomas E. Wilson, counsel, Wilkinson, Cragun & Barker, Independent Insurance Agents of America.

Gentlemen, if you will come forward to the table we will be happy to hear your statements. I have had a chance to look at your statements and I think it might be best for all concerned if you could confine the statements to 10 minutes. We will run the little clock here. The green light will go on for 9 minutes; the yellow light for a minute, and the red light means that's it. If you feel at the end of the interrogation that we haven't had a chance to cover some part of your presentatation that you feel is particularly vital, speak right up and call it to our attention. Your entire statements will be printed in full in the record.

Mr. Naugle, go right ahead.

STATEMENT OF WAYNE L. NAUGLE, PRESIDENT, NATIONAL ASSOCIATION OF PROFESSIONAL INSURANCE AGENTS

Mr. NAUGLE. Mr. Chairman and members of this committee, my name is Wayne L. Naugle of Davidsville, Pa. I am president of the Naugle Insurance Agency, and president of the Professional Insurance Agents, a national association headquartered in Alexandria, Va., representing 33,000 independent property and casualty insurance agents in the United States, Canada, Puerto Rico, and the Virgin Islands.

We appreciate this opportunity to provide our comments on S. 72, the Competition in Banking Act.

PIA is concerned with the continued expansion of bank holding companies into the business of insurance and the lack of interest on the part of the Federal Reserve Board in stopping this expansion in spite of the clear congressional directive to do so.

Senate bill 72 recognizes the need to further limit the activities of bank holding companies in the area of insurance by setting up further tests and criteria for such activities. To this extent, PIA supports S. 72. However, PIA believes that S. 72, while a step in the right direction, does not go far enough. By limiting all insurance activities of bank holding companies to those which are closely and directly related to banking and are likely to produce substantial benefits to the public which clearly and significantly outweigh possible adverse effects, S. 72 strengthens somewhat but does not substantially differ from the current test in the law. The Federal Reserve Board in both the current version of 12 CFR § 225.4(a)(9)(ii) and the Board's proposed amendment thereto, allows bank holding companies to engage in, among other activities, any insurance that is directly related to an extension of credit by a bank or to the provision of other financial services by a bank. To date the Federal Reserve Board has proven itself unwilling to effectively regulate the activity of bank holding companies in the area of insurance under this general standard, and has shown an extreme indifference to the potential of bank holding companies to exert undue economic coercion upon insurance agents.

Therefore, PIA urges this committee to go further in S. 72 to specifically prohibit bank holding companies from engaging in any insurance activities except for a few specified types of insurance which have proven to be proper activities for bank holding companies and with which we do not take issue.[1]

This latter approach has been taken in two bills which are currently pending in Congress. The first bill is S. 3087, which was introduced by Senators Durkin and Hathaway on May 16, 1978 and referred to your committee. This bill would amend section 4(c)(8) of the Bank Holding Company Act of 1956, to prohibit bank holding companies from providing any insurance as a principal, agent, or broker except for life and disability insurance on a debtor in connection with a specific credit transaction and insurance which is offered by a national bank operating in a community of under 5,000 inhabitants. A nearly identical bill, H.R. 11456 was introduced by Representatives Hanley, St Germain, Mitchell, Annunzio, Moorhead, Derrick, Cavanaugh, and Neal in the House on March 10, 1978 and referred to the House Committee on Banking, Finance, and Urban Affairs.[2]

The approach taken by S. 3087 and H.R. 12614 would provide the Federal Reserve Board and the bank holding companies with explicit instructions as to what is and what is not a permissible insurance activity for a bank holding company. We think this is the best approach since it would eliminate the ill effects of the confusing and inconsistent rulings which have been promulgated by the Federal Reserve Board in this area. For the past 7 years the Federal Reserve Board has expended a great deal of time and energy in this area. However, in large part due to its lack of concern for the potential of bank holding companies to exert undue economic coercion upon the insurance business, the Board has failed to carry out Congress' clear intent that insurance activities of bank holding companies be limited. Furthermore, the Board's treatment of this issue has been so confusing that the courts have been unable to effectively review their action. Consequently, the decision of reviewing courts also allow bank holding companies to engage in insurance activities such as the sale of property and casualty insurance, even though those activities are not in fact closely or directly related to banking and the conduct of those insurance activities by bank holding companies is contrary to the public interest. To allow the Federal Reserve Board to continue with this "general standard" approach would be to sanction bureaucratic inefficiency and unbridled growth of bank holding companies at a time when the American public has clearly called for a more effective use of the administrative process and a check upon concentration of economic power.

I. THE FEDERAL RESERVE BOARD HAS ALLOWED AN EXTREMELY BROAD RANGE OF INSURANCE ACTIVITIES UNDER ITS "GENERAL STANDARD"

In 1970 section 4(c)(8) of the Bank Holding Company Act was amended to prohibit bank holding companies from engaging in insurance activities unless the Federal Reserve Board determined that the insurance activities were "so closely related to banking" as to be

---

[1] Such permissible insurance activities would be the providing of insurance as a principal, agent, or broker where such insurance is limited to credit life, credit health, and credit accident insurance and to insurance sold in towns of 5,000 inhabitants or less.

[2] On May 10, 1978, this bill was reintroduced as H.R. 12614. On June 6, 1978, during consideration of H.R. 9600 (the "Safe Banking Act of 1977"), the Subcommittee on Financial Institution Supervision, Regulation, and Insurance, with nearly unanimous endorsement, adopted the language of H.R. 12614 as an amendment to title XIII of H.R. 9600.

a "proper incident thereto," and that the performance of the insurance activity by a bank holding company could reasonably be expected to produce benefits to the public which outweigh possible adverse effects. In 1971, the Federal Reserve Board, citing the 1970 amendments to section 4(c)(8) of the Bank Holding Company Act as authority, promulgated 12 CFR section 225.4(a)(9). This regulation essentially allowed bank holding companies to engage in the following insurance activities:

(1) Any insurance for the holding company and its subsidiaries;

(2) Any insurance directly related to an extension of credit by a bank or to the provision of other financial services by a bank;

(3) Any insurance sold as a matter of convenience to the purchaser so long as this portion of the insurance activity of the bank holding company was insignificant; and

(4) Any insurance sold in a community which the bank holding company demonstrated had inadequate insurance agency facilities or had a population of 5,000 inhabitants or less.

The Federal Reserve Board, whose members have a strong banking background, have been barraged with a great number of applications from bank holding companies seeking permission to engage in nearly every conceivable form of insurance activity. The reaction of the Board to this barrage of applications has been confusing, illogical, and inconsistent. Prior to the recent decision of the fifth circuit in *Alabama Association of Insurance Agents, Inc.*, v. *Board of Governors of the Federal Reserve System*,[3] the Board allowed a broad range of insurance activities. These activities included the following forms of insurance where such insurance was issued to protect assets financed by the bank holding company or to protect the bank holding company's ability to obtain payment of loans:

(1) Fire, theft, and other perils;
(2) Comprehensive insurance;
(3) Collision insurance;
(4) Marine insurance;
(5) Liability insurance;
(6) Property floater insurance;
(7) Homeowner's insurance;
(8) Boiler and machinery insurance;
(9) Surety bonds; and
(10) Performance bonds.[4]

Prior to the fifth circuit opinion in *Alabama Association*, the Board also allowed banks to engage in credit life, credit accident, and health insurance issued for the purpose of assuring the ability of the debtor to repay a debt, and the Board also allowed numerous forms of convenience insurance such as automobile insurance.[5]

In addition to the numerous forms of insurance listed above, bank holding companies made application, albeit unsuccessfully, for still additional forms of insurance. These forms of insurance include:

(1) Business interruption insurance;
(2) Fidelity insurance;

---

[3] 533 F. 2d 244 (Fifth cir. 1976); rehearing denied, 558 F. 2d 729 (Fifth cir. 1977; cert. denied 46 U.S.L.W. 3539. No. 77–668, Feb. 27, 1978.

[4] *Alabama Financial Group, Inc.*, 39 Fed. Reg. 25, 548 (1974); *First National Holding Corporation*, 39 Fed. Reg. 33411 (1974).

[5] Id.

(3) Level term life insurance;
(4) Loss of rent insurance; and
(5) Mortgage guarantee insurance.[6]

The numerous forms of insurance listed above demonstrate the need to replace the ineffective general standard with a specific prohibition upon all but a few specific forms of insurance.

II. ACTIONS OF FEDERAL RESERVE BOARD HAVE BEEN SO CONFUSING AS TO PREVENT EFFECTIVE JUDICIAL REVIEW

The Federal Reserve Board's treatment of this issue of permissible insurance activities for bank holding companies has been so confusing as to prevent effective judicial review thereof. This confusion is in large part due to the Board's continued refusal to set forth a statement of the basis and purpose behind its regulation in this area as is required by the Administrative Procedure Act. Had the Board in its initial promulgation of 12 CFR section 226.4(a)(9) set forth its basis for concluding that the broad range of activities allowed thereunder met the tests of section 4(c)(8) of the Bank Holding Company Act (that is, why those activities were closely related to banking and why the conduct of such activities by bank holding companies would be in the public interest), reviewing courts would have been more easily able to judge the actions of the Board. However, the Board failed to do so in both its promulgation of 12 CFR section 225.4(a)(9) and in its recent proposal to amend that regulation.

That the courts have been confused by the actions of the Federal Reserve Board in this area is made clear by the extreme difficulty the fifth circuit had in reaching its opinion in the *Alabama Association* case. The court issued two rehearing opinions in that case, each of which significantly modified its prior position. In its final opinion, the court upheld the validity of that portion of the regulation which allows bank holding companies to act as insurance agents or brokers with respect to any insurance which is directly related to an extension of credit by a bank or which is directly related to the provision of other financial services by a bank. In so holding, the fifth circuit opened the door for bank holding companies to engage in numerous forms of property and casualty insurance, even though such activities are not in fact closely related to banking and when conducted by bank holding companies are clearly contrary to the public interest. The court might not have made such a decision if the Federal Reserve Board had constructed a clear record below.

On April 10, 1978, the Federal Reserve Board promulgated a proposed amendment to 12 CFR section 225.4(a)(9) in order to conform that regulation to this unfortunate decision of the fifth circuit in the *Alabama Association* case.

III. PROPERTY AND CASUALTY INSURANCE IS NOT CLOSELY RELATED TO BANKING

By allowing bank holding companies to engage in numerous forms of property and casualty insurance in connection with an extension

[6] *Alabama Financial Group, Inc.*, 39 Fed. Reg. 25548 at 25550 (1974); *First National Holding Corporation*, 39 Fed. Reg. 33411 at 33412, 33413 (1974); *Barnett Banks of Florida and Chase Manhattan of New York*, 40 Fed. Reg. 44260 at 44622, 44624 (1975); *Pan American Bankshares, Inc., Miami, Fla.*, 40 Fed. Reg. 44630 at 44632 (1975).

of credit or other financial services by the bank holding company, the Board is given an extremely probanking interpretation to the words "closely related to banking." When one fully understands the intricacies of property and causalty insurance, it becomes clear that the sale of such insurance is not "closely related" to banking within the fair meaning of those words.

The three factors which are most commonly used to determine whether an activity is "closely related" are:

(1) The functional equivalence of the activity to banking;

(2) The ability of the activity to be operationally integrated into the bank's lending process; and

(3) The need of the bank to conduct the activity.

All three of these factors are absent in the case of property and casualty insurance.

There is no functional equivalence between the lending process and the sale of property and casualty insurance. Procedural steps taken in reviewing a loan application and drafting a loan contract are simply different from the procedures inherent in selecting, selling, and servicing property and casualty insurance.

Further, it cannot be argued that the sale of property and casualty insurance can be operationally integrated into the lending process. Property and casualty insurance is categorically different from credit life, credit health, and the limited form of credit accident insurance. These latter forms of insurance are generally written under a blanket policy issued to the lender without underwriting of individual applicants. There are no underwriting decisions to be made by the bank and no consumer decisions with respect to form or scope of coverage.

By comparison, the sale of property and casualty insurance necessitates an analysis of numerous factors, none of which are related to the lending process. The property and casualty insurance agent must assess all of the risks with which his client is faced and attempt to allocate the limited resources of his client to cover the most significant risks in an economical manner. He must be able to reassess his client's coverage needs as his client's business or personal situation changes. In the case of personal property, the agent must design his client's policy to include coverages for special costly items such as jewelry, furs, and art objects, not included in the "standard form" coverage. Also, the property and casualty agent must be familiar with the literally hundreds of different policy forms which he must choose from and often combine in order to give his client the most appropriate coverage. In addition to this extensive knowledge which the property and casualty agent must have of both his client's situation and the form of insurance available which will most properly fit that situation, the agent must also be prepared to service the policy which he sells. In some instances, this may entail the authority to settle small claims in the range of $100 to $6,000 depending upon the company and type of loss. Furthermore, the agent must handle claims for his client so that the client obtains the most speedy, efficient, and fair coverage from the insurance company. All of these skills are beyond the expertise of the normal loan officer. There is simply no parallel between the information and skills needed by the loan officer for the loan transaction and the information and skills required by the property and casualty insurance agent for the issuance of insurance. Consequently, the sale of property and casualty insurance may not be operationally integrated into a loan transaction.

Nor can it be shown that bank holding companies need to engage in the sale of casualty and property insurance. Of course, a bank needs to make sure that the property in which it has a security interest is insured, but there is no need for the bank to sell such insurance. A bank needs buildings and telephones to conduct business, but this need does not make the construction of buildings or the provision of telephone service "closely related" to banking. As was explained above, insurance agents are better trained than a loan officer to see that the property in which a bank has a security interest is adequately insured. Consequently, a bank holding company has no need to engage in the sale of property and casualty insurance.

The fact that property and casualty insurance has nevertheless been treated by the Federal Reserve Board under a "general" standard as "closely related" to banking demonstrates the need for Congress to specifically prohibit bank holding companies from engaging in all but a few specific forms of insurance.

IV. THE FEDERAL RESERVE BOARD HAS SHOWN LITTLE CONCERN OVER THE POTENTIAL OF BANK HOLDING COMPANIES TO EXERT ECONOMIC COERCION UPON THE INSURANCE BUSINESS

Not only has the Federal Reserve Board found the sale of property and casualty insurance to be closely related to banking, but it has also found the conduct of those activities by bank holding companies to be in the public interest. In making this finding, the Board has evidenced a noticeable lack of concern over the potential of bank holding companies to exert undue economic coercion upon the insurance business.

The history of the *Alabama Association* case demonstrates this failure of the Federal Reserve Board to objectively regulate the activities of the bank holding companies in the insurance area. The fifth circuit in that case was reviewing two decisions of the Federal Reserve Board, which in turn had reviewed the recommended decisions of an administrative law judge. The administrative law judge, who was not from the Federal Reserve System, but was "on loan" from another Federal agency, recommended that the major holding companies, First National Holding Co. and Alabama Financial Group, Inc., be denied the right to engage in all forms of insurance except for proprietary and employee insurance, and for credit life, credit health, credit accident, and mortgage redemption insurance.[7]

The bases for both decisions of the administrative law judge were essentially identical. Citing "destructive competition through the possibility of voluntary tying (insurance with lending) particularly in periods of tight money,"[8] the administrative law judge found that reasonable expectation of public benefits was outweighed by the possibility of the adverse effects represented by destruction of competition.

In the *Southern Bankcorporation* proceeding, two bank holding companies controlled over $2 billion of deposits in Atlanta represent-

---

[7] Jan. 14, 1974, recommended decision of the administrative law judge, FRB docket IA–8 (First National Holding Co.) and Feb. 7, 1974, recommended decision of the administrative law judge, FRB docket IA–10 (Southern Bankcorporation).

[8] Feb. 7, 1974, recommended decision of the administrative law judge, FRB docket IA–10 (Southern Bankcorporation).

ing over 50 percent of the market. One of the applicants in that case forecast earnings from marketing insurance in the amount of $4,712,500 annual premiums. The administrative law judge found that the adverse impact upon the Atlanta insurance agents would probably be substantial.[9] Furthermore, in that case there was testimony that a bank holding company would be "more receptive" to a borrower's last offer if insurance premiums were part of the total package. The administrative law judge concluded that "voluntary tying" of insurance to lending was quite possible, and noted that section 4(c)(8) of the Bank Holding Company Act focused upon "possible" adverse effects and not "probable" adverse effects.[10]

In reaching this decision, the administrative law judge also made the following observation, which although apparently ignored by the Federal Reserve Board, is in our view the very reason why your committee must specifically prohibit bank holding companies from engaging in insurance activities:

> The proposition reduced to its simplest terms comes down to this: If a bank, large in its community, using predominantly depositer's funds as capital, is authorized to compete against mostly small insurance enterprises by soliciting its debtor-clientele, it is possible, even probable that the mom-and-pop agency will be driven into merger or out of business entirely; and, to this extent, the American dream of a land of opportunity where every man and woman, with some skill and good luck, can become a proprietor or a partner, rather than merely a clerical employee or an insignificant stockholder, will fade further.[11]

In spite of these alarming findings by the administrative law judge, the Federal Reserve Board rejected in large part the decision of the administrative law judge, and allowed many types of insurance activities which the administrative law judge had found to have presented unacceptable risks of anticompetitive results. In doing so, the Board repeatedly stated that it had found no evidence of attempts by the bank to tie, either voluntarily or involuntarily, the sale of insurance to its provision of banking services. This inclination of the Board to require a showing of actual use of monopoly power by the banks demonstrates the lack of concern of the Board over the potential of bank holding companies to use their extraordinary economic power in an unfair manner. Monopoly power has long been held to be an evil in itself, regardless of whether that power is in fact exercised by its holder.[12]

V. BANK HOLDING COMPANIES CONTINUE TO PRESSURE FOR EXPANDED SCOPE OF PERMISSIBLE INSURANCE ACTIVITIES

Sensing this probanking attitude of the Federal Reserve Board System, bank holding companies have continued to pressure the Board to expand the scope of permissible insurance activities.

Recently, a bank holding company, NCNB Corp., applied to the Federal Reserve Board for approval to retain its indirect subsidiaries which were engaged in the actual *underwriting* (that is, ultimate risk bearing) of property and casualty insurance related to extensions of

---

[9] Id.
[10] Id.
[11] Id.
[12] "So it is that monopoly power, whether lawfully or unlawfully acquired, may itself constitute an evil and stand condemned under § 2 [Sherman Act] even though it remains unexercised" (brackets added). *U.S.* v. *Griffith,* 334 U.S. 100 (1948).

credit by NCNB Corp.'s affiliates. On May 12, 1978, the Federal Reserve Board denied the application finding that the activities of the subsidiaries were not closely related to banking. However, the fact that one Governor on the Board voted against rejecting the application and the very fact that the bank holding company even made the application are indicative of bank holding companies' belief that the Federal Reserve Board will allow them to engage in almost any type of insurance activity.

Further evidence of this attitude on the part of the bank holding companies may be found in the comments which were filed on May 1, 1978, by the American Bankers Association upon the Federal Reserve Board's proposed amendment to 12 CFR section 255.4(a)(9), that regulation which defines the scope of insurance activities which may be engaged in by bank holding companies. In these comments, the American Bankers Association argued that bank holding companies should be allowed to issue extensions or renewals upon credit-related insurance even though the loan which is related to the insurance has been paid in full. It is hard to conceive how the issuance of such renewal insurance by banks can be seen to be "closely related to banking" when such renewals are issued after the period when the loan which was the basis for the issuance of the insurance has been paid. Nonetheless, this position of the American Bankers Association indicates that the bank holding companies feel that the Federal Reserve Board might apply the general "closely related" test in such a manner as to allow renewal insurance.

VI. CONCLUSION

In summary, although S. 72 would tighten somewhat the general standards contained in section 4(c)(8) of the Bank Holding Company Act and in 12 CFR section 225.4(a)(9), S. 72 still utilizes a general standard. The past 7 years have shown that the Federal Reserve Board is unable or unwilling to effectively limit the insurance activities of bank holding companies under a general standard. Accordingly, PIA urges your committee to adopt the approach taken in S. 3087 and H.R. 12614 by specifically prohibiting bank holding companies from engaging in any insurance activities except for a few specific types of insurance activities such as life or disability insurance issued in connection with a specific credit transaction, or insurance issued in towns of populations under 5,000. Such an approach is necessary to effectively limit the insurance activities of bank holding companies and to put an end to the unproductive administrative proceedings which have been going on at great expense for the past 7 years using a general standard.

The CHAIRMAN. Thank you very much, Mr. Naugle.

Mr. Shapiro.

STATEMENT OF JOEL A. SHAPIRO, COCHAIRMAN, COMMITTEE ON FEDERAL LAW AND LEGISLATION, NATIONAL ASSOCIATION OF LIFE UNDERWRITERS, ACCOMPANIED BY WILLIAM B. SCHER

Mr. SHAPIRO. Thank you, Senator.

Mr. Chairman, my name is Joel Shapiro. I'm a full-time life insurance agent in New York City. Off the record, I personally would like to thank the committee for its action on another matter last week.

Senator SCHMITT. I think that's on the record.

Mr. SHAPIRO. I'd like to put it on the record.

The CHAIRMAN. Mr. Shapiro, I'll be right back. You go right ahead. Senator Schmitt will take over. I'll be back in about 2 minutes. I have to answer a phone call.

Mr. SHAPIRO. I'm here in another capacity. I am currently chairman of the Federal Law and Legislation Committee of the National Association of Life Underwriters, better known as NALU, and this morning I'm accompanied by William B. Scher, counsel for NALU based here in Washington.

NALU is a federation of over 1,000 State and local associations representing approximately 135,000 life and health insurance agents, general agents and managers. I would like to take this opportunity to thank the committee for permitting me to testify today on behalf of NALU in support of S. 72.

NALU has long been vitally interested in legislation which seeks to protect the consumer from the results of undue concentration of resources and economic power in any segment of the economy, from decreased or unfair competition, conflicts of interest, unlawful tying arrangements and coercion. We believe that you, Mr. Chairman, have demonstrated your concern about these dangers to the consumer and the economy by introducing this legislation, designed to reestablish competition within the banking industry while at the same time insuring that a healthy line of demarcation is maintained between banking and commerce.

Although NALU is concerned with the increasing concentration of power within the banking industry itself, the members of our association have been primarily concerned with and affected by the expanding diversification of bank holding companies into areas which have been traditionally regarded as nonbanking activities. In our viewpoint, this extension of the banking institutions of our Nation into a variety of other business endeavors has resulted in unfair competition between banks and affected businesses as well as harm to the American consumer.

NALU agrees with the competitive concerns expressed in a report of a survey conducted by the House Committee on Banking and Currency released in 1969 which listed three major adverse consequences resulting from the mixing of banking and nonbanking activities within the same corporate structure. These adverse consequences were stated thus:

(1) There is inevitably a strong temptation to have the banking subsidiary of a holding company extend large amounts of credit, perhaps unwisely, to other holding company subsidiaries, thus creating unsound financial conditions for the bank to the detriment of the bank's depositors, stockholders and the public at large. This is the kind of activity in which some of the larger banks in the country were engaged in the 1920's.

(2) Since banks are the principal suppliers of substantial credit to almost every industrial, commercial and other kind of business in the United States, banks should not be in a position to discriminate unfairly against these users of bank credit by establishing competing subsidiaries and then denying credit to the competitors of the bank's non-banking subsidiaries. This is a particularly serious problem in the many cities and towns all over the United States where there are only one or two major banking institutions to which business can turn for substantial amounts of credit.

(3) Because many large and small businesses, as well as individuals, depend on bank credit for their economic existence, bank subsidiaries of one-bank holding

companies are in a position to insist or "strongly suggest" that if the borrower wants continued access to bank credit, it should also use the services of the holding company's other subsidiaries. These services might include insurance, equipment leasing, property management, accounting, computing, investment and travel services, or any other business the holding company might decide to undertake. This would create unfair competition for non-bank related competitors of these subsidiaries and could in the long run substantially reduce or eliminate competition in many businesses to the detriment of the public interest. [Staff of House Committee on Banking and Currency, 91st Cong., 1st Sess., Report on the growth of unregistered bank holding companies. (Comm. Print 1969.)]

Regarding the possibility of coercion noted in (3) above, I would only add that such practices have been well documented in past hearings before this committee with respect to insurance activities carried on by banking institutions and more indication of the possibilites for such practices will be discussed later in this statement. There is also the distinct possibility of what has become known as "voluntary tying" which may arise when banking institutions are permitted to enter fields not directly related to banking. A good description of the dangers of voluntary tie-ins was provided this committee by Assistant Attorney General Richard McLaren during the 1970 Hearings on the Bank Holding Company Act amendments. In his testimony, Mr. McLaren referred to a situation:

(W)here a potential borrower may independently decide that, just because he might possibly be under watch, it is in his best interest to patronize bank-affiliated enterprises in the hope of improving his chances of obtaining credit from the bank on favorable terms, or indeed at all.

This can be illustrated by an example. A potential loan applicant might voluntarily place his casualty insurance business with a bank-affiliated insurer in hopes of improving his chances for a mortgage loan on the insured property on favorable terms. This would have the same effect as a coercive tie-in. Competition in the tied product, insurance, would be lessened to the extent that customers no longer purchased it entirely on its own economic merit. One such merger might well trigger others and, as a pattern of such bank insurance affiliations developed, market foreclosure in the tied field would become more and more serious.

Such voluntary tying or tying effect, as we called it in a recent case, is the product of market structure—not misconduct.

This structural problem is intensified because present antitrust remedies appear inadequate to deal directly with it. There simply is no illegal practice or conduct for a court to enjoin. Hence, we must concentrate on avoiding a structure which gives rise to such effects. [Hearings on Bank Holding Company Act amendments before the Senate Committee on Banking and Currency, 91st Cong., 1st Sess. (1969.)]

Section 301 of S. 72 provides for important restrictions on the permissible nonbanking activities which may be carried on by bank holding companies and the proposed amendments to section 4(c)(8) of the 1956 Bank Holding Company Act as amended are a commendable and necessary addition to the current law.

While NALU fully supports these provisions, we also feel it desirable that the bill be strengthened to state those activities which are specifically prohibited to bank holding companies. We feel such a statement is important due to the fact that there are certain nonbanking activities which have been deemed permissible for bank holding companies in the past despite the apparent congressional intent behind the 1970 amendments to the Bank Holding Company Act of 1956.

For some time, NALU has become increasingly alarmed by the growing encroachment of banking institutions into the insurance agency business generally, and more particularly the sale of life and health insurance by bank affiliated agencies. While sales of life insurance and health insurance have not generally been deemed permissible activities for bank holding companies per se, such products have been permitted to be marketed by general insurance agencies affiliated with bank holding companies because of a Federal Reserve Board regulation promulgated subsequent to the passage of the 1970 Bank Holding Company Act amendments. This regulation, among other things, essentially permits a bank holding company or its nonbanking subsidiary to market any insurance in communities of 5,000 or less. In a recent development, the Federal Reserve Board has proposed to review this permissible activity as required by a recent Federal court case (see Fed. Reg. 23588–23589).

Another part of the Board's regulation permits bank holding companies and their nonbanking subsidiaries to engage in the sale of insurance directly related to the provision of other financial services by a bank or bank-related firm. The Federal Reserve Board has interpreted such activities to include the sale of life insurance—

(1) Equal to the difference between the maturity value of a deposit plan for periodic deposits over a specified term and the balance in the account at the time of the depositor's death,

(2) In connection with mortgage loan servicing that is provided by a bank or bank-related firm, insurance on the mortgaged property and/or insurance on the mortgagor to the extent of the outstanding balance of the credit extension, provided, that the mortgagee is a beneficiary under such types of insurance policies;

(3) Directly related to the provision of trust services if the sale of such insurance is permitted by the trust instruments and under State law. (See 12 CFR (225.128).)

While this part of the regulation is also currently being reviewed by the Federal Reserve Board in accordance with the same Federal court decision noted above, it would not appear that the Board's interpretation permitting the above-noted activities will be affected by this review. Thus, banking institutions have made many inroads into insurance agency activities which are not "closely related" to banking in most instances. Such activities have been permitted by the regulatory agency through administrative action which appears to be outside the scope of statutory authority.

NALU would note that the Federal court case which has mandated the Federal Reserve Board review of various portions of its regulation affecting permissible insurance agency activities of bank holding companies will, in all probability, have only a minor impact on restricting many of the currently permissible activities. The very fact that litigation continues to occur more than 7 years after the passage of the Bank Holding Company Act Amendments of 1970 with respect to which insurance agency activities are proper for bank holding companies and their nonbanking subsidiaries is indicative of the fact that congressional action is needed in this area.

It is our understanding that the testimony of the Independent Insurance Agents of America will provide documentation of the difficulties they have experienced in attempting to obtain administrative and judicial relief from increasing bank holding company penetration of many kinds of property and casualty insurance agency activities in apparent violation of the intent of Congress in passing the 1970 legislation. It is the opinion of NALU that it is only a matter of time before the bank holding companies will begin to attempt similar full-scale entry into the life and health insurance agency business unless Congress adopts specific language prohibiting such activities.

There are additional reasons why NALU feels that certain insurance agency activities, including the marketing of life and health insurance, ought to be specifically prohibited to bank holding companies and I would like to take this opportunity to point out these additional reasons.

First of all, it should be noted that while it is apparent that the sale of life and health insurance is not "closely related" under the current law or "closely and directly related" under the proposed S. 72 standard, such is not the case, unfortunately, with sales of certain credit life and health insurance products. For instance, it is probable that the sale of credit life and health insurance, when issued in connection with a specific loan or other credit transaction is "closely related" to banking under the current law and an argument would inevitably be mounted that this sale of credit life and health insurance would be "directly related" under the language of S. 72.

Therefore, with respect to credit life and health insurance agency activities, where confusion may arise on the issue of precisely what nonbanking insurance agency activities are permissible, it would seem appropriate to designate those insurance agency activities which are not "closely and directly related" or, conversely, provide a listing of the only insurance agency activities, if any, which would be permissible under S. 72. Such action would be helpful in providing clarification to the regulatory agency regarding congressional intent on arguably directly related credit insurance activities. Parenthetically, I would note that even though credit life and health insurance may be considered directly related to banking, NALU is opposed to the undertaking by banking institutions of any type of insurance agency activity, including the sale of credit life and health insurance. We applaud the congressional finding in this bill that "banking holding companies have extended their services into product markets beyond those directly related to banking in offering insurance agency and underwriting services." Bearing importantly on NALU's feeling that prohibited insurance agency activities should be specifically listed in the bill is the deplorable track record of bank institutions in the field of marketing credit life and health insurance.

In this regard a recent development by a Federal Government regulatory agency would appear to provide implicit recognition of the dangers associated with permitting banking institutions to engage in credit life activities. On September 23, 1977, the Comptroller of the Currency issued a final regulation designed to prohibit the distribution of credit life insurance income to employees, officers and directors of a national bank and to individual stockholders owning more than 5 percent of a national bank's shares. The admitted purpose of the regulation was stated as being to curb self-dealing in the sale of credit life insurance by national bank insiders.

Essentially, the regulation was issued to insure that credit life insurance income derived through bank auspices would accrue to the shareholders of the bank rather than to the benefit of individuals associated with the bank. However, the regulation was premised on several considerations which are particularly relevant to the deliberations of this committee in connection with S. 72. NALU feels that the Comptroller of the Currency accurately set forth the problems associated with permitting credit life insurance to be sold by bank employees when this regulation was issued and the only argument NALU would have with the Comptroller's expressed apprehensions would be with respect to the solution of the problem.

The Comptroller first addressed the problem of unsafe and unsound banking practices which may result from the payment to and retention of credit life insurance commissions to bank insiders such as loan officers. The Comptroller was of the opinion:

> That a loan officer's judgment on credit quality can and may be influenced by the direct financial reward he receives from making a loan with credit life insurance attached. As one commentator noted: "When commissions are received by bank officers, either as outright bonuses or as compensation in lieu of salary, the prospect of personal financial gain is interjected into the lending decision. The gain goes to the officer while the risk is borne by the bank, thereby undermining risk-reward calculation." The Comptroller also notes that bankers have condemned the use of incentives to generate high loan volume because it might inhibit loan quality; the same reasoning would seem applicable to the use of incentives for the sale of credit life insurance on bank loans. [42 Fed. Reg. 48524 (1977)].

The Comptroller then addressed the antitrust considerations which had prompted the promulgation of this regulation with the following statement:

> An additional basis on which the Comptroller promulgates this regulation is his concern that the use of credit life insurance commissions as an incentive to encourage loan officers to sell credit life insurance tends to increase the chances of an illegal tie-in between the sale of credit life insurance and the granting of credit. While the use of incentives to generate sales of one product closely associated with another being sold simultaneously cannot be considered a per se violation of the federal antitrust laws or of the anti-tying provisions of the Bank Holding Company Act Amendments of 1970, special concern is warranted in credit life insurance sales to loan customers in view of the widespread suspicion that such sales are less than fully voluntary on the part of the borrower.
>
> In view of the extensive experience of the Federal Trade Commission in the application of the antitrust laws to the sale of credit life insurance to borrowers, the Comptroller believes the commission's views are entitled to significant weight on this issue. According to the Commission, the Comptroller's regulation "will partially alleviate the problem of coercive and deceptive credit insurance sales practices by eliminating one aspect of a compensation system which tends to foster of abuse. [42 Fed. Reg. 48524 (1977)].

Finally, the Comptroller indicated his opinion that to a limited extent:

> The regulation should have a beneficial impact on consumers who borrow from national banks. Since loan officers are prohibited by the regulation from benefitting personally on the sale of credit life insurance, there is less likelihood that a borrower will be persuaded to purchase unneeded credit life insurance. With the elimination of direct incentives for loan officers, the chance of an illegal tie-in of credit life insurance with the granting of credit decreases. [42 Fed. Reg. 48524–48525 (1977)].

The Comptroller has made his case with respect to the very problems which have concerned NALU about the sale of insurance by banks and bank holding companies. We would hasten to point out that the Comptroller's solution—to channel the profits from the sale of credit life insurance directly into the bank's treasury rather than directly into the bank officer's—or shareholder's—pockets—does not meet the real potential dangers involved when banks—and their holding companies—market insurance. This is due to the fact that there appears to be no viable method to insure that the bank—or bank holding company—may not offer some sort of incentive—either direct or indirect—to its employees for their efforts to tie-in the sale of insurance with the banking service being offered.

Unfortunately, this sad state of affairs was tacitly acknowledged by the Comptroller as part of the background discussion accompanying issuance of the recent regulation wherein it was noted that:

> Provided certain procedures are followed, the Comptroller believes this regulation will have no substantial impact on most of the banks where credit life insurance income is now paid to individuals. If the credit life insurance income is credited to the bank and officers' salaries are adjusted correspondingly upwards to compensate for their lost income, the result, from an accounting standpoint, should be a wash. Some banks converting from a salary-plus-credit life insurance income pay plan to a straight salary arrangement may incur minor additional liabilities where employee fringe benefits have been tied to salary but not to credit life insurance income. [42 Fed. Reg. 48521 (1977)].

As further evidence of the "enterprising" nature of banking institutions and their employees and shareholders when it comes to engaging in insurance activities, NALU would submit to the committee a partial text of a letter written by the Deputy Comptroller of the Currency to the Dallas Regional Administrator of National Banks as published in the May 22, 1978 edition of the American Banker [at page 51].

> The purpose of this letter is to clarify certain questions raised about the new regulation on disposition of credit life insurance income, 12 CFR 2.
>
> 1. It has come to our attention that some bank officers who are licensed insurance agents have entered into reciprocal arrangements with officers of other banks to act as agent for the sale of credit life insurance to the other bank's loan customers. For example, the chief executive officer of Bank A will designate the chief executive officer of Bank B as the agent for the sale of credit life insurance at Bank A, and vice versa, with the result that the two chief executive officers receive the commissions from the sale of credit life insurance at each other's bank.
>
> Where reciprocal arrangements have been made, they amount to a subterfuge and will be considered a violation of 12 CFR 2.4(a). Aside from the fact that the arrangement is a clear evasion of the regulation, it raises the possibility that one of the banks, in an effort to maintain parity of income for the two chief executive officers, will step up its credit life insurance sales program, thereby increasing the possibility that marginal loans will be made to reap additional credit life insurance commissions and that loan officers more frequently will attempt to tie the sale of credit life insurance to the granting of credit. These two concerns were among the considerations prompting the Comptroller to adopt the regulation, and they persuade us that reciprocal arrangements of this kind are unsafe and unsound.
>
> In light of the above, we suggest that national bank examiners inquire about the existence of reciprocal arrangements with officers and directors of other banks.
>
> 2. We have been advised that some bankers and principal shareholders have arranged for their relatives, e.g., grandchildren and adult children, to obtain an insurance agent's license and act as agent for the sale of credit life insurance at the bank and receive commissions. Since section 2.3(d) of the regulations covers only spouses and minor children of officers, directors, employees and principal shareholders, the prohibitions of section 2.4(a) do not apply to grandchildren and adult children. However, where it can be shown that the arrangement relieves or reduces a pre-existing obligation of the bank officer to the relative in question, we will consider the arrangement a violation of section 2.4(a).

NALU respectfully submits that if banking institutions have shown a proclivity for making money at the expense of the American consumer through their marketing methods of credit life and health insurance, and the record of that is all too well documented, then banking institutions ought to be affirmatively prohibited from becoming involved in insurance agency activities such as the sale of life and health insurance where they have little or no experience and expertise and certainly no justifiable direct banking interest.

NALU also feels it advantageous to specifically list those insurance agency activities which are not permissible for bank holding companies in order to help avoid any conflicts which might arise due to contemplated State legislation. Currently, the business of insurance is almost exclusively State regulated. Several State legislatures concerned by increasing banking institution intrusion into the insurance agency business, have recently enacted restrictive State licensing laws prohibiting banks, bank holding companies and their employees from engaging in many insurance agency activities.

Inasmuch as many other State legislatures will be considering similar action, a list of those insurance agency activities prohibited to bank holding companies and their subsidiaries under the Bank Holding Company Act would provide helpful Federal direction to those State legislatures who wish to shape their bills to coincide with Federal laws.

NALU also supports the provisions of section 401 of S. 72 entitled "Uniform Application of Standards Governing Entry Into Bank Related Fields." We feel it very important that there be a consistency in decisions emanating from the two primary Federal regulators of bank holding company subsidiaries—the Federal Reserve Board—charged with the responsibility of regulating bank holding companies and their nonbank subsidiaries—and the Comptroller of the Currency—charged with the responsibility for regulating national bank subsidiaries of bank holding companies— as far as the appropriate outer limits for expansion by bank holding companies into directly related areas is concerned.

Other provisions of the bill which appear particularly beneficial in protecting the public interest appear in sections 601 and 701. Section 601 provides that Federal Reserve Board determinations of permissible 4(c)(8) activities—under the Bank Holding Company Act as amended—will be made on the record and, additionally, this section proposes helpful discovery rules and insures that relevant information pertaining to Board proceedings under 4(c)(8) will be available to interested parties to the proceeding. The general application of the Administrative Procedure Act to Federal Reserve Board rulemaking proceedings is another desirable feature of this section of the bill.

The necessity for these changes was, in part, underscored by a staff report of the Subcommittee on Domestic Finance of the House Banking Committee issued in the latter part of 1973. This report noted the failure of the Federal Reserve Board to provide a useful record on which it based its decisions in several important cases involving interpretation of the Bank Holding Company Act as amended. This report stated the consequences of such failure as being that:

[T]he due process of law is thwarted because those who seek to appeal decisions of the Board are unable to present the details of the Board's findings or its reasoning for purposes of rebuttal. [Staff report of the Subcommittee on Domestic Finance of the Committee on Banking and Currency of the House of Representatives on Financial Institutions: Reform and the Public Interest, 93d Cong., 1st Sess., August 1973.]

Section 701 of the bill, providing for ongoing supervision of bank holding company 4(c)(8) activities by the Board, would seem particularly desirable due to the fact that the net public benefits to the public offered by bank holding companies are all too frequently short-lived.

Invariably, as one compares this bill to the existing law, every provision on a section-by-section basis imposes public interest requirements on Federal Reserve Board proceedings conducted to determine what activities should be permissible for bank holding companies and their subsidiaries.

NALU feels strongly that this is a bill designed to protect the American consumer of banking services as well as the small businesses of America from the excesses perpetrated upon them by increasingly more powerful banking institutions and their expansionary and harmful entry into nonbanking areas.

We urge that every member of the committee give this bill top priority, and once more respectfully request the consideration of additional language further clarifying those insurance agency activities which would be prohibited under this proposed legislation.

In closing, I would like to present to you an excerpt from a decision of an administrative law judge assigned to a Federal Reserve Board administrative proceeding in which insurance agents were challenging bank holding company entry into a wide variety of insurance agency activities. While this finding is of particular relevance to the membership of NALU, it would be equally applicable to many other small businesses trying to survive bank holding company competition.

The judge reached the following conclusion as part of his decision:

The proposition reduced to its simplest terms comes down to this: If a bank large in its community, using predominantly depositors' funds as capital, is authorized to compete against mostly small insurance enterprises by soliciting its debtor clientele, it is possible, even probable that the mom and pop agency will be driven into merger or out of the business entirely; and to this extent, the American dream of a land of opportunity where every man and woman, with some skill and good luck, can become a proprietor or a partner, rather than merely a clerical employee or an insignificant stockholder, will fade further . . . . [Recommended decision of Paul N. Pfeiffer, administrative law judge, FRB docket No. IA-10 (1974).]

Mr. Chairman and members of the committee, I thank you once again for permitting me to express NALU's support of S. 72.

The CHAIRMAN. Thank you very much, Mr. Shapiro.

Mr. Wilson.

STATEMENT OF THOMAS E. WILSON, COUNSEL, WILKINSON, CRAGUN & BARKER, INDEPENDENT INSURANCE AGENTS OF AMERICA; ACCOMPANIED BY EDWARD KREMMER

Mr. WILSON. Mr. Chairman and members of the committee, my name is Thomas E. Wilson. I am with Wilkinson, Cragun & Barker, Washington counsel for the Independent Insurance Agents of America ("IIAA"). I am accompanied at this hearing by Edward J. Kremer, chairman of IIAA's federal affairs committee, and by Jeffrey M. Yates, IIAA's associate general counsel.

IIAA welcomes this opportunity to testify in support of the Competition in Banking Act of 1977 (S. 72). This bill takes needed action to preserve competition in the banking industry, and to clarify and strengthen the current law limiting the participation of banking organizations in nonbanking activities. We thank the committee for inviting us to express our views on matters of such vital importance to our economy.

I. INTRODUCTION

IIAA is a national association of independent property and casualty insurance agents. The association is composed of 51 State associations—including the District of Columbia—which represents more than 34,000 insurance agencies and approximately 150,000 insurance agents across the country. Members of IIAA vary greatly in size; most are smaller businesses having gross incomes of less than $75,000 per year. The agents are proud of being part of an industry in which small business organizations have been able to serve the insurance needs of the public efficiently. This success is attributable to the efficiencies of competitive retail markets which are characterized by large numbers of conveniently located agencies from which the public is able to purchase insurance.

IIAA has long been committed to the preservation of the high level of competition which currently prevails in the retail property and casualty insurance industry. For this reason, we have been concerned with the continuing attempts of large banking organizations to gain entry into our industry. If the enormous resources of banking organizations, coupled with the unfair competitive advantage they would enjoy by virtue of their control over credit transactions, were brought to bear in the retail insurance industry, substantial numbers of nonaffiliated agencies would inevitably be forced into mergers or out of business entirely. The result would be a dramatic reduction of competition. These concerns prompted IIAA to oppose certain applications filed by various bank holding companies to engage in insurance agency activities after the Bank Holding Company Act of 1956—"BHC Act"—was amended in 1970. The litigation involving two of those applications recently came to an end when the Supreme Court declined to review the approval of those applications by the Board of the Governors of the Federal Reserve System—"Board"—and a U.S. court of appeals.[1]

IIAA believes that S. 72 is a farsighted and necessary piece of legislation. The bill recognizes that our national economic well-being is closely linked to the preservation of competition in the banking industry. In addition, the bill takes cognizance of the potentially enormous destructive power banking organizations may exert when they enter into direct competition with the natural occupants of nonbanking markets (for example, insurance agents). Although S. 72 is a step

[1] Alabama Association of Insurance Agents, Inc. v. Board of Governors of the Federal Reserve System, 533 F. 2d 224 (5th Cir. 1976), on rehearing, 544 F. 2d 1245 (1977) (advance sheet only), on rehearing, 558 F. 2d 729 (1977), cert. denied, 46 U.S.L.W. 3541 (Feb. 27, 1978).

in the right direction, in IIAA's view it does not go far enough. As a result of IIAA's litigation experience on the insurance agency issue, an experience we will share with you in detail in a moment, IIAA is convinced that Congress must decide once and for all what nonbanking activities are impermissible for bank holding companies and write appropriate prohibitions into law.

Insofar as property and casualty insurance are concerned, Senator Durkin has recently introduced, and Senator Hathaway has cosponsored, a bill (S. 3087) which would specifically prohibit bank holding companies from engaging as principal or agent in the sale of property and casualty insurance, except in limited circumstances. IIAA fully supports Senator Durkin's initiative and urges this committee to amend S. 72 to include the language of Senator Durkin's proposal, or to report Senator Durkin's bill out of committee as a separate piece of legislation. As our present testimony will show, such action is urgently needed to prevent the property and casualty insurance agency industry from being radically restructed as a result of massive bank holding company entry.

Substantial evidence has already been presented to Congress on the economic issues associated with the problem of bank holding company entry into a variety of nonbanking activities.* For this reason, IIAA will focus its comments on the specific experience it has had with the Board's administration of the BHC Act since that act was amended in 1970. We think that experience will be enlightening of this committee and will provide an ample basis for the relief we believe is crucial in order to protect the public interest.

II. THE HISTORY OF BANK HOLDING COMPANY INSURANCE AGENCY LITIGATION

A. Background: For many years, the Nation's banking legislation has required a separation between banking and other forms of commerce. Since the establishment of the national bank system, Congress was prohibited Federal banking associations from engaging in any activity which was not banking or an incidental power of banks.[1] When Congress enacted the BHC and the 1970 amendments thereto, it continued and extended this principle.[2] Consequently, the BHC Act generally prohibits bank holding companies from owning the shares of any company which is not a bank.[3] The limited exception to this prohibition appear in section 4 of the BHC Act, with the principal exception contained in subsection (c)(8).[4] Section 4(c)(8) essentially provides that a bank holding company may engage in a nonbanking activity if, and only if, it can make an affirmative showing that (i) the particular activity in which it wishes to participate is "closely related" to banking, and (ii) its participation in the activity can reasonably be

*For example, on Mar. 4, 1976, in connection with S. 2721, IIAA alone presented more than 150 pages of testimony and exhibits on this question. Other parties have submitted substantial additional testimony concerning S. 72. Similarly, in the House, testimony was presented during oversight hearings in 1975, and again in connection with the so-called Committee Print in 1976 and the Safe Banking Act of 1977. For these reasons, this issue has been fully aired before this committee and before other committees of Congress.

[1] *See* National Bank Act, ch. 106, § 8, 13 Stat. 101 (1864) (current version at 12 U.S.C. § 24 (Supp. V 1975)).

[2] S. Rep. No. 1084, 91st Cong., 2d sess. 2–3, reprinted in [1970] U.S. Code Cong. & Ad. News 5520–21; S. Rep. No. 1095, 84th Cong., 1st sess. 11–14 (1955).

[3] 12 U.S.C. § 1843(a) (1970).

[4] 12 U.S.C. § 1843(c)(8) (1970).

expected to result in benefits to the public that outweigh possible adverse effects.*

In 1971, the Board promulgated section 225.4(a)(9) of its regulation Y, which enumerated those types of insurance agency activities which the Board considered to be "closely related" to banking within the meaning of section 4(c)(8) of the BHC Act.[1] IIAA and various of its state and local associations subsequently opposed certain bank holding company applications for insurance agency authority which were submitted pursuant to the Board's new regulation. IIAA requested that the applications be set for hearings.

The Board announced that hearings would be held on 22 of the then pending applications.[2] Eventually, four hearings involving eight applications were held. The rest were either withdrawn, settled by stipulation between the parties, or deferred pending the final outcome of the cases set for hearing. Two of these cases ultimately went to the Supreme Court, which recently declined review. We will discuss those cases in detail in this testimony.[3] The remaining are cases currently pending in the courts and, for that reason, will not be discussed.

B. Description of the Applicants and Their Insurance Agency Proposals: The two proceedings which have been finally resolved involved the applications of two bank holding companies, Southern Bancorporation ("Southern") and First National Holding Corp. ("First National"), to engage in a broad range of property and casualty insurance agency activities across a major part of their holding company opertions. Both organizations are powerful financial institutions having total deposits in excess of $1 billion. Southern had five banking subsidiaries which conducted business out of 39 offices throughout the State of Alabama. First National had one banking subsidiary operating out of more than 40 banking offices in the Atlanta area, and a large mortgage company subsidiary with numerous additional offices throughout the State of Georgia.

Each applicant proposed to have one insurance agent located at a central location in Birmingham (Southern) and Atlanta (First National) to serve the insurance needs of persons entering into loan and other financial transactions with their holding company systems. Neither applicant proposed to offer direct billed insurance.[4]

The applicants asserted that the types of insurance agency activities contemplated by their applications conformed with the Board's insurance regulation and were therefore "closely related" to banking within the meaning of section 4(c)(8) of the BHC Act. They also contended that approval of their applications would result in benefits to the public that would outweigh possible adverse effects.

C. IIAA Opposition to the Applications: IIAA's opposition to the Southern and First National applications was twofold. First, IIAA contended that the Board's insurance regulation was invalid. Second, the insurance agents argued that approval of the two applications could not reasonably be expected to result in benefits to the public that would outweigh possible adverse effects.

---

* *Id.*

[1] *See* 12 C.F.R. § 225.4(a)(9) (1977).

[2] *See* 38 Fed. Reg. 6,441 (1973).

[3] *See* note 1 and accompanying text *supra.*

[4] Direct billed insurance is a form of personal lines insurance (automobile and homeowners) which is administered at the insurance company level, rather than the agency level. Direct billed insurance generally offers consumers lower premiums than are available with similar policies administered directly by insurance agencies.

Specifically, the IIAA parties argued that the Board's insurance regulation was bereft of any statement of basis and purpose, as required by the Administrative Procedure Act, and that the regulation was entirely too general and impermissibly vague. The insurance agents also pointed out that, except for sales of credit life and disability insurance, insurance agency activities are neither functionally equivalent to extensions of credit nor operationally able to be integrated into financial transactions. For these reasons, IIAA maintained that the activities proposed by the applicants were not "closely related" to banking within the meaning of the BHC Act.

Insofar as public interest considerations were concerned, the IIAA parties noted that each of the applicants' proposals contemplated only one centrally located insurance agent to service the insurance needs of consumers from all over the States of Alabama and Georgia. Since there were numerous insurance agents in the immediate vicinity of each of the more than 80 offices from which the applicants proposed to offer insurance, the applicants' insurance proposals were manifestly inconvenient to the public.

The insurance agents also pointed out that, since both applicants rejected the sale of lower cost direct billed insurance policies, they would be offering insurance to the consumers at higher prices than were otherwise available through nonaffiliated agents.

Finally, IIAA argued that by combining sales of insurance with extensions of credit the applicants would enjoy an unfair competitive advantage over nonaffiliated agents. The ability of a holding company to control a credit transaction provides it with a unique opportunity through overt coercion, or more subtle means, to influance a borrower who must purchase insurance to protect the collateral standing behind a loan. Even in those instances where a borrower voluntarily decides to purchase insurance through the holding company's affiliated agency—because he thinks it might help him in the loan transaction—he is making his insurance decision without regard to the traditional levers of the market place—lower price and improved service. The result of that decision, whether voluntary or coerced, is the same—it reduces competition in the insurance agency industry.

D. Findings and Recommended Decisions of the Administrative Law Judge: The Administrative Law Judge who heard the evidence presented at trial concluded, based on his reading of congressional intent, that the lines of insurance for which the applicants had sought authorization were "closely related" to banking. He did not, however, believe that the applicants had shown that approval of their applications could reasonably be expected to result in benefits to the public, such as greater convenience, gains in efficiency, and increased competition that outweighed possible adverse effects, such as decreased or unfair competition and undue concentration of economic resources.

Specifically, the Administrative Law Judge found that the applicants' plans to have a single, centrally located insurance agent serving the insurance needs of consumers from across the applicants' respective States was manifestly inconvenient. In fact, he stated that "[t]he insurance consumer would be better served by going to his nearby independent agent for consultation rather to a bank office some distance from the insurance agency subsidiary." [1] Similarly, the Ad-

[1] Recommended Decision, *The Alabama Financial Group, Inc.* (Southern Bankcorporation), FRB Docket IA-10, at 16 Feb. 7, 1974).

ministrative Law Judge rejected the applicants' claims that they would be able to bring a greater level of efficiency to insurance agency operations. On that issue he concluded that, "while [the applicant] may experience some operating efficiency by adding insurance services to its banking and nonbanking functions, there is no proof that the customers will benefit in terms of lower cost of insurance coverage. On the contrary Applicant's policy appears to *deliberately avoid* the most promising technique for insurance customer savings."* The "promising technique" to which the judge referred was the direct billed insurance which would be available through nonaffiliated agencies but not through the applicants.

Finally, the Administrative Law Judge rejected the applicants' claims that approval of their applications would result in increased competition in the insurance business. To the contrary, he found that, in locations where the applicants' banking subsidiaries controlled substantial deposits, independent insurance agents would be subjected to "destructive competition." [1] He also concluded that voluntary tie-ins of insurance sales with extensions of credit were almost inevitable, particularly in times of tight money. He further found that, in markets where insurance agents would be forced to compete with "double-barrelled financial conglomerate[s] . . . the independent commission agents would have difficulty surviving." [2] In this regard, the Judge concluded that "the clientele [of large bankholding companies] that could possibly be subtly influenced to divert [insurance business away] from Atlanta independent agents is so large that many of the latter could be driven out of business or forced to merge into larger units resulting in decreased competition." [3] Ultimately, the administrative law judge concluded as follows:

> The proposition reduced to its simplest terms comes down to this: If a bank, large in its community, using predominantely depositors' funds as capital, is authorized to compete against mostly small insurance enterprises by soliciting its debtor-clientele, it is possible, *even probable*, that the mom and pop agency will be driven into merger or out of business entirely; and to this extent the American dream of a land of opportunity where every man and woman. with some skill and good luck can become a proprietor or a partner, rather than merely a clerical employee or an insignificant stockholder, will fade further.[4]

Thus, the administrative law judge concluded that approval of the applications could not reasonably be expected to result in benefits to the public that outweighed possible adverse effects. He did, however, recommend that the Board authorize the applicants to conduct insurance agency operations in those markets where the control of banking deposits was insubstantial.

E. The Decisions of the Federal Reserve Board: Upon review of the decision of the administrative law judge, the Board, not surprisingly, found that the lines of insurance for which the applicants had sought authorization were largely within the terms of the Board's insurance regulation. The Board also concluded, in most instances without the slightest allusion to the contrary findings of the administrative law judge, that approval of the applications could reasonably be expected

---

*Recommended Decision. *First National Holding Corp.*, FRB Docket IA-8, at 22 (Jan. 14, 1974) (emphasis added).

[1] Recommended Decision, FRB Docket IA-10, at 19.

[2] Recommended Decision, FRB Docket IA-8, at 28.

[3] Id.

[4] Recommended Decision, FRB Docket 1A-10, at 19-29 (emphasis added).

to result in benefits to the public that outweighed any possible adverse effects.

For instance, notwithstanding the manifest inconvenience recognized by the administrative law judge concerning the proposed locations of the applicants' agencies, the Board determined that approval of the applications would result in greater convenience to the public. Similarly, without so much as a single word regarding the question of direct billed insurance, the Board also determined that approval of the applications would be likely to result in "gains in efficiency" within the insurance agency industry. The Board also found that approval of the applications would result in increased competition in the insurance agency business. With that, it approved both the Southern and the First National applications. The IIAA parties, of course, sought review of the Board's decisions in the United States Court of Appeals for the Fifth Circuit.[5]

F. Court of Appeals Decisions—(1) "Closely Related" to Banking: As a result of the Board's failure to provide a statement of the basis and purpose of its insurance regulation, and the generalized nature of that regulation, the court of appeals was ultimately required to issue three separate decisions dealing with the "closely related" issue. In the first decision, the court determined that several portions of the insurance regulation went beyond the Board's statutory authority and were therefore invalid. In its second opinion, the court extended a portion of its first decision and thereby invalidated another portion of the insurance regulation. In its third decision, the court retreated from its second decision and returned the "closely related" issue to essentially the same posture it had been in upon the issuance of the first decision.

Even though it invalidated portions of the Board's insurance regulation, and remanded other portions to the Board for further consideration, the court upheld the regulation to the extent that it permitted sales of property and casualty insurance in conjunction with extensions of credit and the provision of other financial services. The net effect of the court's decisions was to permit bank holding companies to make major inroads into the insurance agency business, thereby potentially restructuring numerous insurance markets in a way that would be adverse to the public interest.

(2) "Public Interest" Test: Despite its ultimate ruling, the court was highly critical of the Board's application of the "public interest" standards engrafted by Congress onto the BHC Act in 1970. In fact, the court rejected the Board's findings on two out of three of the public benefits considerations enumerated in section 4(c)(8).

(a) Greater Convenience: As concerns the question of greater convenience, the court noted that the Board's conclusion was cast in doubt because both applicants proposed to have their insurance offices situated in remote locations in Birmingham or Atlanta. The court criticized the Board for failing to recognize the decrease in convenience which would result from such a situation. Moreover, said the court:

> [T]he Board made no attempt to explain why nonaffiliated insurance agents could not effect the same conveniences through a one-stop shopping system. Loan officers could (and if there is a genuine bank need to insure that acceptable coverage be secured, they will) suggest to the prospective loan customer a reputable

[5] See note 1 and acompanying text supra.

local agent; if the customer is willing, that agent could be telephoned and could perform the same functions as the proposed holding company affiliate agent.*

In addition, the court pointed out that the administrative law judge had come to an opposite conclusion from that of the Board, and that the Board had made no effort whatsoever to explain its departure from his findings. Consequently, the court determined that the Board's findings of greater convenience to the public were not supported by substantial evidence.**

(b) Gains in Efficiency: With respect to the possibility that approval of the applications would result in gains in efficiency, the court recognized that the dispute centered around the sale of insurance policies which were "direct billed." [1] The court pointedly noted that, while the administrative law judge had premised his adverse findings with respect to gains in efficiency primarily on the refusal of the applicants to offer direct billed insurance, the Board had failed "even [to] mention the direct billing concept or the administrative law judge's reliance thereon." [2] Ultimately, the court concluded as follows:

[T]he Board again has failed utterly in its responsibility to consider possible sources of efficiency loss and to arrive at a reasoned evaluation of net efficiency gains. It may well be that the Board could properly have concluded that a net gain would result or that, as First National suggested in its brief, the holding company affiliates would in the future adopt direct billing. But the fact remains that, despite the Administrative Law Judge's explicit reliance upon the negative efficiency effects of non-use of direct billing, the Board fails to so much as mention the issue. Because of this failure, we cannot uphold the Board's finding on this issue.[3]

The Board's decision concerning gains in efficiency was highly disappointing to IIAA for an additional reason not mentioned by the court. When the Board enacted its insurance regulation in 1971, it expressed the expectation that:

[A]ny holding company or subsidiary that acts as an insurance agency on the basis of the new regulatory provision will exercise a fiduciary responsibility—that is, by making its best efforts to obtain the insurance at the lowest practicable cost to the customer.[4]

Since direct billed insurance is generally available at a lower cost than agency billed insurance, and since both applicants rejected the use of direct billed insurance, neither applicant undertook to offer insurance at the "lowest practicable cost to [its] customer[s]." For this reason, the Board's approval of the applications violated its own insurance regulation.

(c) Increased Competition: As we have just noted, the court of appeals unequivocally rejected the Board's findings concerning the greater convenience and gains in efficiency standards of the "public benefits" test. Nevertheless, the court found itself able to uphold the Board's determination that approval of the applications could reasonably be expected to result in increased competition. This portion of the court's decision is anomalous. On the one hand, the court found insufficient evidence to support the Board's findings regarding possible efficiencies (price) and convenience (service); yet, on the other

* 533 F. 2d at 247 (emphasis in original).
** Id. at 248.
[1] See note 11 and accompanying text supra.
** Id. at 248.
[3] Id. at 248–49 (emphasis in original).
[4] 36 Fed. Reg. 15,525 15,526 (1971) (emphasis added).

hand, it found sufficient evidence to determine that approval of the applications would result in increased competition. The court's decision in this regard becomes even more internally inconsistent in light of its finding that, "[w]hile the evidence on [increased competition] certainly can be described as vague, we find that * * * it is enough."* In other words, insofar as the public benefits factors enumerated in the BHC Act are concerned, the court ultimately found two not to have been proven, and one to have been supported by evidence that was merely "vague."

(d) Decreased or Unfair Competition: In his recommended decisions, the administrative law judge expressed concern that borrowers might voluntarily tie their purchases of insurance from the applicants' affiliates to extensions of credit, particularly in times when credit is scarce.[1] This concern has also often been expressed by Congress. For example, the conference report associated the 1970 Amendments to the BHC Act states:

> Tie-ins occur where a customer is forced or induced to accept other products and services along with that product which he seeks. Such tie-ins may result from actual coercion by a seller or from a customer's realization that he stands a better chance of securing a scarce and important commodity (such as credit) by "volunteering" to accept other products or services rather than seeking them in the competitive market place. In either case, competition is adversely affected, as customers no longer purchase a product of service on its own economic merits.[2]

While the Board did specifically address the administrative law judge's concern regarding tie-ins, it totally rejected his findings, even though those findings closely paralleled fears the Board itself has previously expressed to Congress. In 1969, for instance, the Board stated to the Financial Institutions Subcommittee of this committee:

> [B]ecause of the inferior bargaining position of the debtor, he may be susceptible to the loan officer's "suggestions" concerning choice of coverage, premium rates, insurer and agent. As a result, the debtor easily may receive the impression that his loan application may be more favorably considered if he follows such suggestions.[3]

Although the court of appeals seemed to concede that voluntary tying might occur in some instances, it affirmed the Board's conclusions with the statement that "the total amount of possible voluntary tying was not of the magnitude Congress was concerned about."[4]

For the court to have minimized Congress' concern over the danger of tie-ins is inconsistent with the record. Congress had long been highly sensitive to this issue. In fact, the traditional separation of banking and commerce in our economy is a concrete reflection of that concern. Furthermore, this committee's inquiry during its March 4, 1976, hearings on S. 2721, the predecessor of S. 72, focused upon the prevalence and dangers of tie-ins. During those hearings, Edward J. Schmuck, testifying on behalf of six life insurance underwriters, read the following letter into the record:

> I regret very much the incident concerning "Mr. X." I based my decision regarding this matter on what I thought to be the best interest of "Mr. X" and the bank. As I indicated to "Mr. X", our bank could not accept the loan unless we

* Id. at 249.
[1] See, e.g., Recommended Decision, FBR Docket No. IA–10, at 19.
[2] H.R. Rept. No. 1747, 91st Cong., 2d sess. 18 (Conference Rept.), reprinted in [1970] U.S.C. Cong. Ad. News 5569.
[3] Hearings on Consumer Credit Insurance Act of 1969 (S. 1764) Before the Subcomm. on Financial Institution of the Senate Banking Committee, 91st Cong., 1st sess. 168 (1969).
[4] 538 F. 2d at 251.

were allowed to write the credit life insurance. As I discussed by phone, the primary reason for this request to write the insurance, was because this action increased the return of income on the loan by a good margin. Had our bank been denied this additional income, we could not have approved the loan. Because of the extremely tight credit situation, I feel "Mr. X" would not have obtained the loan elsewhere. Therefore, I believed our bank to be doing "Mr. X" a service by granting this type of loan under these circumstances, with credit as tight as it is at present.

I can still appreciate and understand your reasoning and regret that "Mr. X" saw fit to cancel his policy with your company. I am hopeful this situation will not occur again in the future.[1]

During the same hearings, Edward J. Kremer of IIAA read a similar letter received by his own insurance agency in Salisbury, Md.:

Dear Bill: The purpose of this letter is to clear up any misunderstanding that may have arisen as a result of the recent changes in our insurance program. We instructed you to discontinue the automobile dealers physical damage coverage in the package policies that you have so that we could obtain this coverage through "x" bank. As you know, "x" bank does the financing of our new car inventory. This in no way indicates dissatisfaction of your service or that of the company "x". As I explained to you, we feel that we have to place the coverage with the bank because we so frequently request special favors of them. Even if their premiums were to prove a little higher, we would still feel obligated in this way. Please also be assured that this in no way implies that the bank has forced us to make this change in our insurance program. Best wishes.[2]

From this and other testimony which has been elicited by Congress over the years, it is clear that the tying issue has been a paramount concern of Congress, particularly in the context of the bank holding company nonbanking question. For the Board and the court to have been insensitive to this fact is most disappointing.

(e) Undue Concentration of Resources: Another factor which influenced the decision of the administrative law judge was the undue concentration of resources which approval of the applications would cause. In this regard he expressed misgivings over the tremendous financial power of the applicants in comparison with the insurance agencies with which they would enter into direct competition. The Board, once again, showed no appreciation of the economic implications of this problem. For its part, the court admitted that there could be "no doubt either that the insurance businesses of the holding company affiliates [would] be relatively large" or that the applicants controlled " a substantial amount of the banking resources in the relevant markets." [3] Nevertheless, the court, once again, deferred to the "presumed expertise" of the Board on this question and refused to overturn the Board's findings.[4]

III. CURRENT POSTURE OF THE INSURANCE AGENCY QUESTION

After the court issued its third and final decision, IIAA petitioned the Supreme Court to review these cases. On February 27, 1978, the Supreme Court denied IIAA's petition.

Thereafter, the Board initiated proceedings to repromulgate those portions of the insurance regulation which the court of appeals validated, and those other portions which were remanded for further consideration. Parenthetically, it is worth noting that the bank holding companies are now urging the Board to expand the scope of insurance agency activities that would be permitted under the insurance regulation.

---

[1] Transcript at 24–25. Hearings on S. 2721 Before the Senate Banking Committee 94th *Cong., 2d sess.* (March 4, 1976).

[2] *Id.* at 39–40.

[3] *533 F. 2d at 251.*

[4] *Id.*

At bottom, we are left with the following situation. After 7 years of exhaustive and expensive litigation, the Board is proposing to repromulgate essentially the same generalized and imprecise insurance regulation which initiated the whole process in 1971. What is perhaps worse, the litigation has resulted in the creation of an exceedingly bad interpretation of the "public benefits" test, created by Congress in 1970 to require the Board to protect the public interest. As the law now stands, at least in the fifth circuit, insurance agency applications may be approved even though there is no substantial evidence that such approval will result in greater convenience or gains in efficiency, and the only evidence that competition will increase is "vague." These cases demonstrate in classic fashion that the courts generally will not overturn an agency decision, no matter how thin the evidence may be supporting it. In other words, once Congress delegates discretion to an administrative agency, any doubts which a court may have will be resolved in favor of that agency.

IV. THERE EXITS A CRUCIAL NEED FOR THE ENACTMENT OF THE COMPETITION IN BANKING ACT OF 1977

Given the difficult and disappointing experience IIAA has had in the administration of the BHC Act, it should not be surprising that IIAA supports more stringent legislation of the sort contemplated by S. 72. Section 301 of the bill, particularly when it is read in conjunction with the congressional findings set forth in section 2, would make more restrictive the standards under which the Board could authorize bank holding companies to participate in nonbanking activities. Specifically, section 301 would require not only that an activity proposed to be entered be "closely related" to banking; it would also have to be "directly related" to banking. In addition, the activity would have to be not only a "proper incident" to banking—that is, in the public interest—but also a "necessary incident" to banking. Similarly, the bill would require a showing that approval of a bank holding company nonbanking application would produce "substantial" benefits to the public which "clearly and significantly outweight possible adverse effects."

Section 401 would require that any activity determined by the Board to be improper under the BHC Act would also be required to be prohibited for national banking associations by the Comptroller of the Currency. In this way, needed consistency would be brought about between the various regulators of banking organizations.

Section 501 of the bill would establish standards for the sound and competitive financing of holding company affiliates engaged in nonbanking activities. This provision would help bring into greater equilibrium the competitive advantage derived by bank holding company affiliated entities by virtue of the favorable capitalization schemes which are possible under the current law.

Sections 601 and 701 of the bill are of particular importance. These sections would require all Board determinations in the area of nonbanking activities to be made on the record after an opportunity for a formal hearing. In addition, those sections would prohibit ex parte communications and provide to nonbanking parties needed procedural rights which do not exist under current law. Finally, interested persons would be given a right to require the Board to assure that applications to enter nonbanking activities approved by the Board continue to be in the public interest.

IIAA believes S. 72 is an excellent bill. Nevertheless, insofar as the sale of property and casualty insurance is concerned, IIAA believes the bill does not go far enough. Over the last 7 years, IIAA has been required to participate in seemingly endless rulemaking and adjudicatory proceedings on the question of whether the sale of property and casualty insurance is an appropriate activity for bank holding companies. Notwithstanding the adverse results of the cases we have described to you, IIAA remains convinced that it has made the case that bank holding company participation in property and casualty insurance agency activities is not "closely related" to banking or in the public interest. Under these circumstances, IIAA believes it is time that Congress once and for all decide this issue. This could be done either by amending section 301 of S. 72 to include the language of Senator Durkin's S. 3087, or by reporting S. 3087 out of this committee as a separate piece of legislation. The record has been made. With the bank holding company industry poised to enter the retail property and casualty insurance industry, the time for Congress to act is now. Further delay will almost inevitably have severe adverse consequences on the public.

Once again, IIAA thanks the committee for the opportunity to express its views on these very important matters.

[Additional material from the Independent Insurance Agents of America, Inc. follows:]

Research Data Regarding Bank Holding Company Entry into Certain Nonbanking Activities

I. Introduction

The Competition in Banking Act of 1977 (S. 72) would, among other things make more restrictive the standards under which bank holding companies could engage in nonbanking activities. In connection with S. 72, therefore, it is appropriate to examine various aspects of the bank holding company movement, particularly regarding bank holding company entry into various nonbanking industries under Section 4(c)(8) of the Bank Holding Company Act of 1956 (the "Act"), as amended in 1970.

The inquiry undertaken regarding this presentation was made more complex than might have been expected because, since the 1970 amendments to the Act, the Board of Governors of the Federal Reserve System, the agency charged with the responsibility of administering the Act, has itself never systematically studied either the industries it has permitted bank holding companies to enter or the effect of holding company entry on those industries.

The data presented herein relates to bank holding company participation in finance, mortgage banking and factoring activities, the nonbanking activities involving bank holding company entry where meaningful information is publicly available.

Part II of this presentation provides information concerning bank and bank holding company penetration into the finance, mortgage banking and factoring industries. The data shows that, since 1968, bank and bank holding company affiliates in the mortgage banking industry have increased their percentage of total loan servicing by more than 100 percent, from approximately 23 percent of the total in 1968 to approximately 49 percent of the total in 1976 (Table 1). In the finance industry, bank holding company affiliated organizations, between 1967 and 1976, increased their capitalization from approximately 17 percent of the total in 1967 to approximately 22 percent in 1976 (Table 2). Similarly, between 1967 and 1976, bank and bank holding company affiliated factoring companies increased their participation in the industry from approximately 36 percent of the total volume in 1967 to approximately 77 percent in 1976 (Table 4).

Part III hereof compares the capitalization of bank holding company finance and mortgage banking subsidiaries with the capitalization of similar entities which are not affiliated with a bank holding company system. An examination of the publicly available data makes clear that bank holding company finance and mortgage banking subsidiaries are generally more highly leveraged than the nonaffiliated occupants of those industries (Table 5).

On the basis of the information available, therefore, it appears that bank holding company participation in the finance, mortgage banking and factoring industries has significantly increased since the 1970 amendments to the Act, making bank holding companies a significant factor and, in some cases, the dominant force in those industries.

Part IV of this paper presents data which allows a comparison of the size of the bank holding companies which have entered the fields of consumer finance and mortgage banking and the firms which are the "natural occupants" of those industries. One set of data presents current (*i.e.*, recent past) comparisons, while another set presents comparisons at the time of acquisition, registration or board approval.

II. ESTIMATED MARKET SHARE ACHIEVED BY BANK HOLDING COMPANIES IN NONBANKING AREAS

Tables 1–4 provide information concerning bank and bank holding company nonbank subsidiary penetration in mortgage banking, finance (consumer, sales, and commercial combined), consumer finance, and factoring. The derivation of the individual figures in the tables is discussed below.

A. Mortgage banking (table 1)

Mortgage banking firms act as intermediaries between commercial and individual mortgage borrowers and the suppliers of long-term funds. Typically, the mortgage banker will originate individual loans, provide interim or short-term financing from its own funds, package or group loans into larger (*e.g.* $1 million) blocks, and then sell such blocks to institutional investors such as savings and loan associations and insurance companies. The mortgage company will also service the loan during its lifetime (*e.g.*, collect payments, maintain escrow accounts, inspect property, etc.). The servicing activity provides over ⅔ of the average mortgage company's income.[1] There are an estimated 1500 firms in this industry. Banks are involved in this industry both directly and through mortgage banking subsidiary firms.

Theoretically, an ideal measure of bank and bank holding company activity in this industry would require servicing and/or origination data from all of the estimated 1500 firms actively involved in the industry. However, such complete data is publicly unavailable. Therefore, estimates of bank and bank holding company market share were developed within the subclassification of firms which represent the largest servicing entities in the business. These servicing volume figures are routinely compiled and published.

Table 1 presents estimates of aggregated market share attained by bank and bank holding company firms within the category of the 100 largest servicing firms in the industry. The basis for these estimates is the "100 Largest Mortgage Servicers in the U.S." compiled annually by the *American Banker*. Bank and nonbank firms were segregated by using descriptive material provided by the *American Banker* in conjunction with this list, *Moody's Bank and Finance Manual*, and Federal Reserve Board information on bank holding company affiliation.

TABLE 1.—ESTIMATED YEAREND MARKET SHARE ACHIEVED BY BANK AND BANK HOLDING COMPANY FIRMS IN MORTGAGE BANKING (WITHIN 100 LARGEST SERVICERS)[1]

	1968	1972	1974	1976
Number of bank or bank holding company firms	21	39	45	47
Number of nonbank firms	79	61	55	53
Percentage of total servicing by bank or bank holding company firms	22.8	39.2	44.2	48.6
Percentage of total servicing by nonbank firms	77.2	60.8	55.8	51.4

[1] As compiled annually by the American Banker.

B. Finance (table 2)

The area of finance involves a much less well-defined "industry" than is the case with mortgage banking. For example, a number of different types of firms

[1] Mortgage Bankers Association of America, *Mortgage Banking*: 1976, Washington, D.C., 1977.

are involved (including, of course, banks as direct participants). These firms may have different types of finance company activities as their speciality (*e.g.*, consumer finance, sales finance, "old line" factoring, commercial finance, "full-payout" leasing, etc.). They may also have differing mixes of the various finance company activities coming within the generic definition of "finance" activity. In practice, there has been a trend towards diversification and the major firms in this "industry" engage in a number of different types of finance company activities. Because of this diversification, a cautious interpretation is suggested with respect to any market share estimate attributed to this "industry," including those presented below.

Accepting this inherent limitation in the numbers, some estimate of bank holding company aggregated market share can be derived. However, there is also the same data deficiency to be addressed which was noted previously with respect to mortgage banking, *i.e.*, the fact that data is not publicly available. The solution in this case is to confine the estimates to bank holding company market share within the subset of the largest firms in the industry, a subset for which data is available and published routinely. The subset of firms excludes *direct* bank finance company activity and therefore the bank holding company market share estimates must be interpreted as additions to the activities already encompassed by direct bank participation. The subset of firms also excludes firms which are "captives" (*e.g.*, subsidiaries) of manufacturers and which confine their activities to lending activities associated with the manufacturers' products.

Table 2 presents estimates of aggregated market share attained by bank holding company subsidiary firms within the category of the 100 largest noncaptive firms as ranked by the size of capital funds. The basis for these estimates is the "100 Largest Independent or Affiliated Finance Companies" compiled annually by the *American Banker*.[2] Bank and nonbank firms were segregated using Federal Reserve Board material, *Moody's Bank and Finance Manual*, and other standard financial reference sources. For the limited number of instances in which firms could not be unambiguously identified as either bank holding company affiliates or as nonbank firms, they were included in the nonbank category.

TABLE 2.—ESTIMATED YEAREND MARKET SHARE ACHIEVED BY BANK HOLDING COMPANY FINANCE SUBSIDIARIES BASED UPON TOTAL CAPITAL FUNDS (WITHIN 100 LARGEST NONCAPTIVE FIRMS)[1]

	1967	1973	1974	1976
Number of bank holding company subsidiaries[2]	(3)	14	29	35
Number of nonbank firms	(3)	86	71	65
Bank holding company subsidiary capitalization as a percentage of total	16.4–[3] 18.4	15.4	21.1	21.7
Nonbank firm capitalization as a percentage of total	81.6–[3] 83.6	84.6	78.9	78.3

[1] As compiled annually by the American Banker.

[2] These figures include as bank holding company subsidiaries both Walter E. Heller, International and CIT Financial firms which might not be considered "bank-centered" bank holding companies in the traditional sense. Because of the magnitude of the bank assets associated with each of these firms (i.e., over $1,000,000,000 for Walter Heller and over $2,000,000,000 for CIT), however, it was considered appropriate to recognize the bank relationship for the years each existed.

[3] There are approximately 10 firms from the 1967 "Largest 100" noncaptive list which cannot be identified using standard financial references such as "Moody's Bank and Finance Manual." The aggregated capitalization percentage for these 10 is approximately 2 percent of the total for the 100 firms. There are only 2 firms from the other 90 which were controlled by a bank holding company in 1967 and their capitalization as a percentage of the total for the 100 firms was 16.4 percent. The maximum conceivable bank holding company subsidiary percentage is therefore around 18.4 percent; however, a figure that high seems unlikely.

C. Consumer finance (table 3)

The aggregated finance company market share information in Table 3 includes companies involved in one or more of the following: consumer finance, sales finance, commercial finance, and factoring. Table 3 presents similar estimates for companies whose emphasis is in the area of consumer finance. This separate estimate is desirable because of the apparent heavy emphasis that bank holding

[2] The ranking and market share estimates on the basis of capital funds are probably less desirable than ranking based upon total receivables. However, the source information does not provide receivables volume information for all of the 100 largest noncaptive firms. To the extent that there is a systematic difference in capitalization by bank and nonbank firms, the market share estimates are biased.

companies have placed upon entry in this area relative to other areas (measured by number of entrants). The basis for these estimates and the manner in which bank holding company firms were distinguished from nonbank firms is as discussed previously. The firms which specialize in consumer finance were segregated using Federal Reserve Board information, previous studies, discussions with industry specialists, and the descriptive material in *Moody's Bank and Finance Manual*. No firm was included in this category if there existed any ambiguity as to its proper classification. Because the difficulty associated with distinguishing predominantly consumer finance firms from other finance firms increases with time, these estimates date only to 1972.

Consumer finance companies make direct cash loans to customers to be repaid on an installment basis. They are also called "personal finance" companies and "small loan" companies. The activity is to be distinguished from retail sales finance which involves the financing of consumer durables through the purchase of dealer paper. As was the case previously, the estimates below exclude the substantial consumer finance activities undertaken by banks directly and therefore underestimate total banking involvement in this type of activity. Commercial banks were estimated by the Federal Reserve Board to hold directly 45 percent of all personal loans at the end of 1976 and 58.4 percent of all automobile loans.[3] The estimates presented below are limited mainly because they are based upon aggregated company-wide data and therefore include the nonconsumer finance activities of firms which are predominantly consumer finance oriented. Additionally, they exclude the consumer finance activities of non-consumer finance oriented firms.

D. Factoring (table 4)

"Old line" factoring is a form of commercial finance which involved the purchase of a firm's accounts receivable on a nonrecourse basis. Factoring has traditionally been associated with the textile and apparel industries. Because the accounts are purchased on a nonrecourse basis, a more intimate knowledge of the industry is required than would otherwise be the case. The firms involved in this industry include commercial finance firms, specialized factors, and commercial banks. The activities are a subset of those associated with Table 2 above.

Table 4 presents estimates of aggregated market share attained by bank and bank holding company firms in the "old line" factoring business. The basis for these estimates are figures compiled annually by the *Daily News Record* which is a trade publication of the men's and boy's clothing industry. The figures presented constitute essentially the entire industry. Bank and nonbank firms were segregated using Federal Reserve Board information, *Moody's Bank and Finance Manual*, and the *Daily News Record* descriptions. Two firms from the 1967 listing could not be traced and these were classified as independents.

TABLE 4.—ESTIMATED MARKET SHARE ACHIEVED BY BANK AND BANK HOLDING COMPANY FACTORING ENTITIES (BASED UPON OLD LINE FACTORING VOLUMES)[1]

	1967	1972	1974	1976
Number of bank or bank holding company firms	6	20	27	27
Number of nonbank firms[2]	20	10	11	11
Percentage of total old line factoring volume held by bank or bank holding company firms	[3] 35.9	61.3	73.6	76.5
Percentage of total old line factoring volume held by nonbank firms	[3] 64.1	38.7	26.4	23.5

[1] Based upon information published annually by the Daily News Record.
[2] These figures include as bank holding company subsidiaries both Walter E. Heller, International and CIT Financial, firms which might not be considered "bank-centered" bank holding companies in the traditional sense. Because of the magnitude of the bank assets associated with each of these firms (i.e., over $1,000,000,000 for Walter Heller and over $2,000,000,000 for CIT), however, it was considered appropriate to recognize the bank relationship for the years each existed.
[3] Based upon estimates which, for some firms, include commercial finance other than old line factoring.

[3] See, *Finance Facts Yearbook*, 1977, published by the National Consumer Finance Association. The total commercial bank share of *all* consumer credit outstanding (*i.e.*, automobile loans, mobile home loans, personal loans, etc., combined) has increased from 44.6 percent in 1970 to 47.8 percent in 1976.

III. CAPITALIZATION IN BANK HOLDING COMPANY NONBANK SUBSIDIARIES COMPARED WITH INDEPENDENT FIRMS

Table 5 below summarizes the results of studies which have examined leveraging by bank holding company nonbank affiliates in comparison with leveraging by independent firms. The studies have been confined to mortgage banking and consumer finance.

Talley's comparisons were between sets of bank holding company affiliates selected from the "100 Largest" lists compiled annually by the *American Banker* and aggregated industry-wide averages. Rice's comparison included bank holding company affiliate firms and independent firms, all of which were selected from the *American Banker's* "100 Largest" lists as well as industry average figures.[4]

TABLE 5.—COMPARISON OF CAPITALIZATION BY BANK HOLDING COMPANY—NONBANK AFFILIATES AND INDEPENDENT FIRMS

Study	Nonbank affiliate capitalization ratio[1]	Independent firm capitalization ratio[2]
1. Talley:[3]		
a. Consumer finance (1973)	0.160	0.198
b. Mortgage vanking (1973)	.074	.088
2. Talley:[4]		
a. Consumer finance (1973)	.172	.208
b. Consumer finance (1974)	.141	.196
c. Mortgage banking (1973)	.074	.088
d. Mortgage banking (1974)	.075	.085
3. Rice:[5]		
a. Consumer finance (1974)	.153	.177 .185
b. Consumer finance (1975)	.172	.198 .214
4. Rice:[6]		
a. Mortgage banking (1973)	.102	.157 .088
b. Mortgage banking (1974)	.115	.187 .085
c. Mortgage banking (1975)	.143	+.191

[1] Defined as the ratio of equity to total assets.

[2] 2 figures are presented for each of Rice's studies. The first of these is for a sample of firms selected to match the sample of bank holding company affiliate firms which was examined. The second of these is an industry average across all size classes.

[3] Talley, Samuel H. "Bank Holding Company Performance in Consumer Finance and Mortgage Banking." Bank Administration, 52 (July 1975), 42–44.

[4] Talley, Samuel H. "Bank Holding Company Financing," Proceedings of the Federal Reserve Bank of Chicago's 1975 Conference on Bank Structure and Competition, 124–135.

[5] Rice, R. Michael. "Performance of Consumer Finance Subsidiaries of Bank Holding Companies, 1974 and 1975." Unpublished staff study of the Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System, Sept. 13, 1976.

[6] Rice, R. Michael. "Performance of Mortgage Subsidiaries in Bank Holding Companies, 1973–1975." Unpublished Staff Study of the Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System, May 3, 1977.

A more sophisticated analysis was part of the Rhoades and Boczar study[5] for consumer finance firms. Using regression analysis, these authors found a statistically significant positive relationship between leveraging and bank holding company affiliation (*i.e.*, bank holding company affiliates tended to be more highly leveraged than independent firms). A separate equation indicated that this was not attributable to preacquisition differences.

IV. SIZE COMPARISON OF BANK HOLDING COMPANY NONBANK SUBSIDIARIES AND NATURAL INDUSTRY OCCUPANTS

The attached tables taken together allow a size comparison of bank holding company entrants in selected nonbank industries with the natural occupants of

[4] The bank holding company affiliate firm data utilized in these studies is being given confidential status by the Board when such was requested by the banks involved. Therefore, no independent (*i.e.*, non-Federal Reserve Board) research is possible.

[5] Rhoades, Stephen A. and Boczar, Gregory E. "The Performance of Bank Holding Company Affiliated Finance Companies." Staff Study, Board of Governors of the Federal Reserve System (1977).

those industries. Tables 6–8 deal with the mortgage banking industry, while Tables 9–11 deal with the finance company industry. Using the most recent data publicly available, Table 6 presents an asset size comparison for bank holding company parents and their mortgage subsidiaries while Table 9 presents a similar comparison for bank holding company parents and their finance company subsidiaries. Also using the most recent publicly available data, Table 7 compares the size of independent (*i.e.*, nonbank) mortgage companies and their nonbank parents (where applicable), while Table 10 presents similar data for nonbank finance firms. Table 8 presents a comparison of the asset size of the parent bank holding company and the mortgage bank subsidiary at approximately the time of acquisition, while Table 11 presents similar data for finance company acquisitions. Thus, these two tables allow a comparison of the change in size of the appropriate decision-making entity upon bank holding company affiliation. For all of these tables the subset of firms examined was limited to the largest firms in the industry as compiled annually by the *American Banker*.

TABLE 6.—BANK OR BANK HOLDING COMPANY AND MORTGAGE BANK SUBSIDIARY ASSETS AS OF DEC. 31, 1976 (ORDERED BY SIZE OF SERVICING PORTFOLIO)

[In thousands]

Bank or bank holding company, subsidiary mortgage company, and bank holding company parent	Mortgage company assets as of Dec. 31, 1976 [1]	Bank holding company parent assets as of Dec. 31, 1976 [2]
(1) Advance Mortgage Corp. (Parent: Citicorp)	[3] $218,530	$64,281,504
(2) Colonial Mortgage Service Co. (Parent: Philadelphia National Corp.)	[3] 201,255	4,318,417
(3) Pennamco, Inc. (Parent: First Pennsylvania Corp.)	193,807	7,214,021
(4) Cameron-Brown Co. (Parent: First Union Corp.)	[3] 143,910	2,308,390
(5) Kissel Co. (Parent: Pittsburgh National Corp.)	87,112	3,363,431
(6) United California Bank [4] (Parent: Western Bancorp)	130,865	19,672,193
(7) Jacksonville National Bank [4] (Parent: The Charter Co.)	102,314	522,854
(8) Banco Mortgage Co. (Parent: Northwest Bancorp)	94,994	8,358,181
(9) Wells Fargo Mortgage Co. (Parent: Wells Fargo & Co.)	122,025	12,968,664
(10) Mortgage Associates, Inc. (Parent: Industrial National Corp.)	56,894	2,207,970
(11) First Mortgage Corp. (Parent: First & Merchants Corp.)	[3] 87,074	1,819,637
(12) Security Pacific Mortgage Corp. (Parent: Security Pacific Corp.)	[3] 82,712	16,400,732
(13) Citizens Mortgage Corp. (Parent: Manufacturers Hanover Corp.)	193,236	31,482,813
(14) Rainier Mortgage Co. (Parent: Rainier Bancorp)	70,866	3,054,856
(15) VNB Mortgage Corp. (Parent: Virginia National Bankshares, Inc.)	[3] 77,492	2,054,008
(16) American Fletcher Mortgage Co. (Parent: American Fletcher Corp.)	15,015	2,296,151
(17) Latimer & Buck, Inc. (Parent: Fidelcor, Inc.)	[3] 74,579	3,104,704
(18) Bank of America (Parent: BankAmericorp)	[1] 74,267	73,912,940
(19) Housing Investment Corp. (Parent: Chase Manhattan Corp.)	[3] 69,586	45,637,247
(20) Southeast Mortgage Co. (Parent: Southeast Banking Corp.)	62,635	3,393,843
(21) Wachovia Mortgage Co. (Parent: Wachovia Corp.)	55,119	3,560,040
(22) NBD Mortgage Co. (Parent: National Detroit Corp.)	13,089	7,552,509
(23) Mortgage Corporation of the South (Parent: First National Boston Corp.)	[3] 61,854	8,498,586
(24) Galbreath Mortgage Co. (Parent: Chemical New York Corp.)	[3] 58,628	26,613,774
(25) Citizens & Southern Financial Corp. (Parent: Citizens & Southern Holding Co.)	[3] 58,553	3,159,015
(26) NCNB Mortgage Corp. (Parent: NCNB Corp.)	158,314	4,007,112
(27) Mellon National Mortgage Co. (Parent: Mellon National Corp.)	204,906	9,406,712
(28) Mercantile Mortgage Co. (Parent: Mercantile Bancorporation)	[3] 44,459	3,113,230
(29) Engel Mortgage Co. (Parent: Alabama Bancorporation)	[3] 43,567	1,930,705
(30) First Denver Mortgage Co. (Parent: First National Bancorp.)	42,523	1,772,303
(31) Real Estate Financing, Inc. (Parent: First Alabama Bancshares)	[3] 41,982	1,335,145
(32) Peoples Mortgage Co. (Parent: Peoples National Bank) [5]	[3] 40,930	966,722
(33) Seafirst Mortgage Corp. (Parent: Seafirst Corp.)	[3] 40,108	5,309,590
(34) Tharpe & Brooks, Inc. (Parent: First National Holding Corp.)	86,642	2,141,389
(35) United Virginia Mortgage Corp. (Parent: United Virginia Bankshares)	74,983	2,602,281
(36) Lincoln First Real Estate Credit (Parent: Lincoln First Banks, Inc.)	41,719	2,806,484
(37) NCNB Mortgage South (Parent: NCNB Corp.)	50,075	4,007,112
(38) Security Pacific National Bank [5] (Parent: Security Pacific Corp.)	[3] 34,922	16,400,732
(39) Industrial Valley Bank & Trust [4, 5] (Parent: Industrial Valley Bank & Trust)	[3] 34,307	1,229,933
(40) ATICO Mortgage Corp. (Parent: Pan American Bancshares)	[3] 34,177	731,478
(41) New York Urban Servicing Co. (Parent: Fidelcor, Inc.)	[3] 34,117	3,104,704
(42) United Jersey Mortgage Co. (Pzrent: United Jersey Banks)	33,851	2,050,522
(43) Republic Realty Mortgage Corp. (Parent: Continental Illinois Corp.)	[3] 31,509	21,974,815
(44) Indiana Mortgage Corp. (Parent: Indiana National Corp.)	[3] 31,399	1,092,910
(45) Bank of Hawaii [4] (Parent: Hawaii Bancorporation, Inc.)	[3] 30,327	1,314,896
(46) Schumacher Mortgage Co. (Parent: Crocker National Corp.)	44,698	10,711,223
(47) Graham Mortgage Corp. (Parent: Manufacturers National Corp.)	40,505	3,107,378

[1] When available, these figures are from the schedule A supplements to the FR Y–6 reports or from the subsidiary's annual financial report. When figures are unavailable in the schedule A supplements, either because confidential status has been requested or because the mortgage subsidiary's financial data is consolidated on the bank's balance sheet, these numbers represent estimates derived using average industry size class ratios of assets to servicing volumes.

[2] Parent company asset figures are from the FR Y–6 reports.

[3] These figures are estimated using average industry size class ratios of assets to servicing volumes. (See footnote 1 above.)

[4] These servicing entities are banks and not bank holding company subsidiaries. The asset size is an estimate for a mortgage company of the same portfolio servicing volume and is not the bank asset figure. These estimates were also derived using average industry size class ratios of assets to servicing volumes.

[5] Indicates bank not apparently part of a holding company system.

TABLE 7.—INDEPENDENT MORTGAGE COMPANY AND PARENT COMPANY ASSETS (ORDERED BY SIZE OF SERVICING PORTFOLIO)

Independent mortgage company parent company	Estimated mortgage company assets as of Dec. 31, 1976 (thousands omitted)[1]	Parent company assets as of Dec. 31, 1976 (thousands omitted)[2]
(1) Lomas & Nettleton Financial Corp	[3] $465,599	
Parent		(4)
(2) National Homes Acceptance Corp	137,690	
Parent: National Homes Corp		[3] $138,057
(3) Western Mortgage Corp	131,802	
Parent: Westmor Corp		[3] 366,436
(4) Stockton, Whatley, Davin	123,587	
Parent: General American Oil Co. of Texas		[3] 228,082
(5) James T. Barnes & Co	111,233	
Parent		(4)
(6) Mason-McDuffie Corp	108,927	
Parent		(4)
(7) Colwell Co	117,918	
Parent		(4)
(8) Weyerhaeuser Mortgage Co	104,990	
Parent: Weyerhaeuser Co		[3] 3,681,744
(9) Bowest Corp	95,997	
Parent: Bowery Savings Bank		4,448,452
(10) Mortgage & Trust Co	867,208	
Parent		(4)
(11) Northland Mortgage Co	85,493	
Parent: Northland Co		(5)
(12) Western Pacific Financial	[3] 86,611	
Parent		(4)
(13) Bankers Mortgage Co. of California	81,614	
Parent: Transamerica Co		5,209,561
(14) Waterfield Mortgage Co	80,488	
Parent		(4)
(15) Amfac Financial, Inc	76,691	
Parent: Amfac, Inc		[3] 801,672
(16) James W. Rouse & Co	73,797	
Parent: Rouse Co		[3] 507,315
(17) Percy Wilson Mortgage & Finance	70,641	
Parent: United States Steel		9,167,900
(18) Southern Trust & Mortgage Co	70,364	
Parent: Southern Financial Corp		(5)
(19) Caldwell Banker Management Corp	69,979	
Parent: Caldwell Banker & Co		[3] 65,656
(20) Weaver Bros	66,041	
Parent		(4)
(21) J. I. Kislak Mortgage Corp	62,300	
Parent: J. I. Kislak, Inc		(5)
(22) First Mortgage Co. of Texas, Inc	59,539	
Parent		(4)
(23) Tower Mortgage Corp	56,907	
Parent: Investors Diversified Services		[3] 1,749,380
(24) Fidelity Bank & Mortgage	56,732	
Parent		(4)
(25) American General Investment Corp	57,464	
Parent: American General Insurance Co		4,689,257
(26) Jersey Mortgage Co	56,123	
Parent		(4)
(27) Ralph C. Sutro	55,782	
Parent		(4)
(28) Collateral Investment Co	53,946	
Parent		(4)
(29) First Fidelity Mortgage Co	45,989	
Parent: Palomar Financial		[3] 56,088
(30) National Mortgage Co	45,004	
Parent		(4)
(31) Allstate Enterprises Mortgaging	44,013	
Parent: Sears Roebuck & Co		[3] 11,576,573
(32) Midland Mortgage Co	44,816	
Parent		(4)
(33) Ryan Mortgage Co	44,377	
Parent		(4)
(34) Charles F. Curry & Co	43,086	
Parent		(4)
(35) Sherwood & Roberts, Inc	42,774	
Parent: Equitable Savings & Loan		981,854
(36) Murray Investment Co	41,505	
Parent: Murray Financial Corp		(5)
(37) Fort Worth Mortgage Corp	41,033	
Parent		(4)
(38) Molton, Allen & Williams	38,507	
Parent		(4)

[1] These figures are estimated using average industry size class ratios of assets to servicing volumes. The figures for Lomas & Nettleton, Western Pacific Financial, and Detroit Mortgage & Realty, however, are actual figures.
[2] *Parent company* asset figures are from Moody's.
[3] *Indicates asset figure for other* than Dec. 31, 1976.
[4] *Not applicable.*
[5] *Not available.*

TABLE 8.—BANK HOLDING COMPANY AND MORTGAGE COMPANY SUBSIDIARY ASSETS AS OF ACQUISITION DATE[1]

Bank holding company subsidiary mortgage company—bank holding company parent	Acquisition date or approval date	Subsidiaries assets[2] (thousands)	Bank holding company assets[3] (thousands)
1. Advance Mortgage Corp	July 1970	$88,427	
Parent: Citicorp			$25,840,073
2. Colonial Mortgage Service Co	Dec. 31, 1969	108,913	
Parent: Philadelphia, National Corp			2,328,457
3. Pennamco, Inc	Nov. 12, 1969	94,135	
Parent: First Pennsylvania Corp			2,638 000
4. Cameron-Brown Co	May 4, 1968	(3)	
Parent: First Union Corp			1,101,127
5. Kissel Co	Nov. 24, 1969	56,653	
Parent: Pittsburgh National Corp			1,647,897
6. United California Bank	(4)	(4)	
Parent: Western Bancorp			(4)
7. Jacksonville National Bank	(4)	(4)	
Parent: The Charter Co			(4)
8. Banco Mortgage Co	Dec. 31, 1969	8,408	
Parent: Northwest Bancorp			4,105,319
9. Wells Fargo Mortgage Co	Aug. 31, 1973	(5)	
Parent: Wells Fargo and Co			(4)
10. Mortgage Associates, Inc	Mar. 7, 1973	84,485	
Parent: Industrial National Corp			1,743,515
11. First Mortgage Corp	Feb. 26, 1969	40,175	
Parent: First and Merchants Corp			940,146
12. Security Pacific Mortgage Corp.[6]	Dec. 31, 1972	87,236	
Parent: Security Pacific Corp			11,688,925
13. Citizens Mortgage Corp	Nov. 1, 1973	98,055	
Parent: Manufacturers Hanover Corp			10,200,000
14. Rainier Mortgage Co.	1969	30,029	
Parent: Rainier Bancorp			112,587
15. VNB Mortgage Corp	July 12, 1972	21,071	
Parent: Virginia National Bankshares, Inc			1,347,654
16. American Fletcher Mortgage Co	May 15, 1969	5,380	
Parent: American Fletcher Corp			1,431,497
17. Latimer and Buck, Inc	Nov. 1, 1969	12,595	
Parent: Fidelcor, Inc			1,577,992
18. Bank of America	(4)	(4)	
Parent: BankAmericorp			(4)
19. Housing Investment Corp	June 4, 1969	86,692	
Parent: Chase Manhatten Corp			24,525,703
20. Southeast Mortgage Co	(4)	(3)	
Parent: Southeast Banking Corp			(4)
21. Wachovia Mortgage Co	Jan. 1, 1969	1,298	
Parent: Wachovia Corp			1,581,449
22. NBD Mortgage Co	(8)		
Parent: National Detroit Corp			
23. Mortgage Corp. of the South	(9)	40,470	
Parent: First National Boston Corp			6,305,438
24. Galbreath Mortgage Co			
Parent: Chemical New York Corp			
25. Citizens and Southern Financial Corp	(8)		
Parent: Citizens and Southern Holding			
26. NCNB Mortgage Corp	(4)	(4)	
Parent: NCNB Corp			(4)
27. Mellon National Mortgage Co	1969	29,762	
Parent: Mellon National Corp			4,364,715
28. Mercantile Mortgage Co	(10)	4,123	
Parent: Mercantile Bancorp			1,274,094
29. Engel Mortgage Co	1971	40,744	
Parent: Alabama Bancorp			1,930,706
30. First Denver Mortgage Co	1968	6,309	
Parent: First National Bancorp			994,000
31. Real Estate Financing, Inc	(11)	22,089	
Parent: First Alabama Bancshares			754,041
32. Peoples Mortgage Co	(12)		
Parent: Peoples National Bank			
33. Seafirst Mortgage Corp	(4)		
Parent: Seafirst Corp			
34. Thorpe and Brooks	(13)	$66,000	
Parent: First National Holding Corp			$1,030,000
35. United Virginia Mortgage Co	Oct. 1, 1968	1,182	
Parent: United Virginia Bankshares			1,124,779
36. Lincoln First Real Estate Credit	(8)		
Parent: Lincoln First Banks, Inc			
37. NCNB Mortgage South[14]	Aug. 1, 1972	21,996	
Parent: NCNB Corp			1,800,988
38. Security Pacific National Bank	(4)	(4)	
Parent: Security Pacific Corp			(4)
39. Industrial Valley Bank and Trust	(4)	(4)	
40. Atico Mortgage Corp		21,400	

See footnotes at end of table.

TABLE 8.—BANK HOLDING COMPANY AND MORTGAGE COMPANY SUBSIDIARY ASSETS AS OF ACQUISITION DATE [1]—Continued

Bank holding company subsidiary mortgage company—bank holding company parent	Acquisition date or approval date	Subsidiaries assets [2] (thousands)	Bank holding company assets [2] (thousands)
Parent: Pan American Bancshares			437,000
41. New York Urban Servicing Co	Sept. 30, 1973	200,000	
Parent: Fidelcor, Inc			2,278,754
42. United Jersey Mortgage Co	(⁸)		
Parent: United Jersey Banks			
43. Republic Realty Mortgage Corp	June 16, 1970	26,857	
Parent: Continental Illinois Corp			8,864,108
44. Indiana Mortgage Corp	May 19, 1969	13,939	
Parent: Indiana National Corp			1,338,270
45. Bank of Hawaii	(⁴)	(⁴)	
Parent: Hawaii Bancorporation			(⁴)
46. Schumacher Mortgage Co	1973	21,000	
Parent: Crocker National Corp			4,900,900
47. Graham Mortgage Corp	Apr. 24, 1973	15,246	
Parent: Manufacturers National Corp			2,441,310

[1] The data presented in this table were assembled from a review of Federal Reserve Board orders and from a review of bank holding company registration statements and acquisition applications. Additionally, in some instances, it was supplied directly by the Federal Reserve Board as a result of a series of Freedom of Information Act requests. In some instances, the requisite data was not available. The de novo entrants generally indicate situations where a bank's direct mortgage company activity was transferred to a newly formed corporation. Because of name changes, the combining of subsidiaries, and changed Federal Reserve Board requirements, a simple tabular presentation such as this necessarily deletes some relevant information for some companies.

[2] The dates for these asset figures are not generally the same as the acquisition date but some date within a year of that time. The separate asset figures for the parent and the subsidiary do not always represent the same date. In instances where the acquisitions were made prior to the 1970 amendments or prior to the time at which the parent entity became a bank holding company, the information is generally that contained in a registration statement filed with the Board. In such an instance, the dates associated with the data will not be the acquisition dates.

[3] Data on individual acquisitions is not disaggregated.

[4] Not applicable.

[5] De novo entry. A portion of the mortage banking activities of the bank was to be transferred to the new subsidiary. The bank had acquired an independent mortgage company in 1968 and had operated that as a division within the bank. However, no data is available on that acquisition.

[6] Prior to acquisition, firm operated as Kassler & Co.

[7] Prior to acquisition, firm operated as Coast Mortgage Co.

[8] De novo entry.

[9] Acquisition date not available; asset data is as of Dec. 31, 1972.

[10] Acquisition data not available; Mercantile became a bank holding company on Mar. 11, 1971. The holding company asset figures are as of Dec. 31, 1969; those for the subsidiary are as of Mar. 11, 1971.

[11] Acquisition data not available; asset data is as of Dec. 31, 1972.

[12] Not a bank holding company.

[13] Acquisition date not available; data are as published in Federal Reserve Board order approving retention and are as of Dec. 31, 1972.

TABLE 9.—BANK HOLDING COMPANY AND FINANCE COMPANY SUBSIDIARY ASSETS

Bank holding company finance company—bank holding company parent	Finance company assets as of Dec. 31, 1976 (thousands) [1]	Parent company assets as of Dec. 31 1976 (thousands) [1]
1. CIT Financial	$3,523,838	
(Parent)		$7,413,749
2. Walter E. Heller International	3,931,402	
(Parent)		(²)
3. FinanceAmerica	614,761	
BankAmerica Corp		73,912,940
4. First Pennsylvania Financial Services, Inc	194,860	
First Pennsylvania Corp		7,214,021
5. Ritter Financial Corp	126,804	
Manufacturers Hanover Corp		31,482,813
6. TranSouth Financial Corp	160,527	
NCNB Corp		4,007,112

See footnotes at end of table.

TABLE 9.—BANK HOLDING COMPANY AND FINANCE COMPANY SUBSIDIARY ASSETS—Continued

Bank holding company finance company—bank holding company parent	Finance company assets as of Dec. 36 1976 (thousands) [1]	Parent company assets as of Dec. 31, 1971 (thousands)
7. FBS Financial	$58,796	
First Bank Systems, Inc.		$7,843,753
8. Standard Financial Corp.	126,028	
Standard Prudential Corp.		523,855
9. Northwest Acceptance Corp.	133,412	
Orbanco, Inc.		608,256
10. BVA Credit Corp.	164,841	
Bank of Virginia Co.		1,746,811
11. Local Loan Co.	98,625	
Mellon National Corp.		9,406,712
12. CBT Financial Corp.	172,815	
CBT Corp.		2,124,525
13. Gulf Finance Corp.	100,874	
First National Holding Corp.		2,141,389
14. John P. Maguire & Co.	123,033	
Provident National Corp.		1,917,645
15. Public Loan Co.	76,559	
Bankers Trust New York Corp.		22,833,551
16. Signal Finance Corp.	71,882	
Philadelphia National Corp.		4,318,417
17. Congress Factors Corp.	85,795	
Philadelphia National Corp.		4,318,417
18. Fidelcor Financial Centers Corp.	[4] 61,047	
Fidelcor, Inc.		3,104,704
19. Crown Finance Co.	50,730	
First Tennessee National Corp.		2,053,007
20. Ambassador Factors	60,260	
Industrial National Corp.		2,207,970
21. Southern Discount Co.	60,306	
Industrial National Corp.		2,207,970
22. NCNB Financial Services, Inc.	55,608	
NCNB Corp.		4,007,112
23. Schenectady Discount Corp.	31,100	
First Maryland Bancorp.		1,400,079
24. Provident Financial Corp.	28,882	
South Carolina National Corp.		1,000,189
25. M & J Financial Corp.	40,697	
Northwestern Financial Corp.		1,293,290
26. Gibraltor Corp. of America	35,090	
United Jersey Banks		2,050,522
27. Local Finance Corp.	34,753	
American Fletcher Corp.		2,296,151
28. United Virginia Factors	88,177	
United Virginia Bankshares, Inc.		2,602,281
29. Delta Loan & Finance Co.	89	
Delta Loan & Finance Co.		106,801
30. Slavenburg Corp.	[4] 28,058	
NV Slavenburg Bank		([5])
31. Continental Finance Corp. of America	28,604	
First Pennsylvania Corp.		7,214,021
32. Trefoil Capital Corp.	[4] 26,802	
Fidelcor, Inc.		3,104,704
33. Atlantic Discount Corp.	[4] 24,914	
First Amtenn Corp.		1,474,535
34. CMC Finance Group, Inc.	28,663	
First Railroad & Banking Co. of Georgia		352,073
35. Commoloco, Inc.	[4] 21,342	
First Pennsylvania Corp.		7,214,021

[1] The finance company asset figures are either from the "American Banker's" list of "100 Largest Finance Companies in the U.S." as of Dec. 31, 1976 (ranked by size of capital funds), or from the schedule A supplements to the FRY-6 reports.
[2] Parent company asset figures are from FRY-6 reports. In instances where no such figures were available (i.e., when the schedule A data was claimed to be confidential), estimates were derived using average industry-size class capitalization ratios.
[3] Not applicable.
[4] This figure is an estimate derived by using an average industry-size class capitalization ratio.
[5] Not available.

TABLE 10.—INDEPENDENT FINANCE COMPANY AND PARENT COMPANY ASSETS

Independent finance company—parent company	Finance company assets as of Dec. 31, 1976 (thousands)[1]	Parent company assets as of Dec. 31, 1976 (thousands)[1]
1. Household Finance	$3,523,838	
(Parent)		(2)
2. Beneficial Corp	2,727,893	
(Parent)		(2)
3. General Electric Credit Corp	5,056,645	
Parent: General Electric Co		$12,049,700
4. Commercial Credit Co	4,169,928	
Parent: Control Data Corp.[4]		1,827,992
5. Associates Corp. of North America	2,320,869	
Parent: Gulf and Western Industries[4]		[5] 3,471,318
6. Avco Financial Service, Inc	2,269,448	
Parent: Avco Corp.[4]		1,204,212
7. ITT Financial Corp	1,062,446	
Parent: International Telephone & Telegraph Corp		11,070,072
8. Westinghouse Credit Corp	1,204,405	
Parent: Westinghouse Electric Corp		5,318,342
9. Transamerica Financial Corp	809,648	
Parent: Transamerica Corp		5,209,561
10. Borg-Warner Acceptance Corp	838,101	
Parent: Borg-Warner Corp		1,292,600
11. American Credit Corp	603,389	
(Parent)		(2)
12. James Talcott, Inc	(2)	
Parent: Talcott National Corp		447,389
13. American Investment Co	509,047	
(Parent)		(2)
14. General Finance Corp	435,101	
Parent: Loew's Corp		6,225,475
15. Dial Financial Corp	402,908	
(Parent)		(2)
16. Aetna Business Credit, Inc	431,249	
Parent: Aetna Life and Casualty		18,191,490
17. Credithrift Financial Corp	737,643	
(Parent)		(2)
18. Capital Financial Services, Inc	319,028	
(Parent)		(2)
19. Aristar, Inc	[5] 349,498	
(Parent)		(2)
20. American Finance System, Inc	340,378	
(Parent)		(2)
21. USLIFE Credit Corp	160,225	
Parent: USLIFE		2,109,986
22. Southwestern Investment Co	397,576	
Parent: Beatrice Foods		1,898,649
23. Midland Guardian Co	232,773	
Parent: Midland Co		255,260
24. Liberty Loan Corp	354,403	
(Parent)		(2)
25. USI Credit Corp	196,116	
Parent: US Industries		$873,381
26. Interstate Securities Co	219,390	
Parent: ISC Financial Corp		[5] 502,951
27. Commercial Alliance Corp	203,681	
(Parent)		(2)
28. Postal Finance Co	180,940	
Parent: The St. Paul Co.'s		2,532,786
29. A. J. Armstrong	161,651	
(Parent)		(2)
30. Government Employees Financial Corp. (Affiliated with the "Government Employees" companies: Government Employees Insurance Co., Government Employees Life Insurance Co., Criterion Insurance)	199,499	(2)
31. Union Investment Co	[5] 134,635	
(Parent)		(2)
32. Firstmark Financial Corp	214,259	
Parent: Firstmark Corp		[5] 299,992
33. Budget Capital Corp	52,433	
Parent: Budget Industries		[5] 479,766
34. Kentucky Finance Co	96,080	
Parent: Kentucky Central Life Insurance Co		301,132
35. Mercantile Financial Corp	95,472	
Parent: Mercantile Industries		[5] 112,143

See footnotes at end of table.

TABLE 10.—INDEPENDENT FINANCE COMPANY AND PARENT COMPANY ASSETS—Continued

Independent finance company—parent company	Finance company assets as of Dec. 31, 1976 (thousands)[1]	Parent company assets as of Dec. 31, 1976 (thousands)[2]
36. Diner's Club, Inc	$141,078	
Parent: Continental Corp		$5,673,742
37. Nationwide Consumer Service, Inc	85,537	
Parents: Nationwide Mutual, Inc		[5] 1,164,497
Nationwide Mutual Fire Insurance		216,530
38. Fidelity Acceptance Corp	[6] 59,807	
(Parent)		(3)
39. Sun Finance & Loan Co	84,301	
Parent: Sunbeam Corp		[5] 598,763
40. Oxford Finance Companies, Inc	52,014	
Parent: Oxford First Corp		[5] 64,060
41. Mastan Co	61,032	
Parent: Lee National Corp		[5] 182,523
42. Century Acceptance Corp	51,891	
Parent: Cencor, Inc		[5] 70,471
43. Rosenthal and Rosenthal, Inc	100,000	
(Parent)		(3)
44. Allied Finance Co	[6] 70,450	
Parent: Republic Financial Securities		[5] 413,272
45. Commercial Securities Co	[6] 48,056	
(No affiliation listed)		(3)
46. Fireside Securities	[6] 63,788	
(No affiliation listed)		(3)
47. Public Finance Services, Inc	45,533	
(Parent)		(3)
48. Georgia International Finance Co	[6] 58,342	
Parent: Capital Holding Corp		2,027,345
49. Colonial Commercial Corp	[5] 43,589	
(Parent)		(3)
50. Allen Parker Co	[6] 49,198	
Parent: Lane Wood, Inc		65,312
51. Federal Discount Corp	[6] 48,858	
(Parent)		(3)
52. Century Factors	13,209	
Parent: Tanbro Fabrics		(7)
53. Finance Company of America	[6] 44,748	
(No affiliation listed)		(3)
54. Wisconsin Finance Corp	[6] 43,694	
(No affiliation listed)		(3)
55. Union Trust, Inc	[5] 39,432	
(Parent)		(3)
56. Community Credit	[6] 40,331	
(No affiliation listed)		(3)
57. Personal Finance Co	[6] 39,284	
(No affiliation listed)		(3)
58. Heights Finance Co	34,189	
(Parent)		(3)
59. Valley Financial Services	90,789	
(Parent)		(3)
60. Fidelity America Financial Corp	[6] 26,893	
(No affiliation listed)		(3)
61. Peoples Financial Corp	27,088	
(Parent)		(3)
62. Inland Credit Corp	21,505	
(Parent)		(3)
63. Security Mutual Finance Corp	[6] 24,863	
(Parent: Interfinancial, Inc.)		263,974
64. Foothill Group, Inc	39,505	
(Parent)		(3)
65. Pioneer Finance Co	[6] 22,770	
(Parent)		(3)

[1] Except where indicated, finance company asset figures are from the "American Banker's" list of "100 Largest Finance Companies in the U.S." as of Dec. 31, 1976, ranked by size of capital funds.
[2] Parent company asset figures are from Moody's.
[3] Not applicable.
[4] Does not include finance company subsidiary.
[5] Indicates asset figure for date other than Dec. 31, 1976.
[6] This figure is an estimate, derived by using average industry-size class capitalization ratios.
[7] Not available.

TABLE 11.—BANK HOLDING COMPANY AND FINANCE COMPANY SUBSIDIARY ASSETS AS OF ACQUISITION DATE[1]

Bank holding company subsidiary finance company—bank holding company parent	Acquisition date or approval date	Subsidiary assets (thousands)[2]	Bank holding company assets (thousands)[2]
1. CIT Financial	([3])		
2. Walter E. Heller International	([3])		
3. FinanceAmerica		$719,000	
Parent: BankAmerica Corp.			$23,400,000
4. First Pennsylvania Financial Services, Inc.	July 8, 1969	80,313	
Parent: First Pennsylvania Corp.			2,636,605
5. Ritter Financial Corp.	Jan. 3, 1975	82,986	
Parent: Manufacturers Hanover Corp.			19,850,308
6. TranSouth Financial Corp.	([4])	([4])	
Parent: NCNB Corp.			1,850,000
7. FBS Financial	Jan. 28, 1972	7,032	
Parent: First Bank Systems, Inc.			4,406,229
8. Standard Financial Corp.	([3])		
Parent: Standard Prudential Corp.			
9. Northwest Acceptance Corp.	([5])	43,000	
Parent: Orbanco, Inc.			78,000
10. BVA Credit Corp.	([6])		
Parent: Bank of Virginia Co.			1,208,816
11. Local Loan Co.	Sept. 30, 1974	92,753	
Parent: Mellon National Corp.			9,600,400
12. CBT Financial Corp.	1973	11,800	
Parent: CBT Corp.			1,000,000
13. Gulf Finance Corp.	Apr. 21, 1972	2,401	
Parent: First National Holding Corp.			22,200
14. John P. Maguire and Co.	Sept. 14, 1972	80,224	
Parent: Provident National Corp.			1,347,035
15. Public Loan Co.	([7])	$65,912	
Parent: Bankers Trust New York Corp.			$9,950,074
16. Signal Finance Corp.	June 18, 1973	68,356	
Parent: Philadelphia National Corp.			2,986,308
17. Congress Factors Corp.	([8])	59,498	
Parent: Philadelphia National Corp.			2,922,817
18. Fidelcor Financial Centers Corp.	May 29, 1973	40,784	
Parent: Fidelcor, Inc.			1,908,300
19. Crown Finance Co.	1973	28,900	
Parent: First Tennessee National Corp.			1,200,000
20. Ambassador Factors	Dec. 31, 1970	29,543	
Parent: Industrial National Corp.			985,326
21. Southern Discount Co.	1973	35,500	
Parent: Industrial National Corp.			1,200,000
22. NCNB Financial Services, Inc.	([9])	([9])	
Parent: NCNB Corp.			([9])
23. Schenectady Discount Corp.	Feb. 15 1974	18,956	
Parent: First Maryland Bancorp.			[10]684,000
24. Provident Financial Corp.	1973	17,000	
Parent: South Carolina National Corp.			664,600
25. M&J Financial Corp.	([11])	20,384	
Parent: Northwestern Financial Corp.			627,823
26. Gibraltor Corporation of America	Aug. 31, 1972	5,760	
Parent: United Jersey Banks			1,689,367
27. Local Finance Corp.	1972	36,500	
Parent: American Fletcher Corp.			1,000,000
28. United Virginia Factors[12]	1972	89,559	
Parent: United Virginia Bankshares, Inc.			1,544,480
29. Delta Loan and Finance Co.	([3])		
Parent: Delta Loan & Finance Co.			
30. Slavenburg Corp.	([9])	([9])	
Parent: NV Slavenburg Bank			([9])
31. Continental Finance Corp. of America	June 22, 1972	13,500	
Parent: First Pennsylvania Corp.			4,945,511
32. Trefoil Capital Corp.	([12])	7,900	
Parent: Fidelcor, Inc.			2,278,754
33. Atlantic Discount Corp.	1973	26,500	
Parent: First Amtenn Corp.			736,700
34. CMC Finance Group, Inc.	Nov. 19, 1973	19,413	
Parent: First Railroad and Banking Co. of Georgia			300,197
35. Commoloco, Inc.	([13])	15,500	
Parent: First Pennsylvania Corp.			4,945,511

[1] The data presented in this table were assembled from a review of Federal Reserve Board orders and from a review of bank holding company registration statements and acquisition applications. Additionally, in some instances, it was supplied directly by the Federal Reserve Board as a result of a series of Freedom of Information Act requests.

[2] The dates for these asset figures are not generally the same as the acquisition date but some date within approximately a year of that time. The separate asset figures for the parent and the subsidiary do not always represent the same data. In instances where the acquisitions were made prior to the 1970 amendments or prior to the time at which the parent

The CHAIRMAN. Thank you very much, Mr. Wilson.

Gentlemen, I want to commend you on your very strong and helpful and thoughtful statements. They are all highly competent. I do think that while I'm very sympathetic with your position that we ought to recognize what you're asking is that we prevent competition from a source which you say would be unfair and you say would in the long run perhaps reduce competition and you say might have an adverse effect on people who are trying to get into the business, to wit: bank holding companies who don't know much about it and they would be losers.

At the same time, the Justice Department, as you know, and the Antitrust Subcommittee of the Judiciary Committees of the House and Senate, have taken a very positive position that we ought to do all we can to encourage competition everywhere, including competition from big, strong units like bank holding companies, and that the burden of proof must be on those who would oppose competition to show that this would be very unfair and that there are damages and that you can document them.

Now, let me go back to the testimony before this committee a couple months ago on the other side of this issue by the American Bankers Association first. They said this—first let me read it, and then I'm going to ask first Mr. Naugle to comment on it. They said:

> We believe bank holding company involvement in closely related activities has had a positive impact on the financial system's responsiveness to consumer needs. In contrast, we feel proposed changes in Section 301 would actually decrease competition as well as interfere with efforts to provide consumers with a wider range of financial services in a more efficient and convenient way.

Then they say:

> The expansion of bank holding company activities has provided and will continue to provide an alternative source of service that can stimulate competition.

What's your answer to that?

Mr. NAUGLE. Mr. Chairman, in the absence of specific documentation of bank activity in property and casualty insurance, I can only refer to their track record in the area of credit life insurance.

The CHAIRMAN. Well, I think that's your stronger case. I think that's right. There's a clear conflict of interest there. It's not just a matter of stumbling into something they are not competent or at least—or at least he's the guy that provides credit, and if he goes into selling insurance, too, it does become a conflict. We know people selling insur-

---

entity became a bank holding company, the information is generally that contained in a registration statement filed with the Board. In such an instance, the dates associated with the data will not be the acquisition dates.

[3] These situations are not comparable as they represent the acquisition of banks by nonbank entities.

[4] Stephenson Finance Co. acquired July 1969. Continental Acceptance Corp. acquired April 1970. TranSouth's assets as of Dec. 31, 1971 were $79,697,000. The NCNB asset figure presented in the tables is also as of Dec. 31, 1971.

[5] Acquisition date not available; asset data are as of Dec. 31, 1968.

[6] The Federal Reserve Board on Mar. 29, 1974 approved Bank of Virginia's retention of Cavanagh Leasing Corp. and de novo expansion into commercial financing activities. Cavanagh was organized de novo in 1970 to acquire certain assets and liabilities of another firm. As of May 31, 1970, Cavanagh's assets were $2,183,858. The bank asset figure given in the table is for Sept. 30, 1972.

[7] Asset data as of Dec. 31, 1970. Application to retain denied by Board on Aug. 3, 1973.

[8] Asset data as of Dec. 31. 1971; 80-percent interest acquired in 1967.

[9] Not available.

[10] Figure represents deposits and not assets.

[11] Acquisition date not available; asset data are as of Dec. 31, 1970.

[12] Acquisition date not available; asset data are as of Apr. 30, 1972 for subsidiary and as of Dec. 31, 1972 for parent.

[13] Acquisition date not available; asset data are as of Sept. 30, 1972 for subsidiary and as of Dec. 31, 1972 for parent.

ance—the bank loan officer, who has made a lot more out of that than he does out his salary, and I realize there are abuses in that area.

Can you give us any other area where you can document it? Mr. Shapiro gave us a powerful case there, too.

Mr. SHAPIRO. Sir, our association thrives on competition. We sell more life insurance but only when it's fair. We have found in any dealings with the bank when they have that opportunity of that tie-in sale evidenced by all of our testimony on the credit life——

The CHAIRMAN. But how about some of these other areas? Credit life, yes. I think you have made a case. My colleagues may disagree with you, but I think you have made a case. How about some of these other areas?

Mr. SHAPIRO. I can't document anything specific, but the potential for abuse would appear to be similar.

The CHAIRMAN. That documentation is very important because after all, as I say, these people say they want to compete in that area, and one of the great freedoms we have in this country, one of many, is the freedom for business to compete unless there's a very powerful reason why this would be against the public interest.

Mr. SHAPIRO. I think we have named some specific reasons in our statement on the abuses. Mr. Scher, our counsel, would like to comment on something specific.

Mr. SCHER. Senator Proxmire, the abuses which we have detailed in our written statement, some of which we also feel represent evidence of new abuses, have been primarily in the credit life field. To date, although there is some interpretation by the Federal Reserve Board that the bank holding companies may engage in life and health insurance activities other than credit life and health, they have not made full-scale entry into it. In fact, there's been very little, if any, penetration in this area. That is our concern, that based on the credit life experience, they will be going into these areas with a poor track record, and I think the detailed documentation on adverse effects of activities other than credit life and health will have to come in the property and casualty area as penetration increases in these activities.

The CHAIRMAN. Let me ask Mr. Shapiro, while you've got the microphone, this statement that they made before the committee goes on to say that competitively induced rate reduction on banking and nonbanking services is an important direct benefit to the public and leads to an improvement in the quality of competition and market for the services involved.

Now, some complaint was made that this kind of competition has resulted in real damage to some of the insurance agencies. That wasn't documented. I didn't see any evidence of firms that have been driven out of business by this. But at the same time, it's hard to see offhand—and I hope you can provide it for the record—how there could be any impact unless there were lower rates, lower premiums charged, lower prices for the consumer at a time when inflation is our No. 1 economic problem, it seems that any kind of competition would drive down the cost of anything, including insurance, is welcome. So how would you respond to that argument, that the bank holding company's ability to compete induces rate reduction and is an important and direct benefit to the public and leads to the improvement of the quality of competition in the market?

Mr. SHAPIRO. Going back to our comments on credit life, that certainly wasn't the result produced by bank holding company competition. As a matter of fact, it has been demonstrated that the cost to the consumer is higher. So there's one area where certainly they haven't induced lower rates but in fact they have produced higher rates about which the consumer wasn't even aware, and that's our concern.

Where is the line going to be drawn? Are they going to go into other areas where through their power they can loan money and loan dollars to corporations and perhaps suggest or imply they would like to handle the pension plans or corporation life insurance or group insurance? That's our primary concern, and that's the thought we want to leave with this committee.

The CHAIRMAN. Well, you have had this on the books for some time. Let me ask Mr. Wilson. I know he wants to comment. But before he comments, let me ask you this—the ABA went on to say:

> We also believe that the Federal Reserve Board's current approach to the bank holding company regulation has not resulted in the weakening of the banking system despite fears that the 1970 amendments would unleash the banking industry into divergent nonbanking areas; this has not occurred. The Board has not gone beyond or in some respects as far as the activities the Senate Banking Committee held were permissible in the 1970 amendments.

If this testimony by the ABA is correct, you have had 8 years since the 1970 amendments and you have had more than 20 years since the basic legislation in 1956. Where's the damage?

Mr. WILSON. Well, Senator, first of all, I think it's appropriate to point out that the banking institutions are unique creatures in our economy.

The CHAIRMAN. I said that in my opening statement. I agree with that. They have a monopoly on credit.

Mr. WILSON. They have a monopoly on credit and they have a charter which permits them to take the public's deposits and then turn around and compete against them. Furthermore, you take a look at the mortgage banking industry—what's happened recently in the mortgage banking industry? From 1968 to 1976, they have increased their control over the servicing volume by 100 percent, from 23 percent to 49 percent. In these insurance cases we have described, one of the banking witnesses in those cases described the independent mortgage company as "a dead duck." In terms of factoring, they virtually have taken over the factoring business. Since 1967 to 1976, they increased their control of volume from 36 percent to 77 percent.

The CHAIRMAN. Now you may be correct on factoring. Where is the damage to the public interest in this takeover of factoring? I realize it's damaging to the people who had the business and lost the business, and that certainly is a consideration we ought to be concerned about, but as far as the broad public interest is concerned, if a more efficient, competent group comes in that can do a job for less cost and win out, that's the way the system works.

Mr. WILSON. That may be true. As it turns out, factoring, for example, and mortgage banking are both financial activities that banks can do directly as opposed to doing through a bank holding company. I would point out, however, that, for example, with respect to insurance in these cases, First National Holding when it presented evidence to the administrative law judge admitted that within 4 years they would have 27 percent penetration level. Mind you, this is a 27-percent penetration level when they declined to offer insurance at the lowest practicable cost, which would mean they would have a $4.3 million premium volume insurance agency per year which would make them among the top 10 insurance agencies in comparison with the current natural occupants and the members of the Georgia Association of Insurance Agents——

The CHAIRMAN. It's hard for me to follow this because I just don't see—are you saying that certain units in the insurance industry—certain companies have suffered because of this intrusion of bank holding companies?

Mr. WILSON. Bank holding companies admitted that without competing on the basis of price, they would garner 27 percent of the insurance agency market.

The CHAIRMAN. What's been the experience?

Mr. WILSON. We don't have access to that information. The Federal Reserve Board could get that information. That information came on the basis of exhibits that they themselves filed in context with these cases. But, of course, we would have no right to go to the Federal Reserve Board and ask them to examine this.

The CHAIRMAN. Don't you have data on the size and growth or decline or whatever it is of the insurance companies that are competing?

Mr. WILSON. Well, since the 1970 amendments, based on the initiative of IIAA, there have been relatively few banks holding companies that have succeeded in getting into the business. So we really don't have that much experience with it.

The CHAIRMAN. Why have they not succeeded in getting into the business?

Mr. WILSON. At least insofar as sales of insurance across the bank holding company system, the Federal Reserve Board viewed these cases—the ones I have described and others that are currently pending before the fifth circuit—as test cases, and they indicated to other bank holding companies that had applications pending before the Board that they would process them but that they would require full-blown hearings on the record, or their constituents could agree to wait until the outcome of these test cases. So those applications are currently pending at the Board, but they have not been processed; that's principally the reason for it, and it's also a reason why we believe the bank holding company industry is poised now, given the Supreme Court decision, to enter the industry.

The CHAIRMAN. The Association of Bank Holding Companies testified—and I will read a short paragraph of what they said:

> In changing the standards for bank holding company entry into bank-related activities, section 301 of the bill adds new restrictive provisions to the present section 4(c)(8). The result, in our view, will be to effectively eliminate this provision from the act, bringing to an abrupt end the entire beneficial process that Congress has permitted since it first decided in 1956 to subject bank holding companies to Federal regulation. This drastic result would take place with no showing having been made that there has been any adverse impact on any segment of the public. We think Congress should endorse the idea of vigorous, fair competition rather than appearing to support privileged sanctuaries for our competitors in the financial markets.

Now, what is the adverse impact on the public, and what segment of the public is there an adverse impact on?

Mr. WILSON. Well, I can speak with greatest authority and experience on the insurance issue. I can just tell you what the administrative law judge said; the administrative law judge said it would have a severe impact if the double-barreled financial conglomerates go into the insurance business in these various markets. It's going to have a severe impact on competition.

The CHAIRMAN. You see, what I'm having difficulty with is the fact that—maybe this statement by the Association of Bank Holding Companies is inaccurate. They say this would result in eliminating provisions of the act that have been permitted since 1956. Now, that's 22 years, and if after 22 years you can't show any adverse effect on the public other than an opinion of an administrative law judge, it seems to me the case isn't very strong.

Mr. WILSON. Well, first of all, let me point out that under the 1956 act, the standard under section 4(c)(8) was different. Also, this was before the *Arnold Tours* standing cases, where nonbanking competitors did not have standing to come in and challenge applications. Prior to the 1970 amendments, there was not an adversary proceeding. There was an administrative law judge and he reviewed the application and that was it. So there really wasn't much of an opportunity to establish a record on that basis. That's the first thing.

Secondly, the bank holding company movement really got into high gear beginning in 1968, and right after that this act was passed, the current law, which your bill would amend. So consequently, it's not surprising that the situation we have described exists. There were relatively few bank holding companies for a long time.

The CHAIRMAN. Mr. Shapiro, I'd like you to comment on another part of the Association of Bank Holding Companies' testimony. They say:

> In reading the negative laundry list of activities set forth in section 2(c) in light of the new directly related and other restrictive tests proposed in section 301, the bill seems to be prescribing a new definition of what constitutes banking. As we have noted, virtually all of the activities approved by the Board of bank holding companies have been offered by banks themselves for years.

How would you react to that?

Mr. SHAPIRO. Well, I think Mr. Scher is better qualified to answer that question than I am, so I'd like to defer to him.

Mr. SCHER. Senator, did I understand you to say that they made the statement that bank holding companies and banks may both engage in similar activities pursuant to the Bank Holding Company Act?

The CHAIRMAN. What they're saying is the negative laundry list of activities set forth in section 2(c) would proscribe activities in which the bank holding companies have been engaged in for years and they say the result of this has not been adverse.

Mr. SCHER. Well, we feel that to answer that in light of the question which you asked earlier regarding the fact that some of these activities have been occurring for 22 years; we don't feel that any substantial life and health insurance activities have been occurring for the past 22 years and the property and casualty insurance activities are still being litigated 7 years after the Bank Holding Company Act Amendments of 1970. Therefore, we have no full-scale record on the activities in the property and casualty or life and health field.

The only record we really have is with respect to credit life insurance and I think its been well documented that these abuses have occurred. I think the act itself currently provides that the bank holding companies must make an affirmative showing that the activities in which they engage will result in public benefits. Unfortunately, the way the Federal Reserve Board has been interpreting this is to just rubberstamp the applications and, consequently, it is our belief there has not been the required showing demonstrated in the administrative proceedings.

Your bill would seek to change this situation by mandating additional requirements such as a more extensive showing on the part of bank holding companies seeking to engage in nonbank activities that such benefits will in fact accrue to the public.

The CHAIRMAN. Very good.

Mr. Naugle, how do you meet the argument that a bank can sell insurance in connection with its loan transactions and that will offer one-stop shopping convenience to their customers?

Mr. NAUGLE. Well, it is true that the convenience could be a factor. However, we feel that the anticompetitive nature of the tie-in is more of a detriment. I can give you a personal example of this.

My agency is located close to Johnstown, Pa. We have at least one banker in the city of Johnstown who also is an insurance agent. Recently my insurance agency received a memo from his bank advising that a charge of $2 would be made for the bank remitting the premium to us on a homeowners policy, a handling charge of $2. I happen to know one of the men personally in that bank's insurance agency and I called him and asked him if they were also deducting $2 from checks going to the banker's insurance agency. They are not of course. This is one small example of how this is done.

The CHAIRMAN. How do you meet the argument that in some parts of the Nation in inner cities insurance is not available and therefore it's in the public interest for banks to market insurance in those areas?

Mr. NAUGLE. I doubt very seriously that the marketing of insurance in the inner cities would be enhanced by banks being in that business. It is not a problem of salesmen or producers. It's more a problem right now of underwriting acceptance of some types of business in the inner cities. We are currently involved in trying to devise a system of training and putting in place additional producers in the inner cities, but it's a problem of availability, not of marketing or producing.

The CHAIRMAN. You may be right. I think that's probably the case. At the same time, I can't see any harm under those circumstances—maybe I'm wrong—if no insurance is available, in letting a bank sell if they wish. I doubt if they would sell any.

Mr. NAUGLE. Very probable.

The CHAIRMAN. Mr. Wilson.

Mr. WILSON. Senator, that claim was made in context of the First National Holding application with respect to Atlanta and a rather interesting situation developed. The administrative law judge, being a rather tenacious sort, decided he was going to get to the bottom of the issue. There's an area in Atlanta, the intersection of Lee and Gordon Streets, which is apparently in the low income area. First National Holding said they had an office in that area and there was no adequate insurance in that area and their being permitted to sell the insurance would be in the public interest because these people could get insurance.

So the administrative law judge had us call as his witness an agent who we picked out of the yellow pages. The agent came in and he was the administrative law judge's witness. He was asked how many agents were in the immediate area of Lee and Gordon Streets. He said six. Well, what is the principal insurance sold in that area? Substandard insurance. That is very high risk insurance and so forth which First National claimed was unavailable, and that is what he principally engaged in. They asked him if he had ever received a referral for substandard insurance in that area from a nonaffiliated agent. He said no. They asked him if he had ever received any kind of a referral for substandard insurance. He said, "Oh, yes, from Citizens and Southern Holding Co.," which is a grandfathered holding company under the Bank Holding Act which owns an insurance agency in Atlanta, and that's where he got some of his substandard business from. This bank holding company was turning customers away when in his experience no independent agent had ever done that.

The CHAIRMAN. In your testimony you discuss the litigation between the insurance agents and the Federal Reserve. How much would you say the courts relied on discretionary expertise of the Federal Reserve in supporting the Fed's position?

Mr. WILSON. Well, in light of what they said about what the Federal Reserve Board did, I think that the conclusion is inescapable that when the Congress delegates to an administrative agency the exercise of discretion with respect to a given area, the courts are loathe to interfere with the exercise of that discretion, no matter how thin the evidence is regarding what the administrative agency does.

So insofar as the insurance area is concerned, I think the record, Senator, has more than been made that if you give the Federal Reserve Board the discretion they are going to resolve all of their doubts in favor of their constituents, the banks. After all, we're talking about the central bank.

The CHAIRMAN. Would you say that basically the courts have said that since Congress has not legislated it's intended for the Fed to make the decision in place of Congress—we have delegated that authority?

Mr. WILSON. I think that's right.

The CHAIRMAN. And you argue that the Federal Reserve, after all, is the central bank, many of the Governors and I guess most of the Open Market Committee are bankers; they deal with banks all the time and they have a natural feeling of concern for the interest of banks and, therefore, you're not dealing with an objective, fair arbitrator between banks and the insurance industry or other competing industries.

Mr. WILSON. In the nonbanking industries, when they come before the Federal Reserve Board, the body that's authorized by Congress to administer the Bank Holding Company Act, are interlopers when they come there and they are treated that way.

The CHAIRMAN. Well, I'm inclined to agree with you. I would like to see whatever documentation you can give in that respect. It would be very helpful. I know it's hard to get documentation of true prejudice, but if you can come across any——

Mr. WILSON. Well, prejudice might be a bit strong, Mr. Chairman. I think that bias is fair. I think there's a clear bias. I don't want to suggest that there's anything untoward that's gone on or these people aren't honorable men.

The CHAIRMAN. I would say bias can be just as untoward as prejudice. It's fooling around with words. But regardless of how you put it, the Fed, like the Comptroller and the FDIC, deals with banks. Usually they get people on the Fed who come from the banking industry and go back to the banking industry one way or the other, not always but often, and they are great people, fine people, of solid integrity and decency and honesty but they also have that association. It's like somebody from Chicago is likely to be a Chicago Cub fan and in Milwaukee the Brewers and so on. If they got a chance to umpire a game, they might see it a little differently than somebody from the other city whose team was playing.

Well, thank you very much, gentlemen. I very much appreciate your testimony. As I say, it's very expert and useful and we do appreciate it. If there's anything at all you would like to add for the record you can do it now orally or when you correct your remarks. We'd be happy to have you do that.

Mr. SCHER. Senator, just one further comment on your question regarding banks or bank holding companies marketing insurance in the inner city. We have been given to understand that banks won't even lend in some inner city areas, that there are currently and have been hearings on so-called "redlining" and I think the first thing we ought to consider before we permit banks and bank holding companies to commence insurance agency activities in inner city areas, would be to get them to start lending there. Once this has been accomplished, then maybe we could think about some of these other activities.

The CHAIRMAN. That's very helpful. I think it's a good point. We have stressed very hard the redlining problem. One of the arguments that were made of all kinds—insurance and so forth.

I want to thank you gentlemen very much.

Our next panel consists of Mr. John J. Gardiner, vice chairman, National Affairs Committee, National Society of Public Accountants and Mr. Edison R. Zayas, economist, National Federation of Independent Business.

Gentlemen, we are very happy to have you here. We are going to use the same guideline we had before on the light. I might say, a vote is scheduled on the floor at 11:25 and I will have to recess the hearings, but I will be right back after the vote. Mr. Gardiner, go right ahead.

STATEMENT OF JOHN J. GARDINER, VICE CHAIRMAN, NATIONAL AFFAIRS COMMITTEE, NATIONAL SOCIETY OF PUBLIC ACCOUNTANTS; ACCOMPANIED BY JOHN H. FITCH

Mr. GARDINER. Thank you very much, Mr. Chairman.

Mr. Chairman and members of this distinguished committee, my name is John J. Gardiner and I'm from Philadelphia, Pa. My title is vice-chairman of the National Affairs Committee. Originally, Mr. Rudolph J. Passero, of Rochester, N.Y., the chairman of the National Affairs Committee of the National Society of Public Accountants planned to be here to testify today. However, because of urgent business it was impossible for him to arrive in Washington in time for your hearings.

I am also accompanied at this time by John H. Fitch, who is counsel for the National Society of Public Accounts.

Senator, I am pleased to have the opportunity to present the views of the National Society of Public Accountants on S. 72, The Competition in Banking Act of 1977, under current consideration by this committee.

The National Society of Public Accountants' position on this bill is summarized in the testimony and attachments which have been distributed to the chairman and to this committee.

We fully appreciate the fact that this committee performs an important function in the banking and legislative process. It provides a forum for the examination of legislative proposals important to one or more of the diverse sectors of society affected by our banking laws, proposals that might otherwise not receive adequate attention from the Congress. It also encourages continuous review of the application of the banking laws and thereby promotes an atmosphere in which corrective changes might be identified and enacted expeditiously.

Mr. Chairman, my testimony covers five major areas with respect to the future relationship of accountants and the banking industry and the banking community in these United States.

First, professional accountants are regulated by State law and must meet stringent educational, experience, ethical and technical requirements, including mandatory continuing education; while banks and bank employees are exempt from these requirements.

Second, the type of accounting, bookkeeping, and tax service offered by banks is misleading and potentially harmful to the public. This is based on the fact that banks rely on the businessman to code his own financial transactions and which are merely put on the bank computer and regurgitated back. From these figures, the banks prepare monthly P&L statements and financial statements which are then returned to the businessman. There is no professionally trained accountant to insure proper coding of these transactions or to evaluate the information to establish its correctness and reliability, and whether or not it accurately reflects the financial condition of the business. Tax service employees of banks, gentlemen, are not subject to the ethical and technical requirements of the U.S. Treasury Department Circular 230 and therefore cannot represent a client before the IRS in the event of an audit of the books and records of the companies which are being serviced by the banks. Neither does the employee have the knowledge and the expertise of tax laws, rules and regulations to adequately, competently and properly serve a client.

Third, due to the banks' substantial investment in data processing, it can offer such accounting services, et cetera, free or at less than competitive rates in conjunction with their banking services. We would have no objection to the rates if they were competitive; however, we feel that public interest is not being properly served because of the incorrect information conveyed to investors and because of the lack of independent opinions on these financial statements.

Fourth, gentlemen, banks can also use their financing and loan services as levers to encourage a client or a potential client to use their nonbanking services. This potential "Sword of Damocles" is hanging over the head of the businessman who needs a loan and is enough to force him to participate in these nonbanking services. This is potentially disastrous not only for the independent accountant but also for the banks, their depositors and especially investors in these various companies and the Government of the United States.

Finally, gentlemen, the most serious aspects of banks doing accounting work for their clients is the potential conflict of interest and loss of independence of judgment and objectivity which occur. The Congress, as you know, and particularly Senator Metcalf and Congressman Moss, and the Federal Trade Commission, the Department of Justice, and the Securities and Exchange Commission, are all extremely concerned with this problem of independence and objectivity of the independent accountant because of its potential harm to the company, the stockholders, the business and investment community, and the Government.

These agencies are working hard to correct that problem, yet the banks on the other hand are encouraging it.

Mr. Chairman and members of this committee, I want you to know that the accounting profession recognizes the fact that undue restriction of competitive rates is a very important and serious problem. However, we feel that the public interest is much more important and incorrect information conveyed to a potential investor for the reasons that I have mentioned—the lack of independence and the lack of proper coding of transactions—will convey to investors that possibly the information that is submitted to a potential investor could be erroneous and therefore misleading.

Mr. Chairman and members of this committee, I want to take this opportunity on behalf of the National Society of Public Accountants and my colleagues to thank you for the privilege of appearing before you today. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Mr. Gardiner, for you excellent statement. We very much appreciate it.

[Complete statement follows:]

NATIONAL SOCIETY OF PUBLIC ACCOUNTANTS

1717 Pennsylvania Avenue, N.W., Washington, D.C. 20006
Phone (202) 298-9040

Mr. Chairman and members of the Committee, my name is John J. Gardiner. I am a public accountant from Philadelphia, Pennsylvania, a Past President of the National Society of Public Accountants (NSPA), and currently, the Vice Chairman of NSPA's National Affairs Committee.

I am pleased to appear before you to discuss the merits of S. 72, the "Competition in Banking Act of 1977."

The National Society of Public Accountants is a professional organization of some 16,000 independent accountants who represent approximately 10 million clients, 3 million of which are small business entities throughout the 50 states and territories. Our members provide a variety of accounting, auditing, management advisory and tax services principally to the smaller business community and to the general public.

Because licensure of accountants is governed under separate and distinct state laws, our members include public accountants, licensed or registered public accountants, certified public accountants, accounting practitioners and accountants and practitioners utilizing other titles which are permitted under provisions of state law.

Our members are bound to a stringent Code of Professional Ethics and to the Generally Accepted Accounting Principles and Auditing Procedures which have been adopted by the National Society.

As a matter of background information, NSPA has previously testified in favor of similar legislation on four different occasions; in 1965, 1969 and 1970 before the Congress and in 1972 before the

Comptroller of the Currency. Therefore, historically NSPA has supported legislation which would restrict or preclude banks and bank holding companies from offering "non-banking services," particularly accounting and related services.

Accountants in public practice have noticed that within the past several years there have been significant developments in the banking industry which forecast serious consequences for the business community, the U.S. Treasury Department and the professional accountants in our country. The problem arises from the fact that banks in increasing numbers are advertising and rendering accounting, bookkeeping and various tax services to business firms of all types and sizes, as well as to individuals.

Banks and other financial institutions offer these services because of their rather extensive and expensive investments in data processing and other automated recordkeeping equipment. They are out to accelerate their return on investment by engaging in activities beyond their expertise. This equipment is being acquired primarily to enable the individual banks to render more modern and efficient banking services to their customers, and in many cases, to other banks. But, banks are using this equipment beyond their own needs to provide a type of service to the business community which is rather far removed from the traditional concept of banking.

Through various media, banks are advertising that they are now in a position to offer a wide range of accounting, tax and recordkeeping services. These activities may include, but by no means are limited to: payroll preparation services, accounting reconciliation, cost accounting, billing, sales reports, inventory control, financial statements and the preparation and filing of various tax returns. These services are described by the banks as "business services" to distinguish them from more traditional banking functions. However, these "business services" are the same types of services which have been, and presently are being, competently performed for the business community and the general public by independent, professionally trained practicing accountants.

These "business services" are not only outside the scope of normal and traditional banking functions, but, more importantly, they constitute a serious encroachment into the area of practice engaged in by professional accountants. If the present trend is permitted to continue without abatement or control, and if banks are given a free hand to offer more and more variations of "business services," there will be serious repercussions for the business community, the general public and the accounting profession.

In order for the Committee to understand our problem, I would like to briefly define what is generally accepted as "auditing or other professional services in the field of accounting," and their related functions as performed by an independent professional accountant. I will also comment on the reasons for our objections to banks performing these various functions.

The first group of activities in the definition is the design, installation and supervision of internal systems of recordkeeping in terms of money and internal control of financial data.

An important part of the many services rendered by persons trained in the field of accounting is the design and installation of an accounting system for a given business. The accountant studies the nature of the business, determines the types of transactions that will probably occur, and designs or selects the necessary forms and records in which the transactions of the business may be recorded. Beyond that, as the business grows, it is the accountant's responsibility to review the accounting system from time to time, supervise the operation as an expert, and thereby initiate any desirable amplifications or modifications.

A key element in this area of accounting services is the fact that the internal systems of recordkeeping referred to are those expressed in terms of money or finances. Other basic recordkeeping systems, which may involve physical goods or supplies not necessarily related to money or finances, may properly be included in bank activities.

A second area of services would be the use of discretion in recording business transactions of a financial nature. This conforms substantially to the widely known and generally accepted definition of accounting as:

> "...the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character, and interpreting the results thereof."

Professional accounting requires principally mental skills, including the exercise of discretion and judgement, rather than manual labor. When decisions must be made about a particular "bookkeeping" procedure or entry, the element of discretion necessarily follows. And, the exercise of discretion in accounting -- which recordings to make, when, in what amounts, and to what accounts -- are not decisions for banks to make. They are best left to those who are professional, qualified accountants.

It should be noted here that independent accountants in public practice are subject to state regulation and are bound by stringent technical and ethical requirements, including mandatory continuing education to insure their competence, objectivity and independence which protects the public welfare. Banks and bank employees operating the non-banking services are not subject to these requirements which could have a detrimental effect on the business community and the public.

A third category of professional accounting services is the preparation of financial statements from books of account.

At regular intervals the professionally trained independent practicing accountant prepares statements showing the financial position of his clients and the results of his clients' operations. These financial statements are based upon the financial data accumulated in the accounting records. Such statements furnish important information to management, owners, investors, bankers and government agencies.

The preparation and interpretation of periodic financial statements in a meaningful manner, such as the familiar balance sheet or profit and loss statement, is a key service which only a professionally trained accountant is qualified to provide.

While a good recordkeeping system is vital to business health, records in and of themselves are valueless unless they can be properly analyzed to determine where a company has been, where it is now, and where it is likely to be heading. If the average businessman cannot obtain a proper evaluation of the message contained in his records, his accounting needs will hardly be served. All of the records in the world will do him no good unless he can rely with confidence on a professionally trained accountant to tell him what the records mean. It is only the accountant who is trained in financial statement preparation, anylysis and evaluation. Banks should not be permitted to offer or perform these professional services because they are unintentionally misrepresenting their service's value.

Another accounting function is the preparation of tax returns, including Federal, State and local. This is an activity which is completely unrelated to banking because of its close relationship to accounting. In fact, it has been widely said that accounting records and accounting principles are the foundation upon which income tax returns are based.

While it is true that there is no present Federal regulation or control over the competency of those persons or firms who may prepare income tax returns for a taxpayer for a fee, it is believed that this is an activity which banks should not pursue because they lack expertise. It is best for government and the public that the services of trained practitioners be utilized who are thoroughly familiar with the intricacies of Federal, State and local tax laws and the accompanying rules and regulations. It is necessary that the taxpayer -- whether a businessman, corporation or individual -- have the right to look to his tax advisor for follow-up, support and representation if such a need arises.

Since banks are neither attorneys, certified public accountants, nor individuals enrolled to practice before the Internal Revenue Service under Treasury Department Circular 230, and cannot be considered "individuals" permitted limited practice under current Revenue Procedures, they cannot represent a client in the event that client is audited by the IRS. At best, the bank employee could serve as a witness only. It is impossible for a bank to offer professional income tax services to its customers.

It is not our intention to restrict banks in any way from preparing estate, inheritance or fiduciary tax returns or any other tax returns which are necessary in connection with lawful functions as trustee or agent.

Auditing is a procedure by which experts examine accounting records and statements to verify and detect and to give assurance that the records and statements have been prepared in accordance with generally accepted accounting principles.

An independent accountant may make a continuous check of work performed by his client's bookkeeping or accounting department. This activity is generally described as a continuing audit. In addition, a firm may call upon the services of an independent professional accountant to determine whether the financial statements present fairly the overall position of the business and the results of its operations. This assurance from the accountant is vital, not only to management, but to third parties, and particularly banks. Often an accountant is called upon to express a professional opinion in his audit report about the firm's operations as reflected in its financial records.

Auditing and the rendition of professional opinions are considered to be the highest level of public accounting practice. Considerable training and experience are required. At no time should banks attempt to render auditing services because such activities, generally, would be outside of the ability of bank employees. Moreover, such efforts could be in conflict with the bank's overriding relationship with a customer or prospective customer where loans or other financial arrangements are involved and the bank would lack the necessary independence of judgement which is the hallmark of the professional accountant in public practice.

How do these activities relate to the activities of banks and other financial institutions today? The answer is quite simple. Many banks located in various states in the country are actively engaged in soliciting accounting business from the general public. The services offered range in sophistication from simple bookkeeping to rather complex accounting services.

There is no question that these services are valuable to the businessman, but only if they are performed by one with the training, independence and experience necessary to perform them properly. Based on the complaints the National Society has received from its members, the following banks are presently offering to the public some form of accounting services. They include Mercantile Bank of Missouri, First and Merchants National Bank, Old Stone Bank, Malden Cooperative Bank, First National Bank of Boston, Cape Cod Bank & Trust Company, University National Bank of Boca Raton, National City Bank of Cleveland, Continental Illinois National Bank and Trust Company of Chicago, Valley National Bank of Arizona, Greeley National Bank of Colorado, Continental Bank Data Service, and others. This is by no means an exhaustive list. We are reasonably certain that the problem is much more broad than the complaints we have received would indicate.

We object to the banks offering accounting services on two grounds. First, they have neither the independence nor the professional qualifications necessary to perform discretionary accounting services as described earlier in my testimony. Second, they are in the unique position of being able to tie-in the lending of money with the rendering of accounting services.

Accounting services rendered by banks, which are based on automatic data processing, usually are objectionable. They often present results which superficially may be impressive, but which generally are badly distorted because the bank processes entirely what the untrained small businessman gives them. That is, the banks rely on the untrained businessman to code the accounts properly which can and does lead to gross errors and serious consequences. The old adgage, "garbage in, garbage out" is very appropriate here.

The big problem, as we see it, is that with the various brochures, advertisments and publications distributed by banks, there is a distinct impression created that the banks are offering a valuable accounting service. But they are not. They are merely doing some clerical work. With your permission, Mr. Chairman, I offer for the record copies of advertisements and brochures which exemplify the types of services being offered by banks.

Merely keeping records on automatic data processing equipment and occasionally reporting the data stored in the computer is not professional accounting. It is the function of the trained professional accountant to review the raw data, consider it in terms of the individual company, and issue a financial report based upon his professional knowledge.

The importance of financial statement analysis and evaluation is pointed up by the fact that most firms of reasonable size have their

24-934 O - 78 - 27

own accounting departments and their own comptrollers. These key staff personnel are able to provide their organization with professional counseling and advice. But, the small businessman cannot afford such an expense. He has to look outside of his own organization, because he needs accounting and financial advice as much, if not more, than the big business organization. He, therefore, turns to the independent practicing accountant for his services.

There is another possible condition which is likely to exist and which definitely is not in the best interests of the business community. That is, the temptation will be quite strong for some banks to take a position, subtle as is might be, that the availability of loan funds will be predicated on, or at least influenced by, the bank being able to provide accounting and recordkeeping services to the prospective borrower.

For example, if a bank is anxious to obtain new customers for its "business services," it is not inconceivable that undue pressure could be exerted on a prospective borrower in order to persuade the borrower to become a client for the bank's accounting, recordkeeping or tax services. In essence, a bank could say to a prospective borrower: "Since we know what financial information we want, and how we want it presented, let us keep your accounting and bookkeeping records; otherwise, there may be a serious question as to our granting you a loan under any other arrangement." Or, depending on the competitive situation that exists among banks, a bank could advise borrowers that if the borrower utilizes the bank's "business services" he will be able to get his accounting and recordkeeping at less than what he pays his professional independent accountant. Such as statement would, of course, ignore the relative values of the services offered.

The possibility also exists that bank decisions on loan applications might be influenced by the overall profit on the customer's account, including bookkeeping and accounting services, rather than on long-established standards of evaluation. If this were the case, both the user and the non-user of the bank's accounting and recordkeeping services could be hurt, as well as the bank's depositors. The user would suffer by having unwisely obtained funds and incurred an obligation that he may have trouble repaying. Also, the non-user would suffer by having been denied a loan which could have been beneficial under the circumstances, and which could have been repaid from the profits generated by his business. The depositors could suffer by having their funds placed with poor risks (even though potentially a profitable customer, because the bank did his accounting and recordkeeping work) and failing to have funds placed with good risks.

Small businessmen would no longer be able to maintain an independence in mental attitude when seeking professional accounting and tax services. They could be influenced by the thought that relations with the bank might suffer if they did not allow the bank to render these services. The customer might then become a "captive" client of the bank. Such a situation would obviously be detrimental in the long run, not only to the customer, but to the relations between the bank and the accounting profession, because such an arrangement would constitute unfair competition between the bank and professional accountants offering similar services.

Somewhat related to this situation is the problem that would occur if banks could no longer rely on "independently" prepared financial data when evaluating a prospective borrower. At the present time, banks generally place considerable reliance on financial statements prepared by independent practicing accountants. But, if the banks themselves maintain a prospective borrower's financial records, will there continue to be a need for the bank to call for "independent" statements? If not, such procedure might act to the detriment of the bank itself, its customers, and, by the same token, not be looked upon favorably by bank supervisory agencies.

Not only are we concerned about the present situation, but the possibility of escalation will be even more troublesome. For once the bank gets its foot in the door of a business, by providing a portion of the firm's accounting and recordkeeping needs, it does not take much imagination to visualize the bank taking over other accounting services, step-by-step, and possibly eliminating accountants altogether.

Accounting services must be performed by independent professionally trained accountants. No bank can adequately perform such services and remain unbiased and objective in other business relationships with customers.

Banks may disclaim any intent to encroach into the professional accounting field. Yet, the facts are irrefutable. Banks are definitely moving into the area of the independent accountant. It is not only a question of unfair competition, but the invasion of a professional area by a financial profit-making organization and the elimination of independent professional accounting judgement.

An analogy can easily be drawn with the legal profession. The American Bar Association has long recognized that professional judgement must be separated from those that might have a financial stake in a transaction or who are untrained in legal matters. The accounting and legal professions are similar. Prohibitions that apply to banks offering legal services should apply to accounting services also. Otherwise, if banks can perform accounting services, why shouldn't they be able to perform legal services?

There is at the present time legislation passed by the United States Congress which seems to set a precedent with regard to banks engaging in professional accounting services for the public. In 1962 Congress passed the Bank Service Corporation Act (73 Stat. 1132) which allowed small banks to combine to form separate corporations which could own data processing equipment. The objective of the legislation was to allow the smaller banks to compete with the larger financial institutions which could afford to buy or lease data processing equipment.

Section 4 of that Act provides that "no bank service corporation may engage in any activity other than the performance of bank services for banks." It is inconceivable that Congress should have recognized in that statute the need for bank service corporations to be confined in their activities to servicing banks, and banks only, and yet be unwilling to have the same restrictions imposed upon banks themselves.

During the debate on the Bank Service Corporation Act, Mr. Chairman, while proposing an amendment to confine bank service corporations to servicing themselves and other banks only, you stated: "We are in a position to have a bill that provides what the banks really want, and what the members of the Committee feel is justified, and at the same time safeguard legitimate business enterprises which otherwise might be put out of business." It's hard to take issue with your cogent observation.

Moreover, with reference to the prohibition directed at non-banking activities on the part of bank service corporations, the Senate Committee Report on the Bank Service Corporation Act included the following highly relevant statement: "the Bill is not intended as a means to enable banks to engage in non-banking business, and the Committee looks to the bank supervisory agencies to make sure that banks do not organize service corporations for the purpose of entering into businesses other than banking." If Congress were so concerned that banks would organize service corporations that would render non-banking services to the public, then by the same token Congress should be equally as concerned that the banks themselves, as principals, do not enter into any activities other than banking.

And yet, even in this atmosphere of doubtful legality, many banks throughout the country advertise and promote professional accounting and tax return preparation and related services -- activities which normally fall to the practicing professional accountant.

Despite the questionable legality of banks engaging in accounting services through the use of their computer installations, previous Comptrollers of the Currency have ruled that banks may engage in professional accounting services on the basis that accounting is a permissible non-banking activity because it falls within the general category of activities incidental to banking.

The National Society of Public Accountants entertained the possibility of joining in a lawsuit challenging the validity of the Comptroller of the Currency's ruling with regard to accounting. Until just recently we were discouraged by a series of court cases which have held that one seeking to prohibit a bank from engaging in a non-banking service is complaining of an economic loss and has no standing to sue unless Congress has specifically provided that the person bringing suit is of a class specifically protected by statute. I cite for instance the case of Arnold Tours Inc. vs. William B. Camp (428 F. 2nd 359). In that case Judge Aldrich denied an appeal from a district court decision which held that Arnold Tours, a travel agency, had no standing to challenge a ruling by the Comptroller of the Currency permitting banks to engage in the travel agency business. He noted that there was no specific legislative provision prohibiting banks from engaging in the travel agency business. Judge Aldrich said,

> "Congress now knows that if it wishes a particular class of plaintiffs to have, or not to have, standing to seek review of agency rulings, it may make, or not make, the types of legislative provisions discussed earlier in this opinion, and that is the end to the matter."

Following the principles laid down in the Arnold Tours case, Judge Aldrich found in a companion decision, the Wingate Corporation vs. Industrial National Bank, (408 F. 2nd 1147) that data processing service centers were a class which Congress has specifically protected. He cited the 1962 Bank Service Corporation Act (73 Stat. 1132) which I have previously discussed as the expression of Congress' desire to protect service centers.

According to Judge Aldrich's opinion,

> "In order to prevent such corporations being used as a subterfuge for entering into the nonbanking business of data processing, and to protect the interests of certified public accounting firms, Congress provided in Section 4 of that Act (12 USC, 1964) that 'No bank service corporation may engage in any activity other than the performance of bank services for banks.' The legislative history is clear. The prohibition was initially proposed in an

amendment requested by the National Society of Public Accountants, which objected to the original version of the bill which would have allowed bank service corporations to solicit outside business. The accountants feared the threat against their business posed by the corporation's computers. The final provision was an obvious legislative response. (See 108 Cong. Rec. 16499, 22031 (1962); Hearing on Misc. Bank Bills Before the Committee on Banking and Currency of the United States Senate, 87th Cong., 2nd Sess., at 79-80 (1962))."

The National Society was most pleased to see the First Circuit take cognizance of this legislative precedent. This view was upheld by the Supreme Court in Association of Data Processing Service Organizations vs. Camp when ADAPSO was told that it had standing to sue a national bank that offered computer services to the general public. In writing the decision of the Court, Mr. Justice Douglas referred to the Arnold Tours and Wingate cases.

These court decisions illustrate the necessity for Congress to make specific provisions in deciding who is to be protected and who is not. It is perfectly evident from the rulings of the Comptroller of the Currency and the position of the Federal Reserve Board that the practicing professional accountant in America cannot rely upon administrative agencies for fair and equitable treatment.

Therefore, we feel that all bank holding companies, national banks, and all federally insured national institutions should be specifically prohibited from engaging in accounting services as we have outlined here today.

While S. 72 does not go as far as we would like, it is a step in the right direction and addresses one of the most serious aspects of this problem; that of the anticompetitive effect of banks offering accounting services vis a vis the independent accountant in public practice.

This concludes my formal presentation. I will be happy to answer any questions the Committee may have.

Thank you.

MAY 22 1978

CHAS. A. CLARK, JR.

CLARK ACCOUNTING

102 South 2nd St. — P. O. Box 728 — Aberdeen, S. D. 57401
Telephone: (605) 225-8890

Aberdeen, South Dakota
May 18, 1978

NSPA Department of Government Affairs
1717 Pennsylvania Ave. NW
Suite 1200
Washington, DC 20006

Dear Sirs:

This is in answer to Chairman Passero's bulletin on banks doing accounting and bookkeeping.

Our office has done several tax returns where the client has been using their bank's accounting or bookkeeping services. What disturbes me most is that the client seems to feel that if the banks computer has entered the various income and expenses in the various catagories, that it is right and will withstand an IRS audit.

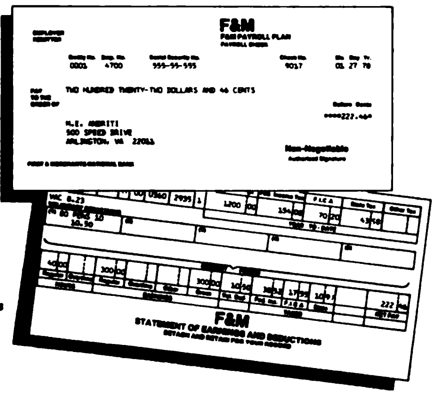
What our client doesn't know and probably has not been informed by the bank, is that the bank's computer operator is just that, a computer operator, and not an accountant or an authority on income taxes. The computer operator is entering the information just as our client codes them, whether right or wrong.

In addition, I find that few of our clients understand the code system that has been set up by their bank.

Sincerely,

C. A. Clark, Jr.
Public Accountant

CAC:sj
copy to: R. C. Leonard
P. O. Box 1117
Pierre, SD 57501



Computed paychecks
Preprinted Time Sheets or Time Cards
Employee Earnings Records
Paycheck Listings
Personnel Records
Reconciliation of payroll checks
Payroll Tax Returns — W2s, W3s, 941s
... and a variety of optional reports

** We can make up conventional paychecks or use F&M's official bank check or direct deposit facilities*

ACCOUNTS RECEIVABLE To control your collections, sales and credit

ACCOUNTS PAYABLE To pay bills, maintain purchase records and generate entries into other systems

GENERAL LEDGER/FINANCIAL REPORTING To create financial statements and supporting journals and ledgers

REAL ESTATE SERVICES Rental and condominium accounting, mortgage records, and construction job costs

For further information call Ronald Coleman collect at F&M (804) 788-2802 or return the attached card

First Class Mail
U.S. Postage
PAID
Permit No. 1245
Richmond, Virginia

BUSINESS REPLY MAIL
NO POSTAGE NECESSARY IF MAILED IN THE UNITED STATES

POSTAGE WILL BE PAID BY

Ronald Coleman
Cash Management Services
First & Merchants National Bank
P.O. Box 27025
Richmond, Virginia 23261

Payroll
Accounts Receivable
Accounts Payable
General Ledger Financial Reporting
Real Estate Services

3RD CLASS
BULK RATE
Permit No. 1225
Richmond, Va.

One of Virginia's largest banking organizations with assets of over $1.8 billion, offers a complete range of commercial banking services. Currently over 150 Virginia companies have their payrolls prepared by the F&M/ADP service, utilizing the F&M official bank check.

The nation's oldest and largest company of its kind serves the computerized bookkeeping needs of almost every kind of commercial or service activity — more than 50,000 clients. Over 3,000,000 Americans have their paychecks prepared by ADP.

☐ I would like more information including your free brochure
☐ I would like to talk with an F&M representative
☐ I am also interested in the services checked below:

☐ Accounts Receivable
☐ Accounts Payable
☐ General Ledger and Financial Statements
☐ Mortgage Banking Accounting
☐ Rental and Condo Accounting
☐ Job Cost Accounting

NAME ______ TITLE ______
ADDRESS ______ CO NAME ______
CITY ______ STATE ______ ZIP ______
NO OF EMPLOYEES ______ TELEPHONE ( ) ______

The Cornerstone of Business.

Talk to the businesses that bank at Old Stone, and you'll discover what makes us better. Many of these businesses are thriving because Old Stone listened when other banks wouldn't. And many more are thriving because Old Stone found creative new approaches instead of relying on tired old formulas.

When you do business with Old Stone Bank, you get a lot more than just a source of cash. You get the kind of expertise and insight that serves as a strong foundation for years to come. You get a cornerstone for your business.

A cornerstone for sound financing.
There are many ways for a business to borrow money, and choosing the right combination can have a dramatic effect on your bottom line. At Old Stone Bank, we can provide you with a financing package that's tailor-made to your specific requirements.

It could include accounts receivable financing to improve your cash flow, a leasing plan to acquire new equipment without a large capital outlay, a line of credit or a short-term working capital loan. Whichever it is, we'll make sure it's best for you.

A cornerstone for future planning.
At Old Stone Bank, we don't claim to have a crystal ball. But we have the next best thing — a sophisticated computer model that can provide your business with a long or short-range financial forecast.

We'll make a comprehensive study that will help you project your sales and profits, analyze acquisition opportunities, and compare the many different methods of financing. It's the kind of edge that provides you with foresight instead of hindsight.

A cornerstone for foreign trade.
If your company is in the international marketplace, Old Stone Bank understands your needs. We can provide you with letters of credit, export financing, collections, foreign exchange and many other services which facilitate doing business overseas.

A cornerstone for efficient accounting.
We look at accounting as much more than an income statement. At Old Stone, we try to increase those profits for you. Through our automated methods, your business records and internal workload can be handled more accurately and economically than ever before.

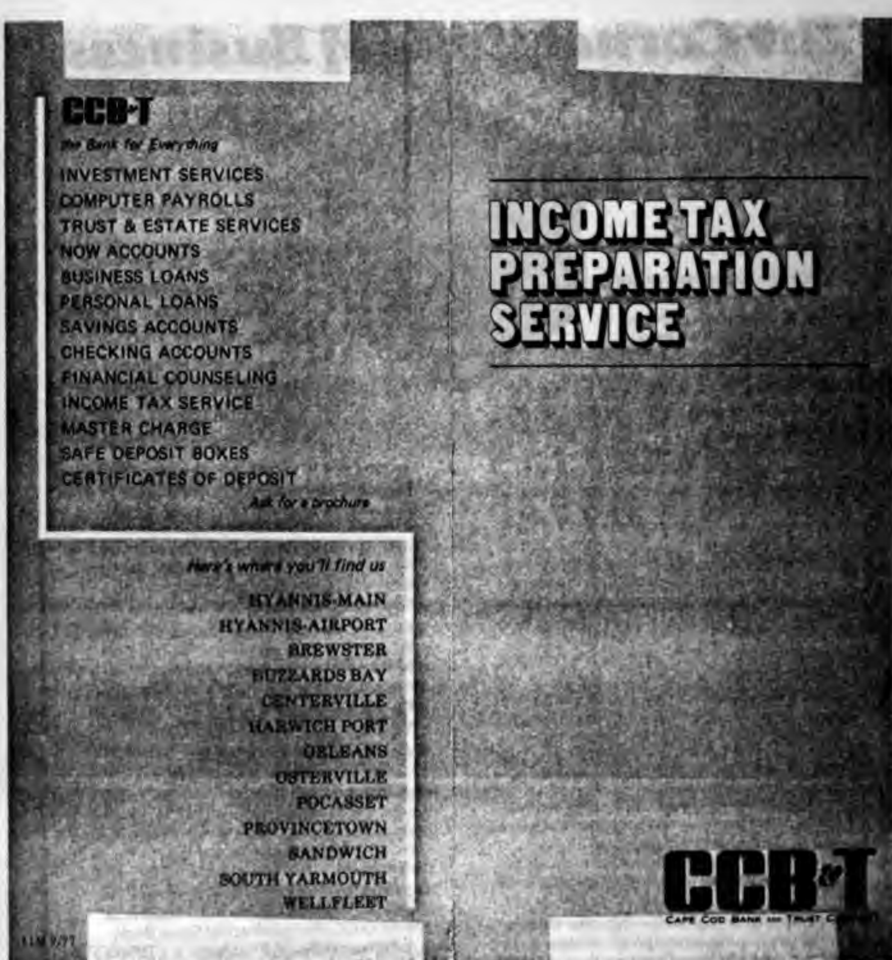
We'll take care of your payroll, labor cost analysis, sales analysis, check reconciliation, accounts receivable and accounts payable. We can even provide you with a cash management system that speeds up the collection of receivables and gives you greater control of disbursements.

A cornerstone for growth.
When your business banks with Old Stone, we become committed to its success as much as you are. We back up this commitment with a Commercial Banking Group that consists of the most knowledgeable professionals around. And we back it up with $1 billion in assets.

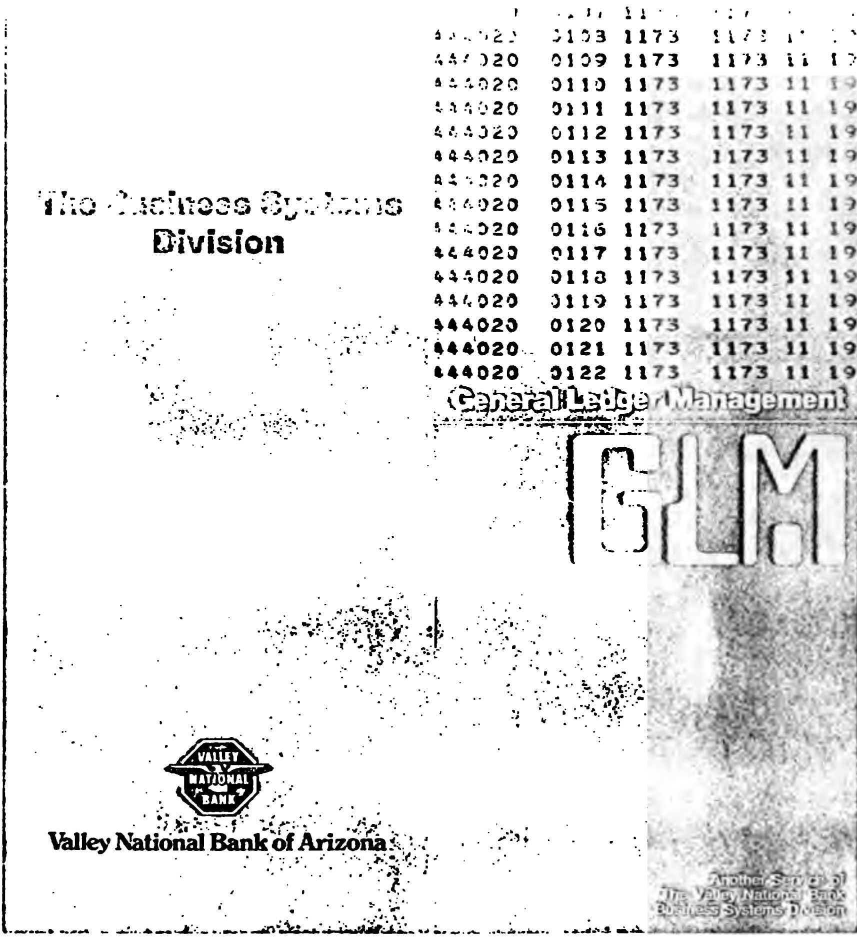
To find out what we can do for your growth, call Joseph F. Murphy, Executive Vice President at 274-7800. Or write to him at Old Stone Bank, 40 Westminster Street, Providence, R.I. 02903. He'll help you lay the groundwork.

OLD STONE BANK

Member Federal Deposit Insurance Corporation


CCB&T
the Bank for Everything
INVESTMENT SERVICES
COMPUTER PAYROLLS
TRUST & ESTATE SERVICES
NOW ACCOUNTS
BUSINESS LOANS
PERSONAL LOANS
SAVINGS ACCOUNTS
CHECKING ACCOUNTS
FINANCIAL COUNSELING
INCOME TAX SERVICE
MASTER CHARGE
SAFE DEPOSIT BOXES
CERTIFICATES OF DEPOSIT
Ask for a brochure
Here's where you'll find us
HYANNIS-MAIN
HYANNIS-AIRPORT
BREWSTER
BUZZARDS BAY
CENTERVILLE
HARWICH PORT
ORLEANS
OSTERVILLE
POCASSET
PROVINCETOWN
SANDWICH
SOUTH YARMOUTH
WELLFLEET
INCOME TAX
PREPARATION
SERVICE
CCB&T


BUSINESS
SERVICES . . .


The Business Systems
Division
General Ledger Management
GLM
VALLEY NATIONAL BANK
Valley National Bank of Arizona
Another Service of
The Valley National Bank
Business Systems Division

We give you monthly:

Journals Activity summarized and balanced by journal, with overall totals provided.

General Ledger Showing full detail for the month in each account, utilizing current as well as year-to-date totals.

Trial Balance Current and year-to-date listing of account balances.

Profit and Loss Statement Showing current and year-to-date profitability. Comparisons to budget and last year, as well as user-defined comparisons are available.

Balance Sheet Showing assets, liabilities, equity, utilizing last-year comparisons for increases and decreases in balance sheet accounts.

Special Reports A variety of additional information is available where desired (see "Important Options" on following page).

You gain:

Flexibility Our General Ledger Management services can be tailored to meet your specific reporting requirements.

Confidentiality Your reports are processed in a restricted access area and handled with the same care and privacy you would exercise in your own facility.

Savings Since Valley Bank's computers do all the posting, tedious and time-consuming detail work is eliminated.

Simplicity General Ledger Management does not "make work" or complicate things in any way. It simply extends the effectiveness of your existing accounting resources.

Accuracy The entire service is computerized, and electronic data processing is the fastest, most accurate method of calculating and producing financial reports yet conceived.

Assistance Continuing education of your authorized personnel by our thoroughly experienced General Ledger Management specialists is a regular part of our service. Special assistance is available at any time.

Important options:

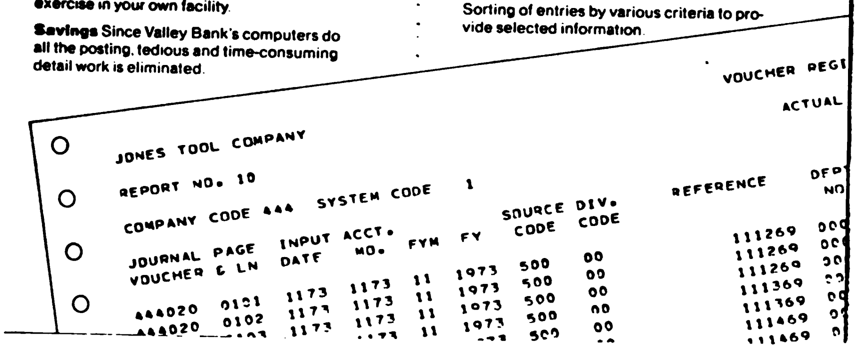
Where desired, additional special reports may be provided:

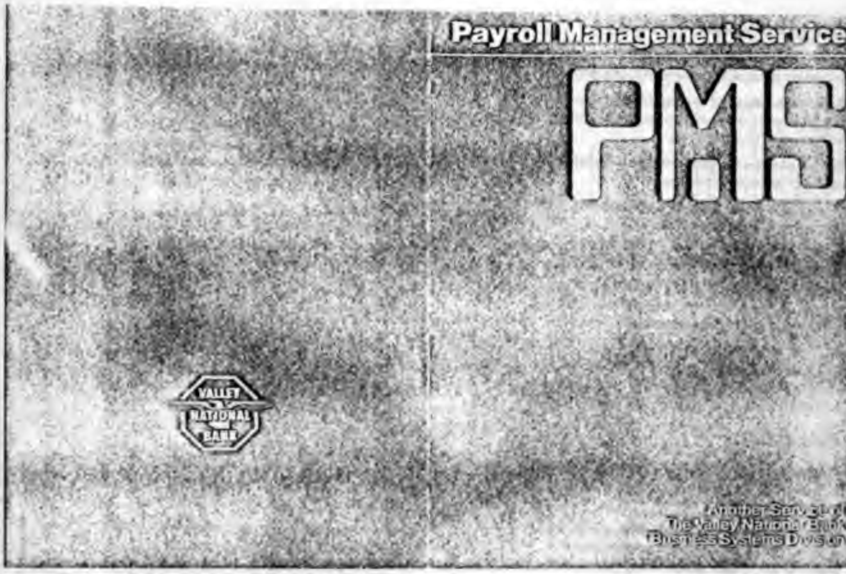
Breakdowns providing profit and loss figures, with balance sheet, for each department or division of company.

Detail General Ledger showing full-year detail by account. This report is especially useful to your accountant for tax and other purposes at year end.

Various expense analyses by departments, divisions or accounting periods.

Sorting of entries by various criteria to provide selected information.




Payroll Management Service
PMS
VALLEY NATIONAL BANK
Business Systems Division

You give us:

For each pay period, the number of hours worked for hourly personnel, and any changes in employee or pay information since the last pay period.

We give you:

1. Completed, pre-signed payroll checks with attached earnings statements reflecting current and year-to-date earnings, taxes and voluntary deductions.

2. A payroll register reflecting employee pay data and check calculations for the pay period, as well as summary totals for departments.

3. A voluntary deduction register providing a detailed breakdown of voluntary deductions.

4. A tax ledger reflecting year and quarter-to-date earnings, taxes, and taxable earnings for employees and departments.

5. A personnel report listing employees alphabetically, with their employee numbers, departments and addresses.

6. An up-dated payroll control register which is used to transmit information to us for production of the next payroll.

7. At the end of each quarter, 941A tax continuation sheets.

8. At year end, automatic production of W-2's for each employee.

You gain:

✔ Direct cost savings: Elimination of printing and stocking of checks and forms, payroll check reconciliation, payroll check signing; substantial reduction of clerical costs.

✔ Simplicity: Senior or highly skilled client personnel are not required to maintain the system. The whole service operates "by exception" — only changes in regular input need be transmitted to us.

✔ Efficiency: Better payroll-cost management through comprehensive reports, simplification of company audits and external reporting, reduction of training time for new or substitute personnel, freeing of senior personnel for greater concentration on profit-related assignments.

✔ Flexibility: The service can encompass many types of compensation: salary, hourly, commission, or combinations thereof. It can be modified to be compatible with any accounting system. Special bonus payrolls may also be produced with special tax computations.

✔ Confidentiality: Your payrolls are processed in a restricted-access area, and handled with the same care and privacy that Valley Bank's own payroll receives.

✔ Accuracy: The entire service is computerized, and electronic data processing is the fastest, most accurate method of calculating and producing payroll reports yet conceived.

✔ Safety: Microfilm records of all checks and major reports produced are kept on permanent file at VNB.

✔ Assistance: Continuing education of your authorized personnel by our thoroughly experienced payroll specialists is a regular part of our service. Special assistance is available at any time. In short, the full services of a top payroll expert are as near to you as your phone.

GL-II

GENERAL LEDGER SYSTEM

GENERAL INFORMATION MANUAL

CONTINENTAL DATA SERVICES

A DIVISION OF CONTINENTAL BANK
3700 NORTH THIRD AVENUE • PHOENIX, ARIZONA 85013
248-6248

SCEDULE B

PAYROLL RATE STRUCTURE

Pursuant to and in accordance with their executed Data Processing Service Agreement Number _____, DSD and Customer agree to the following rates:

Conversion

**$.50 per employee setup on master file.
A minimum fee of fifty dollars ($50.00).**

Processing Charges

The price schedule below is inclusive of the following:

> **All standard supplies and forms, payroll register, deduction register, bond report and labor distribution.**

No. of Payroll Checks	Per Check Per Cycle	941a's	W2's
1- 100	$.50	$15.00/cycle	$15.00/cycle
101- 200	.45	.15 each	.15 each
201- 500	.40	N/C	N/C
501-1,000	.35	N/C	N/C
1,001 and over	.30	N/C	N/C

Master Record Changes:	**Twenty-five cents ($.25) per employee file to which data is added, deleted, or changed.**
New Employees:	**One Dollar ($1.00) each.**
Minimum Per Cycle:	**Twenty-five dollars ($25.00)**
Credit for Automatic DDA Deposits	**Ten cents ($.10) each.**

**Accepted for
CONTINENTAL BANK**

By:

Name:

Title:

Date:

Accepted for

By:

Name:

Title:

Date:

Schedule D

Report Samples and Formats
Page 1 of 18

GL-II REPORTS

Transaction Posting Register

A Transaction Posting Register is automatically produced by the system, reflecting every transaction during a subject reporting period.

For each general ledger account having activity during the period, the report reflects the source, date, and amount of each entry posted to the account, the net change, and the ending balance. Where applicable, reference is made to the appropriate sub-ledger or invoice (the report is printed each time the master file is updated for current activity).

The businessman or accountant will find this document essential for reviewing journal entries and for analyzing the activities in the respective accounts. The Transaction Posting Register serves as a reliable audit trail and should be filed for a convenient historical record. The latter application is meaningful in light of the fact that all changes to and activity in the general ledger, whether submitted by journal entry or produced by the computer, are recorded on the Transaction Posting Register.

CLIENT NO. 1442-3120

APEX MANUFACTURING CORP
UNIVERSAL MOTORS DIVISION
TRANSACTION POSTING REGISTER
FOR PERIOD ENDING 06/30/68

PAGE 1

LEDGER NUMBER DEPT	ACCOUNT TITLE	SOURCE REFERENCE	DATE	TRANSACTIONS CURRENT	TRANSACTIONS YEAR-TO-DATE
1020	CASH-GENERAL FUND	BEGINNING BALANCE			$16,855.12
		RECEIPTS JRNL	06/30/68	50,226.82	
		DISBURSEMENTS JRNL	06/30/68	47,031.57-	
		TOTAL		$ 3,196.25	$20,051.37
1040	CASH-IMPREST FUND	BEGINNING BALANCE			$ 510.82
		DISB CK 1762	06/26/68	130.93-	
		RECEIPTS	06/30/68	119.62	
		TOTAL		$ 11.31-	$ 499.51
1120	ACCOUNTS RECEIVABLE	BEGINNING BALANCE			$82,261.35
	A01105 ABC PRODUCTS INC				
	058017	RECEIPTS	06/03/68	18,359.82-	
	060001	SALES	06/09/68	1,659.32	
	B10923 B & Z ELECTRONIC COMPONENTS				
	018015	RECEIPTS	06/17/68	512.30-	
	028017	RECEIPTS	06/17/68	1,000.00-	
	060012	SALES	06/20/68	4,782.00	
	D14119 DRUCKER CORPORATION				
	060002	SALES	06/10/68	15,404.00	
	060002	SALES	06/12/68	16,575.56	
	E12117 ELLIS MOTORS INC				
	060009	SALES	06/15/68	9,701.33	
	060009	RECEIPTS	06/15/68	9,701.33-	
	G19334 GREEN & ASSOCIATES				
	060002	SALES	06/11/68	972.24	
	M23986 MARTIN COMPANY				
	040012	RECEIPTS	06/02/68	14,214.07-	
	050006	RECEIPTS	06/19/68	6,754.00-	
	060009	SALES	06/15/68	360.12	
		TOTAL		$ 1,086.23-	$81,175.12-
1140	LESS-ALLOWANCE FOR DOUBTFUL ACCOUNTS	BEGINNING BALANCE			$ 3,690.00-
		GENL JRNL-AETNA BRAND	06/07/68	762.00	
		RECEIPTS	06/12/68	500.00-	
		JOURNAL	06/30/68	200.00-	
				$ 62.00	$ 3,628.00-

Schedule D

Report Samples and Formats
Page 2 of 18

Standard and Analytical Reports

Assets and liabilities as reflected in a *Balance Sheet* can be listed on a single page or on separate pages. Three separate levels of totals are shown clearly for better analysis of the data. Optionally, amounts may be rounded to the nearest whole dollar for easier review and improved appearance. Statements, such as "Prepared from the books without audit", and the accountant's name and address can be printed at the bottom of Balance Sheet and Income Statement reports.

The accountant sets up balance sheet nomenclature and triggers for totals in accordance with his established reporting format. The computer then produces all future reports in accordance with the accountant's established format.

Accountants can call for a balance sheet to be printed out on 8½" x 11" paper versus the 11" x 14" paper on which the computer normally prints reports.

CONTINENTAL COMPANY
BALANCE SHEET
MARCH 31, 1968

ASSETS

CURRENT ASSETS		
CASH IN BANK	$ 22,762.15	
PETTY CASH FUND	200.00	
MARKETABLE SECURITIES	15,627.18	
ACCOUNTS RECEIVABLE	74,621.92	
ALLOWANCE FOR BAD DEBTS	1,812.16-	
INVENTORY	84,615.22	
TOTAL CURRENT ASSETS		$196,014.31
FIXED ASSETS		
FURNITURE AND FIXTURES	$ 18,462.12	
ALLOWANCE FOR DEPRECIATION	7,622.16-	
BUILDINGS	80,117.12	
ALLOWANCE FOR DEPRECIATION	41,112.91-	
LAND	20,500.00	
TOTAL FIXED ASSETS		70,344.17
OTHER ASSETS		
PATENTS	$ 6,000.00	
GOODWILL	18,000.00	
TOTAL OTHER ASSETS		24,000.00
TOTAL ASSETS		$290,358.48

LIABILITIES AND CAPITAL

CURRENT LIABILITIES		
ACCOUNTS PAYABLE	$ 35,914.14	
ACCRUED TAXES AND EXPENSES	10,698.26	
FEDERAL INCOME TAX PAYABLE	7,610.18	
NOTES PAYABLE	5,000.00	
TOTAL CURRENT LIABILITIES		$ 59,222.58
FIXED LIABILITIES		
1st MORTGAGE BONDS	$170,000.00	
TOTAL FIXED LIABILITIES		170,000.00
CAPITAL		
COMMON STOCK	$ 25,000.00	
RETAINED EARNINGS	28,525.73	
NET INCOME-YEAR TO DATE	7,610.17	
TOTAL CAPITAL		61,135.90
TOTAL LIABILITIES AND CAPITAL		$290,358.48

Schedule D

Report Samples and Formats
Page 3 of 18

APEX MANUFACTURING CORP
UNIVERSAL MOTORS DIVISION
BALANCE SHEET
JUNE 30, 1968

ASSETS

CURRENT ASSETS		
CASH–GENERAL FUND	$ 20,050	
CASH–IMPREST FUND	500	
TOTAL CASH	20,550	
U S TREASURY NOTES	75,000	
NOTES RECEIVABLE	10,000	
ACCOUNTS RECEIVABLE	81,175	
LESS-ALLOW. FOR DOUBTFUL ACCOUNTS	3,628-	
NET ACCOUNTS RECEIVABLE	77,547	
ACCRUED INTEREST RECEIVABLE	416	
INVENTORY	115,407	
PREPAID INSURANCE	1,612	
TOTAL CURRENT ASSETS		$300,532
FIXED ASSETS		
FURNITURE AND EQUIPMENT	$237,224	
LESS-ALLOW. FOR DEPR-FURN & EQPT.	118,225-	
NET FURNITURE AND EQUIPMENT	118,999	
BUILDINGS	110,510	
LESS-ALLOW. FOR DEPR-BUILDINGS	57,008-	
NET BUILDINGS	53,502	
LAND	50,100	
TOTAL FIXED ASSETS		222,601
OTHER ASSETS		
GOODWILL	$ 10,000	
PATENTS	2,510	
TOTAL OTHER ASSETS		12,510
TOTAL ASSETS		$535,643

Schedule D

Report Samples and Formats
Page 4 of 18

APEX MANUFACTURING CORP
UNIVERSAL MOTORS DIVISION
BALANCE SHEET
JUNE 30, 1968

LIABILITIES AND EQUITY

CURRENT LIABILITIES			
NOTES PAYABLE		$ 51,250	
ACCOUNTS PAYABLE & ACCRUED EXPENSE		36,910	
ACCRUED PAYROLL & PAYROLL TAXES	12,615	12,615	
ACCRUED FEDERAL INCOME TAXES		2,070	
TOTAL CURRENT LIABILITIES			$102,845
LONG TERM DEBT			
BONDS PAYABLE–6%		$160,000	
TOTAL LONG TERM DEBT			160,000
EQUITY			
PREFERRED STOCK		$ 10,000	
COMMON STOCK		200,000	
EARNED SURPLUS		53,793	
RETAINED EARNINGS–YEAR TO DATE		9,005	
TOTAL EQUITY			272,798
TOTAL LIABILITIES AND EQUITY			$535,643

PREPARED FROM THE BOOKS WITHOUT AUDIT
BROWN, ROSS & STEVENSON, CPA'S
ANYTOWN USA

Schedule D

Report Samples and Formats
Page 5 of 18

The *Income Statement* may reflect percentages for each account as they relate to revenue from operations, represented by "Sales" on the sample statement on the following page. With GL/II's unique open chart of accounts feature, an accountant can designate the terminology which is appropriate to a particular client's business. Various sub-totals, such as gross income, operating expenses, net operating profit, and net profit before and after Federal income taxes are indicated, but they are optional to the particular user. As previously stated, amounts can be rounded to the nearest whole dollar for easier review and improved appearance.

The income statement can be sub-divided by department, product, territory, etc., to facilitate detailed analysis, as required. These reports are available to the accountant on a recurring basis or on a special request basis.

CONTINENTAL COMPANY
INCOME STATEMENT
FOR PERIOD ENDED 03/31/68

	CURRENT PERIOD AMOUNT	YEAR TO DATE AMOUNT
SALES		
SALES	$261,109.12	$750,673.27
SALES RETURNS AND ALLOWANCES	1,827.01-	4,819.12-
TOTAL SALES	$259,282.11	$745,854.15
COST OF GOODS SOLD		
BEGINNING INVENTORY, 03/31/67	$ 66,830.28	$180,680.30
PURCHASES	93,107.05	325,210.58
FREIGHT IN	3,012.10	7,177.18
DIRECT LABOR	32,610.07	120,715.21
DIRECT EXPENSE	3,607.71	13,121.60
COST OF GOODS AVAILABLE FOR SALE	$199,167.21	$646,904.87
LESS: ENDING INVENTORY, 03/31/68	23,276.76	$ 23,276.76
TOTAL COST OF GOODS SOLD	$225,443.97	$623,628.11
GROSS PROFIT	$ 33,838.14	$122,226.04
EXPENSES		
SALARIES	$ 28,669.96	$ 80,112.15
PAYROLL COSTS	3,814.12	13,161.12
DEPRECIATION	1,862.27	5,896.14
COMMISSIONS	1,009.00	3,117.12
ADVERTISING	200.00	1,202.14
LEGAL & ACCOUNTING	600.00	1,820.00
TELEPHONE	381.12	1,222.12
BAD DEBTS & COLLECTION	20.00	410.15-
MISCELLANEOUS	110.12	885.05
TOTAL EXPENSES	$ 36,666.59	$107,005.69
NET INCOME BEFORE FED INC TAXES	$ 2,828.45-	$ 15,220.35
FEDERAL INCOME TAXES (ESTIMATED)	$ 1,414.23-	$ 7,610.18
NET INCOME AFTER FED INC TAXES	$ 1,414.22-	$. 7,610.17

Schedule D

Report Samples and Formats
Page 6 of 18

APEX MANUFACTURING CORP
UNIVERSAL MOTORS DIVISION
INCOME STATEMENT
FOR PERIOD ENDED 06/30/68

	CURRENT PERIOD AMOUNT	CURRENT PERIOD PCNT	YEAR TO DATE AMOUNT	YEAR TO DATE PCNT
SALES				
COMPONENTS	$35,710	68.5	$212,621	68.6
SERVICES	16,406	31.5	97,432	31.4
TOTAL SALES	$52,116	100.0	$310,053	100.0
COST OF SALES				
MATERIALS PURCHASED	$22,100	42.4	$138,610	44.7
DIRECT LABOR	10,607	20.4	58,502	18.9
OTHER DIRECT EXPENSES	3,490	6.7	17,960	5.8
TOTAL COST OF SALES	$36,197	69.5	$215,072	69.4
GROSS INCOME	$15,919	30.5	$94,981	30.6
OPERATING EXPENSES				
SELLING EXPENSES				
SALES SALARIES AND COMMISSIONS	$ 7,517	14.4	$ 41,613	13.4
ADVERTISING	982	1.9	5,190	1.7
SHIPPING	205	.4	1,192	.3
OTHER SELLING EXPENSES	407	.8	2,344	.8
TOTAL SELLING EXPENSES	$ 9,111	17.5	$ 50,339	16.2
GENERAL & ADMINISTRATIVE EXPENSE				
OFFICE SALARIES	$ 5,420	10.4	$ 32,600	10.5
SUPPLIES	340	.6	1,915	.6
LEGAL & ACCOUNTING	150	.3	975	.3
DEPRECIATION–OFFICE FURN & EQPT	155	.3	1,070	.4
OTHER GENL & ADMINISTRATIVE EXP	412	.8	2,612	.8
TOTAL GENERAL & ADMINISTRATIVE EXP	$ 6,477	12.4	$ 39,172	12.6
TOTAL OPERATING EXPENSES	$15,588	29.9	$ 89,511	28.8
NET OPERATING PROFIT	331	.6	$ 5,470	1.8
OTHER INCOME				
INTEREST INCOME	850	1.6	$ 5,025	1.6
PROFIT ON SALE OF EQUIPMENT	0		1,050	.3
TOTAL OTHER INCOME	$ 850	1.6	$ 6,075	1.9
NET INCOME BEFORE FED INC TAXES	$ 1,181	2.2	$ 11,545	3.7
FEDERAL INCOME TAXES	260	.4	2,540	.8
NET INCOME AFTER FED INC TAXES	$ 921	1.8	$ 9,005	2.9

PREPARED FROM THE BOOKS WITHOUT AUDIT
BROWN, ROSS & STEVENSON, CPA'S
ANYTOWN USA

Schedule D

Report Samples and Formats
Page 7 of 18

The *Trial Balance* shows the beginning balance, the total debits and credits during the period, and ending balance for each general ledger account. The debit and credit balances are totaled and balanced to zero. If the input submitted was not in balance, the difference can be accumulated in a suspense account for future correction by the user. This procedure eliminates the need for delays and re-runs while permitting the printing of balanced, accurate reports. However, the accountant can specify an upper limit for inclusion in this suspense account.

The retained earnings, year-to-date entry, are printed separately in the Equity section in order to show the net effect of the income and expense accounts. This amount is excluded from the totals to avoid including the profit figure twice in the summation.

If desired, a post-closing trial balance can be produced.

APEX MANUFACTURING CORP
UNIVERSAL MOTORS DIVISION
TRIAL BALANCE
06/30/68

CLIENT NO. 1442-3120 PAGE 1

LEDGER NUMBER DEPT	ACCOUNT TITLE	BEGINNING BALANCE	DEBITS	CREDITS	ENDING BALANCE
1020 H	ASSETS				
1000 T	CURRENT ASSETS				
1020	CASH GENERAL FUND	$ 16,855.12	$50,226.82	$47,031.57	$ 20,050.37
1040	CASH IMPREST FUND	510.82	119.62	130.93	499.51
1060 S	TOTAL CASH				
1080	U S TREASURY NOTES	75,000.00	.00	.00	75,000.00
1100	NOTES RECEIVABLE	10,000.00	.00	.00	10,000.00
1120	ACCOUNTS RECEIVABLE	82,261.35	49,454.57	50,540.80	81,175.12
1140	LESS-ALLOWANCE FOR DOUBTFUL ACCTS.	3,690.00-	762.00	700.00	3,628.00-
1150 S	NET ACCOUNTS RECEIVABLE				
1160	ACCRUED INTEREST RECEIVABLE	345.18	70.68	.00	415.86
1180	INVENTORY	109,407.23	10,943.50	4,943.83	115,406.90
1200	PREPAID INSURANCE	1,842.29	.00	230.18	1,612.11
1400 T	FIXED ASSETS				
1420	FURNITURE AND EQUIPMENT	237,223.85	.00	.00	237,223.86
1440	LESS-ALLOW. FOR DEPR-FURN & EQPT	116,494.66-		1,730.37	118,225.03-
1470 S	NET FURNITURE AND EQUIPMENT				
1480	BUILDINGS	110,509.68	.00	.00	110,509.68
1500	LESS-ALLOW. FOR DEPR-BUILDINGS	56,983.42-	.00	24.73	57,008.15-
1510 S	NET BUILDINGS				
1520	LAND	50,100.33	.00	.00	50,100.33
1700 T	OTHER ASSETS				
1720	GOODWILL	10,000.00	.00	.00	10,000.00
1740	PATENTS	2,715.00	.00	205.00	2,510.00
2000 H	LIABILITIES AND EQUITY				
2000 T	CURRENT LIABILITIES				
2020	NOTES PAYABLE	51,250.00-	.00	.00	51,250.00-
2040	ACCTS. PAYABLE & ACCRUED EXPENSE	35,782.93-	2,021.48	3,148.95	36,910.40-
2060	ACCRUED PAYROLL & PAYROLL TAXES	10,153.37-	.00	2,461.33	12,614.70-
2080	ACCRUED FEDERAL INCOME TAXES	1,809.68-	.00	259.89	2,069.57-
2640 T	LONG TERM DEBT				
2660	BONDS PAYABLE-6%	160,000.00-	.00	.00	160,000.00-
3000 T	EQUITY				
3020	PREFERRED STOCK	10,000.00-	.00	.00	10,000.00-
3040	COMMON STOCK	200,000.00-	.00	.00	200,000.00-
3060	EARNED SURPLUS	52,523.51-		1,269.64	53,793.15-
3080	RETAINED EARNINGS - YEAR TO DATE	8,083.28-	.00	921.45	9,004.73-
3100	SUSPENSE	.00	00	.00	.00
4020 H	SALES				
4040	COMPONENTS	176,911.26-	.00	35,709.57	212,620.83-
4060	SERVICES	81,025.73-	.00	16,406.42	97,432.15-
5000 H	COST OF SALES				
5020	MATERIALS PURCHASED	116,510.19	22,100.15	.00	138,610.34
5060	DIRECT LABOR	47,895.13	10,606.52	.00	58,501.65
5080	OTHER DIRECT EXPENSE	14,469.38	3,490.30	.00	17,959.68
5900 H	OPERATING EXPENSES				
6020 T	SELLING EXPENSES				
6040	SALES SALARIES & COMMISSIONS	34,095.30	7,517.36	.00	41,612.66
6080	ADVERTISING	4,208.39	981.82	.00	5,190.21
6100	SHIPPING	986.93	205.19	.00	1,192.12
6120	OTHER SELLING EXPENSES	1,937.25	406.73	.00	2,343.98
6200 T	GENERAL & ADMINISTRATIVE EXPENSE				
6220	OFFICE SALARIES	27,181.07	5,419.84	.00	32,600.91
6240	SUPPLIES	1,575.19	340.12	.00	1,915.31
6260	LEGAL & ACCOUNTING	825.22	149.65	00	974.87
6280	DEPRECIATION-OFFICE FURN & EQPT	914.63	155.40	.00	1,070.03
6300	OTHER GENL & ADMIN EXPENSE	2,200.22	411.57	.00	2,611.79
7000 H	OTHER INCOME				
7020	INTEREST INCOME	4,175.00-	.00	850.00	5,025.00-
7040	PROFIT ON SALE OF EQUIPMENT	1,050.00-	.00	.00	1,050.00-
8000 H	OTHER EXPENSE				
8020	INTEREST EXPENSE	.00	.00	.00	.00
9020	FEDERAL INCOME TAXES	2,279.81	259.89	.00	2,539.70
		$ .00	$165,643.21	$165,643.21	$ .00

Schedule D

Report Samples and Formats
Page 8 of 18

The *Subsidiary Trial Balance* shows the detailed information for each subsidiary ledger. Ledgers can be maintained at three separate levels of detail—general ledger accounts, subsidiary ledger accounts, and invoice number or equivalent level. The subsidiary trial balance shows general ledger control totals, the subsidiary account totals, and (if available) the invoice level detail. For each level of control the beginning balance, total debits and credits during the period, and ending balance are shown. Invoice amounts are summarized to subsidiary accounts, which are summarized to general ledger control. When used with the transaction posting register, this listing provides a complete analysis of all entries to the subsidiary ledger during the period just processed.

Because journal entries to the controlling accounts are automatically generated by the computer, accurate subsidiary trial balances are assured.

APEX MANUFACTURING CORP
UNIVERSAL MOTORS DIVISION
SUBSIDIARY TRIAL BALANCE
06/30/68

CLIENT NO. 1442-3120 PAGE 1

LEDGER NUMBER DEPT	ACCOUNT TITLE	BEGINNING BALANCE	DEBITS	CREDITS	ENDING BALANCE
1100	NOTES RECEIVABLE	10,000.00 **	.00 **	.00 **	10,000.00 **
	JOHNSON & JOHNSON ASSOC.	5,000.00	.00	.00	5,000.00
	B & B CONSTRUCTION CO	2,500.00	.00	.00	2,500.00
	R. B. ANDERSON	2,500.00	.00	.00	2,500.00
1120	ACCOUNTS RECEIVABLE	82,261.35 **	49,454.57 **	50,540.80 **	81,175.12 **
	A01105 ABC PRODUCT INC	18,359.02 *	1,659.32 *	18,359.02 *	1,659.32 *
	058017	18,359.02	.00	18,359.02	.00
	068001	.00	1,659.32	.00	1,659.32
	B10923 B & Z ELECTRONIC COMPONENTS	26,221.16 *	4,782.00 *	1,512.30 *	29,490.86 *
	018015	512.30	.00	512.30	.00
	028017	2,497.21	.00	1,000.00	1,497.21
	038010	2,347.50	.00	.00	2,347.50
	048007	15,505.53	.00	.00	15,505.53
	058005	5,358.62	.00	.00	5,358.62
	068012	.00	4,782.00	.00	4,782.00
	D14119 DRUCKER CORPORATION	16,713.02 *	31,979.56 *	.00 *	48,692.58 *
	048002	6,239.20	.00	.00	6,239.20
	058007	10,473.82	.00	.00	10,473.82
	068002	.00	15,404.00	.00	15,404.00
	058005	.00	16,575.56	.00	16,575.56
	E12117 ELLIS MOTORS INC	.00 *	9,701.33 *	9,701.33 *	.00 *
	068009	.00	9,701.33	9,701.33	.00
	G19334 GREEN & ASSOCIATES	.00 *	972.24 *	.00 *	972.24 *
	068003	.00	972.24	.00	972.24
	M23906 MARTIN COMPANY	10,968.15 *	360.12 *	20,968.15 *	360.12 *
	048012	14,214.07	.00	14,214.07	.00
	058006	6,754.08	.00	6,754.00	.00
	068009	.00	360.12	.00	360.12
2040	ACCOUNTS PAYABLE & ACCRUED EXPENSE	35,782.93-**	2,021.48 **	3,148.95 **	36,910.40-**
	G11005 GRAYBAR ELECTRONICS	.00-*	1,045.50 *	.00 *	1,045.50-*
	GR-210	.00-	720.50	.00	720.50-
	GR-215	.00-	325.00	.00	325.00-
	G11006 GREENE MACHINERY, INC	3,148.95-*	975.98 *	3,148.95 *	975.98-*
	G2735	3,148.95-	.00	3,148.95	.00-
	G2451	.00-	603.98	.00	603.98
	G2452	.00-	372.00	.00	372.00

Schedule D

Report Samples and Formats
Page 9 of 18

The *Income and Expense Budget Variance Report* compares actual to budget for current period, prior period, and year-to-date. The percentage of variance from budget is given for each item compared.

In Departmental Reporting, this report can be sub-divided by department, product, territory, etc., to facilitate a detailed analysis, as required. Reports such as these are available to the accountant on a recurring basis or on a special request basis.

APEX MANUFACTURING CORP
UNIVERSAL MOTORS DIVISION
INCOME AND EXPENSE BUDGET VARIANCE REPORT
FOR THE PERIOD ENDED 06/30/68

CLIENT NO. 1442-3120 PAGE 1

ACCOUNT TITLE	CURRENT PERIOD ACTUAL	BUDGET	PCNT	PREVIOUS PERIOD ACTUAL	BUDGET	PCNT	YEAR TO DATE ACTUAL	BUDGET	PCNT
SALES									
COMPONENTS	$35,710	$36,000	.8-	$32,468	$34,000	4.5-	$212,621	$210,000	1.2
SERVICES	16,406	15,000	9.4	14,298	14,000	2.1	97,432	87,000	12.0
TOTAL SALES	$52,116	$51,000	2.2	$46,766	$48,000	2.6	$310,063	$297,000	4.4
COST OF SALES									
MATERIALS PURCHASED	$22,100	$20,000	10.5	$19,121	$19,000	.6	$138,610	$117,000	18.5
DIRECT LABOR	10,607	10,000	6.1	9,848	10,000	1.5-	58,502	60,000	2.5-
OTHER DIRECT EXPENSE	3,490	4,000	12.8-	2,950	3,000	1.7-	17,960	21,000	14.5-
TOTAL COST OF SALES	$36,197	$34,000	6.5	$31,919	$32,000	.3-	$215,072	$198,000	8.6
GROSS INCOME	$15,919	$17,000	6.4-	$14,847	$16,000	7.2-	$ 94,981	$ 99,000	4.1-
OPERATING EXPENSES									
SELLING EXPENSES									
SALES SALARIES AND COMMISSIONS	$ 7,517	$ 8,000	6.0-	$ 6,812	$ 6,000	13.5	$ 41,613	$ 42,000	.9-
ADVERTISING	982	1,000	1.8-	795	1,000	20.5-	5,190	6,000	13.5-
SHIPPING	205	300	31.7-	202	300	32.7-	1,192	1,000	33.8-
OTHER SELLING EXPENSES	407	500	18.6-	339	500	32.2-	2,344	3,000	21.9-
TOTAL SELLING EXPENSES	$ 9,111	$ 9,000	7.0	$ 8,148	$ 7,000	4.5	$ 50,339	$ 52,000	4.9-
GENERAL & ADMINISTRATIVE EXPENSE									
OFFICE SALARIES	$ 5,420	$ 5,000	6.6-	$ 5,219	$ 5,000	10.0-	$ 32,600	$ 34,000	6.3-
SUPPLIES	340	300	13.3	360	400	10.0-	1,915	2,100	8.8-
LEGAL & ACCOUNTING	150	200	25.0-	160	300	20.0-	975	1,200	18.8-
DEPRECIATION OFFICE FURN & FURN	155	150	3.3	149	150	.7-	1,070	900	18.9
OTHER GEN & ADMINISTRATIVE EXP	412	500	17.6-	420	500	16.0-	2,612	3,000	12.9-
TOTAL GENERAL & ADMINISTRATIVE EXP	$ 6,477	$ 6,950	6.8-	$ 6,308	$ 7,000	10.5-	$ 39,172	$ 42,000	6.7-
TOTAL OPERATING EXPENSES	$15,588	$16,750	6.9-	$14,456	$14,850	2.7-	$ 89,511	$ 99,000	5.6-
NET OPERATING INCOME	$ 331	$ 250	32.4	$ 391	$ 1,150	66.0-	$ 5,470	$ 4,200	30.2
OTHER INCOME									
INTEREST INCOME	$ 850	$ 900	5.6-	$ 850	$ 900	5.6-	$ 5,025	$ 5,400	7.0-
PROFIT ON SALE OF EQUIPMENT	$ 0	$ 0		$ 120	$ 0		1,000	0	
TOTAL OTHER INCOME	$ 850	$ 900	5.6-	$ 970	$ 900	7.8	$ 6,075	$ 5,400	12.5
NET INCOME BEFORE FED INC TAXES	$ 1,181	$ 1,150	2.7	$ 1,361	$ 2,050	33.6-	$ 11,545	$ 9,600	20.3
FEDERAL INCOME TAXES	$ 260	$ 250	4.0	$ 299	$ 450	33.6-	$ 2,540	$ 2,100	21.0
NET INCOME AFTER FED INC TAXES	$ 921	$ 900	2.3	$ 1,062	$ 1,600	33.6-	$ 9,005	$ 7,500	20.1

Schedule D

Report Samples and Formats
Page 10 of 18

The *Income and Expense Trends Report* compares current operations to the previous year's operations and to operations during the previous period. Fluctuations are highlighted by giving a per cent of change over last year and over the previous period. The per cents of change can highlight significant short-range trends and long-range trends.

The current reporting period can be monthly, quarterly, or semi-annually.

In Departmental Reporting, this report can be sub-divided by department, product, territory, etc., to facilitate detailed analysis, as required. Reports such as these are available to the accountant on a recurring basis or on a special request basis.

APEX MANUFACTURING CORP
UNIVERSAL MOTORS DIVISION
INCOME AND EXPENSE TRENDS REPORT
FOR THE PERIOD ENDED 06/30/68

CLIENT NO. 1442-3120 PAGE 1

ACCOUNT TITLE	CURRENT PERIOD	PREVIOUS PERIOD	PCNT	CURRENT PERIOD PRIOR YEAR	PCNT	YEAR TO DATE CURRENT YEAR	YEAR TO DATE PRIOR YEAR	PCNT
SALES								
COMPONENTS	$35,710	$32,468	10.0	$42,102	15.2-	$212,621	$256,310	17.0-
SERVICES	16,406	14,298	14.7	18,377	10.7-	97,432	171,420	43.2-
TOTAL SALES	$52,116	$46,766	11.4	$60,479	13.8-	$310,053	$427,730	27.5-
COST OF SALES								
MATERIALS PURCHASED	$22,100	$19,121	15.6	$23,540	6.1-	$138,600	$189,320	26.8-
DIRECT LABOR	10,607	9,848	7.7	9,872	7.4	58,582	65,992	11.2-
OTHER DIRECT EXPENSE	3,490	2,950	18.3	2,920	19.5	17,960	24,538	26.8-
TOTAL COST OF SALES	$36,197	$31,919	13.4	$36,332	.4-	$215,072	$279,850	23.1-
GROSS INCOME	$15,919	$14,847	9.9	$24,174	34.1-	$ 94,981	$147,880	35.8-
OPERATING EXPENSES								
SELLING EXPENSES								
SALES SALARIES AND COMMISSIONS	$ 7,517	$ 6,812	10.3	$ 7,965	5.6-	$ 41,613	$ 57,337	27.4-
ADVERTISING	902	795	13.5	893	10.0	5,198	6,850	24.2-
SHIPPING	285	202	1.5	300	31.7-	1,192	1,127	5.8
OTHER SELLING EXPENSES	407	339	20.1	455	10.5-	2,344	3,861	39.3-
TOTAL SELLING EXPENSES	$ 9,111	$ 8,148	11.8	$ 9,613	5.2-	$ 50,339	$ 69,175	27.2-
GENERAL & ADMINISTRATIVE EXPENSE								
OFFICE SALARIES	$ 5,420	$ 5,219	3.9	$ 5,037	7.6	$ 32,680	$ 39,191	16.8-
SUPPLIES	340	360	5.6-	325	4.6	1,915	2,480	30.2-
LEGAL & ACCOUNTING	150	160	6.2-	160	6.2-	975	927	5.2
DEPRECIATION OFFICE FURN & FURN	155	149	4.0	175	11.4-	1,070	1,195	10.5-
OTHER GEN & ADMINISTRATIVE EXP	412	420	1.1-	507	18.7-	2,612	3,405	8.6
TOTAL GENERAL & ADMINISTRATIVE EXP	$ 6,477	$ 6,308	2.7	$ 6,204	4.4	$ 38,172	$ 46,118	15.1-
TOTAL OPERATING EXPENSES	$15,588	$14,456	7.8	$15,817	1.4-	$ 88,511	$115,293	22.4-
NET OPERATING INCOME	$ 331	$ 391	15.3-	$ 8,330	96.0-	$ 5,470	$ 32,587	83.2-
OTHER INCOME								
INTEREST INCOME	$ 850	$ 850		$ 0		$ 5,025	$ 0	
PROFIT ON SALES OF EQUIPMENT	0	120	100.0-	230	100.0-	1,800	230	356.5
TOTAL OTHER INCOME	$ 850	$ 970	12.4-	$ 230	269.6	$ 6,875	$ 230	
NET INCOME BEFORE FED INC TAXES	$ 1,181	$ 1,361	15.2-	$ 8,560	86.2-	$ 11,845	$ 32,817	64.8-
FEDERAL INCOME TAXES	$ 260	$ 299	13.0-	$ 4,109	93.7-	$ 2,540	$ 16,000	84.1-
NET INCOME AFTER FED INC TAXES	$ 921	$ 1,062	13.3-	$ 4,451	79.3-	$ 9,805	$ 16,817	46.5-

Schedule D

Report Samples and Formats
Page 11 of 18

The *Comparative Balance Sheet* shows current financial status as compared to the status a year ago. Ratios showing the per cent of each item to total assets or liabilities are computed for both periods, permitting a more comprehensive analysis. Increases or decreases and the per cents of increase or decrease between periods highlight significant changes which might otherwise be overlooked. The comparative balance sheet is readily adaptable by the accountant as a partial basis for the preparation of a statement of source or an application of funds.

APEX MANUFACTURING CORP
UNIVERSAL MOTORS DIVISION
COMPARATIVE BALANCE SHEET
06/30/68

CLIENT NO. 1442-3120 PAGE 1

	CURRENT YEAR		PCNT OF TOTAL	PREVIOUS YEAR		PCNT OF TOTAL	INCREASE AMOUNT	DECREASE PCNT
ASSETS								
CURRENT ASSETS								
CASH-GENERAL FUND	$ 20,050		3.7	$ 42,080		11.3	$ 22,030-	52.4-
CASH-IMPREST FUND	500		.1	500		.1	0	
U S TREASURY NOTES	75,000		14.0	0			75,000	
NOTES RECEIVABLE	10,000		1.9	500		.1	9,500	
ACCOUNTS RECEIVABLE	81,175		15.2	58,346		15.7	22,829	39.1
LESS-ALLOW. FOR DOUBTFUL ACCOUNTS	3,628-		0.7	2,121-		0.5	1,507	71.1
ACCRUED INTEREST RECEIVABLE	416		0.1	0		0.0	416	
INVENTORY	115,407		21.5	67,485		18.2	47,922	71.0
PREPAID INSURANCE	1,612		0.3	1,415		.4	197	13.9
TOTAL CURRENT ASSETS		$300,532	56.1		$168,205	45.3	$132,327	78.7
FIXED ASSETS								
FURNITURE AND EQUIPMENT	$237,224		44.3	$191,415		51.6	45,809	23.9
LESS-ALLOW. FOR DEPR-FURN & EQPT	118,225-		22.1	99,697-		26.9	18,528	18.6
BUILDING	110,510		20.6	101,400		27.3	9,110	9.0
LESS-ALLOW. FOR DEPR-BUILDINGS	57,008-		10.6	53,012-		14.2	3,996	7.5
LAND	50,100		9.4	50,100		13.5	0	
TOTAL FIXED ASSETS		222,601	41.6		190,206	51.3	$ 32,395	17.0
OTHER ASSETS								
GOODWILL	$ 10,000		1.9	$ 10,000		2.7	0	
PATENTS	2,510		.4	2,510		.7	0	
TOTAL OTHER ASSETS		12,510	2.3		12,510	3.4	0	
TOTAL ASSETS		$535,643	100.0		$370,921	100.0	$164,722	44.4
LIABILITIES AND EQUITY								
CURRENT LIABILITIES								
NOTES PAYABLE	$ 51,250		9.5	$ 21,000		5.7	$ 30,250	144.0
ACCTS. PAYABLE & ACCRUED EXPENSE	36,910		6.9	42,384		11.4	5,474-	12.9-
ACCRUED PAYROLL & PAYROLL TAXES	12,615		2.4	22,110		6.0	9,495-	42.9-
ACCRUED FEDERAL INCOME TAXES	2,070		.4	16,000		4.3	13,930-	87.1-
TOTAL CURRENT LIABILITIES		$102,845	19.2		$101,494	27.4	$ 1,351	1.3
LONG TERM DEBT								
BONDS PAYABLE-6%	$160,000		29.9	0			160,000	
TOTAL LONG TERM DEBT		160,000	29.9		0		160,000	
EQUITY								
PREFERRED STOCK	$ 10,000		1.9	$ 10,000		2.7	0	
COMMON STOCK	200,000		37.3	200,000		53.9	0	
EARNED SURPLUS	53,793		10.0	42,610		11.5	11,183	26.2
RETAINED EARNINGS-YEAR TO DATE	9,005		1.7	16,817		4.5	7,812-	46.5-
TOTAL EQUITY		272,798	50.9		269,427	72.6	3,371	1.3
TOTAL LIABILITIES AND EQUITY		$535,643	100.0		$370,921	100.0	$164,722	44.4

Schedule D

Report Samples and Formats

The *Comparative Income Statement* is a comprehensive report comparing current operations with operations during the same period the year previous. Comparisons are made for the current period and also on a year-to-date basis. Percentages of sales are computed automatically for each period. This feature enables the businessman or accountant to analyze the changes in profit percentages and to consider reasons for these changes.

This report is of particular value in retail and other businesses where seasonal fluctuations often exert a dominant influence upon sales.

APEX MANUFACTURING CORP
UNIVERSAL MOTORS DIVISION
COMPARATIVE INCOME STATEMENT
FOR PERIOD ENDED 06/30/68

CLIENT NO. 1443-3120 PAGE 1

	CURRENT PERIOD				YEAR-TO-DATE				YTD	INC/DEC
	THIS YEAR	PCNT	PRIOR YEAR	PCNT	THIS YEAR	PCNT	PRIOR YEAR	PCNT	AMOUNT	PCNT
SALES										
COMPONENTS	$35,710	68.5	$42,102	69.6	$212,621	68.6	$256,310	59.9	$ 43,689-	17.0-
SERVICES	16,406	31.5	18,377	30.4	97,432	31.4	171,420	40.1	73,988-	43.2-
TOTAL SALES	$52,116	100.0	$60,479	100.0	$310,053	100.0	$427,730	100.0	$117,677-	27.5
COST OF SALES										
MATERIALS PURCHASED	$22,100	42.4	$23,540	38.9	$138,610	44.7	$189,320	44.3	$ 50,710-	26.8-
DIRECT LABOR	10,607	20.4	9,872	16.3	58,502	18.9	65,992	15.4	7,490-	11.3-
OTHER DIRECT EXPENSE	3,490	6.7	2,920	4.8	17,960	5.8	24,538	5.7	6,578-	26.8-
TOTAL COST OF SALES	$36,197	69.5	$36,332	60.0	$215,072	69.4	$279,850	65.4	$ 64,778-	23.1-
GROSS INCOME	$15,919	30.5	$24,147	40.0	$ 94,981	30.6	$147,880	34.6	$ 52,899-	35.8-
OPERATING EXPENSES										
SELLING EXPENSES										
SALES SALARIES AND COMMISSIONS	$ 7,517	14.4	$ 7,963	13.2	$ 41,613	13.4	$ 57,337	13.4	$ 15,724-	27.4-
ADVERTISING	982	1.9	893	1.5	5,190	1.7	6,850	1.6	1,660-	24.2-
SHIPPING	205	.4	300	.4	1,192	.3	1,127	.3	65	5.8
OTHER SELLING EXPENSES	407	.8	455	.8	2,344	.8	3,861	.9	1,517-	39.3-
TOTAL SELLING EXPENSES	$ 9,111	17.5	$ 9,613	15.9	$ 50,339	16.2	$ 69,175	16.2	$ 18,836-	27.2-
GENERAL & ADMINISTRATIVE EXPENSE										
OFFICE SALARIES	$ 5,420	10.4	$ 5,037	8.4	$ 32,600	10.5	$ 39,191	9.2	$ 6,591-	16.8-
SUPPLIES	340	.6	325	.5	1,915	.6	2,400	.6	485-	20.2-
LEGAL & ACCOUNTING	150	.3	160	.3	975	.3	927	.2	48	5.2
DEPRECIATION OFFICE FURN & FURN	155	.3	175	.3	1,070	.4	1,195	.3	125-	10.5-
OTHER GEN & ADMINISTRATIVE EXP	412	.8	507	.8	2,612	.8	2,405	.5	207	8.6
TOTAL GENERAL & ADMINISTRATIVE EXP	$ 6,477	12.4	$ 6,204	10.3	$ 39,172	12.6	$ 46,118	10.8	$ 6,946-	15.1-
TOTAL OPERATING EXPENSES	$15,588	29.9	$15,817	26.2	$ 89,511	28.8	$115,293	27.0	$ 25,782-	22.4-
NET OPERATING INCOME	$ 331	.6	$ 8,330	13.8	$ 5,470	1.8	$ 32,587	7.6	$ 27,117-	83.2-
OTHER INCOME										
INTEREST INCOME	$ 850	1.6	0		$ 5,025	1.6	$ 0		$ 5,025	
PROFIT ON SALE OF EQUIPMENT	$ 0		$ 230	.4	1,500	.3	230	.1	820	356.5
TOTAL OTHER INCOME	$ 850	1.6	$ 230	.4	$ 6,075	1.9	$ 230	.1	$ 5,845	
NET INCOME BEFORE FED INC TAXES	$ 1,181	2.2	$ 8,560	14.2	$ 11,545	3.7	$ 32,817	7.7	$ 21,272-	64.8-
FEDERAL INCOME TAXES	$ 260	.4	$ 4,109	6.8	$ 2,540	.8	$ 16,000	3.8	$ 13,460-	84.1-
NET INCOME AFTER FED INC TAXES	$ 921	1.8	$ 4,451	7.4	$ 9,005	2.9	$ 16,817	3.9	$ 7,812	46.5-

Schedule D

Report Samples and Formats
Page 13 of 18

The *Depreciation Report* lists the full status of all depreciable assets. Each period, the depreciation for each asset is automatically computed and entered into the appropriate general ledger accounts, using any one of four depreciation methods—straight line, sum-of-the-year's digits, double declining balance (at customer—directed percentage), or the accountant's own method. Each item may be treated individually.

Many users will find that GL/II pays for itself many times over with this schedule alone. It can be used for year-end tax purposes and can save much effort in calculating and printing long property asset schedules. Reconciliation to the general ledger account is automatic and accurate. Controls are easily maintained, and historical data is readily available.

APEX MANUFACTURING CORP
UNIVERSAL MOTORS DIVISION
DEPRECIATION REPORTS
6/30/68

CLIENT NO. 1442-3120

SUBSIDIARY NUMBER	ASSET DESCRIPTION	DATE ACQD	ASST LIFE	TYPE DEP.	ASSET COST/ DEPRECIABLE BASE	ACCUM DEPR/ SALVAGE VALUE	BOOK VALUE/ 1ST YR ALLOW	DEPRECIATION
127468	MILLING MACHINE	10/01/67	10	1	$ 77,343.85 65,343.85	$ 39,571.53 10,000.00	$ 37,772.32 2,000.00	$ 544.54
127521	LATHE	12/04/63	10	3	24,000.00 20,000.00	13,626.59 4,000.00	10,373.41	181.67
127581	STAMPING EQUIPMENT	12/29/61	8	0	50,000.00 38,000.00	26,700.00 10,000.00	23,300.00	388.67
127584	PRESS	08/01/67	10	1	45,000.00 38,000.00	20,683.53 5,000.00	24,316.47 2,000.00	316.67
183624	PLYMOUTH SEDAN	08/05/67	4	2	6,500.00 5,500.00	2,520.87 1,000.00	2,979.17 2,000.00	229.17
183621	FORD TRUCK	07/01/66	4	2	3,980.00 3,180.00	2,385.00 800.00	1,595.00	66.25
191710	OFFICE COPYING MACHINE	10/01/67	10	1	17,900.00 14,900.00	7,787.20 1,000.00	10,112.80 2,000.00	124.16
191711	OFFICE COPYING MACHINE	07/01/65	6	0	12,500.00 9,700.00	4,910.00 800.00	7,590.00 2,000.00	140.32
	TOTALS				$237,223.85 194,623.85	$118,225.03 32,600.00	$118,998.82 8,000.00	$1,730.37

Schedule D

Report Samples and Formats
Page 14 of 18

An up-to-date analysis of outstanding receivables, by customer, is provided by the *Accounts Receivable Aging Report*. The amount outstanding for each customer is shown as current to 30 days, 31-60 days, 61-90 days, and over 90 days. Aging is based upon the date entered for each transaction. If desirable, several transactions may be grouped using the same voucher/invoice number and date. A percentage of the amount outstanding for each time period is printed to aid account analysis.

The Accounts Receivable Aging Report becomes a valuable tool for the credit manager in following up on past-due items and for checking customer account status prior to approving current sales. This feature at the invoice level is compatible with an open invoice or "ledgerless" system of maintaining receivables, and is produced as an automatic by-product of GL/II.

APEX MANUFACTURING CORP
UNIVERSAL MOTORS DIVISION
ACCOUNTS RECEIVABLE AGING REPORT
06/30/68

CLIENT NO. 1442-3120 PAGE 1

CUSTOMER NUMBER	CUSTOMER NAME	DATE	INVOICE NUMBER	TOTAL AMOUNT	CURRENT TO 30 DAYS	30 TO 60 DAYS	60 TO 90 DAYS	OVER 90 DAYS
A01106	ABC PRODUCTS INC	06/15/68	060001	1,659.32	1,659.32			
	TOTAL			$ 1,659.32	$ 1,659.32			
	PERCENT OF TOTAL			100.0	100.0			
B10923	B & Z ELECTRONIC COMPONENTS	02/05/68	020017	1,497.21				1,497.21
		03/13/68	020010	2,347.50				2,347.50
		04/24/68	040007	15,505.53			15,505.53	
		05/20/68	050005	5,358.62		5,358.62		
		06/17/68	020012	4,782.00	4,782.00			
	TOTAL			$29,490.86	$ 4,782.00	$ 5,358.62	$15,505.53	$3,844.71
	PERCENT OF TOTAL			100.0	16.2	18.2	52.6	13.0
B64119	BRUCKER CORPORATION	04/15/68	040002	6,239.20			6,239.20	
		05/18/68	050007	10,473.82		10,473.82		
		06/03/68	060002	15,404.00	15,404.00			
		06/03/68	050005	16,575.36	16,575.36			
	TOTAL			$48,692.58	$31,979.56	$10,473.82	$ 6,239.20	
	PERCENT OF TOTAL			100.0	65.7	21.5	12.8	
G19334	GREEN & ASSOCIATES	06/03/68	060002	972.24	972.24			
	TOTAL			$ 972.24	$ 972.24			
	PERCENT OF TOTAL			100.0	100.0			
M23906	MARTIN COMPANY	06/03/68	060006	360.12	360.12			
	TOTAL			$ 360.12	$ 360.12			
	PERCENT OF TOTAL			100.0	100.0			
TOTAL RECEIVABLES				$81,175.12	$39,753.24	$15,832.44	$21,744.73	$3,844.71
	PERCENT OF TOTAL			100.0	49.0	19.5	26.8	4.7

Schedule D

Report Samples and Formats
Page 15 of 18

The *Accumulated Payroll Data Report* is designed to provide the Payroll and Accounting Department with all data necessary for the preparation of various payroll tax reports. In itself, GL/II is not a payroll system, since it does not compute or distribute payroll. GL/II does, however, maintain employee earnings records and provides the small business with a means of posting payroll information and is an aid in the preparation of 941, W-2, and other payroll tax reporting forms.

CENTER DRUG STORE
ACCUMULATED PAYROLL DATA
FOR PERIOD ENDED 06/30/68

CLIENT NO. 0746-0312
STATE IDENT. NO. 143-7261

FEDERAL IDENT. NO. 13-1730467

			QUARTER	YTD		QUARTER	YTD
SOC. SEC. 567-40-9692	STATUS A	FIT WITHHELD	$ 397.50	$ 791.94	STATE TAX WITHHELD	$ .00	$ .00
F M CARDIFF		TAXABLE WAGES PAID	2,650.27	5,279.65	CITY TAX WITHHELD	.00	.00
1462 FERGUSON WAY	M/S S	OTHER COMPENSATION	.00	.00	EXCLUDABLE SICK PAY	.00	.00
SAN JOSE, CA 94100		FICA WITHHELD	116.61	232.30	UNCOLLECTED TAX ON TIPS	.00	.00
STATE CODE 94	STATE FORM NO 943321	TOTAL FICA WAGES PAID	2,650.27	5,279.65	TAXABLE TIPS REPORTED	.00	.00
CITY CODE	CITY FORM NO	GROSS WAGES FOR STATE	2,650.27	5,279.65			
SOC. SEC. 570-50-2760	STATUS A	FIT WITHHELD	$ 348.82	$ 797.65	STATE TAX WITHHELD	$ .00	$ .00
H K KELNER		TAXABLE WAGES PAID	2,493.75	4,985.32	CITY TAX WITHHELD	.00	.00
3476 LIGHTFOOT LANE	M/S M	OTHER COMPENSATION	.00	.00	EXCLUDABLE SICK PAY	.00	.00
SAN FRANCISCO, CA 94030		FICA WITHHELD	109.67	219.35	UNCOLLECTED TAX ON TIPS	.00	.00
STATE CODE 94	STATE FORM NO 943321	TOTAL FICA WAGES PAID	2,493.75	4,985.32	TAXABLE TIPS REPORTED	.00	.00
CITY CODE	CITY FORM NO	GROSS WAGES FOR STATE	2,493.75	4,985.32			
SOC. SEC. 570-52-1930	STATUS T	FIT WITHHELD	$ 406.62	$ 813.24	STATE TAX WITHHELD	$ .00	$ .00
E L BARON		TAXABLE WAGES PAID	2,782.36	5,564.53	CITY TAX WITHHELD	.00	.00
923 TAMARACK DRIVE	M/S S	OTHER COMPENSATION	.00	.00	EXCLUDABLE SICK PAY	.00	.00
SUNNYVALE, CA 94103		FICA WITHHELD	122.41	244.83	UNCOLLECTED TAX ON TIPS	.00	.00
STATE CODE 94	STATE FORM NO 943321	TOTAL FICA WAGES PAID	2,782.36	5,564.53	TAXABLE TIPS REPORTED	.00	.00
CITY CODE	CITY FORM NO	GROSS WAGES FOR STATE	2,782.36	5,564.53			
SOC. SEC. 581-53-2664	STATUS A	FIT WITHHELD	$ 396.52	$ 793.95	STATE TAX WITHHELD	$ .00	$ .00
D B FORSLUND		TAXABLE WAGES PAID	2,588.61	5,177.22	CITY TAX WITHHELD	.00	.00
2509 GLENRIO DRIVE	M/S M	OTHER COMPENSATION	.00	.00	EXCLUDABLE SICK PAY	.00	.00
LOS ALTOS, CA 94022		FICA WITHHELD	113.89	227.79	UNCOLLECTED TAX ON TIPS	.00	.00
STATE CODE 94	STATE FORM NO 943321	TOTAL FICA WAGES PAID	2,588.61	5,177.22	TAXABLE TIPS REPORTED	.00	.00
CITY CODE	CITY FORM NO	GROSS WAGES FOR STATE	2,588.61	5,177.22			
SOC. SEC. 583-51-8119	STATUS A	FIT WITHHELD	$ 169.32	$ 338.64	STATE TAX WITHHELD	.00	.00
H C RESLER		TAXABLE WAGES PAID	1,263.75	2,527.51	CITY TAX WITHHELD	.00	.00
698 SPRING STREET	M/S M	OTHER COMPENSATION	.00	.00	EXCLUDABLE SICK PAY	.00	.00
LOS ALTOS, CA 94022		FICA WITHHELD	55.60	111.21	UNCOLLECTED TAX ON TIPS	.00	.00
STATE CODE 94	STATE FORM NO 943321	TOTAL FICA WAGES PAID	1,263.75	2,527.51	TAXABLE TIPS REPORTED	.00	.00
CITY CODE	CITY FORM NO	GROSS WAGES FOR STATE	1,263.75	2,527.51			
SOC. SEC. 582-51-8119	STATUS A	FIT WITHHELD	$ 338.46	$ 676.93	STATE TAX WITHHELD	$36.11	$72.24
I M TOLBERT		TAXABLE WAGES PAID	2,407.98	4,815.97	CITY TAX WITHHELD	12.00	24.00
198 MOUNTAIN VIEW AVE.	M/S M	OTHER COMPENSATION	.00	.00	EXCLUDABLE SICK PAY	.00	.00
NEW YORK, NY 11041		FICA WITHHELD	105.95	211.90	UNCOLLECTED TAX ON TIPS	.00	.00
STATE CODE 11	STATE FORM NO 111422	TOTAL FICA WAGES PAID	2,407.98	4,815.97	TAXABLE TIPS REPORTED	.00	.00
CITY CODE	CITY FORM NO	GROSS WAGES FOR STATE	2,407.98	4,815.97			
SOC. SEC. 610-61-1963	STATUS A	FIT WITHHELD	$ 225.91	$ 415.82	STATE TAX WITHHELD	$ .00	$ .00
C A BAKER		TAXABLE WAGES PAID	1,801.82	3,603.64	CITY TAX WITHHELD	.00	.00
2491 HOMESTEAD ROAD	M/S S	OTHER COMPENSATION	.00	.00	EXCLUDABLE SICK PAY	.00	.00
SANTA CLARA, CA 94105		FICA WITHHELD	79.28	158.56	UNCOLLECTED TAX ON TIPS	.00	.00
STATE CODE 94	STATE FORM NO 943321	TOTAL FICA WAGES	1,801.82	3,603.64	TAXABLE TIPS REPORTED	.00	.00
CITY CODE	CITY FORM NO	GROSS WAGES FOR STATE	1,801.82	3,603.64			
TOTALS		FIT WITHHELD	$ 2,283.15	$ 4,628.17	STATE TAX WITHHELD	$ .00	$ .00
		TAXABLE WAGES PAID	15,988.44	31,953.84	CITY TAX WITHHELD	.00	.00
		OTHER COMPENSATION	.00	.00	EXCLUDABLE SICK PAY	.00	.00
		FICA WITHHELD	703.41	1,405.94	UNCOLLECTED TAX ON TIPS	.00	.00
		TOTAL FICA WAGES	15,988.44	31,953.84	TAXABLE TIPS REPORTED	.00	.00
		GROSS WAGES FOR STATE	15,988.44	31,953.84			

Schedule D

Report Samples and Formats
Page 16 of 18

Departmental Reports

Three types of departmental operating reports are produced by GL/II, each of the reports in four separate categories. Where consolidated reporting is required, the same reports in four corporate categories can be obtained.

The three types include:

1) An *Income Statement;*
2) An *Income and Expense Budget Variance Report*, and
3) An *Income Expense Trends Report*.

All departmental reports are optional, and those called for can be changed as of each reporting period at the accountant's option.

For some companies, departmental reports are the most powerful analytical feature of the GL/II system. They can be used to break sales and costs down into many meaningful categories, such as sales territories, product lines, cost centers, contract projects, regional organizations, etc. When GL/II's departmental reporting features are combined with the system's capability for producing consolidated company reports, the ramifications for multilocational, multidivisional, or franchising organizations are unprecedented.

EVEREADY STORES, INC.
INCOME STATEMENT
STORE 03

CLIENT 0812-0100 FOR THE PERIOD ENDED 07/31/68 PAGE 1

	CURRENT PERIOD	YEAR-TO-DATE
SALES		
RETAIL	6,700	49,600
WHOLESALE	3,900	26,000
TOTAL SALES	$10,600	$75,600
COST OF SALES		
BEGINNING INVENTORY	1,500	3,000
MATERIALS PURCHASED	2,900	19,400
DIRECT LABOR	2,100	16,100
OTHER DIRECT EXPENSES	500	3,700
LESS: ENDING INVENTORY	500	1,000
TOTAL COST OF SALES	6,500	41,200
GROSS INCOME	4,100	34,400
EXPENSES		
OFFICE SALARIES	1,500	10,000
SUPPLIES	400	1,900
SELLING EXPENSES	250	1,500
SHIPPING EXPENSES	350	2,200
ADVERTISING	250	1,700
DEPRECIATION	180	900
MISCELLANEOUS	180	900
TOTAL EXPENSES	3,110	19,100
NET PROFIT	$ 990	$15,300

Schedule D

Report Samples and Formats
Page 17 of 18

EVEREADY STORES, INC.
INCOME STATEMENT
STORE 03
DEPARTMENT 02

CLIENT 0812-0100 FOR THE PERIOD ENDED 07/31/68 PAGE 1

	CURRENT PERIOD	YEAR-TO-DATE
SALES		
RETAIL	3,500	25,100
WHOLESALE	2,000	13,100
TOTAL SALES	$5,500	$38,200
COST OF SALES		
BEGINNING INVENTORY	1,250	1,400
MATERIALS PURCHASED	2,000	15,100
DIRECT LABOR	1,100	8,100
OTHER DIRECT EXPENSES	300	1,900
LESS: ENDING INVENTORY	1,500	750
TOTAL COST OF SALES	3,150	25,750
GROSS INCOME	2,350	12,450
EXPENSES		
OFFICE SALARIES	800	5,100
SUPPLIES	200	1,000
SELLING EXPENSES	150	800
SHIPPING EXPENSES	200	1,200
ADVERTISING	150	900
DEPRECIATION	100	500
MISCELLANEOUS	100	500
TOTAL EXPENSES	1,700	10,000
NET PROFIT	$ 400	$ 3,100

Schedule D

Report Samples and Formats
Page 18 of 18

EVEREADY STORES, INC.
INCOME STATEMENT
DEPARTMENT 02

CLIENT 0812-0100 FOR THE PERIOD ENDED 07/31/68 PAGE 1

	CURRENT PERIOD	YEAR-TO-DATE
SALES		
RETAIL	6,300	48,200
WHOLESALE	3,700	25,600
TOTAL SALES	$10,000	$73,800
COST OF SALES		
BEGINNING INVENTORY	2,000	2,500
MATERIALS PURCHASED	3,700	28,600
DIRECT LABOR	2,000	15,900
OTHER DIRECT EXPENSES	500	3,500
LESS: ENDING INVENTORY	1,500	2,500
TOTAL COST OF SALES	6,700	48,000
GROSS INCOME	4,300	25,800
EXPENSES		
OFFICE SALARIES	1,400	9,900
SUPPLIES	300	1,800
SELLING EXPENSES	250	1,400
SHIPPING EXPENSES	300	2,000
ADVERTISING	250	1,600
DEPRECIATION	160	800
MISCELLANEOUS	170	850
TOTAL EXPENSES	2,830	18,350
NET PROFIT	$ 1,470	$ 7,450

Characteristics of Continental's Payroll System

Continental Payroll System features, described in their entirety, alone would occupy a volume larger than this General Information brochure. From an operational standpoint, they can be summarized as:

1. Accepts multiple wage rates for each employee, as required;
2. Performs all Federal, State and local withholding tax calculations;
3. Allows for reimbursement of expenses, such as tips, room rent, tools, meals and entertainment;
4. Performs individual departmental, group, or agency payroll calculation and reporting;
5. Generates labor distribution information as a by-product of payroll input;
6. Accumulates statistical information automatically during computer runs, facilitates sophisticated data analysis and reporting;
7. Permits the employer to define special payments and special employee deductions in addition to routine types;
8. Prepares 941a and W2 tax statements;
9. Generates employee checks;
10. Accumulates and reports up to ten deduction categories per employee;
11. Calculates deductions by a percent of earnings or a rate times hours;
12. Issues employee work sheets (feedback report) serving as employer turn-around documents reflecting pay changes for the next payroll.

Some of the Special Features are:

1. Wage calculations for employees paid by salary and hourly rates may be intermixed freely on the same payroll;
2. Federal and State income tax may be calculated on the basis of the number of exemptions claimed or as a fixed amount;
3. Employees may receive their pay either by payroll check or by direct deposit to an individual checking or savings account with Continental Bank.
4. Employee master listings may be prepared upon request.
5. Limit deductions will stop automatically when limit is reached.

Appendix

The appendix shows sample reports and a brief explanation of each. Not all of the reports or options are shown. Maintenance reports have been omitted because of their simplicity.

EXHIBIT I

EMPLOYEE RECORD SHEET

Provides data center with all necessary employee conversion information.

When you decide to use Continental Bank's Payroll System, a meeting will be scheduled with you and a customer service representative who will be assigned to assist you in establishing conversion plans. Conversion schedules will be established for training employees, collecting input data and processing your first payroll reports.

Conversion to the payroll system can be done at any time of the year without losing any quarterly or yearly tax information.

EMPLOYEE RECORD SHEET

☐ New Employee ☐ YTD Change ☐ Name Changes

CO	DEPT 003	EMPLOYEE NUMBER 004

NAME	DATE

1 HOURLY RATE 001 | PERIOD HOURS 006 | PERIOD EARNINGS 002 | FEDERAL TAX 006 | STATE TAX: AMOUNT 042, % RATE 047 | COUNTY TAX: AMOUNT 058, % RATE 058 | CITY TAX: AMOUNT 064, % RATE 069

2 SERIES E BOND: PERIOD 072, DEDUCTION 073, AMOUNT 079, BALANCE 082 | CHECKING ACCOUNT: PERIOD 166, NUMBER 172, DEPOSIT 178 | SAVINGS ACCOUNT: PERIOD 180, NUMBER 187, DEPOSIT 198

3 DEDUCTION 1: PERIOD 082, AMOUNT 091 | DEDUCTION 2: PERIOD 093, AMOUNT 099 | DEDUCTION 3: PERIOD 101, AMOUNT 107 | DEDUCTION 4: PERIOD 109, AMOUNT 115 | DEDUCTION 5: PERIOD 117, AMOUNT 123 | DEDUCTION 6: PERIOD 125, AMOUNT 131 | DEDUCTION 7: PERIOD 133, AMOUNT 139

4 DEDUCTION 8: PERIOD 141, AMOUNT 147 | DEDUCTION 9: PERIOD 149, AMOUNT 155 | DEDUCTION 10: PERIOD 157, AMOUNT 163 | NAME

5 ADDRESS | DISTRIBUTION 520

6 CITY — STATE | ZIP CODE | 3 9 0 | SOCIAL SECURITY NUMBER 390

YEAR TO DATE ADJUSTMENT — PREPAY

7 REGULAR HOURS | OVERTIME HOURS | TOTAL EARNINGS | REGULAR EARNINGS | OVERTIME EARNINGS | OTHER EARNINGS | TOTAL DEDUCTIONS | NET PAY | QUARTER EARNINGS | ADD A / SUB S / P.FD. P

8 FEDERAL TAX | F.I.C.A. | STATE TAX | COUNTY TAX | CITY TAX | SERIES E BOND | DEDUCTION 1 | DEDUCTION 2 | ADD A / SUB S / P.FD. P | DEDUCTION 3

9 DEDUCTION 4 | DEDUCTION 5 | DEDUCTION 6 | ADD A / SUB S / P.FD. P | DEDUCTION 7 | DEDUCTION 8 | DEDUCTION 9 | DEDUCTION 10 | ADD A / SUB S / P.FD. P

DSD-015 Rev. 11/71

EXHIBIT II
FEEDBACK REPORT

The feedback report was designed with your payroll personnel in mind. All the necessary information for payroll reporting is consolidated in one report reducing time spent on payroll preparation and eliminating cross referencing errors. Entries are only required for variable pay information and changes to the employee record.

```
PERIOD END DATE   / /                               YOUR COMPANY NAME                                          PAGE   1
CHECK DATE        / /                                   SUB-TITLE
                                             TIME CARD DATA - EMPLOYEE RECORD CHANGES
IF LAST PAY OF QUARTER CIRCLE -YES-

1-2-3-4-5-WEEKLY                                          FEEDBACK
1-2-3-----BI-WEEKLY
1-2-------SEMI-MONTHLY
1---------MONTHLY
                               - - - - R E G U L A R - - - -   - - - - O V E R T I M E - - -   DESCRIPTION  DIST   S  -RECORD CHANGES-
                               T  HOURS    RATE      SALARY   T  HOURS    RATE      SALARY      OF PAY     CODE   T  CODE      TC

        BX 001           1     -  ---*--  --*----  ----*--    -  ---*--  --*----  ----*--   ----------  ----   -  ---  ---------
ZAMBO,  CHESTER T        1     -  ---*--  --*----  ----*--    -  ---*--  --*----  ----*--   ----------  ----   -  ---  ---------
  2.2500    .00        .00     -  ---*--  --*----  ----*--    -  ---*--  --*----  ----*--   ----------  ----   -  ---  ---------
1 M 0000 0 0 0        2010     DEDUCTIONS 1LA-      5.00  2/               3/E3          4/                9/1-     5.23 ---  ---------
426-42-8420 6718 E ROMA        DEDUCTIONS 6/E-            7/A-     1.0C  8/3-      2.50  9/E2             10/E-          ---  ---------

        BX 001           2     -  ---*--  --*----  ----*--    -  ---*--  --*----  ----*--   ----------  ----   -  ---  ---------
ZAK,  JERRY P            1     -  ---*--  --*----  ----*--    -  ---*--  --*----  ----*--   ----------  ----   -  ---  ---------
  2.5000  35.00        .00     -  ---*--  --*----  ----*--    -  ---*--  --*----  ----*--   ----------  ----   -  ---  ---------
0 S C000 0 0 0        2010     DEDUCTIONS 1LA-    100.00  2/GO             3/E3          4/                9/                ---  ---------
526-76-6427 12455 N 109        DEDUCTIONS 6/A-      5.00  7/               8/            9/E2             10/E-              ---  ---------

        BX 001           3     -  ---*--  --*----  ----*--    -  ---*--  --*----  ----*--   ----------  ----   -  ---  ---------
ZIMMERMAN JR,  PAUL A    1     -  ---*--  --*----  ----*--    -  ---*--  --*----  ----*--   ----------  ----   -  ---  ---------
  4.7500    .00        .00     -  ---*--  --*----  ----*--    -  ---*--  --*----  ----*--   ----------  ----   -  ---  ---------
3 M 0000 0 0 0        2010     DEDUCTIONS 1LA-G    20.00  2/               3/E3          4/1-       4.72  9/2-      5.23 ---  ---------
136-22-9079 NO    ADDRESS      DEDUCTIONS 6/E-            7/3-     1.00  8/E-            9/               10/E-          ---  ---------

        BX C01           4     -  ---*--  --*----  ----*--    -  ---*--  --*----  ----*--   ----------  ----   -  ---  ---------
ZIGLER,  JOHN B          1     -  ---*--  --*----  ----*--    -  ---*--  --*----  ----*--   ----------  ----   -  ---  ---------
  3.4700    .00     138.80     -  ---*--  --*----  ----*--    -  ---*--  --*----  ----*--   ----------  ----   -  ---  ---------
0 M 0000 0 0 0        2010     DEDUCTIONS 1/A-            2/               3/E3          4/                9/1-     5.23 ---  ---------
526-82-3991 1054 W UNIVE       DEDUCTIONS 6LA-     11.5C  7/2-     1.00  8/3-      2.50  9/E2             10/E-          ---  ---------

        BX 002           7     -  ---*--  --*----  ----*--    -  ---*--  --*----  ----*--   ----------  ----   -  ---  ---------
ZUCK,  EDWARD J          1     -  ---*--  --*----  ----*--    -  ---*--  --*----  ----*--   ----------  ----   -  ---  ---------
  2.7500    .00     110.00     -  ---*--  --*----  ----*--    -  ---*--  --*----  ----*--   ----------  ----   -  ---  ---------
5 M 0000 0 0 0        2010     DEDUCTIONS 1/A- G  .5000   2/               3/            4/A-       1.98  9/A-      2.13 ---  ---------
456-44-5363 215 E BROADW       DEDUCTIONS 6/E-            7/1-     1.00  8/              9/               10/            ---  ---------

        BX 002 100000005       -  ---*--  --*----  ----*--    -  ---*--  --*----  ----*--   ----------  ----   -  ---  ---------
ZYLSTRA,  FRANK H        1     -  ---*--  --*----  ----*--    -  ---*--  --*----  ----*--   ----------  ----   -  ---  ---------
  3.0000    .00     120.00     -  ---*--  --*----  ----*--    -  ---*--  --*----  ----*--   ----------  ----   -  ---  ---------
2 M 0000 0 0 0        2020     DEDUCTIONS 1/              2/               3/            4/                9/1-     7.50 ---  ---------
528-63-7963 2525 N EDGEM       DEDUCTIONS 6/              7/               8/A-       .50  9/               10/E3          ---  ---------

        BX C02 100C00008       -  ---*--  --*----  ----*--    -  ---*--  --*----  ----*--   ----------  ----   -  ---  ---------
ZUBIA,  RICHARD B        1     -  ---*--  --*----  ----*--    -  ---*--  --*----  ----*--   ----------  ----   -  ---  ---------
   .C000    .00     300.00     -  ---*--  --*----  ----*--    -  ---*--  --*----  ----*--   ----------  ----   -  ---  ---------
4 M 0000 0 0 0        2040     DEDUCTIONS 1/              2/               3/            4/                9/1-     4.25 ---  ---------
592-84-9569 7819 E WINDS       DEDUCTIONS 6/A-      5.0C  7/A-     1.00  8/A-      1.00  9/               10/            ---  ---------

        BX 002 1C0C00013       -  ---*--  --*----  ----*--    -  ---*--  --*----  ----*--   ----------  ----   -  ---  ---------
ZYLSTRA,  MELVIN         1     -  ---*--  --*----  ----*--    -  ---*--  --*----  ----*--   ----------  ----   -  ---  ---------
  6.2500    .00     250.00     -  ---*--  --*----  ----*--    -  ---*--  --*----  ----*--   ----------  ----   -  ---  ---------
4 M 0000 0 0 0        0050     DEDUCTIONS 1/A- A 10.000   2/               3/            4/                9/                ---  ---------
311-43-6984 10859 W 10P        DEDUCTIONS 6/              7/1-     1.00  8/              9/               10/            ---  ---------
```

EXHIBIT III
FEEDBACK REPORT TRAILER

This computer print out is used by the employer to record the initial payroll statistics for any new employees.

YOUR COMPANY NAME PAGE 2
SUB-TITLE
TIME CARD DATA - EMPLOYEE RECORD CHANGES

- - - - R	E G U L A R	- - - -		- - - - O	V E R T I M E	- - -	DESCRIPTION	DIST	S	-RECORD	CHANGES-
T	HOURS	RATE	SALARY	T	HOURS	RATE	SALARY	OF PAY	CODE	T	CODE	TC
-	---.--	--.----	----.--	-	---.--	--.----	----.--	----------	----	-	---	----------
-	---.--	--.----	----.--	-	---.--	--.----	----.--	----------	----	-	---	----------
-	---.--	--.----	----.--	-	---.--	--.----	----.--	----------	----	-	---	----------
-	---.--	--.----	----.--	-	---.--	--.----	----.--	----------	----	-	---	----------
-	---.--	--.----	----.--	-	---.--	--.----	----.--	----------	----	-	---	----------
-	---.--	--.----	----.--	-	---.--	--.----	----.--	----------	----	-	---	----------
-	---.--	--.----	----.--	-	---.--	--.----	----.--	----------	----	-	---	----------
-	---.--	--.----	----.--	-	---.--	--.----	----.--	----------	----	-	---	----------
-	---.--	--.----	----.--	-	---.--	--.----	----.--	----------	----	-	---	----------
-	---.--	--.----	----.--	-	---.--	--.----	----.--	----------	----	-	---	----------
-	---.--	--.----	----.--	-	---.--	--.----	----.--	----------	----	-	---	----------
-	---.--	--.----	----.--	-	---.--	--.----	----.--	----------	----	-	---	----------
-	---.--	--.----	----.--	-	---.--	--.----	----.--	----------	----	-	---	----------
-	---.--	--.----	----.--	-	---.--	--.----	----.--	----------	----	-	---	----------
-	---.--	--.----	----.--	-	---.--	--.----	----.--	----------	----	-	---	----------
-	---.--	--.----	----.--	-	---.--	--.----	----.--	----------	----	-	---	----------
-	---.--	--.----	----.--	-	---.--	--.----	----.--	----------	----	-	---	----------
-	---.--	--.----	----.--	-	---.--	--.----	----.--	----------	----	-	---	----------
-	---.--	--.----	----.--	-	---.--	--.----	----.--	----------	----	-	---	----------
-	---.--	--.----	----.--	-	---.--	--.----	----.--	----------	----	-	---	----------
-	---.--	--.----	----.--	-	---.--	--.----	----.--	----------	----	-	---	----------
-	---.--	--.----	----.--	-	---.--	--.----	----.--	----------	----	-	---	----------
-	---.--	--.----	----.--	-	---.--	--.----	----.--	----------	----	-	---	----------
-	---.--	--.----	----.--	-	---.--	--.----	----.--	----------	----	-	---	----------
-	---.--	--.----	----.--	-	---.--	--.----	----.--	----------	----	-	---	----------
-	---.--	--.----	----.--	-	---.--	--.----	----.--	----------	----	-	---	----------
-	---.--	--.----	----.--	-	---.--	--.----	----.--	----------	----	-	---	----------
-	---.--	--.----	----.--	-	---.--	--.----	----.--	----------	----	-	---	----------
-	---.--	--.----	----.--	-	---.--	--.----	----.--	----------	----	-	---	----------
-	---.--	--.----	----.--	-	---.--	--.----	----.--	----------	----	-	---	----------
-	---.--	--.----	----.--	-	---.--	--.----	----.--	----------	----	-	---	----------
-	---.--	--.----	----.--	-	---.--	--.----	----.--	----------	----	-	---	----------
-	---.--	--.----	----.--	-	---.--	--.----	----.--	----------	----	-	---	----------
-	---.--	--.----	----.--	-	---.--	--.----	----.--	----------	----	-	---	----------
-	---.--	--.----	----.--	-	---.--	--.----	----.--	----------	----	-	---	----------
-	---.--	--.----	----.--	-	---.--	--.----	----.--	----------	----	-	---	----------

EXHIBIT IV

SAMPLE PAYROLL CHECK AND EARNINGS STATEMENT

Earning Statement shows all current and year to date information for employees records.

Your paychecks are supplied to you signed and in departmental sequence ready for distribution.

Direct deposit feature gives the employee the option of depositing all or part of his pay to his checking and/or savings account.

CONTINENTAL BANK
PAYROLL SERVICE

YOUR COMPANY NAME
SUB-TITLE

PAYROLL CHECK

00 00000 ←CHECK NO.

91-119
1221

DATE
5-21-74

PAY TO THE ORDER OF → JOHN D ZIGLER

10360	AMOUNT
	$103.60

CONTINENTAL BANK
PHOENIX, ARIZONA

VOID
AUTHORIZED BY

⑈110410⑈ ⑆1221⑉0119⑆ ⑈01⑉5113485⑈

8X

YOUR COMPANY NAME
SUB-TITLE
STATEMENT OF EARNINGS AND DEDUCTIONS

PAY PERIOD ENDING
5-21-74

2 7
JOHN D ZIGLER

EARNINGS	TAXES: FEDERAL	FICA	STATE	LOCAL
122.38	.37	7.16	.04	.00
2,296.26	64.94	134.37	6.49	.00
YEAR TO DATE	YEAR TO DATE			

BANK DEPOSITS AUTHORIZED BY YOU: CHECKING	SAVINGS	LOAN
.00	.00	.00

DEDUCTIONS	NET PAY	AMT BY CHECK
11.21	103.60	$103.60

EARNINGS: DESCRIPTION	HOURS	CURRENT AMT	YEAR TO DATE
MISC		110.00	2,131.25
OVERTIME	3.00	12.38	165.01
		122.38	

DEDUCTIONS: DESCRIPTION	CURRENT AMT	YEAR TO DATE
BOND	5.00	
UNION DUES	1,50	387.50
LIFE INSURANCE	1.58	33.18
MEDICAL INS.	2.13	44.73
EMPLOYEE CLUB	1.00	6.00
	11.21	

PLEASE DETACH FOR YOUR RECORDS

34-034 O - 78 - 30

EXHIBIT V
PAYROLL REGISTER

All current and year-to-date information in one report.
Sub-totals by department
Grand totals by company

```
PAYROLL REGISTER                                    YOUR COMPANY NAME                                              07/19/77   07/26/77   1
BX                                                       SUB-TITLE

  D E P A R T M E N T    1
  1        1                  40.00            90.00    90.00                        2.25   5.27     .23      .23   75.79   75.79
ZAMBC CHESTER T        141688 98000  3000 2,146.88 1,980.00  106.88    6.23   161.29175.05   16.12      .70 1770.11            1
  1        2                  35.00            87.50    87.50                        9.00   8.17     .50      .50   61.58    2.00
ZAK JERRY P            186288 79500   400 2,660.54 1,587.50   20.00   10.00   506.14154.03   50.55     2.65 1176.77   59.58    2
  1        3                  40.00           190.00   190.00                       14.18  11.12    2.84     2.84  134.30  134.30
ZIMMERMAN JR PAUL A    336775 96000  9900 5,037.85 4,560.00  423.75   24.72   581.18251.57  111.50     6.50 3532.34            3
  1        4                                  138.80   138.90                       12.75   9.12    1.91           105.29    5.00
ZIGLER JOHN D          238910 16000 10100 3,802.71 3,294.64  351.58   10.73   532.98206.67   79.45          2849.05  100.29    4
  S U B - T O T A L S   1                              506.30                               29.63             3.97          217.09    4
FUI $4,200        316.30      115.00      506.30                             38.19             5.80          276.96
SUI $6,000        506.30            233.00        11,912.14          91.68          777.27             10.25          159.87
FICA $16500       506.30   2,795.00      13,648.00            901.64     1,701.59          258.06         5,328.27

  D E P A R T M E N T    2
  2        7                                  110.00   110.00                               6.44                    93.85
ZUCK EDWARD J          162388 73500  4000 2,406.24 2,241.25  165.01    9.71    64.54190.81    6.49          1682.90   93.85    9
  2           10 TERMINATED
ZIFFER JESSE G         239000 60000       2,550.00 2,550.00                    157.88149.18   29.31          2163.63
  2           20 TERMINATED
ZINNER JOSEPHINE M      91750 20500         917.50   917.50                     91.54 53.67    5.19           769.14
  2   100000005                             120.00   120.00                      4.59  7.02     .46            59.93   59.53
ZYLSTRA FRANK H        161000 48000  4400 2,834.00 2,640.00  144.00    8.00   255.49162.86   25.53          2335.12            6
  2   100000008                             300.00   300.00                     32.17 17.55    3.22           235.81  100.00
ZURIA RICHARD B        212250  4000  1000 5,945.00 5,500.00   45.00   11.25   470.50819.00   47.09          4524.52  135.91    7
  2   100000013                             250.00   250.00                     22.38 14.63    7.24           184.75
ZYLSTRA MELVIN         166650 60500   600 3,525.88 3,477.50   48.38   26.00   397.06206.20   35.21          2539.12  134.79    8
  S U B - T O T A L S   2                              780.00                               45.64                           159.93    4
FUI $4,200        480.00                  780.00                             59.14             5.92           614.36
SUI $6,000        790.00            100.00        17,726.29          54.96          1,531.81                               414.41
FICA $16500       780.00   2,665.00      18,178.64            407.39     1,472.81          156.77        14,005.43
```

PAYROLL REGISTER
79X

YOUR COMPANY NAME
SUB-TITLE

07/14/77 07/20/77 20

G R A N D T O T A L S	0X				1,296.30				75.27		3.97		417.02	8
		115.00		1,296.30				97.32		11.90		991.30		
			333.00		29,538.39		106.64		2,309.08		10.25		574.29	
		5,460.00		31,826.64		1,304.03		3,254.40		414.93		29,333.70		

DEPOSIT AMOUNT 991.30
PAYROLL ACCOUNT
PRE-PAY AMOUNT
PLUS ADJ YTD
MINUS ADJ YTD

TAXABLE EARNINGS
FUI $4,200 LIMIT 796.30
SUI $6,000 LIMIT 1,296.30
FICA $16500 LIMIT 1,296.30

*** 0 Y-T-D CROSSFOOT ERRORS

CHECKING 219.23
SAVINGS 192.79
P LOAN .00
M LOAN 5.00

EXHIBIT VI
DEDUCTION REGISTER

All current and year-to-date deduction information.
Sub-totals by department
Grand totals by company

SUPPLEMENT TO PAYROLL REGISTER
BY

YOUR CCPPANY NAME
SUB-TITLE

07/19/77 07/20/77 1

EMPLOYEE NAME	TOTAL OTHER EARNINGS	TOTAL DEDUCTIONS	UNION DUES	TIPS & GRATLT.	BONUS	LIFE INSURANCE	MEDICAL INS.	PERSONAL PUR.	EMPLOYEE CLUB	UNITED FUND	SICK PAY	MISC.	[illegible]
D E P A R T M E N T 1													
1 1		6.23					5.73		7.00				
ZAMBC, CHESTER T	60.00	73.61			60.00		26.61	15.00	12.00	10.00			
1 2		10.00						5.00					5.00
ZAK, JERRY P	653.06	770.38		625.38	27.68			110.00					25.00
1 3		24.72	20.00			4.72							
ZIMMERMAN JR, PA	54.60	513.96	448.00		54.60	33.04	20.92		4.00	8.00			
1 4		10.73					5.23	5.50					
ZIGLER, JOHN D	166.56	134.61	5.00				36.61	69.00	4.00	10.00	166.56	10.00	
S U B - T O T A L S 1			20.00				10.46		1.00				5.00
		51.68				4.72		10.50					
			453.00		142.28		94.14		20.00		166.56		25.00
	934.22	1492.56		625.38		33.04		194.00		29.00		10.00	
D E P A R T M E N T 2													
2 7		9.71				1.58	2.13		1.00				5.00
ZUCK, EDWARD J		511.12	387.50			34.76	46.96	5.00	7.00				20.00
T 2 10													
ZIFFER, JESSE G		10.00								10.00			
T 2 20													
ZINNER, JOSEPHIN		3.00							2.00				
2 100000005		8.00					7.50			.50			
ZYLSTRA, FRANK H	50.00	55.00					45.00			10.00		50.00	
2 100000008		11.25					4.25	5.00	1.00	1.00			
ZUBIA, RICHARD B		83.50					25.50	20.00	9.00	20.00			
2 100000013		26.00	25.00						1.00				
ZYLSTRA, MELVIN		349.20	342.20						7.00				
S U B - T O T A L S 2			25.00				13.88		3.00				5.00
		54.96				1.58		5.00		1.50			
			729.70				117.38		25.00				20.00
	50.00	1011.82				34.76		35.00		40.00		50.00	

SUPPLEMENT TO PAYROLL REGISTER   SUB-TITLE   07/19/77   07/20/77   2

EMPLOYEE NAME	TOTAL OTHER EARNINGS	TOTAL DEDUCTIONS	UNION DUES	TIPS & GRATLT.	BONUS	LIFE INSURANCE	MEDICAL INS.	PERSONAL PUR.	EMPLOYEE CLUB	UNITED FUND	SICK PAY	MISC.	MISC EARN
G R A N D T O T A L S			45.00				24.34		4.00				10.00
		106.64				6.30		15.90		1.90			
			1,187.70		142.28		211.50		45.00		166.56		65.00
	994.22	2504.39		625.38		67.80		229.00		68.00		60.00	

EXHIBIT VII
SAMPLE DISTRIBUTION ANALYSIS

YOUR COMPANY NAME — DISTRIBUTION ANALYSIS — PAGE 1
SUB-TITLE — 7/19/77

			HOURS			GROSS			
DIST	DEPT	EMPLOYEE	REGULAR	OVERTIME	TOTAL	REGULAR	OVERTIME	TOTAL	EMPLOYEES
50						250.00		250.00	1
		DIST TOTALS				250.00*		250.00*	1*
2010			115.00		115.00	616.30		616.30	5
		DIST TOTALS	115.00*		115.00*	616.30*		616.30*	5*
2020						120.00		120.00	1
		DIST TOTALS				120.00*		120.00*	1*
2040						300.00		300.00	1
		DIST TOTALS				300.00*		300.00*	1*
		FINAL TOTALS	115.00*		115.00*	1,286.30*		1,286.30*	8*

EXHIBIT VIII
SAMPLE 941a

FORM 941a (Rev. July 1967)
U.S. Treasury Department
Internal Revenue Service

CONTINUATION SHEET FOR SCHEDULE A OF FORMS 941, 941-M, 941SS, OR 943
REPORT OF WAGES TAXABLE UNDER THE FEDERAL INSURANCE CONTRIBUTIONS ACT

YOUR COMPANY NAME
STREET ADDRESS
CITY, STATE

Type or print in this space employer's identification number, name, and address exactly as shown on the return.

Date Quarter Ended 6/30/73

Page Number State [redacted] Federal 1

If this form is used as a continuation sheet for Form 943, Employer's Annual Tax Return for Agricultural Employees, please check here.

SEE INSTRUCTIONS IN PUBLICATION NO. 393
Attach only original continuation sheets to your tax return. Do not send a carbon copy to the Internal Revenue Service.

EMPLOYEE'S SOCIAL SECURITY ACCOUNT NUMBER	NAME OF EMPLOYEE (Please type or print)	TAXABLE F.I.C.A. WAGES Paid to employee in Quarter (Before deductions) Dollars Cents	TAXABLE TIPS REPORTED (See instructions Item 20, Form 941) Dollars Cents	STATE TAXABLE WAGES	TOTAL WAGES	EXCESS WAGES OVER STATE LIMIT — OR — Date Separated / Weeks Worked
426 42 8420	ZAMBO, CHESTER T	1416 88		1416 88	1416 88	
526 76 6427	ZAK, JERRY P	1237 50	625 38	1237 50	1237 50	
136 22 9079	ZIMMERMAN, PAUL A	3367 75		3367 75	3367 75	
526 82 3991	ZIGLER, JOHN C	2222 54		2389 10	2389 10	
456 44 5363	ZUCK, EDWARD J	1623 88		1623 88	1623 88	
523 63 7963	ZYLSTRA, FRANK H	1560 00		1560 00	1560 00	
592 84 9569	ZUBIA, RICHARD B	2122 50		2122 50	2122 50	
267 92 0395	ZIFFER, JESSE G	2380 00		2380 00	2380 00	
311 43 6584	ZYLSTRA, MELVIN	1666 50		1666 50	1666 50	
526 62 7204	ZINN, LOLITA	1400 00		1400 00	1400 00	
022 35 8602	ZOLA, EMYLA	2700 00		2700 00	2700 00	
877 67 3167	ZINNER, JOSEPHINE M	917 50		917 50	917 50	
252 53 4610	ZIZZO, ARTHUR L	2100 00		2100 00	2100 00	
378 54 1244	ZINK, FLOYD C	1461 88		1461 88	1461 88	
327 13 4369	ZACHARY, LAWRENCE F	1200 00		1200 00	1200 00	
521 47 6066	ZUCKERMAN, MAX T	2240 00		2240 00	2240 00	
533 20 4746	ZUSCHKE, FRANCIS D	1535 00		1535 00	1535 00	
511 44 1 33	ZAHN, KARL M	1466 67		1465 87	1466 87	
613 46 2124	ZIPP, JON	2166 25		2165 25	2166 25	
466 69 1004	ZELENDEK 0773, GORMA	1625 00			12250 00	12250 CC

TOTALS FOR THIS PAGE. [redacted] Number of employees (Federal) $ [illegible] 625 38 [illegible] 47201 61 12250 00

Taxable wages and taxable tips reported

36-1894723

687

EXHIBIT IX
SAMPLE W2

YOUR COMPANY NAME
STREET ADDRESS
CITY, STATE 99999

Wage and Tax Statement 1974 XXXXXX
Copy B To be filed with employee's FEDERAL tax return
← Type or print EMPLOYER'S identifying number, name, address and ZIP code

00-0000000 FEDERAL IDENT. NO. | 00-00000 STATE IDENT. NO. | 1975

FEDERAL INCOME TAX INFORMATION		SOCIAL SECURITY INFORMATION		STATE OR LOCAL INCOME TAX INFORMATION		
1 Federal income tax withheld	2 Wages, tips and other compensation	3 FICA employee tax withheld	4 Total FICA wages	6 Tax withheld	7 Wages Paid	8 State or locality
19.94	138.80	8.12	13.88	2.99	138.80	ARIZ

EMPLOYEE'S social security number ▶ 526-82-3991

ZIGLER, JOHN D

5 Uncollected employee FICA tax on tips	9 Tax withheld	10 Wages paid	11 State or locality

OTHER INFORMATION

Was employee covered by a qualified pension plan, etc.?	Contribution to individual employee retirement account	Cost of group term life insurance included in box 2	Excludable sick pay included in box 2	1. Single 2. Married
YES ☐ NO ☐				

An "X" in the upper left corner indicates this is a corrected form.

Type or print EMPLOYEE'S name, address and ZIP code above

This information is being furnished to the Internal Revenue Service and appropriate State officials.

Form W-2 94-0743750 Department of the Treasury—Internal Revenue Service

2

YOUR COMPANY NAME
STREET ADDRESS
CITY, STATE 99999

Wage and Tax Statement 1974 XXXXXX
Copy A For Internal Revenue Service Center
← Type or print EMPLOYER'S identifying number, name, address and ZIP code

00-0000000 FEDERAL IDENT. NO. | 00-00000 STATE IDENT. NO. | 1975

FEDERAL INCOME TAX INFORMATION		SOCIAL SECURITY INFORMATION		STATE OR LOCAL INCOME TAX INFORMATION		
1 Federal income tax withheld	2 Wages, tips and other compensation	3 FICA employee tax withheld	4 Total FICA wages	6 Tax withheld	7 Wages Paid	8 State or locality
19.94	138.80	8.12	13.88	2.99	138.80	ARIZ

EMPLOYEE'S social security number ▶ 526-82-3991

ZIGLER, JOHN D

5 Uncollected employee FICA tax on tips	9 Tax withheld	10 Wages paid	11 State or locality

OTHER INFORMATION

Was employee covered by a qualified pension plan, etc.?	Contribution to individual employee retirement account	Cost of group term life insurance included in box 2	Excludable sick pay included in box 2	1. Single 2. Married
YES ☐ NO ☐				

If this is a corrected form, put an "X" to the right of the number in the upper left corner.

Type or print EMPLOYEE'S name, address and ZIP code above

For instructions see Form W-3 and back of Copy D

Form W-2 94-0743750 Department of the Treasury—Internal Revenue Service

OTHER MANAGEMENT SYSTEMS AVAILABLE

- General Ledger
- Labor Distribution
- Payroll
- Inventory Control
- Mailing Label Processing

NATIONAL SOCIETY OF PUBLIC ACCOUNTANTS

1717 Pennsylvania Avenue, N.W., Washington, D.C. 20006
Phone (202) 298-9040

Office of the District III Governor
803 West Broad Street, Suite 311
Falls Church, Virginia 22046

May 22, 1978

Mr. R. J. Passero, Chairman
National Affairs Committee
National Society of Public Accountants
1717 Pennsylvania Avenue, N. W.
Washington, D. C. 20006

Dear Rudy:

Your request of May 5, 1978 asks for comments appropriate for testimony regarding S 72-The Competition in Banking Act of 1977.

My comments pertain to items 1, 3, 4 and 6 of Senator Proxmire's letter.

The banking industry probably needs more control and regulation than any other one because of the unique position it plays in our economy and the daily affairs of every person and business in our country.

This industry has already received unprecedented privileges from congress in order to carry on bank related activities.

If the banking industry is granted permission to expand their activities beyond those directly related to banking, the industry is handed a lever that can be used to the detriment of competing industries and the general public.

The awesome economic lever given to the banking industry with their loan making abilities create a debtor creditor relationship that could be exploited easily by banks to the detriment of the accounting profession and the general public. This debtor creditor relationship hands the banking industry an advantage that, when used, would place accountants in a very unfair position for acquiring and retaining certain clients.

Another consideration that deserves comment concerns the quality of the non banking services being performed by the banking industry. Computer generated financial statements produced by bank computers will be incomplete, misleading and often in error. In this situation the general public is the biggest loser.

I enjoyed our Massachusetts meeting and participating with a group of very dedicated NSPA leaders very much.

Sincerely,

Rob Grille

Robert Grille

RG:be

Page 24 NORTHERN OHIO BUSINESS JOURNAL November 28, 1977

Small companies need lots of tender loving care. And we have just the bankers who know how to "mother" your assets and help you grow.

They're managers. They manage money. Other people's money. And they do it very well.

They are looking for small-and medium-sized companies that they can help become bigger.

They want to offer you a payroll direct deposit plan that can pay off in savings for you and convenience for your employees.

They want to provide computer accounting services to help you control your cash flow and pinpoint problem areas that could be costing you profits.

They want to help you with credit investigations so you can extend credit only where it's due. And collect your receivables easier.

They want to provide you with other services you can profitably use–flexible financing, forecasting, export/import services, freight payment plans, leasing programs, personal and pension trusts and more.

National City Bank is a big bank that understands business. Large or small. Our bankers understand your problems. Talk your language. Hire them!

Just call John Eustis at 861-4900 and say "I need some TLC."

National City Bank
Cleveland, Ohio

Member FDIC

Is your company overlooking the "hidden money" it already has?

Our free Cash Management Review will help you uncover it.

Expert analysis may quickly show you how usable cash can readily be "created" . . . cash that already exists but is now hiding within the operations of your company.

This is especially likely if you have multiple plant or office facilities, scattered bank accounts, and disbursements for payables from many locations. With that kind of structure, it's particularly vital that you get the full story on latest cash management trends and improvements.

That's where we come in. Our seasoned cash management staff will review with you your current operations and identify specific corporate needs. Included will be your collection system, the way you concentrate your funds, and the method by which you disburse funds.

You'll then receive from The First a written analysis . . . with our suggestions for "creating" and stretching corporate dollars. (Perhaps you've been overlooking such basics as the best concentration and reconcilement services for your needs, the right lock-box setup, zero-balance service, data transmission, or electronic banking.)

To take advantage of this free review, just give Roy Kelley a call at (617) 434-3870.

It could be the call that starts your company looking in the right places for extra money.

The First people to talk to The First

THE FIRST NATIONAL BANK OF BOSTON

808/16

At tax-time Freedom Federal Savers get a little extra help from the specialists

H&R BLOCK
THE INCOME TAX PEOPLE

If preparing your tax returns has always taxed your patience — Relax! We'll have H & R Block do it for you for a nominal fee. They'll save you a lot of work and worry and their knowledge of the latest tax developments that pertain to you could save you a lot of money.

These H & R Block services are available ...

1977 Massachusetts state income tax return and the following federal tax schedules:

Schedule A — Itemized Deductions
Schedule B — Dividends & Interest
Schedule D — Sale of Cap. Assets
Schedule E — Pensions & Annuities
Schedule G — Income Averaging
Schedule R — Retirement Credit

Also available at an additional charge:

Schedule C — Self-employment Income
Schedule E — Part 2 Multiple Rentals
Schedule F — Farm Income Expense
plus 1977 Out-of-state Income Tax

Freedom Federal Savings ... the only financial institution with offices across Massachusetts to offer H & R Block tax service to its savers.

All savings account holders are eligible for H & R Block's 1977 income tax preparation at worthwhile savings

Call or visit an office listed below for more information and to arrange a confidential appointment.

Springfield • 1243 Main St.
739-7367
Springfield • Forest Park
560 Sumner Ave. • 732-7236
Westfield • Westgate Plaza
Route 20 • 562-5671

New England's Largest
Freedom Federal Savings
Joseph T. Benedict, President & Chairman
Home Office 22 Pearl-Elm St., Worcester, Ma. 01608 (617) 791-6661

CONTINENTAL BANK

[illegible] NATIONAL BANK AND [illegible] COMPANY OF CHICAGO • [illegible] SOUTH [illegible]

Dear Continental Customer:

As a customer of Continental Bank, you have placed confidence in us to provide you the finest in financial service. Now, with tax filing deadlines quickly approaching, you may be particularly interested in a special Continental trust and investment service-- personal income tax preparation.

Annual changes in the federal, state and city tax laws make it difficult to keep abreast of all tax filing details. Continental Bank's personal income tax preparation service assures you that your return will be done on time and in accordance with the latest tax regulations. The hourly charge is $35 for tax preparation service on your federal, state and city tax reports.

Now is the time to arrange for your income tax preparation. Give me a call today at 828-4586 to find out more about Continental Bank's tax preparation service. Or use this postage paid reply card and we will call you.

Sincerely,

Hugh Cummings

Hugh Cummings

A. Clyde Rohrs & Associates
Accountants
PHONE 358-8282
12003 E 47th STREET
KANSAS CITY, MISSOURI 64133

A. CLYDE ROHRS, PARTNER
GARY C ROHRS, PARTNER

MEMBER OF
NATIONAL SOCIETY OF
PUBLIC ACCOUNTANTS
INDEPENDENT ACCOUNTANTS
SOCIETY OF MISSOURI

June 8, 1977

JUN 13 1977

Mr. Stanley Stearman
Executive Vice-President
National Society of Public Accountants
1717 Pennsylvania Avenue N.W.
Washington, D.C. 20006

Dear Stan:

Enclosed you will find a brochure which the Mercantile Banks here in Missouri are mailing out with all their bank statements.

This amounts to a direct solicitation of my clients business and I'm unhappy about it.

Mercantile is based in St. Louis and operates banks in Kansas City and all across the state.

Is there anything being done about this kind of encroachment into our field of endeavor? First it was payroll check writing--now it is the whole bit. Isn't there anything to stop them?

Best regards,

Clyde

A. Clyde Rohrs

jch

enc

ENROLLED TO PRACTICE BEFORE THE INTERNAL REVENUE SERVICE
ACCREDITED BY THE ACCREDITATION COUNCIL FOR ACCOUNTANCY

FLORIDA ACCOUNTANTS ASSOCIATION
EXECUTIVE OFFICES: 2120 S.W. 23rd AVENUE
FT. LAUDERDALE, FLORIDA 33312 PHONE 581-7596

AC ? 305

GORDON M. WIGGIN
Executive Director

May 30, 1978

2 1978

Mr. R. J. Passero, Chairman
National Affairs Committee
National Society of Public Accountants
1717 Pennsylvania Avenue, N. W.
Washington, D. C. 20006

Dear Mr. Passero:

In response to your bulletin of May 8th, President Bill Farwell has asked me to send you the enclosed copies of correspondence relative to a letter circulated by the University National Bank of Boca Raton.

Included are letters to Florida Representative John Lewis, copies of his correspondence and an interpretive ruling from Mr. John G. Hensel, Regional Administrator of National Banks, Atlanta, Georgia.

Sincerely,

Gordon M. Wiggin

Gordon M. Wiggin
Executive Director

GMW:rt
encls.
cc: Executive Committee

FLORIDA ACCOUNTANTS ASSOCIATION

EXECUTIVE OFFICES · 2120 S.W. 23rd AVENUE
FT. LAUDERDALE, FLORIDA 33312 • PHONE 581-7596

January 17, 1977

From the office of:
President

1-18-78

Representative John W. Lewis
P. O. Box 9028
Jacksonville, Fla. 32208

Dear John:

In conjunction with our Association's efforts to obtain licensing of the non-certified accountants, I am concerned with the banking industry "getting into the act".

I am enclosing a copy of a flyer sent to the customers of the University National Bank of Boca Raton.

Your comments as to whether or not this is a valid service to be afforded by banks, will certainly be appreciated.

Cordially,

Bill

J. W. Farwell

JWF:df

P.S. Mr. Torres is a member of FAA.

cc: State Affairs Committee
Mr. George Torres

733-8866

UNIVERSITY NATIONAL BANK OF BOCA RATON

3903 NORTH FEDERAL HIGHWAY

POST OFFICE DRAWER
BOCA RATON, FLORIDA

December 1, 1977

Dear Valued Customer:

Our bank, in cooperation with Automatic Data Processing, Inc., now makes available to you four totally-computorized accounting services; Payroll, Accounts Receivable, Accounts Payable, and General Ledger.

Each of these services is tailored to your individual requirements in its respective area; and all of them are designed for companies, of all sizes, who are discovering that "do-it-yourself" accounting is becoming more costly and burdensome than ever.

Automatic Data Processing is the nation's largest payroll processor, with more than 25 years experience and over 10,000 payroll, accounts receivable, accounts payable, and general ledger clients. All of that experience and know-how is now at your disposal through our bank.

With these new services, you immediately free up high-priced personnel for more constructive financial work, and you avoid peak work loads caused by illness, vacations, and holidays. For example, our new service will prepare all your 941A's and W-2's as well as quarterly and annual Federal, state, and local tax reports.

In short, we now offer you complete accounting services, through your own bank, with data processing done by one of the world's largest data processing specialists.

Should you wish to obtain additional information about this service, please contact a Commercial Banking Officer at the bank.

Sincerely,

Richard S. Schang

Richard Schang
Executive Vice President

FLORIDA HOUSE OF REPRESENTATIVES
DONALD L. TUCKER, Speaker JOHN L. RYALS, Speaker Pro Tempore
COMMITTEE ON COMMERCE

John R. Forbes
Chairman

John W. Lewis
Vice Chairman

May 23, 1978

Mr. James W. Farwell, President
Florida Accountants Association
2221 University Boulevard, West
Jacksonville, Florida 32217

Dear Mr. Farwell:

At the request of Representative John Lewis, I contacted you on February 2, in reference to your letter of January 17, concerning the accounting services offered by University National Bank of Boca Raton. At that time I informed you that I had requested the Florida Department of Banking and Finance to contact the United States Comptroller of Currency concerning whether the services offered by the Boca Raton bank were permissible. The Department did so on that date (see enclosed).

Unfortunately, the Regional Administrator of National Banks did not reply until May 15(see enclosed). In that response, Mr. Hensel states that if the bank's activities encompass only automated bookkeeping services, then they are permissible for a national bank.

I apologize for the extended delay in responding to your inquiry, however, neither I nor the Florida Department of Banking and Finance has any control over the Administrator of National Banks.

Jack Herzog, Staff Director
310 House Office Building, Tallahassee, Florida 32304 (904) 488-2123

Mr. J.W. Farwell
May 23, 1978
Page 2

Again, I am sorry for the delay. If I can be of any further assistance, please do not hesitate to call on me.

Sincerely,

Wyatt D. Martin

Wyatt Martin
Commerce Committee Counsel

WM/gb

Encl.

GERALD A. LEWIS
COMPTROLLER OF FLORIDA

OFFICE OF COMPTROLLER
STATE OF FLORIDA

TALLAHASSEE
32304

February 2, 1978

Mr. Wyatt T. Martin
Committee Counsel
Committee on Commerce
House Office Building
Room 310
Tallahassee, Florida 32304

Re: Accounting Services Offered by University National Bank of Boca Raton as being a Permissable Banking Activity

Dear Wyatt:

Pursuant to your request concerning activities of the University National Bank of Boca Raton I have, this date, contacted Mr. H. Gary Pannell, Regional Counsel, Sixth National Bahk Region, in Atlanta. Mr. Pannell has requested a copy of the advertising letter from the bank for study as he was hesitant to express an opinion over the telephone.

I have written Mr. Pannell expressing our interest in this matter. I anticipate that he will contact me shortly after he has had an opportunity to study the situation. I will contact you immediately upon receiving any word.

If we may be of further assistance please do not hesitate to contact me.

Sincerely,

Barry F. Rose

Barry F. Rose
Legal Research Assistant
Division of Banking

BFR:bjc.

OFFICE OF COMPTROLLER
STATE OF FLORIDA

TALLAHASSEE
32304

GERALD A. LEWIS
COMPTROLLER OF FLORIDA

February 2, 1978

Mr. H. Gary Pannell
Regional Counsel
Sixth National Bank Region
Suite 2700, Peachtree - Cain Tower
229 Peachtree Street, N.W.
Atlanta, Georgia 30303

Re: Accounting Services as Permissable Banking Activity

Dear Mr. Pannell:

Pursuant to our telephone conversation of this morning I am enclosing a copy of an advertising letter from University National Bank of Boca Raton. As you can see, the letter offers "complete accounting services" as a banking service.

Our question is whether this is a permissable activity for national banks. You are aware, of course, that we have a "competitive equality" statute in Florida that would allow state-chartered banks to engage in this activity if permitted for national banks--hence our interest in this matter.

Thank you for your assistance.

Sincerely,

Barry F. Rose
Legal Research Assistant
Division of Banking

BFR:bjc

Enclosure

Comptroller of the Currency
Administrator of National Banks

Sixth National Bank Region
Suite 2700, Peachtree Cain Tower
229 Peachtree Street, N.E.
Atlanta, Georgia 30303

Regional Administrator of National Banks

RECEIVED
MAY 19 1978
BANKING DEPARTMENT
COMPTROLLERS OFFICE

May 15, 1978

Mr. Barry P. Rose
Legal Research Assistant
Division of Banking
Office of Comptroller
State of Florida
Tallahassee, Florida 32304

- File
- Follow-up
- Cy-FDIC
- Cy-S/E
- Subject file

Dear Mr. Rose:

This is in response to your letter of February 2, 1978, concerning the ability of national banks to offer "complete accounting services". The phrase "complete accounting services" encompasses a wide range of possible activities, hence it was necessary to premise our research on the assumption that only automated bookkeeping services were offered.

Interpretive Ruling (12 CFR § 7.3500) is the Comptroller's definitive statement regarding national banks and their furnishing of data processing services. This provision states:

> "A national bank may use data processing equipment and technology to perform for itself and others all services expressly or incidentally authorized under the states applicable to national banks. For example, as part of its banking business and incidental thereto, a national bank may collect, transcribe, process, analyze, and store, for itself and others, banking, financial, or related economic data."

Accounting services, involving banking, financial, or related economic data, are within the scope of this regulation, provided such services are performed only by automated bookkeeping. Under Interpretive Ruling 7.3500 automated bookkeeping services can be offered by national banks to any person or entity and not merely to other banks or existing customers.

We trust this has been responsive to your inquiry.

Sincerely yours,

John G. Hensel

John G. Hensel
Regional Administrator of National Banks

PUBLIC ACCOUNTANTS SOCIETY OF COLORADO
SUITE 380
720 SOUTH COLORADO BOULEVARD
DENVER, COLORADO 80222
TELEPHONE (303) 758-2561

RECEIVED JUN - 8 1978

May 30, 1978

FROM THE OFFICE OF
Everett L. Hanson
Secretary

2 1978

National Society of Public Accountants
Department of Government Affairs
1717 Pennsylvania Avenue, N.W., Suite 1200
Washington, D. C. 20006

Gentlemen:

In response to your inquiry of May 8 concerning advertisements of banks offering "non-banking" services such as accounting or bookkeeping, we are enclosing a photocopy of an advertisement which appeared in the March 1, 1978, issue of the GREELEY (Colorado) TRIBUNE.

This offering would most certainly have an anticompetitive economic effect on many of the accountants and bookkeepers who provide similar services in the Grpeley area as their principal occupation.

It is regrettable that banks offering such services as these are not, at least, required to also advertise the limitations of such bookkeeping systems, i.e., that no transaction can be recorded until and unless it goes through the bank account (checks and deposits outstanding at month's end would not be recorded), also, that proper journals and ledgers are not maintained. It seems that they should be forced to advertise that the system is simplistic and not adequate for the accounting needs of most businesses.

We hope that this will contribute to NSPA's testimony before the Senate Committee on Banking, Housing and Urban Affairs on Senate Bill 72.

Yours very truly,

Secretary

Enclosure

RECEIVED M

The CHAIRMAN. Mr. Zayas.

STATEMENT OF EDISON R. ZAYAS, ECONOMIST, NATIONAL FEDERATION OF INDEPENDENT BUSINESS; ACCOMPANIED BY WILLIAM J. DENNIS, JR., DIRECTOR, RESEARCH STAFF

Mr. ZAYAS. Thank you, Mr. Chairman.

Mr. Chairman, I am Edison Zayas, economist for the National Federation of Independent Business (NFIB). Accompanying me today is William J. Dennis, Jr., director of our research staff. On behalf of NFIB and its 530,000 member firms across the country, I am grateful to have this opportunity to express our views on S. 72, the Competition in Banking Act of 1977.

Our primary concern lies with section 301 of the bill, which would restrict permissible activities under section 4(c)(8) of the Bank Holding Company Act of 1956 to those "directly" related to banking. This section would require that the activity be "directly" related to banking, and it would also tighten both the existing "closely related" test, as well as the "public benefits" test. Activities permitted under section 4(c)(8) would have to meet two basic tests under section 301. In the first place, in order to be permissible, an activity will have to be "so closely and directly related" to banking or managing or controlling banks as to be "a proper and necessary incident thereto." Moreover, it would be necessary that the activity be "likely" to produce benefits to the public; it would be necessary that the beneficial effect of the activity "clearly outweigh" adverse effects; and it would also be necessary that the activity not have a tendency to lead to an undue concentration of "economic or financial" resources. NFIB strongly supports this section of S. 72.

Currently, NFIB has approximately 25,000 member small businesses that are facing competition from bank holding company affiliates engaged in nonbanking related activities. These NFIB members are involved in real estate, insurance, accounting, property leasing, data processing, management consulting, marketing of securities, travel services, et cetera. Freedom of entry is high in these industries, and the business environment is highly competitive. These small businesses are accustomed to, and unafraid of competition. Furthermore, they do not seek protection from it. It is simply the view of our members that it is unreasonable to expect them to successfully compete in the long run, with affiliates of institutions that have special, and unique privileges and powers over money and credit.

It is also the view of our members that commercial banks should not use their earnings to compete with the business they have been chartered to serve. Commercial banks not only extend credit to businesses, they also serve businesses in a financial consulting capacity. This consulting service, provided by the holding companies, is a vitally important input to businesses of any size, and small businesses in particular, tend to rely heavily on such financial advice. When considered in this light, one has to question the propriety of bank holding company participation in the same commercial activities of the clients they are supposed to be serving.

To be sure, a fair number of small businesses have probably failed due to their inability to compete fairly with nonbank holding company affiliates. Unfortunately, scarcity of relevant data does not permit us to document these failures and the casual relationships behind them. Overall, we at NFIB recognize that as of yet, bank holding company competition in nonbanking areas has not significantly altered the market structures in the industries involved. Even if the appropriate data were available, it would still be too early to detect any decipherable trends, and attribute observable market structure changes to holding company competition. The point we wish to emphasize is that our primary concern lies in insuring competition on equal grounds for our members, and the avoidance of potential conflicts of interest on the part of the commercial banking industry. We believe that as a result of the prevalent managerial philosophy in holding company organizations, affiliation with banking institutions may provide nonbanking affiliates with abilities to compete unfairly, with little or no resulting public benefit.

THE ROLE OF NONBANKING ACTIVITIES IN BANK HOLDING COMPANIES

In discussing the issue of bank holding company involvement in nonbanking activities, it is important to understand the purpose of the holding company's participation in those activities. Originally, the concept of the organizational form of the holding company was developed in order to circumvent restrictive State branching laws which are effectively anticompetitive. Generally speaking, the advent of the holding company has served to increase competitiveness in the commercial banking industry, to the benefit of the public at large.

In the last 10 to 15 years, however, commercial banks have faced stiff competition not only from within the industry, but also from the ever-growing thrift institutions, who have increasingly been granted powers previously only available to commercial banks. Consequently, the commercial banking industry has been making efforts to differentiate their products in order to remain competitive. It is in this context that holding company activity in nonbanking areas can and should be viewed.

Principally, the role of nonbanking affiliates in the scheme of the overall operations of a holding company can be seen in two distinct ways. First, the purpose of the nonbanking affiliates may be to act as a profit center within the holding company. Ostensibly, one would expect the holding company to become involved in nonbanking activities that are profitable relative to its respective industry. In this case, the nonbank affiliate would behave as a profit maximizer, thus bolstering the company's earnings, and helping to offset the profit decline caused by increased competition in the banking areas. On the other hand, the purpose of the nonbank affiliate may be to complement and support the principal banking operations of the holding company. In this role, the purpose of nonbank activities would be to enhance the attractiveness of the overall package of services provided by the banking affiliates. For example, a businessman shopping around for a commercial loan who also is in need of data processing services, might be attracted to a bank that can offer him a package deal. The ability to offer such complementing services, increases the attractiveness of borrowing from that bank. Essentially, this is the concept of "full-service banking."

The manner in which the nonbanking affiliates are operated is greatly affected by the role it plays within the holding company. If its role is to act as a profit center, and simply add to the company's overall earnings, then the nonbank affiliate would behave as a profit maximizer. In doing so, the nonbank affiliate would equate its marginal costs to its marginal revenues and earn a normal profit. So long as the nonbank affiliate did not have privileged access to vital inputs, it would be able to compete fairly with unaffiliated firms. However, if the nonbank affiliate's role is to complement and support the banking activities of the holding company, then the nonbank affiliate would not necessarily behave as a profit maximizer. Under these circumstances, management of the holding company would be primarily concerned in maximizing the profits of the holding company via its banking operations. Consequently, substandard earnings performance of the nonbank affiliates—due to submarket pricing policies—relative to its respective industry, would be tolerated by company management since they are not concerned with the performance of the nonbank affiliate per se. Of course, overly poor performance would not be tolerated if its operations are endangering the soundness of the holding company. In this instance, management would measure nonbank affiliate performace by the extent to which its existence has made the primary banking function more attractive to its bank customers.

Although one can only speculate, available information seems to indicate that nonbank affiliates are serving the latter function. According to a Federal Reserve staff study on the bank holding company movement, available evidence suggests that holding companies tend to operate their organizations more as integrated entities, than as separate operations.[1] That is, holding company management typically seeks to maximize the profits of the holding company as a whole, not the individual affiliates. Given that nonbank affiliate assets have comprised only 5 percent of total bank holding company assets, and have exhibited little growth, it seems reasonable to suggest that nonbanking activities do not serve primarily as a source of profits to holding companies. Rather, it is more reasonable to contend that the role of nonbank affiliates is more supportive in nature, and that they do not act as profit centers. Consistent with this contention, are Federal Reserve staff studies suggesting that some nonbank affiliates tend to be less profitable and more highly leveraged than their independent counterparts.[2] Moreover, the same study indicated that affiliated companies did not have significantly different operating expenses from unaffiliated companies.

To the extent that nonbanking affiliates do not maximize profits, counterpart independent competitors are placed at a competitive disadvantage. In order to make nonbanking services attractive to their bank customers, nonbanking services of the holding company are provided at fees below current market rates. This may partly explain the relative lack of profitability, given that operating expenses were not found to differ between affiliates and independents. Submarket pricing may be particulary evident when the nonbanking services are tied in with banking services. The nonbanking affiliates are capable of doing

---

[1] The Bank Holding Company Movement to 1978: A Compendium, a study by the staff of the Board of Governors of the Federal Reserve System.

[2] Refer to footnote 1.

this since they can pass on added risk to the parent corporation. If they in fact do this, seemingly competitive prices are not necessarily a reflection of greater efficiency in providing these nonbanking services.

Given that independent competitors must behave as profit maximizers if they are to remain in business, their pricing policies must be reflective of their operating costs. Independent competitors would not be capable of pricing below market rates since they must absorb any operating losses. Consequently, if nonbanking affiliates are indeed operated in this manner, independent counterparts are faced with a formidable competitive threat, even if affiliated competitors are not relatively more efficient. Although bank holding companies may not be purposefully pursuing what are effectively "loss-leader" tactics, the net longrun effect could conceivably be just that.

NET PUBLIC BENEFITS

Upon reading the above, a typical reaction might be to say, so what? The fact is that nonbanking affiliates of holding companies provide their services at lower rates, and are thus providing increased benefits to the public.

In truth, there is nothing to indicate that there are net benefits to be had resulting from holding company activity in nonbanking areas. As mentioned earlier, Federal Reserve Staff studies indicated that certain nonbanking affiliates had somewhat lower earnings than their independent counterparts. Given that the affiliated firms were found to be more leveraged, one would have expected them to have had higher earnings to offset the increased risk typically associated with added leverage. The fact that the affiliated firm's earnings performance was not superior to its competitors, indicates that the affiliates pass on the added risk to the holding company, since someone must bear that risk. If this increased risk is to be offset, another affiliate of the holding company must pass it on. To the extent that the banking affiliates pass on the risk, bank customers will either receive lower returns on their savings, pay more in service charges, or perhaps pay higher interest rates on loans. This is consistent with findings showing affiliated banks to have higher earnings than independent banks—affiliated banks also had higher costs. It is, therefore, not at all clear, based on the admittedly sketchy studies, that the customers of the holding company as a whole are any better off.

In addition, three observations can be made. In the first place, by assuming the added risk of the nonbanking affiliates, and tolerating their relatively low earnings, holding companies may be effectively subsidizing inefficiency and thus misallocating financial resources. This would not be true if the existence of the nonbanking services resulted in more than offsetting profit increases through the banking affiliates. However, the fact that banks affiliated with holding companies have not noticeably outperformed nonheld banks, would indicate that this is not the case.[3]

Second, small businesses are also depositors, as well as borrowers at banks. To the extent that banking affiliates do indeed pass on the risk

[3] "Have Multibank Holding Companies Affected Commercial Bank Performance?" Federal Reserve Bank of St. Louis Monthly Review, April 1978.

associated with the leverage positions of the nonbanking affiliates, small businesses are effectively subsidizing their competitors.

Finally, many proponents of holding company involvement in nonbanking areas, contend that greater economies are achieved by the nonbanking firms through affiliation. This assertion runs contrary to the findings that were published in the April 1978 issue of the St. Louis Federal Reserve Bank Monthly Review. According to this article, operating expenses of banking affiliates tended to be higher than those of independents. This was attributed to higher employee benefit costs and greater "other expenses" than independent banks. The author claimed that the more expensive benefit plans are usually extended to subsidiaries throughout the holding company, thus raising the subsidiary's cost structures. In addition, the study conducted by Rhoades & Boczar on affiliated finance companies, did not find the affiliated companies to have lower cost structures, relative to independent finance companies.[4] It is important to recognize then that in many industries, minimum optimal scales of production are achieved at relatively low levels. In other words, "big" is not always a necessary and sufficient condition for optimal efficiency.[5] Although the data is not available, it is difficult to believe, for example, that greater economies—and thus public benefits—are achieved by travel agency affiliation with bank holding companies.

To be sure, one must be careful in drawing firm conclusions from the results of the Federal Reserve Staff studies. The time periods covered in those studies are short, and some of the methods of analysis are subject to serious shortcomings. However, it is quite clear that if net efficiency gains are to be had from bank holding company affiliation—implying net public benefits—they simply are not evident from what we have observed. Consequently, to argue for holding company involvement in nonbanking areas, on the premise that they can provide those services more efficiently, is clearly not supported by the available facts. Low pricing of nonbanking services by affiliated companies is not necessarily a reflection of their greater efficiency in offering those services. Rather, it may merely indicate the nonbanking affiliate's ability to pass on its lack of profitability to the holding company. Again, the effect would be to place independent competition at a disadvantage, even though they may be offering the same services as efficiently as the nonbanking affiliates.

CONCLUDING REMARKS

We would like to emphasize that NFIB is not in favor of legislation that would serve to dampen competition within the commercial banking industry. We believe that the organizational concept of the holding company has in many ways, allowed commercial banks to compete more effectively with each other. The consequent effect has been to increase the intensity of competition in the banking industry to the benefit of the consumer and small businesses. In many local markets, banking affiliates of holding companies have increased competition,

[4] Stephen A. Rhoades and Gregory E. Boczar, "The Performance of Bank Holding Company—Affiliated Finance Companies," Staff Economic Studies, No. 90 (Federal Reserve Board, 1977).

[5] Alan R. Beckenstein, "The Economics of Production and Distribution As They Impact Small Business," *The Journal of Contemporary Business*, Spring 1976, Vol. 5, No. 2.

and the independent banker's response has also been to intensify competition.[6] Commercial banks are now seeking to serve the small business sector more than ever before. Much of this can be attributed to some of the procompetitive effects of the bank holding company movement. Small businesses depend almost entirely on commercial banks as a source of external funds, and would thus be hurt by legislation that diminishes competition in the commercial banking industry.

However, the procompetitive effects of the bank holding company movement within the commercial banking industry, have not derived from their relatively new ability to offer nonbanking services. The legal form of the holding company has simply allowed banks to serve wider geographical areas and compete more effectively with banks that previously faced little competition.

Bank holding company involvement in nonbanking activities on the other hand, has provided no discernable public benefits and has not served to increase competition in the nonbanking areas. To argue the contrary is to ignore the existing evidence.

For the reasons outlined above, we believe that commercial bank ownership of nonbanking related firms is unsound in principle, and potentially anticompetitive. We therefore, must favor any attempts to limit further commercial bank entry into areas not directly related to the business of banking.

Mr. Chairman, I again would like to thank the committee for this opportunity to express our views on section 301 of S. 72.

The CHAIRMAN. Thank you very much, Mr. Zayas.

Mr. Gardiner, you have a very strong and direct attack on the competence of the bank operations with respect to accounting. You say accounting services often present results which superficially may be impressive, but which generally are badly distorted because the bank processess entirely what the untrained small businessman gives them. That is, the banks rely on the untrained businessman to code the accounts properly which can and does lead to gross errors and serious consequences. The old adage, "garbage in, garbage out" is very appropriate here.

That's a pretty powerful indictment. Why are not banks regulated when they engage in accounting services the same way as accounting firms are regulated by the States? You simply have a bank automatically exempt because they're regulated by the State banking commission? Does that give them an exemption and a right to proceed without the same kind of scrutiny as the accounting firm has?

Mr. FITCH. Yes. Senator Proxmire, the way accountants are licensed under State law is based primarily on the fact that they are in public practice as accountants. They must meet certain educational, experience requirements, and an institution offering accounting services through its employees would not qualify within the ambience of a State law licensing accountants.

The CHAIRMAN. That would explain why they wouldn't qualify, but how can they do these services? How can they compete? How can they get into the business? It would seem if they aren't qualified they wouldn't be allowed to do it. I couldn't go out without the kind of

[6] Refer to footnote 3.

training you have described and say I'm an accountant because that would be a violation of the State law. How can the bank get into it?

Mr. FITCH. That's a good question, Senator.

The CHAIRMAN. Have you gone to court on that?

Mr. FITCH. No, sir; we have not.

The CHAIRMAN. Why not? It seems to me you would have an excellent case.

Mr. FITCH. Well, we've thought about it.

The CHAIRMAN. After all, if somebody went out of a bank and tried to practice law or tried to engage in medicine—they felt they could take an appendix out or engage in brain surgery—they would be in a whale of a lot of trouble, and accounting can be just as complicated and require just as much expertise as medicine and law.

Mr. FITCH. One of the problems is there is no national or Federal licensing of accountants and since the Comptroller of the Currency and the Federal Reserve Board have indicated that these services are banking services then the State I don't believe would get involved with that kind of a situation, but I really can't answer why there has been no litigation in this area.

The CHAIRMAN. In what State or States is this most prevalent? Can you name one or two so we can get in touch with the State authorities and follow up on that as a committee?

Mr. FITCH. We've found it in the Northeast, Massachusetts is a State that participates in this, also Ohio, and Florida.

The CHAIRMAN. That's very good. We'll follow up with Massachusetts and Ohio. Massachusetts has an excellent banking commissioner and very aggressive and highly competent and we will get in touch with her as well as the Ohio commission.

Now you say further, Mr. Gardiner:

> The big problem, as we see it, is that with the various brochures, advertisements and publications distributed by banks, there is a distinct impression created that the banks are offering a valuable accounting service. But they are not.

You don't have those advertisements attached. We would very much like to have them. Are you saying that the banks can advertise in this way and an accountant could not or would not? Is there an ethical prohibition of some kind in the profession or is there a regulation?

Mr. GARDINER. Recently Senator, professionals have been permitted to advertise and therefore the answer to that question is no. What we are saying is that the banks should be restricted from doing accounting, bookkeeping, tax services of any type, for the reasons that the information is fed to them by the businessman who is sometimes not sophisticated in coding——

The CHAIRMAN. I'm not on that question now. I understand that and we are going to work on that one. What I'm concerned about now is the advertising, the publications that you say are distributed by banks giving a distinct impression that the banks are offering a valuable accounting service.

Now I want to make sure that you're saying there that they are doing something here, that they are competitors, that the accountants are not doing and perhaps cannot do. Is that correct?

Mr. FITCH. Yes, Senator, until the lawyer advertising case, all professionals, including accountants, were restricted under ethical provisions from advertising or soliciting business. Therefore, the banks, not coming under the ambience of this kind of a situation, could advertise extensively. That's not the case now. Accountants today can advertise as freely as banks, with certain restrictions.

The problem and the point that we are trying to make here is the fact that the service that they are offering is not truly an accounting service. It's more a data processing service because the accounting portion is done by the client. He has to do the accounting work and then give it to the bank which puts it on their computer and it comes out in a nice little format with all the information there, but it's not truly an accounting service.

The CHAIRMAN. I appreciate that. That's very, very helpful. The reason I'm following up on this and pursuing it is because when the securities people came in they pointed out that the banks are advertising for investors to invest in the banks in various ways and they point out that there's no way that a securities firm could do it. The SEC wouldn't let them do it. There are all kinds of specific requirements the SEC requires the securities firms to comply with, but the banks are free of that. That's something we want to get into and, of course, rectify, and you apparently have a somewhat different problem here because you say the advertising by professionals is now permitted. It's new. We don't know how it's going to develop, but if it does develop it certainly should comply with certain clear requirements of truth and comprehensiveness and so forth so it is fair, and they ought to be uniformly regulated.

Gentlemen, I'm going to have to leave temporarily, but I will be back in about 10 minutes. I have to go to the floor to vote. I apologize for detaining you but I will be back in about 5 or 10 minutes.

[Short recess.]

The CHAIRMAN. Mr. Gardiner, in your statement you say that "banks should not be permitted to offer or perform these professional services because they are unintentionally misrepresenting their service's value."

Can you tell us exactly how the banks are misrepresenting the value of the services?

Mr. FITCH. Yes, sir. As I was explaining previously, the banks in their publications and brochures, and so forth, are indicating that they offer accounting services, preparation of payrolls, bookkeeping services, preparation of financial statement, profit and loss statements, and so forth, when in fact they are not. The businessman is doing it. They are putting it on their computer and giving it back to the company based on the way he codes the information or the transaction.

Now this, to us, is misleading because it's not really accounting.

The CHAIRMAN. What's the magnitude of this? How major is it? Would you say they have moved in to the extent of 2 percent, 5 percent, 10 percent? Are they really making major encroachments in some areas?

Mr. FITCH. Yes; they are. In some areas the banks have found that the offering of these services has not been profitable and they have discontinued it, whereas other banks—the larger ones or the ones that are in the smaller towns where they command a substantial portion of the financial community—are offered them at a greater volume. However, I don't have the exact figures on it.

The CHAIRMAN. But your impression is that this is something where the competition is not as severe in the big cities but in the smaller towns, the smaller communities, the banks are providing a service and taking it away from the accounting profession?

Mr. FITCH. I would say that's a fair statement. I think in the larger cities you have a greater concentration of the accounting profession and a greater availability to the public of a variety of accountants from which they can choose. This still doesn't negate the fact that the banks, the larger banks in the larger cities, use their financial and loan power to force a potential client who applies for a loan into their nonbanking services. It doesn't negate that, but at least there is more opportunity for competition in the larger cities because there's a greater concentration of accountants there.

The CHAIRMAN. I'm not sure exactly what you would prevent here however. There's no question that if you've got an auditing job that has to be done and a small firm is to be audited in a small community the bank wouldn't audit them. I don't think you're saying that they would.

Mr. FITCH. No, sir.

The CHAIRMAN. What you're saying is that they would take the data that the businessman himself provides and just put it through their computer and I'm not sure how this would take business away from a local accounting firm, No. 1. No. 2, I'm not sure that maybe some of that processing might not be something that would be useful and valuable and probably ought to be provided and wouldn't be provided absent the bank doing it, and they do have a computer and very often the small accounting firm wouldn't have one available.

Mr. FITCH. Yes, sir.

The CHAIRMAN. Mr. Gardiner, did you want to talk a minute?

Mr. GARDINER. I will say a word on that, Senator. You misunderstand that when the coding of the various expenses such as an item of auto and delivery repairs to some equipment—if the businessman for some reason or other felt that rather than capitalize this item and depreciate it over a certain number of years it might be advantageous to him to charge it off all in 1 year thereby putting him in a lower tax bracket—and we assure you, Senator, that the bank would not catch that item as having been an expense item and the tax returns at the end of the year are then prepared from the information that has been submitted by code by the owner of the business. His intentions may be to not pay the proper amount of tax and therefore if enough of these transactions were put through the computer when the end of the year came around and the tax returns were prepared it would show a substantially lower taxable income and thereby misstating the clients true tax liability.

The CHAIRMAN. What I have in mind is some of the little towns around Madison, Wis. where I live. There's an accounting firm, Virchow Krause—it's an excellent firm. It's a firm I used before I came to the Senate, and they have a number of offices in various communities. It's one of the most highly respected accounting firms around. They work very closely with the banks on a mutually respected basis. They don't seem to have any problem with the banks moving in on their operations. They use the banks. They advise their clients on how to use the banks and so forth.

Is that uncommon or wouldn't that approach be more common than the notion of the banks taking away from an accounting firm business? Because I can understand why the banks might have a function to perform here. As I say, they have the mechanical devices an accountant may or may not have and they could be very useful in that respect.

Unfortunately, I'm going to have to run again. That's the last 7½ minutes of a rollcall. We had one following another. I'm sorry. I'll be right back.

[Short recess.]

The CHAIRMAN. Mr. Zayas, in your testimony you point out that bank holding company subsidiaries of bank holding companies are less profitable than their nonbank counterparts. You then indicate that this may be due to lower prices charged by these companies or as a result of lower fees charged to these subsidiaries by their parent bank holding companies.

Your conclusion is completely at odds with our information which is that bank holding companies charge higher prices and that their expenses—such as higher management fees—account for this decreased profitability. Can we have your comments on this?

Mr. ZAYAS. I'm basing most of this on a Federal Reserve staff study that was put out. Basically, I'm not sure that many people know exactly——

The CHAIRMAN. Can you give us those Federal Reserve staff studies?

Mr. ZAYAS. They are listed in the written statement.

The CHAIRMAN. I've got a chapter from the Federal Reserve staff studies and let me just read a little part of it: "Based upon the above findings"—page 9 on the chapter on bank affiliates—"with respect to efficiency ratios, it may appear that affiliations with bank holding companies" the principal reason for the higher total expenses as noted in most of the studies was the higher other operating expense category. It's been suggested by these researchers that the higher expenses may be attributed to management fees charged by holding companies. Other expenses reported in this other operating expense category such as retainer and legal fees and fees paid to directors and committee members may also be unique to holding companies. Each of these expenses are methods of transferring income within a holding company system in lieu of dividend payments and thus may not be truly reflective of the organization's "which are common in the larger holding company organizations are another factor contributing to higher expenses."

That does seem to contradict your observation and it is from the Federal Reserve staff study.

Mr. ZAYAS. Yes. I address that partly in the testimony when I discuss the argument of efficiency gains, but the problem is you have to ask the question: Why is it that certain nonbanking affiliates have substandard earnings relative to their independent counterparts, given that their operating expenses tend to be higher, at least from those studies that you just mentioned?

One conclusion might be that they may be charging lower prices and their ability to do this is simply because they can pass on the added risk to the parent corporation.

The CHAIRMAN. Well, I don't see anything in the staff study that indicates that they are charging lower prices.

Mr. ZAYAS. No; there's nothing to show that.

The CHAIRMAN. In fact, the indication would be the reverse. Any kind of a competent business—and the banks are by and large competent—I mean holding companies—would price their services so they cover their costs or get out of the business.

Mr. ZAYAS. That's the question. That's exactly what I asked and what I addressed. Why is it that they are involved in these businesses when according to the Federal Reserve staff studies the nonbanking affiliates are not performing as far as their earnings performance is concerned?

The CHAIRMAN. The answer is they don't care about that maybe because they pass them on to the guys that run the company and higher management fees and they rip it off.

Now in your concluding remarks you indicate that bank holding companies have had a beneficial competitive effect in the banking business by allowing banks to compete with other banks over wider geographic areas. But you do not favor bank expansion into nonbank fields.

My question is this: Would you then favor interstate branching for banks as a means of increasing competition in the banking industry? Would competition be fostered by banks competing in the banking business rather than in the nonbanking business?

Mr. ZAYAS. I'm not sure I understand your question.

The CHAIRMAN. As you know, at the present time, interstate branching is not permitted.

Mr. ZAYAS. Yes, sir.

The CHAIRMAN. One way that you increase competition is to permit interstate branching. If you did that, then you wouldn't have to have the holding company device and if you did that banks would compete but they would compete with other banks. You would have in Wisconsin the First National Bank of Chicago coming in and establishing its branch to compete with the Wisconsin banks. They wouldn't be competing with the insurance business or with the accounting business or with the independent businesses that you represent. They would be competing with other banks.

Mr. DENNIS. Senator, our organization is operated on the principle of membership participation and voting on various type of issues. We have not at this time put the question of branch banking to our members. Therefore, we have no position, so to speak, on the question of branch banking.

The CHAIRMAN. OK. Gentlemen, I want to thank you very much for your very helpful testimony. I want to commend you on the excellent job you have done in presenting it.

Mr. Gardiner, I know you had short notice and you were serving in place of another person. I think you did a fine job and your colleague certainly did too. Mr. Zayas, we want to thank both of you gentlemen very much.

The committee will stand adjourned.

[Whereupon, at 12:15 p.m., the hearing was adjourned.]

[Additional material received for the record follows in the Appendix:]

APPENDIX

United States Senate
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
WASHINGTON, D.C. 20510

December 29, 1977

The Hon. Arthur F. Burns
Chairman, Board of Governors
Federal Reserve System
20th and Constitution Ave., N. W.
Washington, D. C. 20551

Dear Mr. Chairman:

I appreciate your staff briefing the Senate Banking Committee staff this morning on the Federal Reserve's Study of the Bank Holding Company Movement. (See memo of Robert A. Eisenbeis to files dated December 28, 1977.)

In order that this Committee may derive the full benefits of this Study in relation to consideration of S. 72, I would appreciate its completion and transmission to the Committee by February 15, 1978. I would anticipate that shortly thereafter legislative hearings on S. 72 will be held by this Committee.

I thank you in advance for your cooperation with the work of this Committee.

Sincerely,

William Proxmire
Chairman

CHAIRMAN OF THE BOARD OF GOVERNORS
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

January 6, 1978

The Honorable William Proxmire
Chairman
Committee on Banking, Housing
and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Thank you for your letter of December 29. The Board was pleased to make members of its staff available to brief your Committee's staff on our study relating to the bank holding company movement.

As the members of our staff indicated at the December 29 briefing, it is their expectation that the study will be completed by about the end of March. The Board has assigned a high priority to this effort, but because of its scope and complexity the study probably cannot be completed by February 15 as requested in your letter. Nevertheless, I understand your need for this kind of background information and I have urged the staff to complete its work on this project as soon as possible.

I want to emphasize that the current study is a continuation of a broad, long-standing Federal Reserve System research effort on bank holding companies. Your staff was given a copy of a recent Board staff study that provided an assessment of the bank holding company movement, including its impact on competition, community convenience and needs, efficiency, concentration of resources, and financial soundness. That staff paper also identified a number of key issues needing further research. The present study represents an expansion and updating of the earlier work and I would anticipate that the current effort will point up areas requiring further analysis. I can assure you that the Board will continue to encourage a strong research program in this area.

With respect to your reference to the upcoming hearings on S.72, it is my understanding that the provisions of that bill are very similar to those of Title XIII of H.R. 9086, the Safe Banking Act of 1977. Governor Coldwell testified for the Board on this legislation before the House Subcommittee on Financial Institutions Supervision, Regulation and Insurance on September 28 of last year. I am enclosing a copy of his testimony for your information. Governor Coldwell's remarks on Title XIII appear on pages 13-17.

I hope that the information I have provided will be helpful to the Committee in its consideration of S.72. Please let me know if I can be of further assistance.

Sincerely yours,

Arthur F. Burns

Enclosure

FOR RELEASE ON DELIVERY

STATEMENT

by

PHILIP E. COLDWELL

MEMBER

of the

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

before the

Subcommittee on Financial Institutions
Supervision, Regulation and Insurance

of the

Committee on Banking, Finance and Urban Affairs

U.S. House of Representatives

on

H.R. 9086

September 28, 1977

Mr. Chairman, I appreciate the opportunity to testify before this Subcommittee on behalf of the Board of Governors on H.R. 9086, the Safe Banking Act of 1977. Before I address some of the more important provisions of the bill directly, the Board believes that it is important to place the bill in the context of prior efforts.

As you are aware, Mr. Chairman, in September 1975 the Board proposed legislation on behalf of the three bank regulatory agencies designed to improve supervisory effectiveness. These proposals arose from a study by the agencies subsequent to the Franklin National Bank failure of possible legislative actions to aid the agencies in their goal of preventing or ameliorating difficult bank situations.

The legislation recommended by the agencies was included in the Financial Reform Act and was in large part embodied in S. 2304 which was reported out of the Senate Committee on Banking, Housing and Urban Affairs in the 94th Congress. This legislation was subsequently found to be necessary and supported by the General Accounting Office in its study entitled Federal Supervision of State and National Banks. In this session of Congress, the majority of these proposals were reported out of the Senate Banking Committee as S. 71 and, in fact, recently passed the full Senate.

The Board believes that the proposals embodied in S. 71 are relatively noncontroversial and are needed in our on-going supervisory work. As you are aware, H.R. 9086 contains a large number of provisions which are unrelated to the basic supervisory thrust of S. 71 or raise new issues. Furthermore, many of these provisions are likely to be controversial and we are frankly concerned that such controversy will interfere with the passage of the other necessary, noncontroversial provisions.

Many of the additional titles which go beyond the basic supervisory thrust of S. 71 represent a potential over-reaction to recent public discussion of certain practices. The Board does not condone abuse of a bank for the benefit of insiders. In fact, the majority of the proposals reflected in the Board's original legislative recommandations in the supervisory field are designed to curb such abuses and enable the agencies to take more effective supervisory action when such abuses are discovered. However, we believe that the adoption of additional restrictions without the benefit of a full factual analysis could result in significant harm to the business of banking and interfere with the provision of credit to the economy. If the practices sought to be corrected are indeed potentially harmful and widespread, then legislative action may be needed. However, if such practices appear to be sometimes beneficial or reflected in only a few banks, then examination, supervisory, and perhaps regulatory, action reinforced by the additional tools of S. 71 would appear to be adequate to meet the problem.

The combination of the existing provisions of S. 71 with the additional restrictions in H.R. 9086 are excessive in light of existing knowledge of the problem and too severely restrict the ability of banks to provide loans to credit-worthy local businesses. Furthermore, the legislation will severely interfere with the ability of financial institutions to obtain qualified outside directors. The provisions relating to transfers of bank stock by individuals are too restrictive in view of the known nature of the problem and would interfere with the ability of banks to obtain capable successor management through which it will serve the community. Again, substantial revisions are proposed in the Bank Holding Company area without a demonstration that there is a problem needing to be remedied. These portions of the bill should not be enacted without extensive analysis and study of the problems involved.

For these reasons, we urge that the Subcommittee go forward with those noncontroversial provisions of H.R. 9086 which are embodied in S. 71 and for which the agencies have an on-going need, and separate out other portions of the bill for further study and consideration. Board testimony on S. 71 reflects many of the prime reasons for this supervisory thrust and I ask that it be placed in the record on these hearings.

I would now like to turn to the Board's comments on some of the specific provisions of the bill. The bill is, as I have already noted, so extensive and touches on so many important areas that, in the time allowed, I will only be able to provide the Board's comments on some of the major issues raised by the bill. I am submitting for the record a section-by-section analysis of the bill which sets forth the Board's comments on those provisions of concern to the Board.

I will now turn to Title I of the bill, which incorporates many of the proposed improvements in the bank supervisory and regulatory area which passed the Senate in S. 71. As I have noted earlier, the Board strongly supports these provisions and urges their immediate enactment. However, the Board questions the need for some of the changes which have been made. In the area of "insider lending" particularly, the changes to S. 71 which are made in Title I are too restrictive and would unduly constrain legitimate lending practices without measurable countervailing public benefit. The net result of these provisions would be to prevent many businessmen from lending their expertise to bank boards.

First, Title I would modify the aggregate lending provisions of S. 71 so that they would apply to a director and his related companies whether or not that director was an officer or 10 per cent shareholder. The Board believes that such a provision would severely limit the availability of qualified directors for banks, particularly in smaller communities. In such smaller communities, it is not at all unusual for an outside director to control more than one local business. This bill would force the outside director to choose between the local availability of credit for those businesses and his service as a bank director. The result of such a choice could be to deprive the bank of experience and advice.

In our view, the requirement elsewhere in Title I that loans to insiders be approved by two-thirds of the board of directors and that such loans not be extended unless they are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons and do not involve more than the normal risk of repayment or present other unfavorable features adequately protects against possible abuses. Unless a director were also an officer or a 10 per cent or greater shareholder it is unlikely that he would be able to induce the other directors to make a questionable loan, particularly in view of the liability to which the other directors would subject themselves under the civil penalty provisions.

The requirement that the aggregate loan limitation on loans to covered insiders be set at 50 per cent of the statutory loan limit to an individual borrower will again provide a strong disincentive for outside directors to serve on bank boards. Once the statute has been amended to aggregate all loans for a particular insider and his related interests, it does not appear that there is any substantial decrease in risk to the bank's safety or solvency by moving from 10 per cent to 5 per cent of the total capital and surplus of the bank.

Title I further places a ceiling on aggregate lending to all insiders. We do not believe such a provision to be necessary or appropriate. The aggregation of loans to the interests of any one insider is based on the premise that such a concentration is more risky in the case of an insider because those loans might be made on less than an arm's-length basis. While an argument might be made that similar considerations of risk would support an additional limitation on the aggregate of a bank's loans to all insiders and their interests, our experience has not shown that an additional limitation is necessary. In cases that have come to our attention involving insider lending abuses, those abuses have been limited to one or a few, generally controlling, individuals and have not typically involved the entire board, particularly its outside directors. An additional limitation on the aggregate of loans to insiders and their interests, which would rule out the major portion of such loans, would be a serious deterrent to the ability of banks to attract independant outside directors. In addition, it would restrict a bank's ability to lend to companies and individuals best known by the bank to be credit-worthy and would require banks to ration credit among the directors and companies they control.

In closing the Board's comments on Title I of the bill, we believe that it is necessary to consider the cumulative effect of the proposals which have been made. In sum, if the proposals are adopted as proposed, a bank may find it impossible to obtain qualified outside directors who are required by a subsequent title of this bill. Such, almost punative, provisions should not be imposed since there is no showing of any significant number of instances where outside directors have abused their positions. Again, with respect to other insiders, the harshness of the remedy far exceeds the frequency of demonstrated abuses.

The next major portion of the bill on which the Board wishes to comment is Title VI, which would radically change the ground rules for the transfer of ownership of bank stock by requiring prior approval of the Federal Deposit Insurance Corporation (with input from the Comptroller of the Currency or the Board, as the case may be) before any individual could acquire control of an insured bank. Since 1956, in its consideration of the Bank Holding Company Act and the various amendments thereto, Congress has carefully drawn a distinction between corporate and individual ownership. In fact, it was not until 1970 that Congress expanded the coverage of the Bank Holding Company Act to partnerships owning bank stocks. Similar distinctions have been consistently drawn under the Savings and Loan Holding Company Act. These previous actions on the part of Congress have basically reflected a concern for the marketability of bank stocks, a desire not to unduly discourage changes in the control of banks, and a respect for the individual's rights to buy or sell stock. Particularly in the nation's smaller communities, successor ownership and management have to be readily available, and many changes in control and management of banks result in more effective and responsible ownership, are highly desirable, and should be encouraged.

Any regulatory requirement for prior approval would necessarily impose burdens, costs and delays which would hinder such changes, desirable as well as undesirable, restrict the marketability of bank stock, and discourage some young persons of promise from entering the banking industry. The costs and burdens of this type of Federal legislation should not be imposed on the more than 14,400 insured banks in the country without better demonstration of a compelling need for the legislation or that the goals of bank safety and soundness cannot be reached through less obtrusive legislation. Undoubtedly there are instances in which changes of control have led or will lead to adverse impacts on the bank involved. However, the Board seriously questions whether the approval process contemplated would prevent enough of these instances to justify the costs involved. Additionally, we are concerned whether appropriate standards for the exercise of discretion to permit or deny individual ownership can be drafted which will adequately balance the individual's rights with the protection of the institution. We believe the standards imposed in the Title as drafted are too indefinite and would give too much authority to the supervisory authority. Further, a conflict could arise between the standards applied for individual ownership under this Title and those imposed for corporate ownership under the Bank Holding Company Act.

In this regard, the Board believes that there is a less disruptive method by which the goal of attempting to prevent adverse impacts of bank ownership changes can be achieved. Section 7(j) of the Federal Deposit Insurance Act presently requires that reports of change of control of financial institutions be filed by the institution when it realises that such a change has occurred. The Board believes that it might be appropriate to require filing of a report by the acquiring person no later than the date of consummation of any change of 25 per cent or more ownership. Civil penalties should apply for the failure to file such a report, and the report should contain much of the information required by Title VI. In this manner, if there were any circumstances regarding such a substantial ownership change which gave rise to a suspicion by the bank regulatory agency that the bank involved might be abused as a result of such change, the bank regulatory agency would be in a position to have its personnel monitor developments at the bank and take action before the bank suffered any serious adverse impact. We believe that such an approach would adequately balance supervisory concerns with individual rights and the necessity for the marketability of bank stock.

The Board believes that under certain circumstances there is some merit to the concept introduced in the bill of applying a margin requirement to all bank stocks whether or not publicly traded. However, we believe a requirement of a 50 per cent margin as proposed by the bill would make it extremely difficult to provide for successor ownership and management at smaller institutions in smaller communities. Rather, we believe a more appropriate margin would be 25 per cent and that there should be regulatory exemptive authority depending on the circumstances. Such a margin requirement should apply when control is being acquired and where the loan involved is from a commercial bank. Otherwise, such bank stock loans should be set on the same terms and conditions as other bank loans.

With respect to the provisions relating to correspondent balances, the basic purpose of Title VIII of the bill appears to be to prevent an insider of one bank from influencing the placement of such balances as a means of obtaining loans, probably at preferential terms, from another bank. To this end the title would prohibit bank A, which has a correspondent account from bank B, from lending to insiders of bank B, or if bank A has lent to insiders at bank B, from opening up a correspondent account for bank B.

The title goes on to prohibit a bank keeping a correspondent balance with another bank from making a loan to an insider of that correspondent or a bank having such a loan from opening up a correspondent account at such bank. With respect to the latter prohibition, there appear to be few, if any, known cases where banks providing correspondent accounts were abused in the manner which the provision is apparently designed to prevent and we question its necessity.

The Board strongly supports the purpose of preventing insiders from profiting through the placement of correspondent balances and we have previously taken action to attempt to insure that such abuses do not occur. The exposure to such abuse is particularly high in the case of an officer or controlling stockholder of a bank. However, rather than prohibit such relationships, the Board believes that limits could be imposed on shifts of correspondent accounts or the size of the accounts not justified by services rendered. In addition, we believe that a requirement for no preferential treatment should be imposed on all bank stock loans whether or not a correspondent balance exists. Such requirements should be backed up with civil penalties and the Committee may wish to consider the desirability of such a provision in conjunction with the aforementioned margin requirement as an alternative to the prohibitions of Title VIII.

The bill, however, would also reach "outside directors" and will prevent credit-worthy loans by banks which have correspondent relationships with the bank on whose board they sit. It must be remembered that in many instances a correspondent bank is in the best position to judge the credit of people in a downstream correspondent. In view of the restrictions proposed in Title I relating to insiders borrowing from their own institutions, the provision is overly broad and would unfairly restrict the ability of these individuals to obtain credit.

The Board, therefore, believes that outside directors, that is, directors who are not otherwise officers or 10 per cent shareholders, should be removed from the prohibitions of Title VIII and that only the requirement of nonpreferential treatment be instituted with respect to loans to such individuals. That is, the loans should be required to be on no more favorable terms and present no more risk of collectability than comparable loans to third parties.

As it has in the past, the Board favors enactment of a right to financial privacy bill and one which would, as would Title XI, extend the disclosure prohibition to any person rather than just covering disclosure to governmental agencies. We are somewhat concerned, however, that there may be certain technical details in this bill which would impede the Board's ability to carry out its statutory functions.

Section 1110(e) should be amended to make it clear that the title does not authorize withholding of financial information which regulatory agencies have a statutory right to collect whether or not a statute specifically requires the information to be reported. Furthermore, we believe that 1110(b) should be amended to include not only supervisory but also monetary and regulatory functions.

Section 1109 could have the unintended effect of disabling the bank supervisory agencies from exchanging information between themselves or from making relevant information available to the Department of Justice and the Securities Exchange Commission for enforcement purposes.

We therefore believe that a sentence should be added at the end of 1189 which states:

> Nothing in this title prohibits any supervisory agency from exchanging examination reports or other information with another supervisory agency, or from supplying information to a prosecutorial or enforcement agency concerning a possible violation of a regulation or statute administered by the supervisory agency.

We are concerned, however, with section 1184 of the bill relating to the nonauthorized use of terminals and disclosure of a customer's transactions at those terminals. While the Board is generally in favor of such precautions, we believe that this portion of the bill is overly vague. Any provisions relating to EFTS security should set forth standards and methods of security with great specificity in order to enable financial institutions to properly comply with the section. For this reason, we recommend that this section of the bill be deleted so that it may be later considered in greater detail.

The title of the bill relating to holding companies incorporates a number of provisions which were embodied in S. 71 that would improve the Board's supervisory authority over bank holding companies and the Board urges the immediate enactment of these. In addition, this title would authorize the waiver of the 30-day notice requirement in the Bank Holding Company Act in the case of emergency or failing bank situations. The Board believes that enactment of this provision is extremely important and, while it was not incorporated in S. 71, the Board believes it to be completely noncontroversial and recommends its immediate enactment.

Section 1307 of the title would require the Board to promulgate regulations requiring that each bank holding company and its banking subsidiaries include on its board a "reasonable" number of persons who are not affiliated with the holding company or its subsidiaries. The Board believes such a provision preempts the prerogative of shareholders under both national and State law. To our knowledge such a requirement is without precedent and we are aware of no showing of a compelling need to interfere with the rights of shareholders in this regard.

Title XIII of the bill also contains, in sections 1308 through 1313, provisions which would drastically alter the present regulatory scheme for bank holding companies contained in the Bank Holding Company Act of 1956, as amended. As I noted in my introduction, the Board is quite concerned that, due to the size and complexity of H.R. 9086 and the number of important issues covered therein, adequate consideration may not be given as to the desirability of these amendments.

The amendments would prohibit any bank acquisition by a bank holding company if it would result in the bank holding company holding more than 20 per cent of the total assets held by all banks and bank holding companies in the State in which the bank is located. We seriously question the desirability of such a rigid asset limitation and do not believe any need has been shown to impose such a limitation. Recent studies have shown no trend, on a nationwide basis, toward increased concentration during 1968 through 1975. In fact, aggregate concentration declined. Further, during the period 1960 through 1974 there was no overall trend toward increased Statewide concentration.

As a general matter, a requirement of this nature could lead to an anticompetitive market protection for some banks. Furthermore, as drafted, the limitation might have inequitable results between various banking organizations depending on whether the assets were inter-State or intra-State or perhaps derived from an international business, or State deposits, which may fluctuate. The focus on the total assets approach also overlooks the impact of present and future bank-type authority granted nonbank financial intermediaries that might intensify competition to commercial banks for some banking services.

Further, no single percentage figure would be appropriate for all the States due to a number of factors, including, among others, the number of bank and nonbank competitors, competition from out-of-State institutions, the existing size distribution of competitors, the recent history of bank expansion, and legal or economic impediments to unrestrained competition such as home office protection laws. The provision further interferes with the right of a State to determine the desirable banking structure for that State.

We note, however, that section 1308 would allow the Board to deny a bank acquisition which was not in the public interest even though the anticompetitive effects of the acquisition would not rise to the level of a violation of the antitrust laws. We believe that this would constitute a desirable clarification of existing law.

The bill also makes numerous changes in section 4(c)(8) of the Bank Holding Company Act. A number of these changes are consistent with present Board practices or make minor changes in emphasis which would have no substantial effect on the administration of the Act. We would note, however, that the proposed revised standards delete the provision of present law that permits the Board to differentiate between activities undertaken de novo and activities commenced by the acquisition of a going concern. We believe the authority to encourage de novo acquisitions has promoted competition and we strongly recommend that it be retained.

The Board is quite concerned with the requirement that a non-bank activity be not only closely related to banking, but also "directly" related and that it be not only a proper incident thereto, but a "necessary" incident. All of the nonbanking activities presently permitted by the Board were carefully considered under the guidance furnished by the legislative history of the 1970 amendments and after obtaining extensive public comment. A major change in the standards for permissible activities such as that contemplated in section 1309 should only be based on substantial factual evidence that the change is needed. The Board's staff is currently preparing a rather comprehensive study and review of bank holding company activity which would assist in determining whether any change in the present standards for permissible activities would be in the public interest. We believe a major change such as suggested in section 1310 should await the outcome of this study and other factual evidence.

The Board believes that section 1311 of the bill relating to "sound and competitive financing of nonbanking activities" is generally consistent with existing Board authority and practices under the Bank Holding Company Act. We do, however, object to the requirement that intercompany transaction reports be made available to the public, as these reports contain sensitive information comparable in some respects to bank examination reports.

The Board strongly objects to the additional hearing and administrative procedures contained in section 1312 et seq. The Board's present procedures under the Bank Holding Company Act are consistent with the Administrative Procedure Act and provide for an adjudicative hearing on individual applications when there are disputed questions of fact. Section 1312 would depart from the Administrative Procedure Act by requiring a formal hearing for the promulgation of regulations and all individual case determinations whether or not there are factual matters in controversy.

The courts and other authorities on administrative law have long recognized the distinction established by the Administrative Procedure Act between rulemaking and adjudication. Adjudication and a formal hearing are required to determine facts about particular parties, their activities, businesses and property. On the other hand, a rulemaking proceeding is less formal because typically the issues do not relate to evidentiary facts as to which the veracity and demeanor of witnesses would be important. We believe that the precedents in administrative law demonstrate that the public interest is safeguarded and best served by avoiding the cumbersome procedures of formal adversary hearings. In connection with rulemaking, the experience of those few agencies who use formal hearings is that such rulemaking proceedings are unreasonably lengthy. Accordingly, we believe that the Board's present procedures should be continued.

Finally, we are concerned with the provisions requiring the Board to process a patition to commence a proceeding to consider the issuance, amendment or repeal of any order or regulation relating to nonbank activities. We note that under the Administrative Procedure Act there is a present right for any person to petition the Board for the adoption or amendment of a regulation. Additionally, the Board recognizes its responsibility to continually review its regulations and supervise on an ongoing basis the operation of nonbank activities by bank holding companies. However, we believe that the procedure established to challenge the operation of individual companies provides a continuing possibility of collateral attacks on a bank holding company wishing to engage in a bank-related activity. The continuing possibility of unfounded attacks could deter many bank holding companies from engaging in nonbanking activities. This in turn would result in the curtailment of the possible benefits obtained under the Bank Holding Company Act from more innovative and compatitive services in bank-related fields.

In conclusion, Mr. Chairman, I would again like to emphasize that the Board believes that the provisions of H.R. 9086 which were originally embodied in S. 71 are constructive and necessary. We commend the Committee on having included them in this bill and recommend their immediate adoption. While the Board is in sympathy with a number of objectives of the additional provisions and might support modified versions of some of the proposals, we believe extensive study should establish tha necessity and desirability of any additional lagislation. The Board would be happy to cooperate with and assist the Committee in any such study it may wish to undertake.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

G. WILLIAM MILLER
CHAIRMAN

April 10, 1978

The Honorable William Proxmire
Chairman
Committee on Banking, Housing
and Urban Affairs
United States Senate
Washington, D. C. 20510

Dear Mr. Chairman:

With this letter I am forwarding two copies of the study that has been prepared by the Board's staff on the economic and financial implications of the bank holding company movement.

As Chairman Burns indicated in his letter to you of January 6, 1978, this study draws heavily from the Federal Reserve System's continuing research program on bank holding companies. It consists of a comprehensive review of the available research on bank holding companies and covers the principal areas of legislative and regulatory concern: competition, public benefits and community convenience and needs, operating performance and efficiency, safety and soundness, and concentration of resources. As you will see, even with the large amount of research that has been undertaken in this area, it is difficult to draw many unambiguous conclusions about the impact that bank holding companies have had to date. This is especially true with regard to the nonbanking activities of bank holding companies owing to the relatively brief interval since passage of the 1970 Amendments to the Bank Holding Company Act and the fact that most of the data on such activities cover the years of 1974 and 1975 — a period when the nation was in a relatively severe recession. Nonetheless, I believe that, overall, the research has made important contributions to our understanding of bank holding companies.

The Honorable William Proxmire

The staff study also identifies several important areas in which additional work is needed, and I have instructed the staff to pursue this research. I can assure you that the Board will continue to monitor closely the performance and economic implications of the bank holding company movement.

Sincerely,

Bill

The Bank Holding Company Movement to 1978: A Compendium

A Study by the Staff of the Board of Governors of the Federal Reserve System*

Robert A. Eisenbeis, Associate Research Division Officer, Division of Research and Statistics was responsible for the general direction of this study. It was prepared by the staff of the Financial Structure Section under the supervision of Joe M. Cleaver, Chief. Stephen A. Rhoades played a major role in getting the study completed through valuable technical advice and editorial assistance. Principal contributors were James Burke, Timothy J. Curry, Anthony Cyrnak, Cynthia A. Glassman, Stephen A. Rhoades, John T. Rose, and Donald T. Savage. Robert J. Lawrence provided helpful insights and comments. Other members of the staff of the Board of Governors also contributed to the completion of this study.

24-934 O - 78 - 34

Contents

Section I

A Review of the Evidence on the Bank Holding Company Movement: Summary

Introduction

Seven years have elapsed since the passage of the 1970 amendments to the Bank Holding Company (BHC) Act of 1956. During this time, bank holding companies have become the predominant organizational form in commercial banking, accounting for almost 71 percent of total domestic bank deposits. At the same time, many of these firms have expanded into those nonbanking activities that have been authorized by the Federal Reserve Board under the Act. Because of their increasing and significant size, multi-market structure and behavioral characteristics, it is likely that bank holding company organizations will have important and unique effects on the operations and performance of their bank and nonbank affiliates and the industries in which they compete. It is essential to understand the nature of these effects because of their potential implications for regulatory and supervisory policy.

Although bank holding companies, as they are presently structured, have been in existence only a short period of time, a substantial body of research has already been developed that focuses on many different facets of the bank holding company movement. The primary areas investigated follow the general concerns embodied in the Bank Holding Company Act. These include the effects of bank holding companies on (1) efficiency and performance of subsidiaries, (2) bank soundness, (3) competition, (4) concentration of resources and (5) public benefits and convenience and needs.

The purpose of this compendium is to review the available published research on those aspects of BHC activity that are relevant to public policy. Specifically, the eight papers in the compendium cover six different topic areas. The first is a background history of the bank holding company movement and federal regulation of bank holding companies. The second area consists of three papers dealing with the internal operations of these organizations and covers (1) operating policies, (2) performance and financial characteristics and (3) cost and economic efficiency. The third area follows directly from the efficiency and performance reviews and focuses on the safety and soundness implications of the growth of bank holding companies. The fourth and fifth topic areas examine the competitive effects of the growth of bank holding companies and their effects on concentration of banking and financial resources. The last section deals with the public benefits and effects on community convenience and needs that have resulted from the expansion of bank holding companies.

An attempt has been made to make this review of the available studies extensive, if not exhaustive. This has a two fold purpose. First, as part of a continuing research effort, it will provide the Board of Governors and the public with a relatively complete and documented summary of the current state of research on BHCs and will serve as background for any future policy debates about BHC regulatory and supervisory policy. Second, by establishing what is not known, or remains uncertain, about BHCs, it will provide a basis for formulating future research efforts within and outside the Federal Reserve System.

It is important to emphasize that this review leads to few unambiguous conclusions about the effects that the bank holding company movement has had on the nation's financial system or on public benefits. Given the relative newness of the bank holding movement in its present form, there are few areas in which a sufficient and consistent record of evidence exists to allow firm conclusions to be reached about BHCs. Particularly in the nonbanking area, the lack of data, the relatively brief time that many activities have been authorized, the paucity of studies and the fact that much of the evidence is from a period in which there was a severe decline in economic activity, all serve to limit the ability to make generalizations about the effects of bank holding companies. Even where there is strong and consistent evidence, there are offsetting considerations which must be weighed in evaluating the overall impacts of BHCs. The remaining sections of this summary paper briefly review the principal findings in the compendium,and the last section attempts to synthesize these results.

History

Review of the history of federal regulation of bank holding companies, beginning with the Banking Act of 1933 and continuing through the Bank Holding Company Act of 1956 and its amendments in 1966 and 1970, leads to several general observations. First, there has been a remarkable continuity of issues dealing with the expansion and regulation of bank holding companies. The principal concerns have been with (1) concentration of resources and the maintenance of the separation between banking and commerce and (2) the use of the bank holding company form as a means to circumvent restrictions on branch banking. Second, more often than not bank holding company laws have been preventative in nature rather than being directed toward the correction of actual abuses. Third, the present degree of regulation of bank holding companies was achieved by a gradual and sequential process as more and more holding companies were brought under the coverage of the Acts. Finally, it is now clear that the flexibility of the bank holding company form has resulted in significant changes in the way in which American banking firms are organized.

Operating Policies, Performance and Efficiency

Operating Policies

An important consideration in evaluating the performance of bank holding companies as well as interpreting the implications of proposed changes in regulatory and supervisory policies centers on the extent to which BHCs operate their subsidiaries as single integrated entities as opposed to collections of commonly-owned but autonomous companies. The available evidence is limited but suggests that BHCs tend to operate their organizations more as integrated entities than as separate operations. This is reflected in part by the fact that BHCs typically try to exercise control, through organizational structure, over the management philosophy and broad operating policies of both their bank and nonbank subsidiaries.

In addition, BHCs generally exercise at least some control over various specific operational areas. However, this seems to be somewhat less so, on average, with bank subsidiaries than with nonbank subsidiaries. In addition, there appears to be more variance among BHCs in the degree to which they integrate their bank subsidiaries relative to their nonbank subsidiaries. Finally, one factor which no doubt limits full integration of any BHC system is the legal restrictions that apply to financial transactions between a bank subsidiary and its bank and nonbank affiliates.

Performance

The organizational structure and perceived behavior of BHCs have led many observers to expect that they will have an important effect on the financial and operating performance of their subsidiaries. Because of the relevance of firm performance to several policy areas related to competition and safety and soundness, and because of data availability, BHC performance is the most extensively investigated facet of the BHC movement.

Evidence from simple univariate analyses as well as more sophisticated analyses has yielded relatively consistent and conclusive results. First, it is clear that multi-BHCs have had a significant effect on the asset structure of acquired banks. Most notably, BHC banks hold less cash and U.S. government securities, more state and municipal bonds and more loans per dollar of assets than independent banks. Second, in addition to holding what is generally regarded to be a riskier portfolio, the evidence indicates that multi-BHC banks exhibit lower capital-to-asset ratios than comparable independent banks. Third, BHC banks exhibit significantly higher earnings and expenses subsequent to affiliation while their profitability remains relatively unchanged. Finally, BHC banks do not grow any faster than other banks. In short, BHC banks exhibit riskier portfolios and more leveraged capital positions than similar unaffiliated banks, but their profitability and growth are no different.

As with many of the issues raised by BHCs, evidence on the impact of BHCs on performance of nonbank affiliates is extremely limited. Therefore, any conclusions must be regarded as tentative. In fact, only two of the 17 activities authorized have been studied. In mortgage banking, the evidence from the one available study suggests that BHC affiliates are not as profitable, do not grow faster and are more highly leveraged than independents. With respect to the consumer finance industry, the two studies show that BHC affiliates are less profitable, more highly leveraged, incur marginally higher interest expenses on borrowed funds and grow faster than independent finance companies. In sum, the only consistent evidence from the two nonbank activities that have been subjected to empirical investigation is that the nonbank affiliates of BHCs tend to be less profitable and more highly leveraged than their independent counterparts.

Efficiency

In evaluating proposed acquisitions by BHCs, the Board is required to consider the effect of the proposal on efficiency. This requirement is explicit under Section 4(c)(8) of the BHC Act and implicit under Section 3(a)(3). Since gains in efficiency may be regarded as a public benefit, possible efficiency gains must be weighed against possible adverse competitive and financial effects of acquisitions.

The large size of BHC organizations has led many observers to expect that affiliation with a BHC will lead to economies of scale as well as economies of organization. The available empirical work deals almost entirely with bank affiliates and suggests that a bank can achieve some economies of scale by affiliating with a bank holding company. However, it will also incur additional expenses. Small affiliated banks--especially unit banks--may not be able to achieve levels of output sufficient to offset these increased expenses until they reach a sufficient size. Thus, as affiliated banks grow (over $30 to $40 million), the economies of affiliation enable holding company subsidiary banks to operate as, or more, efficiently than independent banks. These same studies also suggest that these gains in efficiency taper off as the affiliated banks become large.

Less sophisticated "ratio" studies imply that affiliated banks have higher "other" operating expense ratios than unaffiliated banks. This is probably due to management fees and other expenses charged by the parent BHC as a means of transferring funds within the organization, and hence, should not necessarily be interpreted as evidence of organizational diseconomies or inefficiencies.

There is only fragmentary evidence pertaining to efficiency and the existence of scale economies in the nonbanking activities of bank holding companies. The one available study indicated that affiliated finance companies did not have significantly different operating expenses from unaffiliated companies.

Safety and Soundness

The past five years have seen increased concern about the stability of the banking system. Particular interest has been focused on the impact of BHCs and expansion in the nonbanking areas on bank safety and soundness. There are four avenues through which the BHC form of organization may be expected to affect the risk exposure of banks. These include (1) expansion of banking type activities through nonbank affiliates, (2) expansion into other bank activities, (3) multibank expansion and (4) parent company leveraging.

With respect to banking activities, multibank expansion has resulted in increased risk exposure through greater leveraging and riskier portfolios for subsidiary banks than for independent banks. Whether this is offset entirely or ameliorated by the attendant geographic diversification is not known. With respect to nonbank affiliates, the little available evidence indicates that such affiliates are more highly leveraged than their independent counterparts. At the same time, there is also some weak evidence of product-line diversification benefits resulting from nonbank expansion which would tend to reduce risk. Finally, available evidence suggests that parent holding companies have leveraged significantly in recent years. In many cases, this leveraging has provided equity funding for BHC banks; however, even with such equity injections, BHC banks as a group still tend to be more highly leveraged than their independent counterparts.

Although BHCs may maintain a riskier financial position in their banking and nonbank affiliates than do independent banks or comparable nonbank firms, the diversified structure and legal organization of BHCs makes it difficult to assess the net effect of this increased risk exposure and whether it has actually reduced safety and soundness in the banking system. Moreover, it remains to be seen whether this apparent risk-taking is greater than is socially desirable.

Competition

Under Sections 3 and 4 of the BHC Act, the Federal Reserve Board is required to consider the possible adverse effects of proposed bank and nonbank acquisitions in deciding whether or not they should be approved. This concern for the competitive effects of BHC acquisitions arises from the recognition that the degree and intensity of competition in a market will determine economic performance of the market in terms of the prices paid and profits realized. The empirical studies relevant to assessing the impact of BHCs on competition have not examined the impacts that BHCs have had on market prices, price-cost margins or profits. Rather they have focused on the effects of BHCs on market structure and made inferences about market performance from changes in market structure. That is, if BHCs result in an increase in the number of independent firms operating in a market, for example, the inference is that this is a positive structural effect that must have a procompetitive effect on market performance.

In general, because of the apparent aggressiveness of BHCs and because the organizational form provides a convenient mechanism to circumvent restrictive branching laws and other barriers to entry, it has been anticipated that BHCs would have a procompetitive effect on market structure. Certainly *de novo* expansion, to the extent that it results in new entry into markets, must be procompetitive. Bank holding companies have expanded *de novo*, but the majority of this expansion has been within markets in which the organization already operated. Studies of the effects of BHCs on banking market concentration--an important dimension of bank market structure--have yielded mixed results. The bulk of the work suggests that BHC activity has had little systematic or significant effects on banking market concentration and, hence, little pro or anticompetitive effects.

Conclusions regarding the competitive effects of BHCs in nonbanking activities must be regarded as highly tentative, because there have been so few studies and these are subject to serious shortcomings. What evidence exists suggests that in consumer finance, BHCs may have had a procompetitive effect since the relatively rapid growth of BHC affiliates could be due to procompetitive pricing policies. In mortgage banking, however, BHC affiliates are less profitable and more highly leveraged than independents. This provides little indication of either a pro or anticompetitive effect on pricing behavior or performance. In short, available evidence suggests that BHCs have little, if any, effect on competition in banking or nonbanking markets.

Concentration of Banking and Financial Resources

Throughout the history of legislation regulating BHCs, the Congress expressed concern with various dimensions of concentration--market concentration and aggregate or undue concentration. This reflects a concern about implications of market concentration for competition and the possible implications of state and national levels of concentration for basic segments of the economic system as well as the socio-political systems.

Bank holding companies have not significantly increased their control over aggregate financial resources in the economy as a whole; nonbanking resources still account for less than 4 percent of bank holding company resources. BHCs now control about 71 percent of domestic bank deposits, but only about 8 percent of these deposits are outside lead banks. Thus, most of the recent increase in BHCs' share of domestic deposits is due to conversion by existing banks to the BHC form of organization and not to acquisitions by existing BHCs.

Bank holding companies also have not significantly increased concentration in commercial banking at the national, state or local levels. Nationally, concentration in banking has declined gradually, but steadily, since 1934. It has been estimated that between 1968 and 1973, concentration is at most 2-3 percentage points above what it might have been if bank holding companies had not existed. Similarly, at the statewide level, concentration has declined on average between 1960 and 1976 (although it increased slightly since 1970) or at best remained stable, depending upon the measures used. The greatest declines, however, have been in the most and least concentrated states. Large increases in concentration directly attributable to bank holding company acquisitions have been limited to the low and moderately concentrated states. Locally, no significant, systematic increases in concentration have been attributed to bank holding companies. In general, local markets have tended to exhibit more competitive structures.

Within the more significant nonbanking industries--mortgage banking, consumer finance companies, leasing and factoring--in which bank holding companies have been permitted to expand, the picture is more mixed. Bank holding companies have not been a significant force in the leasing industry. Significant consolidation and structural change have taken place among consumer finance companies, and a number of the top 100 firms have been acquired by financial and nonfinancial companies and banks; but bank holding companies have not played an important role in this process. Bank holding companies are important owners of mortgage banking firms and now account for 42 of the top 100 mortgage servicers, but very few have been acquired since the early 70s. Factoring is the one industry that now is most clearly dominated by banks and bank holding companies which now have about 56 percent of the factoring business and 17 of the top 20 firms. Most of these firms have been acquired since 1968.

Convenience and Needs and Public Benefits

Under Section 3 of the BHC Act of 1956 as amended in 1966, the Board is required to consider the convenience and needs of communities in evaluating proposed BHC bank acquisitions. The Board shall not approve cases with adverse competitive effects in violation of Section 7 (Clayton Act) standards unless they are clearly outweighed by the positive effects on convenience and needs. Under Section 4(c)(8) of the BHC Act, as amended in 1970, a more stringent test applies; and the Board must deny a proposed acquisition in the nonbanking area unless it produces net public benefits.

Partially because of the difficulty of conceptualizing and measuring public benefits and convenience and needs, there have been very few studies on the subject. Those few that have been conducted reveal several points. First, in considering BHC applications, the Board focuses on several public interest considerations including the ability to obtain additional capital, provide additional or new services, increase competition, and improve efficiency and managerial resources. It is concluded, however, that if a serious anticompetitive effect exists, convenience and needs factors seldom, if ever have tipped the scale in favor of approval. Second, the chief public benefit resulting from BHC activity has been the increased availability of credit to the local community (through loans and municipal finance). Counterbalancing this increased credit availability, however, have been greater leveraging and some indication of poorer operating performance in nonbank markets. Third, the one study of post acquisition effects found that BHCs have tended to fulfill most, but not all, of the public benefit actions they have proposed--most notably with respect to trust services and data processing services, recruitment,and loan expansion.

Conclusions and Directions for Future Work

The evidence suggests the principal economic effect of the BHC movement to date has been to facilitate increased leverage and the acquisition of more loans and other risky assets, mainly for the bank subsidiaries. To the casual observer, this may suggest a weakening of the stability of the financial system. However, there are a number of factors that must be considered. First, it is not clear that increased risk taking by individual BHC subsidiaries implies that the overall organization has become more risky. This would be true only if there were no benefits from organizational and geographical diversification. Unfortunately, there is little evidence on the extent to which BHCs have resulted in reduced risk through diversification. Second, from a supervisory and public policy point of view, increased risk taking in the system as a whole should only be of concern if it is assumed that the financial system has already achieved the socially desirable level of risk. If the opposite is the case, then the increased risk that might be attributable to BHCs would clearly be in the public interest. Third, the increase in BHC leverage has enabled the organizations to expand lending, particularly to consumers and state and local governments. While such lending may be riskier than holding liquid assets or U.S. government securities, it clearly represents what might be viewed as a potentially socially desirable use of financial resources. An overall assessment, then, of the effects of increased leverage attributable to BHCs requires a balancing of what might, or might not, be increased organizational and/or system risk against the benefits that result from increased availability of funds.

Few other aspects of BHC operations yield as consistent results as the impacts on leverage. To the extent that BHCs have resulted in increased competition, the evidence suggests it is through de novo expansion or foothold entry rather than by acquisition of significant competitiors. The common argument, however, is that de novo expansion is costly and not economical. Moreover, there may be long delays between the time an institution expands in this way, until it becomes an effective competitor. Again, however, next to nothing is known about the alternative costs of entry and foothold expansion.

Perhaps the least is known to date about BHC nonbanking activities. Only two activities have received attention at all in the published studies--mortgage banking and consumer finance--and here the evidence suggests little about the long run impacts of BHCs. Not only are the studies few in number, they also suffer from the weakness that they cover a short time span at the early phase of BHC involvement in the activity. Equally important--and this applies to most of the work on BHCs in general--much of the evidence on the impacts of BHCs was generated during the period in which the economy experienced the greatest decline in economic activity since the Great Depression. Thus, it is not clear whether the results can be generalized.

In terms of directions for future work that would be relevant to formulation of public policy, there are several areas that seem critical. The first relates to the operational and organizational characteristics of

24-934 O - 78 - 35

a BHC and the extent to which it affects risk taking. Included should be work on the relationship between diversification and risk as well as (1) the extent to which risk may be transferred from one subsidiary to another in a BHC and (2) the role of capitalization in a BHC and its effects on the riskiness of the organization. Second, additional attention is needed on the competitive effects of BHC affiliation. Existing work has been directed toward the effects on structure and not the implications for behavior, rivalry, and price-cost margins. Third, the work on efficiency and performance needs to be expanded with particular emphasis on the effects of alternative means of transferring funds within a system on measured efficiency. Fourth, there has been no analysis of the effects of BHCs on fund flows and allocation of resources.

Section II

A HISTORY OF THE BANK HOLDING COMPANY MOVEMENT 1900-1978

Donald T. Savage

In the last decade, the bank holding company has become an increasingly important form of American commercial banking organization. As of mid-1977, banks owned by holding companies operated over one-half of all commercial bank offices and held over 70% of all commercial bank assets. In addition, the 1,945 bank holding companies regulated by the Board of Governors of the Federal Reserve System controlled $50-$55 billion of assets in permissible nonbanking activities, an amount equal to approximately 5% of the assets of the commercial banking system. This paper traces the history of the bank holding company movement and the statutes by which bank holding companies are regulated.

Four interesting general observations emerge from this history. First, there has been a remarkable continuity of issues over the decades. For example, the use of the multibank holding company as a substitute for branching was an issue in the early 1900s and is still an issue today. Likewise, the objective of creating and maintaining a separation between commercial banking and other lines of commerce has persisted over the years.

Second, the bank holding company laws have been justified more as preventive measures than as corrective measures. Proponents of expanded bank holding company regulation have argued that new legislation was necessary to prevent the monopolization of banking by holding companies or the formation [illegible] large banking-industrial conglomerates. However, few specific bank holding company abuses were ever cited as justification for new legislation.

A third interesting observation is the length of time which was required to obtain comprehensive Federal regulation of nearly all bank holding companies and to achieve the present degree of separation of banking and nonbanking activities. Possibly because legislation was largely preventive rather than corrective in nature, the present degree of regulation of bank holding companies was achieved on an incremental basis over the years.

Fourth, the development of bank holding companies and the statutes governing their operation have unquestionably had a major impact on the American economy. It seems probably that the structure of American banking and industry would be quite different if: (1) bank holding companies had not developed; (2) greater branch banking powers had been permitted by the states or by Federal law; (3) bank holding companies had been allowed to expand interstate after 1956; or (4) if the nonbanking activities of bank holding companies had not been restricted.

The Origins of the Bank Holding Company

Although often classified as branch systems, the First and Second Banks of the United States and many of the state-owned banks organized in the 1800s were similar to holding companies because the various branches were able to exercise considerably more autonomy than the normal branch office. 1/ The modern form of bank holding company, however, is more an outgrowth of the chain bank than of these early, government-sponsored banks.

Chain banking, characterized as the ownership of more than one bank by an individual or small group of individuals, was most prevalent in the Midwest, Pacific Northwest and the South. According to Cartinhour, the

---

1/ Fischer, Gerald C., American Banking Structure (New York: Columbia University Press, 1968) pp. 11-17.

Beecher chain of banks, established in North Dakota in 1884, was the earliest known chain banking system. The Witham-Manley chain was one of the first large chains; organized in 1889, this chain contained over 180 banks which were located primarily in Georgia and Florida. The Witham chain failed as a result of the collapse of the Florida land boom in 1926. 1/

Group banking, the early term for a bank holding company, is the ownership of two or more banks by a separately organized corporation and is of somewhat later origin than chain banking. The development of the bank holding company depended upon amendments to state corporation laws to permit one corporation to purchase the stock of another corporation. In 1889 New Jersey became the first state to grant this power to corporations; prior to that time, holding companies were created by specific acts of state legislatures. Subsequent to the New Jersey action, several other states amended their statutes to permit the formation of holding companies. 2/

Group banking is usually distinguished from chain banking on the basis of corporate, rather than individual ownership, of bank stock. Two other differentiating factors are also cited in the early literature. First, group banking was characterized as being centered around a "lead" metropolitan

---

1/ Cartinhour, Gaines Thomson, Branch, Group and Chain Banking (New York: The Macmillan Company, 1931) pp. 82-87.

2/ Hogenson, Palmer T., The Economics of Group Banking (Washington, D.C.: Public Affairs Press, 1955) p. 10.

bank. Second, group banking usually had some form of central management while the chain banks did not provide centralized services. 1/

Cartinhour cites the Adam Hannah Company, organized in 1900 in Minnesota, as the first company established to hold the controlling stock interest in banks. 2/ The early holding companies were relatively small and usually identified with one individual in a manner not dissimilar from chain banking systems. The Bancitaly Corporation provides a significant exception to the size generalization, but as a rule the major forces for the expansion of group banking did not develop until the 1920s.

Bank Holding Companies in the 1920s

There are no data on group banking in the early 1920s. The earliest comprehensive study of group banking was conducted by the Federal Reserve System as part of the 1930 Hearings on Branch, Chain and Group Banking held by the House of Representatives. By that time, there were 287 groups and chains which controlled 2,103 of the 24,026 United States banks. Other data, which distinguished between groups and chains, indicated that there were 28 groups controlling 511 banks; these 511 banks held approximately 10% of the loans and investments of all banks in the United States. 3/

1/ Willit, Virgil, ed. Selected Articles on Chain, Group and Branch Banking (New York: The H.W. Wilson Company, 1930) p. 16.

2/ Cartinhour, Op. cit, p. 90.

3/ Fischer, Gerald C., Bank Holding Companies (New York: Columbia University Press, 1961) p. 31.

Forces for Bank Holding Company Expansion

The growth of bank holding companies in the 1920s has been attributed to several factors. First, the waves of failures among small rural banks during the agricultural depression of the 1920s created a need for some type of structural change to provide stable banking services in rural areas. The bank holding company provided services in areas left without banking services as a result of bank failures, offered a form of geographic risk-diversification, provided experienced bank managers who could draw on the resources of the lead bank in the holding company, and provided centralized services for the members of the group.

Second, the high level of business mergers during the 1920s is cited as a cause of holding company growth. Bankers, like other businessmen, desired to form larger firms and increase expected profit levels. The decline of local independent businesses and the growth of retail chain stores eliminated many of the customers of the independent small town bank and created a perceived need for larger banks to service the credit needs of growing nonfinancial businesses.

Third, the growth of some bank holding companies caused the formation of other holding companies as a protective reaction. For example, the major banks in Minnesota claimed to have formed holding companies as a device to protect their correspondent banking business from the encroachment of Eastern and Western banks which were buying stock in Midwestern banks. It was argued that by forming regional groups the dominance of credit markets by the New York banks could be avoided.

Fourth, restrictions on branch banking have always been cited as a major cause of holding company growth. With unit banking, the central city bank could not follow its customers to the suburbs. In addition, the hope or expectation that branching laws would be liberalized on a statewide or nationwide basis encouraged the formation and growth of holding companies as a foundation for future branch banking systems.

Finally, the rising stock market of the 1920s facilitated the sale of stock by the bank holding companies and offered profit-making opportunities to those promoting the sale of securities. Chain banking systems did not have as easy access to the capital markets and the relative advantage of the holding company form of multiple bank ownership increased as the public became more interested in bank holding company securities. 1/

As bank holding companies grew, there was also a growing concern, especially on the part of bank regulators, about the implications of the group banking movement. A basic concern was whether or not the banks owned by an unregulated holding company could be effectively supervised; groups composed of state and national banks and banks located in many different states presented an even more complex problem. 2/

1/ Fischer, Bank Holding Companies, Op. cit., pp. 19-27.

2/ Cartinhour, Op. cit., pp. 241-243.

Many regulators, and many independent bankers, expressed the fear that group banking would result in an excessive concentration of banking resources. In response to these fears, some states passed legislation forbidding the ownership of banks by holding companies. 1/

Until 1935, bank stockholders were liable to the bank's creditors for an amount equal to the par value of their stock. The effectiveness of this double liability provision was questionable when the sole stockholder was a holding company with no assets other than bank stock. While some groups held added assets to ensure that the holding company could meet its obligation as a bank stockholder, other groups made no provision for meeting this obligation. 2/ Some states required that bank holding companies assume the double liability responsibility. 3/

Other concerns were expressed during the 1920s as bank holding companies expanded. Fears included the impact of bad holding company management on a large number of banks, the possible failure of the lead bank to support small holding company subsidiaries, speculation in bank holding company stock, and the transfer of bad assets between the various banks in the group. 4/ The pressure for regulation of group banking was growing but action was to be delayed until the depression years.

1/ Hogenson, Op. cit., pp. 11-12.

2/ Willit, Op. cit., pp. 197-199.

3/ Cartinhour, Op. cit., p. 246.

4/ Ibid, pp. 242-254.

The Depression and Bank Holding Company Regulation

The 1930s brought bank failures and economic crisis on a scale never before experienced in the United States. This section outlines the impact of the depression on bank holding companies, state bank holding company legislation, and the enactment and enforcement of the bank holding company provisions of the Banking Act of 1933.

The Impact of the Depression

The bank failures of the 1930s had both positive and negative effects on the bank holding company movement. Naturally, many bank subsidiaries and parent holding companies failed. The holding company subsidiary bank failure rate appears, however, to be about one-half the failure rate for all banks. If the failures of two large Detroit bank holding companies[1/] could have been averted, the survival rate of bank holding companies would have been outstanding because these two groups accounted for nearly one-half of the $1.5 billion of total deposits in suspended group banks in the years 1930-1934. During the 1930-1934 period, 201 banks in 40 groups failed.

As of the end of 1931 there were 97 groups with 978 banks. By the end of 1936 there were 52 groups with 479 banks; 42 of the 52 groups had been on the 1931 list of groups. Ten new groups were added during the period and 55 were dropped from the list. Of the 55 groups not on the 1936 list,

---

1/ The Detroit failures resulted from both the impact of the depression on the Detroit economy and the management practices of the bank holding companies. The holding companies depleted bank capital to maintain dividends and allowed insider loans and loans secured by holding company stock. See: Fischer, Bank Holding Companies, Op. cit., pp. 54-56.

24 were dropped because of holding company insolvency, 17 were dropped because of the conversion of banks to branches, and 14 were excluded because of reclassifications or dissolution of the holding company.

The 55 bank holding companies which were dropped from the holding company list between 1931 and 1936 controlled 367 banks. Of these banks, 190 suspended payment, 100 were converted to branches, 34 were merged, absorbed, consolidated or voluntarily liquidated and 43 were eliminated from group bank classification. 1/

In some cases, the depression years provided some expansion opportunities for bank holding companies. Transamerica Corporation was asked by the Governor of Nevada to provide banking services in that state after suspensions closed many of the state's banks. In other cases, the announcement of a bank's affiliation with a large holding company was sufficient to restore confidence in the bank and end a run on the bank. Many of the lead banks of holding companies were able to provide sufficient funds to their smaller subsidiaries and prevent failures. In 1932-1934, 127 banks in 39 groups suspended; this represented 13% of group banks. By contrast, for all commercial banks the failure rate was 28.4%, or 5,510 of 19,375 banks. The lower failure rate of group banks tended to weaken the anti-holding company forces.

1/ "Group Banking in the United States," 24 Federal Reserve Bulletin (1938) pp. 97-101.

State Regulation of Bank Holding Companies

Pressure for the regulation of bank holding companies arose very early in the development of group banking. In 1909, the Commissioner of Banking in Wisconsin warned of the threat of monopoly control of banking and cited the purchase of several Wisconsin banks by the Minnesota holding companies. He advocated legislation "to discourage this evil in every proper manner." 1/

Several states attempted to control specific problems associated with the holding company movement but these efforts were not judged to be very effective. A few states, such as New Jersey and West Virginia, simply prohibited the purchase of bank stock by holding companies, but in most states legislation was not enacted or did not prevent holding company growth. 2/

In 1929, Wisconsin passed legislation which extended double liability provisions to the owners of bank holding company stock, required out-of-state holding companies to qualify to do business in Wisconsin, and subjected bank holding companies to the supervision of the State Banking Department. 3/ The Wisconsin legislation was probably the most comprehensive state law on the subject at the time.

1/ Willit, *Op. cit.*, p. 124.

2/ Cartinhour, *Op. cit.*, pp. 201-206.

3/ *Ibid.*, pp. 200-201.

Federal Legislation in 1933

The depression of the 1930s and the massive bank failures of the period transferred the pressures for action from the states to the Federal level. The question of the value of bank holding companies became entangled with the analysis of the causes of bank failures and the search for more stable forms of banking structure. All of the pressures and problems came together in the 1930 Hearings on Branch, Group and Chain Banking 1/ held by the Committee on Banking and Currency of the House of Representatives.

Five bills were considered within the context of the 1930 Hearings; these bills ranged from providing for expanded examinations of holding companies to the abolition of holding companies. 2/ The first Federal bank holding company legislation, which was incorporated in the Banking Act of 1933, was introduced by Senator Glass.

The Banking Act of 1933

While the Banking Act of 1933 3/ is remembered mainly for establishing the bank deposit insurance system, it also started the process of regulating bank holding companies. The 1933 Act defined a holding company as:

1/ House of Representatives of the United States, Hearings before the Committee on Banking and Currency, Branch, Group and Chain Banking, 71st Congress, 2nd Session, (Washington, D.C.: United States Government Printing Office, 1930).

2/ For details of the various bills, see: Fischer, Bank Holding Companies, Op. cit., pp. 60-61.

3/ 48 Stat. 162 (1933).

> ...any corporation, business trust, association or other similar organization - (1) Which owns or controls, directly or indirectly, either a majority of the shares of capital stock of a member bank or more than 50 per centum of the number of shares voted for the election of directors of any one bank at the preceding election, or controls in any manner the election of the majority of directors of any one bank; or (2) For the benefit of whose shareholders or members all or substantially all the capital of a member bank is held by trustees. 1/

This definition of a holding company has several key features, some of which were to cause subsequent problems. First, majority ownership of the bank was the basic standard for defining control of the bank.

Second, the 1933 Act covered only those holding companies which owned a Federal Reserve member bank. A group composed exclusively of state nonmember banks was not subject to the provisions of the law. Thus, any holding company which desired to escape regulation could convert its national banks and state member banks to state nonmember banks.

Third, one-bank holding companies were covered by the 1933 Act. Two years later, the Banking Act of 1935 included a provision which resulted in most one-bank holding companies being granted exemptions from the 1933 Act. The Banking Act of 1935 exempted:

> ...any organization which is determined by the Board of Governors of the Federal Reserve System not to be engaged, directly or indirectly, as a business in holding the stock of, or managing or controlling, banks, banking associations, savings banks, or trust companies. 2/

1/ 48 Stat. 162 (1933) §2c.

2/ 49 Stat. 684 (1935) §301.

The Federal Reserve interpreted this provision to exempt organizations which were technically not engaged in the group banking business. One bank was not a group and most of the exemptions granted by the Board were for one-bank holding companies.1/

The holding companies subject to the Act were required to apply to the Federal Reserve for a permit to vote their stock for the election of directors of subsidiary banks. In acting upon applications for voting permits, the Board was required to consider the applicant's financial condition, the character of management, and the effect of the granting of a permit on the subsidiary banks.

As a condition of receiving a permit, the law required that: (1) bank holding companies, as well as their subsidiary banks, be subject to examination; (2) all subsidiary banks be subject to examination individually and in conjunction with the examination of other subsidiary banks and the holding company; (3) individual or consolidated statements of condition of subsidiary banks be published and made available to the regulators; (4) the holding company maintain a reserve fund of marketable assets which would eventually grow to 25% of the par value of bank stocks owned by the holding company (this provision was reduced by the Banking Act of 1935 which eliminated the double liability provisions of national bank stock and reduced the necessary amount of holding company reserves); 2/ (5) bank

---

1/ "Group Banking in the United States," Op. cit., p. 98.

2/ Fischer, Bank Holding Companies, Op. cit., p. 64.

holding company employees be subject to the criminal penalties applicable to bank employees for crimes such as false entries; (6) securities companies be separated from bank holding companies within 5 years; and, (7) bank holding companies not pay dividends from funds other than their net earnings.1/

The Banking Act of 1933 also amended the Federal Reserve Act by adding Section 23A to control loans by banks to their affiliates and to other holding company affiliates. The general rule that a bank could not lend more than 10% of its capital and surplus to any one affiliate and no more than 20% of capital and surplus to all affiliates combined was intended to limit problems such as those which had arisen from bank financing of affiliated securities firms.

Acting under the 1933 Act, the Federal Reserve System developed regulations 2/ and considered applications for voting permits. As applications were received, the Federal Reserve examined the holding company and its affiliates before issuing a voting permit. Records indicate that 125 general voting permits were issued in the 1934-1956 period. More frequently, the Federal Reserve issued limited voting permits pending the satisfaction of conditions imposed upon the holding company. In the 1934-1956 period, 517 limited permits were granted; most of the permits were issued prior to 1936. 3/ In addition, under the Banking Act of 1935,

---

1/ "Group Banking in the United States," Op. cit., p. 98.

2/ Regulation P, Series of 1933. 1933 Annual Report of the Board of Governors of the Federal Reserve System, pp. 304-312.

3/ Data compiled from the Annual Report of the Board of Governors of the Federal Reserve System, 1934-1956.

the Board of Governors exempted 202 organizations, mostly one-bank holding companies, from regulation under the Act.

While the 1933 legislation addressed some of the problems identified by the critics of the bank holding company movement, many difficulties remained to be reconsidered in future legislation. Other than being required to divest affiliates engaged in the underwriting or distribution of securities, bank holding companies were still free to engage in any other line of commerce. The interstate operations of holding companies were not limited and no provisions were made to regulate new bank acquisitions by holding companies. As indicated, one-bank holding companies were usually exempted and groups composed exclusively of non-member banks were not regulated. On the latter point, Lamb indicates that "in a few minor instances group banks have withdrawn from membership in the Federal Reserve System to avoid the need for voting permits..." 1/

The Bank Holding Company Act of 1956

The Banking Act of 1933 left problems unresolved and the pressures for greater regulation of bank holding companies continued. This section examines developments during the period between the Banking Act of 1933 and the 1956 Act, discusses the Bank Holding Company Act of 1956, and considers policy actions under the 1956 Act.

1/ Lamb, W. Ralph, Group Banking (New Brunswick, New Jersey: Rutgers University Press, 1962) p. 177.

Pressures for Legislation, 1933-1956

The pressure for new legislation continued even though the relative size and importance of bank holding companies did not increase. Data on the number of bank holding companies are not available on a consistent definitional basis. In 1936, there were 52 holding companies (defined as groups containing three or more banks) which controlled banks holding 14% of commercial bank deposits in the United States. By 1945, using the three bank definition, there were 33 bank holding companies controlling 12% of deposits. As of 1954, there were 46 holding companies controlling only 8% of deposits even though a bank holding company was defined on the basis of owning 25% or more of two or more banks. Thus, given that the definition of a bank holding company for data presentation was liberalized over the period, the relative importance of holding companies appears to have declined. 1/

The 1933-1956 period brought a continuing flow of proposed bank holding company legislation. In 1937, Senator McAdoo proposed limiting a bank holding company to ownership of 10% or less of the stock of a member bank; at the same time, he proposed permitting greater branching powers for national banks. In 1938, President Roosevelt proposed the elimination of all holding companies -- both banking and nonbanking. 2/

Even World War II did not eliminate the concern with bank holding companies. Bills continued to be introduced and the Federal Reserve Board, in its 1943 Annual Report, listed the deficiencies of the 1933 legislation

---

1/ These, and other data, can be found in Fischer, American Banking Structure, Op. cit., p. 97.

2/ Cartinhour, Op. cit., pp. 64-65.

and proposed "that immediate legislation be enacted preventing further expansion of existing bank holding companies or the creation of new bank holding companies." 1/

In the post World War II period, interest in new legislation continued and grew. Between mid-1949 and mid-1955, fifteen bank holding company bills were introduced in the Congress. Support for new legislation was increased in 1953 when the Supreme Court failed to set aside the Court of Appeals' decision against the Board of Governors in the Transamerica case. The Federal Reserve had charged that Transamerica had violated Section 7 of the Clayton Act by its purchases of banks in five Western states. While Transamerica did hold substantial percentages of total deposits in these states, the Board failed to show evidence of a reduction of competition in local markets. The Board's unsuccessful case was based on statewide concentration, but the courts narrowed the relevant market area to local communities and the majority of Transamerica's purchases had been in localities where the company had not acquired other banks. 2/

The forces working for and against enactment of a bank holding company bill were fairly constant over the period. In the later years, the issue of multibank holding companies as a substitute for branching appeared to become relatively less important and the desire to abolish holding companies became a desire to increase regulation. Concern for the maintenance of competition in both banking and nonbanking activities

---

1/ 1943 Annual Report of the Board of Governors of the Federal Reserve System, p. 37.

2/ Fischer, Bank Holding Companies, Op. cit., pp. 68-69.

continued over the period. Delays in the passage of new legislation resulted from the lack of significant bank holding company abuses, questions relative to the division of regulatory responsibilities between the Federal banking agencies, and concern over the role of state bank holding company regulations. 1/

The Bank Holding Company Act of 1956

The Bank Holding Company Act of 1956 was a compromise between the various interested groups. The Act solved some, but not all, of the problems encountered by the Federal Reserve System in its administration of the 1933 legislation. By 1956, the Board of Governors was stressing the need for changes in the holding company law, rather than the opposition to holding companies expressed in its 1943 Annual Report.

I. Definition of a Bank Holding Company.

As was to be the case in subsequent legislation, a key part of the 1956 Act was achieving agreement on the definition of a bank holding company. When finally enacted, the Act defined a bank holding company as an organization owning 25% or more of the stock of two or more banks. The Federal Reserve testified that 50% ownership would be an adequate cut-off point to indicate control of the bank, but was not opposed to the 25% definition. The Board wanted to include one-bank holding companies under the law in order to achieve the separation of bank and nonbanking activities. The Congress,

---

1/ Fischer, Bank Holding Companies, Op. cit., p. 69.

however, chose to exclude the one-bank holding companies. 1/

The definition of a bank holding company included those cases in which the company was able to control the election of a majority of the directors of two or more banks, or a trust which held 25% or more to the stock of two or more banks. Exemptions were granted for: (1) fiduciary ownership of stock; (2) companies registered under the Investment Company Act of 1940; (3) shares held during a securities underwriting or for proxy solicitations; (4) cases in which 80% of the assets of the company were in agriculture; (5) religious, educational or charitable organizations; and (6) partnerships.

II. Coverage of the Act

The Bank Holding Company Act of 1956 applied to all subsidiary banks, rather than being limited to Federal Reserve System member banks. Prior approval of the Board of Governors was required for any organization to: (1) become a bank holding company; (2) acquire stock in a bank if the purchase would result in ownership of more than 5% of the bank's stock; or (3) acquire the assets of a bank or merge with another bank holding company.

III. Expansion of Bank Holding Companies

The Bank Holding Company Act of 1956 established standards for the Board of Governors to use in considering applications to form bank holding

---

1/ "Memorandum of the Views of the Board of Governors of the Federal Reserve System Regarding Bank Holding Company Legislation Submitted to the Senate Banking and Currency Committee on July 5, 1955," Control of Bank Holding Companies, Hearings before a Subcommittee of the Committee on Banking and Currency, United States Senate, 84th Congress, 1st Session, (Washington, D.C., United States Government Printing Office, 1955) pp. 76-77.

companies and applications for the acquisition of a bank by a bank holding company. The factors to be considered were:

> (1) the financial history and condition of 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 area concerned, and (5) whether or not the effect of such 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. 1/

The first four factors to be considered were relatively clear but the fifth factor established no guidelines and proved to be a problem in the subsequent administration of the Act.

The Act also limited bank holding company expansion by prohibiting future interstate bank acquisitions by holding companies unless such acquisitions were specifically authorized by the statutes of the state in which the bank was located. Given that no state had a statute authorizing acquisitions by out-of-state holding companies, the formation of nationwide holding company systems was prevented. Existing interstate holding companies were allowed to retain their subsidiary banks.

The potential expansion of bank holding companies was also limited by reserving to the states the right to restrict bank holding companies. Thus, a state could prohibit bank holding companies or could pass on individual holding company applications before the application came before the Board of Governors. The Board was also required to seek the opinion of state banking agencies in cases involving state-chartered banks or the opinion of the Comptroller of the Currency in cases involving national banks.

1/ Public Law 511, Chapter 240, 84th Congress, 2nd Session, H.R. 6227 § 3(c).

IV. Nonbanking Activities

One of the long-standing objectives, which was accomplished by the 1956 Act, was the separation of nonbank-related activities from multibank holding companies. The Act prohibited ownership of shares in nonbank corporations, other than approved bank-related activities, and required bank holding companies to divest shares of nonbank-related businesses within two years.

The 1956 Act allowed multibank holding companies to engage in certain activities -- owning and managing bank holding company property, providing services to subsidiary banks, operating a safe deposit company, or liquidating property acquired by subsidiary banks. Beyond these specifically permitted activities, the Board of Governors was permitted to allow other nonbanking activities which were "of a financial, fiduciary, or insurance nature" if these activities could pass the test of being "so closely related to the business of banking or managing or controlling banks as to be a proper incident thereto." 1/ 2/ Thus, the basic principle of separation of banking and other lines of commerce was established for multibank holding companies. Another 14 years would be required to extend this provision to one-bank holding companies.

V. Other Provisions of the 1956 Act

The 1956 Act provided the statutory powers for the Board of Governors to require bank holding company reporting and to issue regulations to carry out the intent of the Act. Provisions were also made in the Act to prohibit

---

1/ Public Law 511, Chapter 240, 84th Congress, 2nd Session, H.R. 6227 §4(c)(6).

2/ In several cases the Board permitted the operation of insurance agencies, but there were very few applications to engage in nonbanking activities other than those specifically permitted by the Act.

nearly all transactions between banks and holding company affiliates with minor exceptions in cases of transactions between sister bank subsidiaries.

Regulation Under the Bank Holding Company Act of 1956

During the period 1956-1965, the Board of Governors considered 21 applications for the formation of bank holding companies and approved 15 of these applications. In the same period, 95 applications for the acquisition of banks under Section 3(a)(3) were filed and 80 were approved. 1/ Seventeen of the 95 acquisition applications were to acquire newly formed banks and the remainder were for existing banks. 2/

Hall's analysis of the Board's actions during the period suggests that applications which did not change the existing structure of the market were approved and those applications which changed market structure were denied. 3/ He indicated that the Board had given little weight to the benefits to the community or the banks, had evaluated competition in terms of the effect of the proposed acquisition on other banks, and had measured size 4/ as either: (1) overlap of markets; (2) deposits involved; (3) rank of the banks in their markets; or (4) resources controlled by all holding companies in the market area.

1/ Annual data are found in Jessee, Michael A. and Steven A. Seelig, Bank Holding Companies and the Public Interest (Lexington, Mass.: Lexington Books, D.C. Heath & Co., 1977) p. 14.

2/ Compiled from historical records at the Federal Reserve Board, Washington, D.C.

3/ Hall, George R., "Bank Holding Company Regulation," Southern Economic Journal, XXI (April, 1965) pp. 342-355.

4/ Size refers here to the "...size and extent of the bank holding company system..." test provided for the last of the five factors to be considered by the Board in evaluating bank holding company applications.

In the First New York Corporation case, Hall found absolute size of deposits involved to be the important factor because the proposal would have created a system twice as big as the next largest system. The absolute amount of deposit overlap, and size relative to competitors were cited as factors in the denial of the Morgan New York State case. Relative size in the market, amount of deposits in the market controlled by holding companies, and effect on competitors were cited as factors in the Pipestone decision. 1/

Backman also examined the early cases decided under the 1956 Act. Backman indicated that the consideration of financial history and condition, prospects, and management had been pro forma and were always found to be satisfactory. He also argued that "a given degree of concentration has been viewed as more anticompetitive when accounted for by a holding company than by an independent bank." 2/

On the nonbanking side, only five companies were affected by the divestiture requirements of the 1956 Act. Several companies were exempted by Congress in order to prevent hardships. The largest organization affected was Transamerica Corporation; indeed, Transamerica, as well as at least one Senator, felt that the law was written with Transamerica as its primary target. 3/ Transamerica formed Firstamerica Corporation to assume its banking assets, distributed the Firstamerica stock to the Transamerica stockholders, and ceased to be a bank holding company.

1/ Hall, George R., Op. cit., pp. 348-351.

2/ Backman, Jules, "The Bank Holding Company Act," The Bulletin of the C.J. Devine Institute of Finance. New York University Graduate School of Business Administration. Bulletin No. 24-25, (April-June, 1963), p. 46.

3/ Klebaner, Benjamin J., "The Bank Holding Company Act of 1956," Southern Economic Journal XXIV (January, 1958), pp. 313-326.

During the period 1956-1965, bank holding company expansion was relatively limited, and the holding company share of total bank deposits did not show a significant amount of growth. At the end of 1956, there were 47 separate bank holding company groups (after eliminating duplications arising from the ownership of one holding company by another holding company). These 47 groups controlled 428 banks (3.2% of all insured commercial banks) and 1,211 banking offices (5.7% of all offices of insured commercial banks). In terms of total deposits, bank holding company subsidiary banks held 7.6% of total deposits in insured banks.

At the end of 1965, there were 48 separate bank holding companies controlling 468 banks (3.5% of insured commercial banks) and 1,954 banking offices (6.6% of all banking offices). Deposits in holding company banks were 8.3% of total deposits in all insured banks.

By the end of 1965, multibank holding companies registered under the 1956 Act were operating in 32 states. In 20 of these states (16 states in 1956) bank holding companies held more than 10% of total commercial bank deposits. In 11 states (10 states in 1956) they held more than 30% of total deposits and in 3 states (3 states in 1956) registered bank holding companies held more than 50% of total deposits. 1/ 2/

In spite of the fact that bank holding company growth in the 1956-1965 period was not very great, pressure continued for revisions of the 1956 Act. The problems of the 1956 Act are discussed in the following section.

1/ Board of Governors of the Federal Reserve System, Banking and Monetary Statistics 1941-1970 (Washington, D.C.: Board of Governors of the Federal Reserve System, 1976) pp. 133, 444, and 453.

2/ For added analysis of the growth of multibank holding companies see: Boczar, Gregory E., "The Growth of Multibank Holding Companies: 1956-1973" Staff Economic Studies 85. (Washington, D.C.: Board of Governors of the Federal Reserve System, 1976.)

The 1966 Amendments to the Bank Holding Company Act of 1956

The passage of the Bank Holding Company Act of 1956 left some issues unresolved and the Federal Reserve encountered some difficulties with the 1956 Act. This section covers the problems of the 1956 Act, the 1966 Amendments to the Act, and policy actions under the Amended Act.

Problems of the 1956 Legislation

The 1956 Act required the Board of Governors to file, within two years of the passage of the Act, a report to the Congress describing any difficulties with the administration of the Act. This report, submitted on May 7, 1958, contained 25 detailed recommendations for amendments to, or clarifications of, the Act.

The first problem cited by the Board was the difficulty of balancing the convenience and needs, financial history and condition, prospects, and management factors against the fifth factor, the effect of approval on the public interest, the size and extent of the holding company and the preservation of competition. The Report cited the case in which a bank holding company having a large share of the market applies to establish a new bank in a community needing additional banking services. What trade-off should be made between the convenience and needs of the community and the expansion of the market share of the holding company?

Other questions and issues raised by the Board included: (1) the weight to be given to state bank holding company laws; (2) the restrictions placed on transactions between banks in a holding company; and (3) the issue of inclusion of one-bank holding companies.[1/]

The 1966 Amendments

The 1966 Amendments eliminated some of the exemptions from the 1956 Act and expanded the number of organizations covered by the Act. The major exemptions eliminated were for registered investment companies and their affiliates, religious, charitable and educational institutions, and nonbusiness long term trusts. The two major organizations brought under the provisions of the amended Act were the Alfred I. Dupont Estate (which controlled 30 banks as well as many nonbanking enterprises) and Financial General Corporation (which through subsidiaries owned 21 banks in five states and the District of Columbia).

The 1966 Amendments eliminated the voting certificate requirements applied by the Banking Act of 1933. In addition, the 1966 Amendments repealed Section 6 of the 1956 Act. Section 6 had been intended to prevent unsound financial transactions between the subsidiary banks and between the subsidiary banks and the parent holding company, but had prohibited all normal banking transactions between the subsidiary banks, except for certain non-interest-bearing deposit transactions. The 1966 Amendments

---

1/ "Report Under Bank Holding Company Act" 44 Federal Reserve Bulletin (1958) pp. 776-796.

applied Section 23A of the Federal Reserve Act to transactions between a subsidiary bank and its parent holding company and sister subsidiaries. Transactions between sister bank subsidiaries which were exempted from Section 23A were the previously permitted deposit relationships and the purchase of loans on a non-recourse basis.

The major portion of the 1966 Amendments dealt with the development of revised standards for the evaluation of holding company applications. Early in 1966, the Congress had amended the Bank Merger Act of 1960 in order to correct for the different competitive standards applied by the three Federal banking agencies and to adjust for the Supreme Court's rulings in the Philadelphia National Bank and Lexington Bank cases. 1/

The competitive standards applied to bank mergers by the 1966 Amendments to the Bank Merger Act of 1960 were also placed in the 1966 Amendments to the Bank Holding Company Act of 1956. These standards now require the Board of Governors to deny:

(1) any acquisition or merger or consolidation under this section which would result in a monopoly, or which would 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, or

(2) any other proposed acquisition or merger or consolidation under this section whose effect in any section of the country may be substantially to lessen competition, or to tend to

1/ For discussions of bank merger legislation and cases, see: Hall, George R. and Charles F. Phillips, Jr., Bank Mergers and the Regulatory Agencies (Washington, D.C.: The Board of Governors of the Federal Reserve System, 1964); Kintner, Earl W. and Hugh C. Hansen, "A Review of the Law of Bank Mergers:, Boston College Industrial and Commercial Law Review XIV (December, 1972); and Edwards, Franklin R., "Bank Mergers and the Public Interest: A Legal and Economic Analysis of the 1966 Bank Merger Act" Banking Law Journal LXXXV (September, 1968).

> create a monopoly, or which in any other manner would be in restraint of trade, unless it finds that the anti-competitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served. 1/

The new standards apply the Sherman Act and Clayton Act tests to bank holding company regulation. The Board cannot approve any application which would violate the Sherman Act. Applications which would violate Section 7 of the Clayton Act cannot be approved unless the Board finds that the anticompetitive effects are clearly outweighed by the convenience and needs of the community.

Policy Actions and Bank Holding Companies, 1966-1970

During the years 1966 through 1970, multibank holding companies grew quite rapidly. By the end of 1970, there were 111 separate bank holding companies controlling 895 banks (6.6% of insured commercial banks) and 4,155 banking offices (11.8% of all banking offices). Deposits in holding company banks were 16.2% of total deposits in all commercial banks. 2/ Between the end of 1965 and the end of 1970, the multibank holding company share of

---

1/ 80 Stat. 237 §3(c).

2/ Banking and Monetary Statistics, 1941-1970, Op. cit., pp. 139, 443, 458.

total deposits had nearly doubled. 1/ During this five year period there were 81 applications to form new bank holding companies compared to only 21 in the previous 10 years. The number of applications to acquire banks also increased rapidly during the period; 261 applications were considered, compared to only 95 in the previous 10 years. 2/ Twenty-two of the applications to acquire banks were for de novo banks organized by the applicant holding company.

The 1970 Amendments to the Bank Holding Company Act of 1956

The 1970 Amendments extended coverage of the 1956 Act to include the ownership of banks by partnerships and gave the Board of Governors the power to determine that an organization is a bank holding company by virtue of its ability to control a bank without owning 25% of the stock. Reflecting the rapidly rising number of one-bank holding companies in the late 1960s, the focus of the 1970 Amendments was on the regulation of one-bank holding companies and the nonbanking activities of bank holding companies.

1/ The one bank holding company is considered in the next section.

2/ Jessee and Seelig, Op. cit., p. 14.

The Growth of One-Bank Holding Companies

Many one-bank holding companies had been exempted, by the Board, from the holding company provisions of the Banking Act of 1933 and the 1956 Act had excluded one-bank holding companies from regulation. Most one-bank holding companies existing prior to 1956 were relatively small, were located in unit banking states, and their nonbank activities -- mainly real estate and insurance agencies -- were primarily local activities. In 1956 there were only 117 unregulated one-bank holding companies with total deposits of $11.6 billion. 1/ By 1965, there were 550 one-bank holding companies but the major banks had not yet converted to one-bank holding company status. In 1956-1960 there were 53 one-bank holding company formations, but in 1960-1966 there were 291 formations. From 1966 to June 1968, 201 more one-bank holding companies were formed and from June 1968 to the end of 1970 there were 690 more new one-bank holding companies created. 2/

Some reasons for the rapid growth of one-bank holding companies can be cited, but there may be others. Those cited include: (1) the ability to use the holding company as a means of raising funds free from the

---

1/ Upshaw, William F., "Antitrust and the New Bank Holding Company Act: Part III", Monthly Review, Federal Reserve Bank of Richmond (April 1971) pp. 3-8.

2/ "One-Bank Holding Companies Before the 1970 Amendments" 58 Federal Reserve Bulletin, (1972) pp. 99-1008.

constraint of Regulation Q interest rate ceilings and Regulation D reserve requirements (until 1973); (2) the economies of scale achieved by using expensive bank data processing equipment for other nonbanking activities; (3) the legal obstacles and court challenges to attempted bank diversification into other activities; 1/ and (4) the geographic expansion across state lines which was permissible for nonbank activities but not for banks.

The growth in the number of one-bank holding companies and the formation of one-bank holding companies by many of the nation's largest banks aroused the fears of bank regulators, the Congress, independent banks, and the independent competitors of the nonbank subsidiaries of bank holding companies. A staff report of the Banking and Currency Committee of the House of Representatives indicated Congressional concern that unregulated one-bank holding companies would: (1) require the bank subsidiary to lend excessively to nonbank subsidiaries; (2) force the bank subsidiary to discriminate against the competitors of the nonbank subsidiaries; and (3) force bank customers to patronize the other companies in the holding company as a condition of receiving credit from the bank subsidiary. 2/ There were also fears that if a bank were allowed to be part of a large conglomerate, American industry would develop along the lines of the

---

1/ Upshaw, Op. cit., pp. 4-5.

2/ The Growth of Unregistered Bank Holding Companies - Problems and Prospects, Staff Report for the Committee on Banking and Currency, United States House of Represenatatives, 91st Congress 1st Session (Washington, D.C.: United States Government Printing Office, February 11, 1969) p. 2.

Japanese zaibatsu. Finally, there was concern over the ability of non-holding company banks to compete with the wide range of financial services offered by the one-bank holding companies. 1/

The passage of the 1970 Amendments to the Bank Holding Company Act of 1956 involved a long and complex political struggle and there were substantial changes in the form of the original bills considered by the Congress. Congressman Patman's bill was introduced on February 17, 1969, but final legislation was not enacted until December 18, 1970. Passage of a bill was delayed by controversies over the division of regulatory responsibilities between the various Federal banking agencies, possible exemptions for small bank holding companies, anti-tying provisions, attempts to prohibit some nonbanking activities, and "grandfather" provisions. 2/

Provisions of the 1970 Amendments

The following subsections deal with the provisions of the 1970 Amendments, as enacted, and some of the various alternatives considered in the legislative process.

(1) Coverage of One-Bank Holding Companies

All of the bills considered by the Congress extended regulation to one-bank holding companies, as the Federal Reserve System had suggested annually for decades. There was some move in the Senate to exempt small one-bank holding companies and conglomerates from the coverage of Section 4 (dealing

1/ Weiss, Steven J., "Bank Holding Companies and Public Policy," New England Economic Review (Boston: Federal Reserve Bank of Boston, January/February 1969) p. 27.

2/ A complete history of the development of the 1970 Amendments can be found in Jessee and Seelig, Op. cit., pp. 19-32.

with nonbanking activities) but this provision was eliminated by the Conference Committee and the Board of Governors was given statutory power to exempt one-bank holding companies under certain conditions. 1/

(2) Nonbanking Activities

The House version of the bill restricted the definition of permitted nonbanking activities and included a list of prohibited activities. The final Act left the determination of permitted activities to the Board of Governors under the conditions that: (1) activities must be "so closely related to banking or managing or controlling banks as to be a proper incident thereto," and; (2) that the performance of any activity by a holding company subsidiary must "reasonably be expected to produce benefits to the public, such as greater convenience, increased 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." 2/ In addition, the Board of Governors was authorized to differentiate between applications to engage in an activity through a de novo subsidiary and application to engage in an activity through the acquisition of an existing firm.

1/ 84 Stat. 1763.

2/ 84 Stat. 1763.

(3) Grandfathered activities

The Senate version of the 1970 Amendments allowed bank holding companies to continue engaging in those nonbanking activities begun before June 30, 1968 and this approach was ultimately selected over the House of Representatives' approach, which would have required divestitute of all impermissible activities begun after the passage of the Bank Holding Company Act of 1956. The Board was given two years to review the grandfathered activities of bank holding companies with assets in excess of $60 million. Banks engaged in activities not permitted by the Board of Governors were given until December 31, 1980 to divest either their banks or their impermissible activities.

(4) Anti-tying provisions

The 1970 Amendments included the Senate prohibitions against bank holding companies requiring the users of bank services to also use the services of nonbank subsidiaries of the holding company.

(5) Adminstration of the Act

The administration of the amended Bank Holding Company Act of 1956 was left with the Board of Governors of the Federal Reserve System. The Administration's original bill would have divided the regulatory responsibility between the three Federal banking agencies, as in the regulation of bank mergers. Other proposals would have divided the responsibility for approving nonbank acquisitions. 1/

1/ Jessee and Seelig, Op. cit., pp. 19-26.

With the passage of the 1970 Amendments, the two major objectives of bank holding company regulation were achieved; most bank holding companies were subject to regulation, and statutory and regulatory controls were placed on the expansion of bank holding companies into other businesses.

Bank Holding Companies and Regulation after the 1970 Amendments

The years 1971-1976 were active years for the formation and expansion of bank holding companies; the numbers of new formations and acquisitions rose through 1973 and then continued at lower levels through the rest of the period.

In the period 1971-1976, 745 applications to form holding companies were approved and 57 were denied. Approvals of bank acquisitions totalled 1,377 (including 288 acquisitions of de novo banks organized by holding companies) and another 92 applications were denied. 1/

For nonbanking activities, the Board, in the period 1971-1977, approved 17 types of nonbank activities and denied 11. For the period 1971-1976, there were 2,753 approved applications to engage in these activities. 2/ 3/

By the end of 1976, bank holding companies were operating in all 50 states and the District of Columbia. 25.8% of all banks were owned by bank holding companies; one-bank holding companies owned 10.2% of all banks

---

1/ Jessee and Seelig, Op. cit., p. 14 and 1976 Annual Report of the Board of Governors of the Federal Reserve System, p. 410.

2/ Jessee and Seelig, Op. cit., p. 36 and 1976 Annual Report of the Board of Governors of the Federal Reserve System, p. 410.

3/ For added detail on entry into nonbanking activities in the 1971-1973 period, see also, Rhoades, Stephen A., "Changes in the Structure of Bank Holding Companies Since 1970," Journal of Bank Administration (October, 1976) pp. 64-69.

and multibank holding companies owned 15.6% of all banks. In terms of banking offices, 50.2% were owned by holding companies with the division being 26.3% by multibank holding companies and 23.9% owned by one-bank holding companies. By the end of 1976, 66.1% of all commercial bank deposits were held by subsidiaries of bank holding companies. Multibank holding companies held 34.2% of total deposits and one-bank holding companies held 31.9% of total commercial bank deposits. 1/

Although bank holding companies operated in all states by the end of 1976, deposit shares varied widely. Bank holding companies held 10% or less of total deposits in only one state. In six states, the share of holding companies was between 10% and 30% of total deposits. A 30% to 50% deposit share was held in nine states and in 26 states the share was in the 50% to 75% range. In nine states the holding company share of deposits exceeded 75%. 2/

In administering the Bank Holding Company Act, the Board of Governors developed many policies to cover specific types of cases. One policy, which has been a consistent concern of the Board, is that a bank holding company should be a source of strength to its subsidiary banks and should maintain adequate capital in its subsidiary banks. The Board's concern in this area was reflected in the adoption of the "go slow" policy in 1974. During 1974, the Board denied applications to engage in foreign

---

1/ Board of Governors of the Federal Reserve System, Annual Statistical Digest 1972-1976 (Washington, D.C.: Board of Governors of the Federal Reserve System, 1977), p. 314.

2/ Ibid, pp. 311-313.

ventures by Bankamerica Corporation, 1/ First National City Overseas Investment Corporation, 2/ and First Chicago International Finance Corporation. 3/ In all of these cases, the Board indicated that it would prefer to see funds devoted to improving the capital position of the applicant's subsidiary banks. Given that these applications were for relatively small subsidiaries of very large organizations, the denials represented a clear policy move.

In December 1974, Governor Holland 4/ spelled out the problems of concern to the Board which had resulted in the adoption of the "go slow" policy. The Board was concerned with bank failures, the deterioration of bank capital, heavy reliance on liability management, excessive loan commitments, deterioration in the quality of bank assets, foreign exchange risks, and the slow resolution of problem bank cases. Governor Holland indicated that:

> The policy is evident in cases in which we have felt that either an organization's capital or its liquidity positions have been stretched. We have denied, in such cases, applications for acquisitions of other firms in permissible lines of activity, except when we felt the public benefits of a particular acquisition were exceedingly strong. We have also refused, for the time being, to add new lines of activity to the permissible list for bank holding companies.

As of the end of 1977, it appeared that the "go slow" policy was, at least partially, still in effect. The volume of applications

---

1/ 60 Federal Reserve Bulletin (1974) pp. 517-519.

2/ 60 Federal Reserve Bulletin (1974) pp. 521-522.

3/ 60 Federal Reserve Bulletin (1974) pp. 519-521.

4/ Statement by Robert C. Holland, Member, Board of Governors of the Federal Reserve System, before the Subcommittee on Bank Supervision and Insurance of the Committee on Banking and Currency, U.S. House of Representatives, December 12, 1974. Reprinted in 60 Federal Reserve Bulletin (1974) pp. 838-841.

decreased in the years after the institution of the "go slow" policy and the number of new permissible nonbanking activities -- other than those to be considered on a case-by-case basis -- had not expanded.

BIBLIOGRAPHY

Backman, Jules. "The Bank Holding Company Act," The Bulletin of the C.F. Devine Institute of Finance, Nos. 24-25, New York: Graduate School of Business Administration, New York University, (April-June, 1963).

Bank Holding Company Act of 1956. 70 Statutes 133 (1956).

Bank Holding Company Act Amendments of 1966. 80 Statutes 238 (1966).

Bank Holding Company Act Amendments of 1970. 84 Statutes 1760 (1970).

Banking Act of 1933. 48 Statutes 162 (1933).

Banking Act of 1935. 49 Statutes 684 (1935).

Board of Governors of the Federal Reserve System. Annual Report of the Board of Governors of the Federal Reserve System. Various years.

Board of Governors of the Federal Reserve System. Banking and Monetary Statistics, 1914-1941. Washington, D.C.: Board of Governors of the Federal Reserve System, 1976.

Board of Governors of the Federal Reserve System. Banking and Monetary Statistics, 1941-1970. Washington, D.C.: Board of Governors of the Federal Reserve System, 1976.

Board of Governors of the Federal Reserve System. Annual Statistical Digest, 1971-1975. Washington, D.C.: Board of Governors of the Federal Reserve System, 1976.

Board of Governors of the Federal Reserve System. Annual Statistical Digest, 1972-1976. Washington, D.C.: Board of Governors of the Federal Reserve System, 1977.

Board of Governors of the Federal Reserve System, Federal Reserve Bulletin, Various issues.

Board of Governors of the Federal Reserve System. "Memorandum of the Views of the Board of Governors of the Federal Reserve System Regarding Bank Holding Company Legislation Submitted to the Senate Banking and Currency Committee on July 5, 1955." U.S. Congress, Senate. Subcommittee of the Committee on Banking and Currency, Control of Bank Holding Companies, Hearings, before a Subcommittee of the Committee on Banking and Currency, Senate, 84th Cong. 1st sess. 1955.

Board of Governors of the Federal Reserve System, Statement of Robert C. Holland, Member, Board of Governors of the Federal Reserve System, before the Committee on Banking and Currency of the House of Representatives of the U.S. Congress on December 12, 1974. 60 Federal Reserve Bulletin (1974).

Boczar, Gregory E. "The Growth of Multibank Holding Companies: 1956-1973," Staff Economic Studies, No. 85, Washington, D.C.: The Board of Governors of the Federal Reserve System (1976).

Cartinhour, Gaines Thomson. Branch, Group and Chain Banking. New York: The Macmillan Company, 1931.

Edwards, Franklin R. "Bank Mergers and the Public Interest: A Legal and Economic Analysis of the 1966 Bank Merger Act," Banking Law Journal, LXXXV (September, 1968), 753-796.

Fischer, Gerald C. American Banking Structure. New York: Columbia University Press, 1968.

Fischer, Gerald C. Bank Holding Companies. New York: Columbia University Press, 1961.

"Group Banking in the United States." 24 Federal Reserve Bulletin (1938) 97-101.

Hall, George R. "Bank Holding Company Regulation," Southern Economic Journal, XXXI (April, 1965), 342-355.

Hall, George R., and Phillips, Charles F. Jr. Bank Mergers and The Regulatory Agencies. Washington, D.C.: The Board of Governors of the Federal Reserve System, 1964.

Hogenson, Palmer T. The Economics of Group Banking. Washington, D.C.: Public Affairs Press, 1955.

Jessee, Michael A. and Seelig, Steven A. Bank Holding Companies and the Public Interest: An Economic Analysis, Lexington, Mass.: Lexington Books, D.C. Heath & Co., 1977.

Kintner, Earl W., and Hansen, Hugh C. "A Review of the Law of Bank Mergers," Boston College Industrial and Commercial Law Review, XIV (December, 1972), 213-265.

Klebaner, Benjamin J. "The Bank Holding Company Act of 1956," Southern Economic Journal, XXIV (January, 1958), 313-326.

Lamb, W. Ralph. Group Banking. New Brunswick, New Jersey: Rutgers University Press, 1962.

"One Bank Holding Companies Before the 1970 Amendments." 58 Federal Reserve Bulletin (1972) 999-1008.

"Report Under Bank Holding Company Act." 44 Federal Reserve Bulletin (1958) 776-796.

Rhoades, Stephen A. "Changes in the Structure of Bank Holding Companies Since 1970," Journal of Bank Administration, (October, 1976).

U.S. Congress. House. Committee on Banking and Currency. Branch, Group and Chain Banking. Hearings before the Committee on Banking and Currency House of Representatives, 71st Cong., 2nd sess., 1930.

U.S. Congress. House. Committee on Banking and Currency. The Growth of Unregistered Bank Holding Companies - Problems and Prospects, Staff Report. Washington, D.C.: U.S. Government Printing Office, 1969.

Upshaw, William F. "Antitrust and the New Bank Holding Company Act: Part III," Monthly Review, Federal Reserve Bank of Richmond (April, 1971), 3-8.

Weiss, Steven J. "Bank Holding Companies and Public Policy," New England Economic Review, Boston: Federal Reserve Bank of Boston (January/February, 1969), 3-29.

Willit, Virgil, ed. Selected Articles on Chain, Group, and Branch Banking. New York: The H.W. Wilson Company, 1930.

Section III

Bank Holding Companies as Operational Single Entities: A Review

John T. Rose

One of the more interesting questions relating to the bank holding company (BHC) movement concerns the extent to which BHCs operate their subsidiaries as a single integrated entity, as opposed to a collection of commonly-owned but autonomous companies.1/ On the one hand, some observers have argued that a rational holding company will view its subsidiaries as members of an investment portfolio,2/ thus implying little or no role for the parent company in overseeing the operations of these companies. On the other hand, the fact that BHCs often pay "large" acquisition premiums for their bank subsidiaries3/ suggests in such cases that the parent holding company believes it can generate more income from a bank as a subsidiary than that bank can generate in an independent status. This, in turn, implies at least some role for the parent company in supervising the affairs of these bank subsidiaries.4/

To date, however, little empirical research has been specifically directed to the operating policies of BHC groups. Rather, most scholars

---

1/ The implications of this question touch upon a number of important questions relating to BHC expansion, including financial market structure and competition, interregional fund flows, BHC economies of scale and organization, and bank safety and soundness.

2/ See, for example, Irvin and Stanley [14] and Jessup [16].

3/ Whether BHCs also pay premiums for their nonbanking subsidiaries is unknown.

4/ For a discussion of acquisition premiums paid by BHCs for their bank subsidiaries, see Darnell [5; 6] and Piper and Weiss [23]. Also, in another context, Mingo [22] discusses the possibility that holding company management "...may have to operate an acquired bank in a relatively risky manner in order to justify the [high] purchase price."

have chosen to skirt this question and focus instead on the post-acquisition performance of BHC subsidiaries.1/ There are several possible reasons for this. First, performance studies provide a means of focusing directly on the end result of BHC affiliation without having to link the final effects of affiliation to the operating policies of holding company management. Moreover, it may be argued that to the extent that BHCs are integrated as single entities, any significant changes in the operations of the subsidiaries to conform with the parent company's policies should be reflected somewhere in the subsidiaries' performance.

Second, the few studies of BHC operating policies necessarily focus on <u>formal</u> policies designed to integrate the holding company group. To the extent, however, that the holding company system is welded together less formally, the performance of the various subsidiaries may still be affected, even though unattended by formal integrating policies on the part of the parent company.2/

Third, performance studies generally rely on readily available financial data and employ statistical methods of analysis. In contrast,

---

1/ See, for example, performance studies by Johnson and Meinster [17], Mayne [20], and Mingo [22], dealing with the effect of BHC affiliation on bank performance, and studies by Rhoades and Boczar [24] and Talley [27], dealing with the impact of BHC affiliation on nonbank company performance.

2/ Weiss [29], for example, notes that "...a feeling of group identity, which more or less pervades any holding company organization, is conducive to close cooperation and common operational policies among subsidiaries even in systems where there is no structural compulsion to follow the leadership of the holding company." This is underscored by Jesser and Fisher [15] who report, "Although the degree of control varies widely among the twelve bank holding companies questioned,...all twelve have, over the years, established by trial and error, by precedent, and simply by tradition, a set of understood controls or limitations."

studies of parent company operating policies typically involve <u>ad hoc</u> survey work, the results of which often do not lend themselves to statistical analysis.

Finally, present law limits financial transactions between sister banks within a BHC system as well as between these banks and other entities within the holding company group. 1/ In addition, there are restrictions on the amount of dividends that a bank can pay out during a single year. 2/ To the extent that these restrictions limit a BHC's ability to function as a single integrated entity, they necessarily complicate any investigation of BHC operating policies since any conclusions must be viewed in the context of the various regulatory constraints.

Still, the study of BHC operating policies seems a useful complement to the study of post-acquisition subsidiary performance, for several reasons. First, knowledge of BHC operating policies should suggest areas in which to look for performance changes, although not all performance effects may be "predicted" by simply examining (formal) BHC operating policies. Second, to the extent that operating policies are <u>not</u> reflected in performance

---

1/ Section 23A of the Federal Reserve Act generally limits a bank's financial transactions with a single affiliate to no more than 10 percent of the bank's capital and surplus and limits transactions with all affiliates combined to no more than 20 percent of the bank's capital and surplus. In addition, loans and extensions of credit from a bank to its affiliates are subject to strict collateral requirements. (For further discussion of Section 23A, see Board of Governors [1] and Golembe [2].

2/ National banks and state member banks are limited by law in the amount of dividends that they can pay in any year to the net profits of that year plus an amount equal to the retained profits of the two previous years, without prior regulatory approval. Moreover, Cates [3] argues that "[i]n practice, a bank is limited from paying out more than a regulator deems prudent, and a good rule of thumb might be to question the sustainability of a bank dividend that regularly exceeds (or which needs to exceed) 50% of net income."

changes, it may be useful to look for reasons why they are not. Third, whether a bank's "corporate veil" can be pierced for the benefit of the creditors of its parent holding company or another subsidiary of the parent seems likely to depend on the extent to which the BHC system is operated as a single entity.1/ Thus, information on BHC operating policies should be useful in assessing the significance of this particular risk to BHC banks. Finally, in view of the various legal restrictions on intra-BHC financial transactions, examination of BHC operating policies may shed light on the effectiveness of these restrictions and their impact on BHC operations.

In the remainder of this paper, we review the results of the few studies that have focused specifically on the operating policies of BHCs. In so doing, we focus in Section I on the banking side of the holding company; in Section II, on the nonbanking side. Within each section we look at the degree of parent company (or lead bank) control as reflected both in organizational structure as well as in specific operational areas. Based on this review, we should be able to make some tentative generalizations in Section III regarding the extent to which BHCs are presently operated as single entities.

One word of caution is in order. Because each of the several published studies is based on survey and/or personal interview results and relies primarily on descriptive analysis, it is sometimes difficult to compare findings of different studies, particularly when it comes to assessing the degree of control exercised by most parent holding companies over their bank subsidiaries vis-a-vis their nonbank subsidiaries. Accordingly, the

---

1/ The consensus of legal opinion seems to be that a bank is generally protected from creditor claims and suits against the bank's parent holding company or a sister subsidiary, provided that the bank and its affiliates are clearly operated as separate businesses and are portrayed as such to the public. (See Chase [4], Schotland [25], and Vojta [28].)

assessment of parent company control in this review is based not only on specific findings reported in the various studies but also in some cases on this reviewer's inferences from the different studies as to the importance and strength of such control.

I. BHC Operating Policies with Respect to Subsidiary Banks

In all, there have been only five published studies of BHC operating policies with respect to subsidiary banks. The earliest of these was published by Fischer [9] in 1961;1/ next came works by Weiss [29] in 1968,2/ Lawrence [18] in 1971,3/ Jesser and Fisher [15] in 1973, and Stodden [26] in 1975. In each case, information was taken from surveys of various holding company groups: Fischer, 27 BHCs (apparently nationwide); Weiss, all registered BHCs in New England (a total of five at the time);

1/ In a subsequent published comment, Fischer [10] briefly summarizes the findings of his study with respect to the degree of centralized control that BHCs generally exercise over their bank subsidiaries. In addition, Fischer reported in 1968 [8] that additional questionnaire surveys conducted in 1964 and 1966 revealed few major changes in BHC operating policy from that which he originally reported in 1961.

2/ Weiss acknowledges that his findings are based largely on research carried out by Thomas H. Hodges. Hodges reports his findings in two unpublished papers [12; 13].

3/ A unique feature of Lawrence's study is his design of a measure of the degree to which each of several policy areas is centralized in the parent holding company (or its lead bank). In addition, he calculates an overall Centralization Index, based on the group of centralization measures for the various policy areas. Using regression analysis, he tests whether the Centralization Index or any of the centralization measures for the individual policy areas is correlated with various economic and organizational characteristics of the holding company, including (1) the deposit size of the holding company, (2) the number of banks controlled by the holding company, (3) the geographical extent of the holding company's operations, (4) the size of the holding company's lead bank relative to other banks in the organization, (5) the number of years the holding company has been in existence, and (6) the lines of communication between the holding company and its banks. However, he reports no statistically significant relationship between any of his centralization measures and any of these holding company characteristics; in fact, he does not present any of his regression results but only describes his analysis.

Lawrence, 52 companies nationwide; Jesser and Fisher, 12 BHCs nationwide; and Stodden, 16 holding companies in Texas.

Taken together, the five studies cover a wide variety of operational areas. Still, there is considerable overlap with generally consistent findings. Subsequent discussion, therefore, is designed to present a composite picture of typical or "average" BHC operating policy with respect to subsidiary banks with miminum reference to specific studies. In this regard, one fact that is emphasized by most researchers is that the amount of formal control exercised by BHCs over their bank subsidiaries varies sharply among different companies, from very little control in some cases to extremely tight control, approximating that of a branching system, in other cases. Such variance applies with respect to both the degree of overall control exercised by the parent holding company as well as the amount of control exercised in specific operational areas.[1/] The significance of this finding is that it necessarily complicates efforts to generalize an "average" BHC, since any such "average" is attended by a substantial variance.[2/]

1/ This is consistent with evidence presented by Fraas [11], indicating significant differences among BHCs in the performance of their subsidiary banks. However, when Mayne [21] used Lawrence's centralization measures to test the hypothesis that the degree of centralization in various policy areas is reflected in subsidiary bank performance, she generally found little correlation between bank performance and the degree of centralization. This suggests either that Lawrence's classification system does not accurately represent management policies or, as noted earlier, that identification with the BHC group informally unifies subsidiary bank operating policies regardless of the degree of formal centralization on the part of the parent holding company.

2/ Moreover, available evidence offers few clues either as to the reason for this variance or as to what type of BHCs may be more or less centralized. Fischer notes that holding companies with a large number of small banks are more likely to shift officers among subsidiary banks, as well as to assist such banks in cash management. Also, Jesser and Fisher note that centralization seems to be primarily a characteristic of larger BHCs, at least in the area of branching decisions. However, as mentioned above, Lawrence found no statistically significant correlation between the degree of centralization and various holding company characteristics, including holding company size.

1. Organizational Structure

Perhaps the most important area for purposes of determining the degree of operational integration relates to the parent company's overall control through organizational structure. It appears that usual BHC practice is to try to ensure that the subsidiary banks' management philosophy and broad operational policies are consistent with those of the parent company but otherwise to give the individual banks considerable autonomy, provided that their profit performance is consistent with the parent company's expectations.1/ To this end, several practices are most common. First, BHCs generally attempt to maintain the local character of the boards of directors of their subsidiary banks by allowing the senior management of the banks to nominate their own directors, with the holding company usually retaining final approval on all such nominations. At the same time, some direct representation by the parent holding company on its subsidary banks' boards is not unusual. Often this is accomplished by expanding the size of the board with additional members to represent the holding company rather than by replacing local directors.2/ Second, many holding companies have formal

---

1/ As Jesser and Fisher report, "Of the twelve holding companies questioned, nine allow their chief executive to be fairly independent, although when a bank is not doing well, the full weight of the holding company is brought to bear."

2/ Where there is no direct representation by the parent company, it may still send representatives to the board meetings of its bank or arrange for some of its officers to serve in an official capacity in the various banks. In some cases, representation by the subsidiary banks on the parent holding company's board of directors is used as a means of integrating the organization.

committees made up of senior management of both the parent company and the subsidiary banks to deal with specific operations or policy areas; such committees typically meet monthly or quarterly. Finally, it appears to be usual practice for the parent holding company to have final say in the selection and promotion of senior management of its subsidiary banks.

Consistent with this broad overall control is the fact that frequent financial reporting by the subsidiary banks to their parent company appears to be the rule. In addition, it seems to be common practice for the parent company to require and review individual budgets of the various bank subsidiaries. Moreover, a centralized audit department managed by the parent holding company is not uncommon, and holding companies (or their lead banks) often provide accounting services to their subsidiary banks. All of these activities undoubtedly facilitate a BHC's oversight of its subsidiary banks' performance without requiring a direct role for the parent company in managing the operations of individual banks.

2. Specific Operational Areas

Still, there are some operational areas where the parent holding company (or its lead bank) exercises greater control than in other areas, or at least where it assumes a significant coordinating role. Principal among these areas are (1) investment securities management, including federal funds management, (2) correspondent relationships with banks outside the holding company system, including loan participations with such banks and the amount of correspondent balances kept in these banks, and (3) bank capital management, including capital expenditures and *de novo* branch expansion.[1/]

1/ Although Lawrence characterizes bank capital management as an area that is neither highly centralized nor decentralized, he also emphasizes that it is an area in which almost all holding companies exert some control. Control in this area is also noted by Weiss, Jesser and Fisher, and Stodden.

One area where the degree of control is subject to some debate pertains to broad loan policy, particularly loan mix. Both Fischer and Weiss argue that most BHCs exercise some control over general loan composition, and both cite as evidence the fact that many BHCs have "encouraged" their subsidiary banks to expand further into the field of consumer lending.1/ Stodden, on the other hand, claims that BHCs do not get involved in subsidiary bank loan policy unless there is a shortfall in bank profit performance. Likewise, Lawrence classifies loan portfolio management as a decentralized policy area and claims that his findings are at variance with those of Fischer in this regard. In fact, however, Lawrence's findings in this area are somewhat self-contradictory as he also notes that "...companies rated centralized and moderately centralized [which includes three-quarters of his sample] take an active role with respect to management of the loan portfolio," which seems entirely consistent with the findings of Fischer and Weiss. In final analysis, it seems safe to conclude that most BHCs probably do exercise at least some control over broad loan policy of their bank subsidiaries, though the extent of such control may vary considerably among different organizations.

1/ In his 1968 work, Fischer [8] writes, "Probably the least centralized of all activities in [BHC] systems is the lending function." Further reading, however, makes clear that he is speaking primarily of lending policy with respect to individual loan applications rather than broad loan mix. Indeed, he notes, "...in consumer credit and in special fields as leasing, the [holding company] headquarters is frequently very active, encouraging and promoting consumer credit and providing advice and consultation not only to the affiliate bank but to the customer in the case of leasing."

In addition to the above policy areas, many BHCs (or their lead banks) provide various services to their bank subsidiaries, the effect of which is to help tie together the holding company system. These services may include principally data processing, advertising, market research, international and trust services, and the procurement of equipment, supplies, and insurance.

Turning to areas of greatest subsidiary bank autonomy, three seem to be most common. These include (1) setting prices for bank services, (2) evaluating individual loan applications,[1/] and (3) decision-making with respect to lower level management and personnel. Lawrence attributes bank pricing autonomy to the concern of most BHCs for the

---

1/ In fact, Fischer implies that most BHCs do not even set maximum lending limits on their subsidiary banks, and Weiss reports that the parent company may expect to be consulted only before an "unusually large or complicated" loan is made.

antitrust implications of coordinated pricing policies.[1/] Likewise, Fischer reports in his 1968 work a similar concern with respect to decision-making on individual loan applications As for subsidiary bank independence in the area of lower level management and personnel, this may be less common in recent years than in the past, as the more recent studies report greater inter-bank mobility of officers, more centralized management training programs, and a certain degree of uniformity in salary schedules[2/] and fringe benefits. Still, the role of the parent holding company appears to be considerably less in this area than in other more centralized policy areas.

One important area for evaluating organizational integration pertains to inter-bank transactions within a BHC system. In that regard, Lawrence reports two significant findings. First, while the BHC (or its lead bank) often takes an active role in handling federal funds transactions of its bank subsidiaries (as part of the parent company's overall program of investment securities management for its banks), purchases and sales of federal funds among sister banks in a BHC system are rare.[3/] Second, interbank loans as well as purchases and sales of loan paper among sister banks are also rare. Taken together, these results are

---

1/ Lawrence devotes considerable space in his paper to analyzing this issue and concludes that the concern of most BHCs in this area is unwarranted.

2/ Fischer reports in his 1961 study that local competitive conditions are of primary importance in setting salary schedules. More recently, Jesser and Fisher also note the importance of local competitive conditions in determing the pay scales of junior officers and staff employees. At the same time, they also report a certain degree of inter-bank mobility for officers and officer candidates, which suggests more uniform salaries at those levels.

3/ Lawrence does not specifically note the latter point, but it seems to be implied from his discussion and the reported comments of several of the BHCs that participated in his survey.

consistent with the hypothesis that the limitations imposed by Section 23A of the Federal Reserve Act represent an effective constraint on financial transactions between affiliated banks, even in the case of BHC groups that may otherwise be significantly integrated. Indeed, Lawrence specifically points to Section 23A as the major factor limiting interbank loans between affiliated banks, and Golembe [2] notes the difficulties imposed by Section 23A on bank affiliates that wish to engage in federal funds transactions or purchase and sales of loan paper.1/ Thus, it seems safe to conclude that whatever financial integration of sister bank subsidiaries might be desired by the parent holding company, such integration is effectively constrained by present law, except to the extent that it can be satisfied through loan participations among the affiliated banks.2/

1/ Actually purchases of loan paper by a bank subsidiary from a sister bank subsidiary if made without recourse, are exempt from the restrictions of Section 23A However, in the case of such non-recourse transactions, prudence dictates that the acquiring bank make an independent credit appraisal for any purchased loans. Golembe argues that this in turn requires that the purchasing bank duplicate the appraisal work of the selling bank and thereby limits the advantages associated with any such purchase/sale transactions. In view of the affiliation of the purchasing and selling banks, one may wonder why the two banks could not simply share appraisal records in order to expedite any such transactions However the absence of such sharing is consi tent with the fact that bank subsidiaries are generally given complete autonomy with respect to individual loan decision-making, and, therefore, they may be ess inclined to cooperate in this regard than their affiliation would otherwise suggest.

2/ Evidently, loan participations among affiliated banks are increasing. This is seen in the fact that Fischer and Weiss reported little of this activity in their early studies whereas more recent studies report more activity in this area. Lawrence, for example reports loan participation as an area of centralized policy-making in that most BHCs impose some type of restrictions on the ability of their bank subsidiaries to participate in loans with banks outside the holding company system. Likewise, Jesser and Fisher. include loan participations as a service performed by most BHCs (or their lead bank) along with investment management, auditing, data processing, etc. Stodden also notes that [l]oan participations are customarily offered to [BHC] system members first."

II. BHC Operating Policies with Respect to Nonbank Subsidiaries

There has been only one published study of BHC operating policies with respect to nonbank subsidiaries. That study, by Lawrence [19], involved personal interviews with senior officials of 27 bank holding companies, most of which would rank among the largest (in total assets) holding companies in the nation. 1/

In contrast to the findings of the various studies dealing with BHC control over bank subsidiaries, Lawrence finds considerable homogeneity regarding BHC control over nonbank subsidiaries. Specifically, he finds that <u>all</u> of his sample holding companies (or their lead banks) exercise substantial control over their nonbank subsidiaries, though there is some tendency to allow greater autonomy for acquired subsidiaries, particularly the larger ones, than for *de novo* subsidiaries. In part, this homogeneity and the substantial centralization of control may reflect the large size of most of the sample BHCs, though this point is no doubt subject to debate in view of Lawrence's earlier work [18] on centralization of control over bank subsidiaries.

1. Organizational Structure

The control which BHCs exercise over their nonbank subsidiaries generally appears to go beyond the parent company's role in coordinating the management philosophy and broad operational policies of its bank subsidiaries. Evidence of this is seen principally in the fact that the majority of the members of the boards of directors of the nonbank subsidiaries are usually officials of either the parent holding company or its lead bank. In addition, frequent (at least monthly) meetings between the holding company and subsidiary officials appear common, and such meetings typically cover all aspects of a subsidiary's operations. Finally, most

1/ None of these 27 BHCs were among the 52 companies used by Lawrence [18] to examine the operating policies of BHCs with respect [illegible]

BHCs have final say over the selection of senior officers of their nonbank subsidiaries, though, as noted earlier, this practice seems to be common with respect to bank subsidiaries as well.

Other aspects of control that are generally common to both bank and nonbank subsidiaries include a review of the budgets of the various subsidiaries and a centralized auditing program. In addition, a sizable number, though not a majority, of companies reported that they centralize the accounting function in the parent company (or its lead bank).

2. Specific Operational Areas

As for specific operational areas where the parent company exercises significant control over its nonbank subsidiaries, capital management seems to be most important. Indeed, Lawrence reports that all of his sample BHCs determine the liability and capital structure of their nonbank subsidiaries, and many raise all of the funds of their subsidiaries, including bank credit.1/ 2/

1/ Jesser and Fisher [15] also note the practice of most BHCs to provide funds to their nonbank lending subsidiaries.

2/ Among the various BHCs, however, there is disagreement as to the proper approach to capital and liability management. One approach, used by two-thirds of the companies in Lawrence's sample is the "building block" approach, which "...holds that the liability and capital structure of a subsidiary should approximate the liability and capital structure which would be regarded as acceptable for that firm if it were an independent entity... A variation of this approach is that, while each subsidiary need not be 'soundly' capitalized, the appropriate consolidated position of the organization is approximated by the sum of what would be the 'building block' liability and capital structures of the subsidiaries." The other approach, used by one-third of Lawrence's sample BHCs, holds that the "appropriate" liability and capital structure of a large BHC system involves a "...higher debt-to-equity ratio than that which would be approximated by summing the 'appropriate' liability and capital structures of a collection of comparable independent firms." The rationale behind this approach is that "...a large, diversified organization enjoys the advantages of a more stable stream of earnings and a greater capacity to raise capital than small, independent firms."

Other areas of moderate parent company control include (1) setting maximum lending limits for the senior officers of credit granting subsidiaries, (2) sharing of BHC facilities, especially computer facilities, (3) personnel management, including setting salary schedules, and (4) the cross-selling of services produced by different subsidiaries. On the other hand, areas where BHCs exercise the least influence over their nonbank subsidiaries include (1) the pricing of nonbank subsidiary services, (2) marketing, and (3) selecting outside banking connections.1/ 2/

In these areas, there is much similarity with BHC treatment of bank subsidiaries. BHCs exercise considerable control over the capital management of both their bank and nonbank subsidiaries though the parent's role in this area may be somewhat greater in the case of nonbank subsidiaries. In addition, sharing of computer facilities is common to both types of subsidiaries, while pricing decisions are usually left to the individual subsidiaries in both cases. Marketing seems to be an area of some difference: BHCs sometimes supply marketing/advertising services to their bank subsidiaries but seldom provide such services to their nonbank subsidiaries. On the other hand, BHCs rarely set maximum lending limits

1/ The fact that BHCs generally exercise little control over their nonbank subsidiaries' outside banking connections likely reflects, in part at least, the insignificance of such connections given the important role that BHCs play in raising funds for their nonbank subsidiaries.

2/ It is interesting to compare these results with those of a 1972 Federal Trade Commission study of nine conglomerate corporations. That study found that the areas of principal operating policy change with respect to acquired companies included auditing, insurance, and the management of borrowing and credit lines. Specifically, the parent company generally consolidated the auditing function of all its subsidiaries in one outside auditing firm, transferred insurance administration to the parent's headquarters, and took over the management of borrowing and credit lines for its acquired companies. (See FTC [7, Chapter III].)

for the senior officers of their subsidiary banks but do exercise this right to some degree in the case of their nonbank subsidiaries. Finally, BHCs generally exercise a moderate role in lower level personnel management in the case of nonbank subsidiaries but little or no role in this area with respect to bank subsidiaries, though this appears to be changing in recent years as parent holding companies take on more responsibility in this area.

Lawrence gives no information regarding the degree of intercompany transactions involving nonbank subsidiaries. However, in view of the minimal inter-bank transactions, due to the restrictions imposed by Section 23A of the Federal Reserve Act, it seems likely that transactions between subsidiary banks and their sister nonbank companies are also rare since Section 23A applies to these transactions as well.

III. Summary and Conclusion

The purpose of this review was to provide a basis for answering the question of whether BHCs generally operate their subsidiaries as a single integrated entity or simply as a portfolio of investments. While available evidence is limited, it nevertheless appears that most BHCs are trying to manage their organizations as integrated entities, at least to some degree. This is reflected in part by the fact that BHCs typically try to exercise control, through organizational structure, over the management philosophy and broad operating policies of both their banks and nonbank subsidiaries. In addition, BHCs generally exercise at least some control over various specific operational areas, both on the banking and nonbanking sides. The extent of such integration, however, seems to be somewhat less, on average, with regard to bank subsidiaries than with regard to nonbank subsidiaries. In addition, there appears to be more variance among BHCs in the degree to which they integrate their bank subsidiaries relative to their nonbank subsidiaries. However, it should be emphasized that these conclusions are based on studies that have focused on BHC operating policies with respect to either bank or nonbank subsidiaries. No studies have compared the degree of control exercised by the same group of BHCs over both their bank and nonbank subisdiaries. Finally, one factor which no doubt limits full integration of any BHC system is the legal restrictions that apply to financial transactions between a bank subsidiary and its bank and nonbank affiliates.

References

[1] Board of Governors of the Federal Reserve System. "A Discussion of Amendments to Section 23A of the Federal Reserve Act Proposed by the Board of Governors of the Federal Reserve System."

[2] Carter H. Golembe Associates, Inc. "Loans by Banks to Their Affiliates and Section 23A of the Federal Reserve Act." Report prepared at the request of the Association of Registered Bank Holding Companies, November 18, 1974.

[3] Cates, David C. "Analyzing the Parnet of a Bank Holding Company," The Magazine of Bank Administration, LII, No. 11 (November, 1976), pp. 42-45.

[4] Chase, Samuel B. Jr. "The Bank Holding Company -- A Superior Device for Expanding Activities?" Policies for a More Competitive Financial System, Proceedings of a Conference, Federal Reserve Bank of Boston, June, 1972, pp. 77-87.

[5] Darnell, Jerome C. "Bank Mergers: Prices Paid to Marriage Partners," Federal Reserve Bank of Philadelphia Business Review, July, 1976, pp. 16-25.

[6] ________________. "What is your Bank Worth?" The Magazine of Bank Administration, XLIX, No. 6 (June, 1973), pp. 24-31.

[7] Federal Trade Commission. "Conglomerate Merger Performance: An Empirical Analysis of Nine Corporations," Staff Economic Report, November, 1972.

[8] Fischer, Gerald C. American Banking Structure. New York: Columbia University Press, 1968.

[9] ________________. Bank Holding Companies. New York: Columbia University Press, 1961.

[10] ________________. "Bank Holding Company Affiliates: Branches or Unit Banks," Journal of Business, XXXVII, No. 1 (January, 1964), pp. 47-48.

[11] Fraas, Arthur G. "The Performance of Individual Bank Holding Companies," Staff Economic Studies, No. 84, Board of Governors of the Federal Reserve System, 1975.

[12] Hodges, Thomas H. "An Outline of the Operational Policy of Four Bank Holding Companies in the First Federal Reserve District," Federal Reserve Bank of Boston, unpublished, June, 1968.

[13] ______________. "The Bank Holding Company Structure: An Examination and Case Study," Unpublished B.A. Thesis, Harvard College, March, 1968.

[14] Irwin, Manley R. and Kenneth B. Stanley. "Regulatory Circumvention and the Holding Company Journal of Economic Issues, VIII, No. 2 (June, 1972), pp. 395-416.

[15] Jesser, Edward A. Jr. and Kenneth H. Fisher, "Guidelines for Bank Holding Company Management," Bankers Magazine, 156, No. 3 (Summer, 1973), pp. 13-20.

[16] Jessup, Paul F. "Portfolio Strategies for Bank Holding Companies," The Bankers Magazine, 152, No. 2 (Spring, 1969), pp. 78-85.

[17] Johnson, Rodney D and David R. Meinster. "The Performance of Bank Holding Company Acquisitions: A Multivariate Analysis," Journal of Business, 48, No. 2 (April, 1975), pp. 204-212.

[18] Lawrence, Robert J. "Operating Policies of Bank Holding Companies -- Part I," Staff Economic Studies, No. 59, Board of Governors of the Federal Reserve System, April, 1971.

[19] ______________. "Operating Policies of Bank Holding Companies -- Part II: Nonbanking Subsidiaries," Staff Economic Studies, No. 81, Board of Governors of the Federal Reserve System, March, 1974.

[20] Mayne, Lucille S. "A Comparative Study of Bank Holding Company Affiliates and Independent Banks, 1969-1972," The Journal of Finance, XXXII, No. 1 (March, 1977), pp. 147-158.

[21] ______________. "Management Policies of Bank Holding Companies and Bank Performance," Journal of Bank Research 7, No. 1 (Spring, 1976), pp. 37-48.

[22] Mingo, John J. "Managerial Motives, Market Structures and the Performance of Holding Company Banks," Economic Inquiry, XIV, No. 3 (September, 1976), pp. 411-424.

[23] Piper, Thomas R. and Steven J. Weiss. "The Profitability of Bank Acquisitions by Multi-bank Holding Companies," Federal Reserve Bank of Boston New England Economic Reivew, September/October, 1971, pp. 2-12.

[24] Rhoades, Stephen A. and Gregory E. Boczar. "The Performance of Bank Holding Company-Affiliated Finance Companies," Staff Economic Studies, No. 90, Board of Governors of the Federal Reserve System, August, 1977.

[25] Schotland, Roy A. "Bank Holding Companies and Public Policy Today," Compendium of Papers Presented for the FINE Study, U.S. House of Representatives, Committee on Banking, Currency and Housing, 94th Congress, second session, Book I, June, 1976, pp. 233-283.

[26] Stodden, John R. "Survey of the Operating Policies and Performance of Texas Multibank Holding Companies: Preliminary Findings," Proceedings of a Conference on Bank Structure and Competition, Federal Reserve Bank of Chicago, 1975, pp. 253-259.

[27] Talley, Samuel H. "Bank Holding Company Performance in Consumer Finance and Mortgage Banking," The Magazine of Bank Administration, LII, No. 7 (July, 1976), pp. 42-44.

[28] Vojta, George J. "Capital Adequacy: A Look at the Issues," The Magazine of Bank Administration, XLIX, No. 9 (September, 1973), pp. 22-25.

[29] Weiss, Steven J. "Bank Holding Companies and Public Policy," Federal Reserve Bank of Boston New England Economic Review, January/February, 1969, pp. 3-27.

Section IV

THE PERFORMANCE OF BANK HOLDING COMPANIES: A REVIEW OF THE LITERATURE

Timothy J. Curry

Introduction

Since the passage of the Bank Holding Company Act an extensive body of research analyzing the performance of bank holding companies has been published.[1/] Interest in bank holding company performance has been generated by the structural changes in the American financial system introduced by the expansion of these organizations since 1970. As of mid-year 1977, bank holding companies controlled more than 70 percent of the total domestic commercial bank deposits of the nation. In addition, the 1970 Amendments to the Bank Holding Company Act of 1956 led the way for diversification by bank holding companies into those nonbank activities determined by the Federal Reserve to be "closely related to banking."[2/] Until now, there has been little empirical evidence showing the impact that bank holding companies have had upon performance of firms acquired in the non-banking, financially related industries. The lack of research in this area is likely explained

---

1/ For purposes of this paper, performance refers to profitability, expense, income, and various other financial characteristics such as capitalization, loan capacity, rates of return, etc.

2/ Bank holding companies have shown the greatest interest in entering consumer and commercial finance, mortgage banking, and leasing industries.

by severe data limitations and the fact that the movement into the non-bank sphere is relatively recent. The next section will review empirical studies of bank performance. The third section will review the empirical research on the performance of non-bank subsidiaries of bank holding companies.

I. Bank Holding Companies and Bank Performance

Most of the early studies analyzed the performance of holding company subsidiary banks by focusing upon the post-acquisition changes in the portfolio and operating ratios of these acquired firms relative to a control group of comparably-sized independent banks. The studies reviewed analyze changes in portfolio and operating policies of holding company subsidiary and non-affiliated banks through direct observation of changes in various balance sheet and income statement ratios including those reflecting, 1) asset structure, 2) loan portfolio composition, 3) earnings and expenses, 4) capital structure, 5) profitability, and 6) growth. Any significant differences in these ratios between the two groups in the post-acquisition period were attributed to the effects of holding company affiliation. From an analysis of the significant changes in these operating ratios, conclusions were drawn about the social costs and benefits of this movement. In terms of statistical methodology, the earlier empirical studies employed a simple univatiate statistical analysis ("t" test for differences in group means).[1/]

Later empirical studies employed more sophisticated statistical techniques utilizing various forms of multivariate analysis to overcome the defects of earlier studies. Regardless of the methodology, however, both groups of studies, for the most part found similar results. Although there had been some research on the performance of bank holding companies as early as 1961, the bulk of the empirical evidence on this topic has been published since the late 1960's. Given the large body of empirical studies in this area, it is now possible to draw some conclusions concerning the performance effects of these organizations.

Asset Structure

Theory suggests that diversification reduces risk. Therefore, it has been argued that because the holding company vehicle permits geographical diversification in banking, the overall level of risk to the firm would be lower than to the non-diversified firm. This fact may allow more risk-taking on the part of individual subsidiary units of bank holding companies relative to comparably sized non-diversified independent banks. This change in behavior may be reflected, for example, by the choice of a bank's assets. It has

---

1/ These studies were criticized in the literature for violating certain ceteris paribus conditions. See Johnson and Meinster [14].

also been stated that the attitudes toward risk preferences may be different for managers of holding company affiliated banks than for independent banks. That is, the formation of the holding company *per se*, which permits expansion, may indicate more aggressive managerial behavior. If this is so, it may be reflected in the choice of a riskier portfolio and operating policies of acquired firms. Finally, it has been posited that simply the change in the organizational structure of a bank from an independent firm to a subsidiary of a bank holding company may induce behavioral changes in portfolio policies on the bank level since individual units of the holding company group could always turn to the parent for financial and managerial assistance if necessary. For these reasons, in part, affiliation *per se*, may produce more risk-taking behavior on the part of subsidiary units in the post-acquisition period.

In line with this hypothesis, the overwhelming number of empirical studies analysing the performance of holding company subsidiary units indicate that the asset structure of these firms reflects greater risk-taking behavior in the post-acquisition period. The research implies that subsidiaries of bank holding companies hold significantly lesser amounts of cash assets than do comparable independent banks [10, 13, 21]. In addition, holding company units also hold significantly fewer U.S. government securities [1, 13, 191, 21, 22, 23, 34, 38] and significantly more state and municipal securities than do comparable independent units [1, 15, 21, 22, 23, 25, 34]. Also, the empirical studies examining the post-acquisition asset structure of holding company units clearly show that bank holding company subsidiaries exhibit significantly higher loan-to-asset ratios than do independent banks [10, 11, 13, 15, 28, 34].

Therefore, the extensive empirical evidence indicates fairly conclusively that the post-acquisition asset structure of acquired subsidiary banks displays a greater risk orientation as reflected in the changes of their portfolio ratios. The findings that holding company subsidiaries invest a higher proportion of their assets in loans, indicates that bank holding companies more than likely extend more credit to their local communities.

Loan Portfolio Composition

Many studies that have analyzed the post-acquisition loan portfolio policies of acquired subsidiary banks, find that bank holding companies have had an important impact upon the loan structure of acquired banks. Bank holding companies tend to make more of all types of loans except farm loans. Two early empirical studies found that bank holding company subsidiary banks make more consumer loans [15, 34]. However later, more sophisticated empirical studies have found no evidence that holding company banks make more consumer loans. The empirical evidence on the effect of holding company affiliation upon other types of loans is mixed or inconclusive. Existing studies have found a statistically significant difference between holding company and independent banks in only two loan categories (business and real estate). One study shows that holding company banks make significantly more business loans [23] while two studies show the reverse in [21,]5]. In addition, two studies found that bank holding companies exhibit a significantly higher real estate loan to total assets ratio than do comparable independent banks]21,]5].

Overall, the evidence from an analysis of the post-acquisition loan portfolio of holding company subsidiary units clearly suggests that these organizations pursue more aggressive lending policies than independent banks. They commit a significantly higher portion of their total assets to loans. However, the evidence is mixed and inconclusive regarding holding company subsidiary banks' choice of particular types of loans.

Earnings and Expenses

Because bank holding companies tend to have more risky asset structures than their independent counterparts, it is likely that these organizations would exhibit significantly higher levels of total operating revenue to assets than the non-affiliated independent group in the post-acquisition years. This is indeed the case. Many empirical studies have found that these organizations significantly increase the earnings stream of acquired subsidiary banks [10, 11, 15, 21, 38].

Studies have also found that bank holding company subsidiary banks exhibit a significantly higher level of total operating expenses to assets than independent banks [15, 19, 38].1/ The source of this higher expense stream can be explained partly by the fact that bank holding companies pay significantly higher employee benefits [19], pay significantly higher interest on time and savings deposits [5, 11];2/ and have a significantly higher "other" current expenses to total assets relative to independent banks [10, 15, 19, 21, 34]. The source of such high "other" expenses reported by these banks has been attributed to management fees levied against the subsidiary for services rendered by the holding company. From this evidence, it is clear that after acquisition bank holding companies significantly increase both the earnings and expenses of their subsidiary banks.

Profitability

While bank holding company subsidiaries experienced both a significant increase in the total revenue to assets and the total

---

1/ One study found the reverse [21].

2/ However, to the extent that this higher interest paid on time and savings deposits reflects a different mix of these deposits, then it is not clear that affiliated banks are in fact paying higher interest rates on these deposits. Nevertheless, at least three studies have found for the most part, no significant difference in the ratio of time and savings deposits to total deposits between affiliated and independent banks [10; 19;

expense to asset ratios, the net effect upon profitability is unknown. Two studies have found that holding company banks experience a significantly lower net income to total assets ratio than independent banks [5, 19]. One study found the reverse [21]. Two other studies have found that bank holding company subsidiary units experience a significantly higher net income to total capital ratio than independent banks [21, 25] while one study found the reverse [19]. However, the net income to total capital ratio is not generally regarded as a satisfactory measure of profitability because of the discretion that banks have over their capital accounts. Moreover, in the case of bank holding companies the roles of parent and subsidiary bank capital and debt are not clear because of double leveraging. Finally, due to the use of expense generating methods to transfer income within a holding company system, it cannot be unambiguously concluded that bank holding companies have substantially improved or reduced the overall profitability of their subsidiary banks.

Capital Structure

A priori, it is difficult to assess the likely impact of the effect of holding company affiliation upon the capital structure of acquired firms. On the one hand, it is probably easier for holding company firms to raise additional capital since these firms are usually better known and their stock is more widely traded than smaller independent banks. Thus, more capital funds should be made available to supplement the capital base of the acquired subsidiary banks. Conversely, geographical diversification through the holding company system reduces the overall level of risk. Thus consistent with this lower level of risk,holding companies may hold lower capital levels in subsidiary banks. In addition, since holding company subsidiaries may view the parent holding company as a safety valve, this may explain the ability of subsidiary banks to maintain lower capital to asset ratios.

Several empirical studies confirm that bank holding company subsidiary banks exhibit significantly lower total capital to total assets [12, 21, 25] and equity capital to total assets ratios [5, 8, 12] than comparable independent banks. Next to the empirical literature on the post-acquisition asset structure of acquired banks, the results from studies on the capital structure of these organizations are the most consistent. The lower capital ratios exhibited by subsidiary units of bank holding companies, however, may be consistent with the lower levels of risk attached to the diversified firm. Whether this offsets or ameliorates significantly the increased risk orientation of their commercial banks (riskier portfolio and lower capital to asset ratios) is not known.

Growth

It has been argued that bank holding company systems usually possess on the average more financial and managerial resources, and tend to be more aggressive and expansion minded than independent banks. Thus, holding company banks should experience higher growth rates as measured by deposits or assets, than non-affiliated firms. Although this sounds plausable, there is no evidence that affiliated banks grow faster than independent firms. Of the studies that have analyzed this question, none have found a significant difference between the growth rates of holding company units and independent banks.

II. Bank Holding Companies and the Performance of Non-Banking Affiliates

Since the passage of the 1970 amendments to the Bank Holding Company Act of 1956, the Federal Reserve Board has permitted bank holding companies to enter a range of financially related activities. Most of which, however, were already permitted as activities for national banks. Two of the most popular types of activities for these organizations to enter have been mortgage banking and consumer finance. Since data on individual non-bank subsidiaries of bank holding companies are not generally reported, there have been few empirical studies analyzing the post-acquisition performance of these firms. To date, there have been only three empirical studies analyzing two types of activities (mortgage banking and consumer finance) which have attempted to determine the impact of holding company affiliation upon performance [30, 31, 35]. Although these studies are a important first step, it is too early to reach any firm conclusions because of the very limited empirical information and the relatively short period that bank holding companies have been engaged in some of these activities. This section will review the empirical literature on this subject.

Mortgage Banking

Mortgage banking has been one of the most popular non-banking industries that bank holding companies have entered since 1970. As of December 1976, some of the largest mortgage firms have become affiliated with bank holding companies. Under Section 4(c)(8) of the 1970 Amendments, bank holding companies must demonstrate that the acquisition of a non-banking financially related firm would produce public benefits. Thus, bank holding companies in filing their applications for prior approval to the Federal Reserve Board have made many claims that public benefits would flow from consummation of their acquisition. Some of these benefits would flow from improved performance in terms of (1) profitability; (2) capital structure; and (3) growth. These are discussed below.

Profitability

Bank holding companies typically claim that affiliation with a mortgage banker will provide the mortgage firm with more capital funds at a lower cost, because the parent company should be able to raise funds more easily than the independent firm. If this is so, then the lower borrowing cost should improve the profitability of the mortgage banking affiliate. Moreover, holding companies claim that they can improve the operating efficiency of these firms because, they possess superior managerial resources. If these assertions are true, then holding companies should have important effects upon the post-acquisition profitability of acquired mortgage affiliates.

One study has examined this question [35]. Talley studied the performance of 42 mortgage banking affiliates of bank holding companies for the years 1973 and 1974. Talley's findings indicate that mortgage banking affiliates of bank holding companies were less profitable than the mortgage banking industry as a whole for both 1973 and 1974. However, as the author indicates, the results should be taken with caution since the relatively brief post-acquisition period that mortgage firms were affiliated with bank holding companies in this study is not indicative of the long run performance of these firms. A much longer post-acquisition history is required. Also, because Talley never adjusted for the pre-acquisition operating performance of acquired firms, the study was not totally capable of isolating the effects of holding company affiliation. It is possible that bank holding companies acquired mortgage firms with operating characteristics not representative of the industry as a whole. Nevertheless, this limited information does indicate that expectations concerning the post-acquisition profitability of mortgage affiliates of bank holding companies were not, for whatever reasons, realized over the period covered by this study.

Capital Structure

The effects of bank holding company affiliation on capitalization of the acquired firms is again difficult to determine. To the extent that additional capital funds are made available to the mortgage affiliates, these firms may exhibit higher capital to asset ratios than non-affiliated firms. However, to the extent that diversification lowers risk to the holding company system, then the parent holding company may choose to leverage their subsidiary mortgage firms beyond industry standards.

One study has investigated this question to date [35]. The findings indicate that bank holding company subsidiary firms leveraged their mortgage affiliates beyond industry standards for the years 1973 and 1974. In this respect, Talley found that the mortgage affiliates of bank holding companies exhibited lower equity capital to total assets ratios than did the industry as a whole during these two years. Although these findings are tentative, they are consistent with empirical research that shows that holding companies significantly increase the leverage of their banking subsidiaries as discussed in the first section of this paper.

Growth

Bank holding companies claim that affiliation with mortgage bankers will significantly increase the flow of funds into the residential mortgage market. If this is true, then affiliated mortgage bankers should experience faster growth rates in terms of the volume of originations or loan servicing than independent mortgage firms.

One study analyzed this issue by comparing a sample of mortgage banking affiliates of bank holding companies and a group of independent mortgage firms [30]. Growth was measured by the change in the servicing portfolio for 32 acquired and independent firms for the years 1968 to 1972.1/ A multiple regression model was used in order to consider the influence of other variables on the servicing portfolio as well as to hold other factors constant. The results of this study indicate that mortgage firms affiliated with bank holding companies did not grow faster than comparable independent firms as measured by the growth in the volume of loan servicing. This study also found that the bank subsidiaries of holding companies did not increase or decrease the level of their real estate loans outstanding upon acquiring a mortgage banker. Thus, although the findings are tentative, at least one study indicates that bank holding companies, contrary to their original claims, have not increased the relative flow of funds to the real estate market when compared with independent firms.

Consumer Finance

Since 1970, bank holding companies have acquired a number of consumer finance companies. As of December 31, 1976, a few of the larger consumer finance companies have become affiliated with bank

---

1/ As the author indicates, a better measure of growth would be the volume of mortgage originations overtime but these data were not available.

holding companies. To date, there have been only two empirical studies that have examined the (1) expense; (2) profitability; (3) capital structure; and (4) growth effects of bank holding company acquisitions on the performance of consumer finance companies [31, 35].

Expenses

One study found some indication that consumer finance company affiliates of bank holding companies experience higher rather than lower borrowing costs than independent firms [31]. This finding is surprising since holding companies claim that they will lower borrowing costs to the affiliate and that these gains will be passed on to the public in the form of lower prices or better quality of services.

Profitability

As in mortgage banking and other non-banking activities, bank holding companies make claims concerning the public benefits that would flow from the acquisition of a finance company by a bank holding company. For example, these organizations claim that through their superior borrowing capacity they could increase the supply and reduce the cost of loanable funds to their affiliates. However, in the one study that has investigated this question there was no evidence that bank holding companies have lowered the borrowing costs to affiliated consumer finance companies [31]. In addition, holding companies also claim that they are capable of improving the operating efficiency of acquired firms by providing competent management and by supplying services to the affiliate at lower cost than the consumer finance affiliate could produce themselves or purchase from another source. If any part of these claims are true, then holding companies may be able to lower expenses and improve the post-acquisition profitability of these acquired firms.

Talley [35] found that consumer finance company subsidiaries are less profitable than non-affiliated independent firms. He used a sample of 14 major consumer finance company affiliates for the years 1973 and 1974. In both 1973 and 1974 the findings show that consumer finance company affiliates of bank holding companies had both lower net income to equity capital and net income to assets ratios than did the sample of independent firms in the study. As in the previously discussed study on mortgage banking, these findings by Talley are only suggestive because of the short post-acquisition period of the affiliated group under holding company control and the failure to adjust for the pre-acquisition performance of the sample of acquired firms. Of course, lower profitability, by itself, could be due to increased aggressiveness rather than reduced efficiency.

A later study [31] used multiple regression analysis and adjusted for the pre-acquisition performance of holding company affiliated consumer finance companies, but the results were similar to the Talley study. The authors selected a sample of 37 firms

(23 independent and 14 affiliated) for the pre-acquisition test and 38 firms (23 independent and 15 affiliated) for the post-acquisition test. They found that the consumer finance company affiliates of bank holding companies were significantly less profitable than the independent group for the year 1974. While this study was more sophisticated than the Talley study, it still focused on only one year of post-acquisition experience for the affiliated group (1974). Thus, this finding must also be considered tentative. Nevertheless, both studies indicate that the *a priori* expectations concerning the post-acquisition profitability of affiliated finance companies were not realized in the initial samples of firms examined.

Capital Structure

Given that risk is likely to be reduced with diversification, it is possible that holding companies would choose to leverage their consumer finance company affiliates in a fashion similar to their banking and mortgage banking affiliates. The two studies [31, 35] find that bank holding companies leverage their consumer finance company affiliates more than on-affiliated independent firms. One study found that for both 1973 and 1974, consumer finance company affiliates of bank holding companies were leveraged beyond the industry as a whole [35]. A second study found similar results [31]. Therefore, it appears from the available evidence that bank holding companies leverage their consumer finance affiliates to a greater extent than non-affiliated firms.

Growth

One study found that consumer finance company affiliates of bank holding companies grow faster than non-affiliated independent finance companies where growth is measured by total assets [31].

III. Summary and Conclusions

Given the large body of empirical research on the performance of bank subsidiaries of bank holding companies, it is now possible to draw some conclusions concerning the post-acquisition performance of these firms upon being acquired by a bank holding company.

1. The most consistent empirical evidence analyzing the post-acquisition operating policies of bank subsidiaries of bank holding companies suggests that bank holding companies have had the strongest impact upon the asset structure of acquired firms. It is clear from the evidence that bank holding company subsidiaries choose riskier investment and loan policies in the post-acquisition period. These firms hold less cash assets and U.S. government securities; hold more state and municipal securities and make more loans per dollar of assets than do their independent counterparts.

2. There is no evidence that the composition of the loan portfolio of holding company subsidiary bank changes systematically subsequent to affiliation.

3. Bank holding company subsidiary banks exhibit significantly higher post-acquisition earnings and expense streams than do comparable independent banks while the overall level of profitability of these firms is relatively unchanged in the post-acquisition period.

4. Bank holding companies leverage their subsidiary banks significantly more than comparable independent banks. A number of the empirical studies show that holding company banks exhibit significantly lower capital to assets ratios than comparable independent banks.

5. The evidence shows that holding company banks on average do not grow any faster than independent banks as measured by the growth in total deposits of these organizations.

Unlike the literature on the post-acquisition performance of subsidiaries of bank holding companies, however, the research on non-bank financially related firms that have been acquired by holding companies is very limited. Thus, the conclusions n from research in this area must be considered tentative est.

1. To date, bank holding companies have not had a significant positive impact upon the post-acquisition operating performance of non-bank affiliates. Two empirical studies analyzing the post-acquisition performance of mortgage affiliates of bank holding companies find that these firms are not as profitable; do not grow any faster; and are higher leveraged than the industry as a whole.
2. The available evidence with respect to the performance of consumer finance company affiliates of bank holding companies also indicates that at least to date, the claims by bank holding companies have not been fulfilled. The limited evidence indicates that consumer finance affiliates of bank holding companies are: less profitable, more highly leveraged, incur higher interest expense on borrowed funds, and grow faster than independent consumer finance companies.

REFERENCES

1. Carter H. Golembe Associates, Inc., "The Future of Registered Bank Holding Companies: Operation, Regulation, and Potential in a Changing Financial Environment," The Association of Registered Bank Holding Companies, March, 1971.

2. Drum, Dale S., "MBHCs: Evidence After Two Decades of Regulation," Business Conditions, Federal Reserve Bank of Chicago, December, 1976, pp. 3-15.

3. ____________, "Nonbanking Activities of Bank Holding Companies," Economic Perspectives, Federal Reserve Bank of Chicago, March/April, 1977, pp. 12-21.

4. Fischer, Gerald C., Bank Holding Companies, Columbia University Press, New York, 1961.

5. Fraas, Arthur G., "The Performance of Individual Bank Holding Companies," Staff Economic Studies, No. 84, Board of Governors of the Federal Reserve System, 1975. A summary of this paper appeared in the Federal Reserve Bulletin, Vol. 61, 1975, pp. 472-473.

6. Gady Richard L., "Performance of Rural Banks and Changes in Bank Structure in Ohio," Economic Review, Federal Reserve Bank of Cleveland, November/December, 1971.

7. Heggestad, Arnold A., "Riskiness of Investments in Nonbank Activities by Bank Holding Companies," Journal of Economics and Business, Vol. 27, Spring, 1975, pp. 219-223. A slightly modified version of this paper was also published as "Diversification, Risk, and the Bank Holding Company," Banker's Magazine, Vol. 159, Winter, 1976, pp. 109-112.

8. ____________ and John J. Mingo, "Capital Management by Holding Company Banks," Journal of Business, Vol. 48, No. 4, October, 1975, pp. 500-505.

9. Herzig-Marx, Chayim, "Holding Companies and Deposit Variability," Business Conditions, Federal Reserve Bank of Chicago, March, 1976.

10. Hoffman, Stuart G., "The Impact of Holding Company Affiliation on Bank Performance: A Case Study of Two Florida Multibank Holding Companies," Working Paper Series, Federal Reserve Bank of Atlanta, January, 1976. An earlier summary of this was published as "A Florida Case Study: Performance of Holding Company Banks," Monthly Review, Federal Reserve Bank of Atlanta, December, 1975, pp. 202-205.

11. Jackson, William, "Multibank Holding Companies and Bank Behavior," Working Paper 75-1, Federal Reserve Bank of Richmond July, 1975.

12. ______________ and Steven A. Seelig. Bank Holding Companies and the Public Interest: An Economic Analysis, Lexington, Mass.: D.C. Heath and Company, 1977.

13. Johnson, Rodney D. and David R. Meinster, "The Performance of Bank Holding Company Acquisitions: A Multivariate Analysis," Journal of Business, Vol. XLVIII, April, 1975, pp. 204-212.

14. ______________ "An Analysis of Bank Holding Company Acquisitions: Some Methodological Issues," Journal of Bank Research, Vol. IV, No. 1, Spring, 1973, pp. 58-61.

15. Lawrence Robert J. "The Performance of Bank Holding Companies," Board of Governors of the Federal Reserve System, June, 1967.

16. ______________, "Operating Policies of Bank Holding Companies -- Part I," Staff Economic Studies, No. 59, Board of Governors of the Federal Reserve System, April, 1971.

17. ______________, "Operating Policies of Bank Holding Companies -- Part II: Nonbanking Subsidiaries," Staff Economic Studies, No. 81, Board of Governors of the Federal Reserve System, March, 1974.

18. ______________ and Samuel H. Talley, "An Assessment of Bank Holding Companies," Staff Economic Studies, Board of Governors of the Federal Reserve System, Federal Reserve Bulletin, Vol. 62, No. 1, January, 1976, pp. 15-21.

19. Light, Jack S., "Effects of Holding Company Affiliation on De Novo Banks," Proceedings of a Conference on Bank Structure and Competition, Federal Reserve Bank of Chicago, 1976, pp. 83-106. A condensed version of this study is published as "Effect of Holding Company Affiliation on De Novo Banks," Business Conditions, Federal Reserve Bank of Chicago, July, 1976, pp. 11-15.

20. Mayne, Lucille S., "Management Policies of Bank Holding Companies and Bank Performance," Journal of Bank Research 7, No. 1, Spring, 1976, pp. 37-48.

21. ________________, "A Comparative Study of Bank Holding Company Affiliates and Independent Banks, 1969-1972," The Journal of Finance, Vol. XXXII, No. 1, March, 1977, pp. 147-158.

22. McCleary, Joe W., "Bank Holding Companies: Their Growth and Performance," Monthly Review, Federal Reserve Bank of Atlanta, October, 1968, pp. 131-138.

23. ________________, "Absentee Ownership -- Its Impact on Bank Holding Company Performance," Monthly Review, Federal Reserve Bank of Atlanta, August, 1969, pp. 99-101.

24. Mingo, John J., "Capital Management and Profitability of Prospective Holding Company Banks," Journal of Financial and Quantitative Analysis, Vol. X, No. 2, June, 1975, pp. 191-203.

25. ________________, "Managerial Motives, Market Structures and the Performance of Holding Company Banks," Economic Inquiry, Vol. XIV, No. 3, September, 1976, pp. 411-424.

26. Moyer, R. Charles and Edward Sussna, "Registered Bank Holding Company Acquisition: A Cross-Section Analysis," Journal of Financial Quantitative Analysis, September, 1973.

27. Nader R. and J Brown, "Disclosure and Bank Soundness: Non-Bank Activities of Bank Holding Companies," Public Interest Research Group, Washington, D.C., June 30, 1976.

28. Piper, Thomas R., The Economics of Bank Acquisitions by Registered Bank Holding Companies, Research Report No. 48, Federal Reserve Bank of Boston, March, 1971.

29. ________________ and Steven J. Weiss, "The Profitability of Bank Acquisitions by Multi-Bank Holding Companies," Federal Reserve Bank of Boston, New England Economic Review, September/October, 1971, pp. 2-12.

30. Rhoades, Stephen A., "The Effect of Bank Holding Company Acquisitions of Mortgage Bankers on Mortgage Lending Activity," Journal of Business, July, 1975.

31. ____________ and Gregory E. Boczar, "The Performance of Bank Holding Company-Affiliated Finance Companies," Staff Economic Studies, No. 90, Board of Governors of the Federal Reserve System, 1977.

32. Rose, P.S. and D.R. Fraser, "Bank Holding Company Diversification into Mortgage Banking and Finance Companies," Banking Law Journal, Winter, 1974, pp. 976-994.

33. Schotland, Roy A., "Bank Holding Companies and Public Policy Today," Compendium of Papers Prepared for the FINE Study, U.S. House of Representatives, Committee on Banking, Currency and Housing, 94th Congress, Second Session, Book I, June, 1976.

34. Talley, Samuel H., "The Effect of Holding Company Acquisitions on Bank Performance, Staff Economic Studies, No. 69, Board of Governors of the Federal Reserve System, 1974.

35. ____________, "Bank Holding Company Performance in Consumer Finance and Mortgage Banking," The Magazine of Bank Administration, LII, No. 7, July, 1976, pp. 42-44.

36. Upson, Roger B. and Paul F. Jessup, "Returns From Bank Holding Companies," Banker's Magazine, Spring, 1972.

37. Varvel, Walter A., "The Motivation for Bank Holding Company Acquisitions," Working Paper 76-2, Federal Reserve Bank of Richmond, 1976.

38. Ware, Robert F., "Performance of Banks Acquired by Multibank Holding Companies in Ohio," Economic Review, Federal Reserve Bank of Cleveland, March/April, 1973.

39. Weiss, Steven J., "Bank Holding Companies and Public Policy," New England Economic Review, Federal Reserve Bank of Boston, January/February, 1969, pp. 3-27.

Section V

BANK HOLDING COMPANY AFFILIATION AND COST EFFICIENCY

James Burke

The Bank Holding Company Act of 1956, as amended in 1970, directs the regulatory agencies to consider the probable effects of a merger or acquisition upon competition. Any findings of significant anticompetitive effects may, however, be offset by a number of considerations which indicate that, overall, convenience and needs in the case of a bank acquisition, and the public interest in a nonbanking case, would be served by approval of a particular combination. 1/ As stated explicitly in Section 4(c)(8) of Regulation Y, one of these offsetting factors is "gains in efficiency" which would be achieved through bank holding company acquisitions of nonbank firms. Although "efficiencies" are not specifically mentioned in Section 3(a)(3) of Regulation Y, which pertains to bank acquisitions, it is stated therein that:

> In every case, the Board shall take into consideration the financial and managerial resources and future prospects of the company or companies and the banks concerned, and the convenience and needs of the community to be served.

Since the financial resources and future prospects of an acquired firm can indeed be affected if efficiencies are realized, the Board has often made references to economies of scale in assessing the merits of an acquisition. The Board has also recognized that the public may benefit

---

1/ For a more complete discussion of these factors see the paper by Cyrnak in this compenduim.

directly, if firms provide better services or lower the prices charged to consumers as a result of lower costs. 1/

This paper reviews the existing evidence with respect to economies achieved by both banks and other firms after they are acquired by bank holding companies (BHCs). 2/ In Section I studies which pertain to bank acquisitions are reviewed and non-bank acquisitions are discussed in Section II.

I. Bank Acquisitions and Efficiency

Economic efficiency, as it has been interpreted by researchers in this area can pertain to both economies of scale and economies of organizational structure. Economies of scale occur when a bank is able to increase its output of services by some amount with a less than proportionate increase in costs, i.e., per unit costs decrease as banks increase in size. Organizational economies, however, refer to lower costs attributable to affiliation with either a branch system or a holding company organization.

There are a number of reasons why researchers, regulators, and bankers have come to expect increased efficiencies after banks affiliate

---

1/ However, the Supreme Court has indicated in both bank and non-bank cases that economies are not an anti-trust defense to illegality. See FTC v. Proctor and Gamble Co., 87 S. Ct. 1224, 1231 (1967).

2/ Although there is an extensive body of research pertaining to economies of scale in banking, only those studies which pertain specifically to economies of holding company affiliation (by either unit or branch banks depending upon the samples used by researchers) are discussed in this study.

with holding companies. Affiliations almost always involve closer ties with branch-like networks of banks, usually comprised of a large lead bank and several geographically dispersed affiliates. Each subsidiary can draw upon the expertise and resources of the lead bank and other affiliates and expand their output of various services. The parent holding company, especially if quite sizable, may also provide additional capital and improve upon the management of acquired banks. Many holding companies also provide for centralized purchasing and advertising as well as legal counsel and tax advice.

A. Cost Studies

Although the literature dealing with economies of scale in banking is very extensive, there have been relatively few empirical studies which focused specifically upon the economies of scale associated with holding company affiliation. The methodology employed in both of these areas of study was essentially similar. Most of these studies employed Federal Reserve Functional Cost data[1/] rather than expense data from the Reports of Condition. The statistical techniques employed in these studies were generally

---

1/ Since 1962, the Federal Reserve System has offered a functional cost accounting service member banks. Participating banks receive a cost breakdown among operating functions for their bank as compared to a large group of similar sized banks. Economists within the Federal Reserve System have found that the managers of FCA participating banks are significantly more profit oriented and cost conscious than the average bank manager. Thus, while it is possible to determine whether potential economies of scale exist, it is difficult to generalize about the extent to which they are being realized by holding company affiliate in general. See Heggestad, A.A. and Mingo, J.J., "On the Usefulness of Functional Cost Analysis Data," mimeographed, Board of Governors Federal Reserve System, 1973.

much more sophisticated than the portfolio ratio studies which are discussed in Section B. In some instances a single cost function or production function was estimated while in other studies a disaggregate approach was used. The disaggregated approach requires the estimation of separate functions for various bank outputs, e.g., time deposits, demand deposits and securities.

Kalish and Gilbert [7] were among the first researchers to employ FCA data in a cost function approach specifically designed to test for organizational economies. Output was defined as total earning assets, and average costs as net annual operating expenses. In another estimation, output was defined as gross revenue and average cost as the ratio of revenue to net operating expenses.1/ It was found that affiliated banks were uniformly more efficient than independent unit banks and that larger affiliated banks were more efficient than independent branch as well as unit banks.

1/ Studies of this sort which employ only one output dimension rather than estimating cost functions for several bank assets result in biased estimates of cost efficiency in favor of banks which hold greater proportions of assets with lower costs.

Another FCA study [10] by Longbrake and Haslem focused only upon the demand deposit function. Costs were analyzed in relation to the scale of output and the form of organization - unit, branch bank, or holding company affiliate. In this study it was also found that when the average account balance and the number of accounts per office are large, affiliated banks have lower operating costs per dollar of demand deposits than independent banks.

In another study by Longbrake and Johnson [11], cost functions for seven different categories of services were estimated. Those included demand deposits, time deposits, instalment loans, business loans, real estate loans, securities, and safe deposit boxes. It was found that unit non-affiliates were more efficient than offices of branch banks or holding company organizations when office size is less than $10 million in deposits. These results indicate that coordination expenses will exceed economies stemming from centralization when an office with less than $10 million in deposits becomes a holding company affiliate. However, as office size increases, average unit costs decline more rapidly in branch offices and holding company affiliates so that at some office size they will be more efficient than unit banks. Affiliates were found to realize economies in those activities and functions which can be centralized more easily in a holding company; for instance when increasing the output of demand deposit services by expanding office size, unit affiliates were subject to substantial economies while unit non-affiliates witnessed slight diseconomies.

Benston and Hanweck [1] also estimated numerous cost functions for the period 1969-74 using FCA data. The results indicated that through affiliation, independent banks may reduce average costs in several important banking functions (demand deposits, real estate lending, and administrative services). For example, BHC affiliates on average tended to have about a 12 percent lower average cost than independents for the demand deposits function. The results further indicated that banks affiliated with larger BHC organizations tend to have lower average costs.

Mullineaux [12] in a study primarily concerned with cost differences between branch and unit banks also performed a statistical test to determine whether holding company affiliation had any effect upon bank costs. His findings suggested that affiliated unit banks experienced some cost reductions but that these were not statistically significant. For branch banks, however, affiliation was shown to increase costs. This latter finding, however, is not surprising, since as many researchers have suggested, there may be some duplication of functions involved in combined branch-holding company systems. The sample of banks used in this study were located in Federal Reserve Districts 1, 2, and 3 where such combinations are common.

In another cost function study which used 1964 Reports of Condition data from the ninth Federal Reserve District (Minneapolis), Schweitzer [14] found that banks in the $3.5 million to $25 million asset size class, were more efficient than independent banks. The organizational economics, more substantial for affiliates of large groups, suggest that holding company affiliation affords unit banks many of the benefits presumed to be associated with branch banking.

The studies reviewed in this section suggest that banks which affiliate with holding companies incur some expense due to costs of centralization. Small unit banks may not achieve levels of output sufficient to offset these expenses. However, as affiliated banks become larger, (over $30 to 40 million in deposit size) economies of affiliation enable holding company subsidiary banks to achieve lower average costs than similar sized independent banks.

B. Portfolio Ratio Studies

Although they were not specifically designed to analyze holding company efficiency, there have been several studies whose results bear upon the issue. These studies focused upon holding company performance in general by comparing a number of affiliated banks with control groups of independent banks. They analyzed differences in asset structure, operating policies, prices and services, as well as earnings and expenses.2/ 3/

1/ One could expect, a priori, that unit banks which become affiliated with holding companies have more to gain in the way of efficiences than banks which are already part of branch networks. It should be recognized, however, that some holding company affiliated banks may realize somewhat smaller economies of scale than branch banks since varying degrees of autonomy granted to subsidiaries may limit opportunities to centralize some operations.

2/ Although total operating expenses as reported on the Consolidated Report of Income (Form F.R 107) include several categories, the principal ones are salaries and wages, pension and employee benefits, interest on deposits, and "other" operating expenses. If a particular performance study contained no findings with respect to cost or expense differences, it is not discussed in this section.

3/ See the paper by Curry for a more general discussion of these performance studies.

The earliest broad-based study of this sort was completed by Lawrence [8] in 1967. He analyzed 32 financial ratios of 43 bank pairs located in several states. The only expense category in which holding company affiliates had significantly higher ratios was "other" operating expenses. Talley [15] later completed a similar study which included 82 pairs of banks and again the findings revealed that affiliated banks had higher "other" operating expenses. Two other studies confined to the states of Florida and Ohio, respectively, also indicated that holding company affiliated banks had higher operating expenses. The Florida study by Hoffman [2] compared 29 measures of bank performance for a sample of 13 paired affiliated and independent banks for each of two holding companies. The subsidiaries of one of the holding companies experienced significantly higher operating expenses than affiliates of the other; however, both had somewhat higher expenses than the independent banks. The higher cost was again attributable primarily to the "other" operating expense category. Ware [16] in his Ohio study compared 27 performance ratios for 44 affiliated vs. independent pairs of banks. In keeping with the findings of other studies it was found that acquired banks had a significant post-acquisition increase in "other" operating expenses. In another study by Light [9] which included a sample of 192 <u>de novo</u> banks located in 24 states, it was revealed that holding company affiliates have higher total operating expenses. Further analysis revealed that these higher costs were in large part attributable to the sub-categories; higher employee benefits and higher other expenses.

Based upon the above findings with respect to efficiency ratios, it may appear that affiliation with a bank holding company results in organizational diseconomies rather than organizational economies. The principal reason for the higher total expenses as noted in most of the studies was the higher "other" operating expense category. It has been suggested by these researchers that the higher expenses may be attributed to management fees charged by holding companies. Other expenses reported in this "other" operating expense category, such as retainer and legal fees and fees paid to directors and committee members, may also be unique to holding companies. Each of these expenses are methods of transferring income within a holding company system in lieu of dividend payments and thus may not be truly reflective of organization diseconomies. It also may be that more comprehensive pension and employee benefits programs which are common in the larger holding company organizations are another factor contributing to higher expenses.

The findings of these studies have been questioned by Johnson and Meinster [5] because of the statistical methodlogy employed. Each used a simple "t" test to test for univariate differences in group means. The assumption that pairing the affiliated bank with a similar sized local bank provides an adequate control procedure for the purposes of such comparisons has also been criticized.

II. Non-Bank Acquisitions

Since passage of the 1970 Amendments to the Bank Holding Company Act the Board has approved 17 activities as permissible for bank holding companies. In applications submitted to the Board, holding companies typically claim as a public benefits that a proposed acquisition will result in lower cost and increased operating efficiency.1/

Although there is currently much interest in the post-acquisition performance of holding company affiliated non-bank firms there is a paucity of empirical studies relating to this subject. The reason for this lack of evidence is that the data necessary to conduct such studies are not readily available. In addition, many of these acquisitions were made quite recently; thus, the post-acquisition period of analysis would not be of sufficient duration to derive meaningful results. The only published empirical study to date in which some reference to efficiencies is made, was recently completed by Rhoades and Boczar [13] of the Federal

---

1/ See Jessee and Seelig [3].

24-934 O - 78 - 41

Reserve Board staff. The authors compared the operating characteristics of a sample of 25 independent and 15 bank affiliated consumer finance companies.[1/] In keeping with holding company claims it was hypothesized that costs would be lowered since the organizations could provide accounting, computer, and personnel services to the finance subsidiary rather than having the subsidiary provide these services for itself or contract for them with an outside party. The results indicated that prior to their acquisition, the affiliated companies were not significantly different from the independent companies in terms of performance and financial soundness. After affiliation, it was determined that the holding company subsidiaries still did not have lower operating expenses than independent companies. This study generally does not confirm the arguments of bank holding companies that their entry into the consumer finance industry will yield numerous public benefits, among them lower operating costs.

Summary

With respect to cost efficiency, there is a good deal more empirical evidence relating to holding company acquisitions of banks than non-banking firms. The findings relative to non-banking firms must be judged as in the preliminary stages. Although some portfolio ratio studies of acquired banks indicate that affiliates have higher expenses

---

1/ In addition to the small sample size another major shortcoming of this study is that it included only one year of post-acquisition data.

in some categories, these studies do not address the question of overall cost efficiency or costs related to the production of specific bank services. Studies which have used more refined statistical methods and have examined several areas of bank costs, suggest that although affiliated banks incur coordination expenses they also realize economies in the production of several bank services. Like some smaller branch bank offices, smaller holding company affiliates may not have sufficient volume to offset some of these centralization expenses, but as they expand output, per unit costs for many services are significantly lower than those incurred by independent unit banks.

REFERENCES

1. Benston, G., and Hanweck, G. "A Summary Report on Bank Holding Company Affiliation and Economies of Scale," In Conference on Bank Structure and Competition, Chicago: Federal Reserve Bank of Chicago, 1977, pp. 158-168.

2. Hoffman, S. "The Impact of Holding Company Affiliation on Bank Performance: A Case Study of Two Florida Multibank Holding Companies," Working Paper Series, Federal Reserve Bank of Atlanta, January 1976.

3. Jessee, M. and Seelig, S. "An Analysis of the Public Benefits Test of the Bank Holding Company Act," Monthly Reivew of the Federal Reserve Bank of New York, June 1974, pp. 151-152.

4. Jessup, P. "Acquisitions by Bank Holding Companies: Promise Performance, Potential," In Conference on Bank Structure and Competition, Chicago: Federal Reserve Bank of Chicago, 1974, pp. 15-28.

5. Johnson, R. and Meinster, D. "An Analysis of Bank Holding Company Acquisitions Some Methodological Issues," Journal of Bank Research, IV (Spring 1973), pp. 58-61.

6. Johnson, Rodney D. and Meinster, David R. "The Performance of Bank Holding Company Acquisitions: A Multivariate Analysis," Journal of Business, XLVIII (April, 1975), pp. 204-12.

7. Kalish, L. and Gilbert, R.A. "An Analysis of Scale and Organizational Form in Commercial Banking," The Journal of Industrial Economics, Vol., 21, July 1973, pp. 293-307.

8. Lawrence, R. The Performance of Bank Holding Companies, Wash., D.C.: Board of Governors of the Federal Reserve System, June 1967.

9. Light, J. "Effects of Holding Company Affiliation on De Novo Banks," In Proceedings of a Conference on Bank Structure and Competition, Chicago: Federal Reserve Bank of Chicago, 1976, pp. 83-105.

10. Longbrake, W and Haslem, J. "Productive Efficiency in Commercial Banking: The Effects of Size and Legal Form of Organization on the Cost of Producing Demand Deposit Services," forthcoming, Journal of Money, Credit, and Banking.

11. Longbrake, W. and Johnson, M "Economies of Scale in Banking," Magazine of Bank Adminsitration, July 1975, pp. 32-38.

12. Longbrake, W. "Differential Effects of Single-Plant, Multi-Plant, and Multi-Firm Organizational Forms on Cost Efficiency in Commercial Banking," Working Paper No. 74-7, Federal Deposit Insurance Corporation, Wash. D.C., 1974.

13. Mullineaux, D. "Branch Versus Unit Banking: An Analysis of Relative Costs." In Changing Pennsylvania's Branching Laws: An Economic Analysis," Technical Papers, Philadelphia: Federal Reserve Bank of Philadelphia, 1973.

14. Rhoades, S. and Boczar, G. "The Performance of Bank Holding Company Affiliated Finance Companies," Staff Economic Studies #90, Washington, D.C.: Board of Governors of the Federal Reserve System, 1977.

15. Schweitzer, S. "Economies of Scale and Holding Company Affiliation in Banking," Southern Economic Journal, October 1972, pp. 258-66.

16. Talley, S. "The Effect of Holding Company Activity on Bank Performance, Staff Economic Studies #69, Washington, D.C.: Board of Governors of the Federal Reserve System, 1972.

17. Ware, R. "Performance of Banks Acquired by Multibank Holding Companies in Ohio," Economic Review, Federal Reserve Bank of Cleveland, March-April, 1973.

Section VI

The Effect of the Bank Holding Company Movement on Bank Safety and Soundness: A Literature Review

John T. Rose

In recent years considerable concern has been expressed in various quarters regarding the stability of the American banking system. This concern may be attributed in large part to the rise in the number of bank failures, particularly the failure of several relatively large banks. In addition, the secular trend toward greater aggressiveness in the banking industry, as reflected in declining bank capital ratios, more aggressive management of bank asset and liability portfolios, and rapid expansion by many banks into foreign markets,[1/] have no doubt contributed to public interest in the soundness of the banking system.

The bank holding company (BHC) movement, too, has raised questions regarding bank safety and soundness. Indeed, Congress expressed some concern in this area when it enacted the Bank Holding Company Act by requiring that the Federal Reserve Board give attention to the matter of bank soundness both in deciding bank acquisition cases as well as in determining whether BHCs should be permitted to engage in various nonbanking activities.[2/] More recently, interest in the risk exposure of BHC banks

---

1/ This trend is discussed in some detail in [38].

2/ Section 3(c) of the Bank Holding Company Act requires that in every case of a bank acquisition under the Act, the Federal Reserve Board "...shall take into consideration the financial and managerial resources and future prospects of the company or companies and the banks concerned..." In addition, Section 4(c)(8) of the Act requires that in determining whether a particular nonbanking activity is appropriate for BHCs, the Board must consider whether the performance of the activity by an affiliate of a holding company "...can reasonably be expected to produce benefits to the public... that outweigh possible adverse effects such as...unsound banking practices."

has received an added boost as BHCs have, in the aggregate, acquired a large number of nonbanking subsidiaries, some of which are engaged in activities that are prohibited to banks. Moreover, some of the larger (over $100 million assets) bank failures of recent years involved BHC banks, and two of the three largest bank failures were BHC subsidiaries.[1/]

The present study addresses the question of whether the BHC movement has served to weaken the stability of the banking system. More specifically, this study explores whether the organizational/financial flexibility inherent in the holding company form of banking organization has resulted in an increase in the risk exposure of BHC banks.

The flexibility of the holding company form offers four avenues by which the risk exposure of BHC banks may be affected. These include (1) expansion of banking activities via nonbanking affiliates,[2/] (2) BHC expansion into new activities, (3) multibank expansion, and (4) parent company leveraging. In the remainder of this paper, each of these avenues is examined in a separate section. Within each section, the following appear: (A) a summary of the principal theoretical issues; and (B) a review of any relevant empirical evidence.

I. Expansion of Banking Activities Via Nonbanking Affiliates

A. Theoretical Issues[3/]

One avenue by which the flexibility of the holding company form may affect bank risk exposure pertains to the opportunity for BHCs to expand

---

1/ Franklin National Bank, New York, and Hamilton National Bank of Chattanooga were BHC subsidiaries; U.S. National Bank of San Diego was not.

2/ As used in this paper, the term "affiliate" refers to the parent holding company of a given bank or any other subsidiary of the parent, but not to a subsidiary of the bank.

3/ The theoretical discussion in this section is somewhat protracted due in part to the fact that the various elements of BHC bank risk exposure are here defined in some detail. With these definitions, the theoretical discussion in later sections can be abbreviated.

certain of their banking activities via nonbanking affiliates. In particular, holding companies enjoy two routes for such expansion, including (1) spinning off banking activities to nonbanking affiliates and (2) acquiring companies engaged in activities that are already permissible to banks. Each of these routes is discussed below.

1. Spinning Off Banking Activities

One route open to the BHC to expand its banking activities is to spin off certain activities from the bank (whether they be departments within the bank or subsidiaries of the bank) to a nonbanking affiliate(s).1/ By so doing, the spun-off activity is relieved of the geographical restrictions that apply to banks, thereby facilitating expansion of the activity into new geographic markets.

The impact of such spin-offs on bank risk exposure is twofold. First, the bank may experience a change in its direct risk exposure (i.e., the risk associated with the bank's own activities). Depending on whether the riskiness of the spun-off activity (as measured by the coefficient of variation of activity profits)2/ is greater or less than the average riskiness of activities remaining in the bank, bank risk exposure could be decreased or increased, respectively. Moreover, to the extent that the

---

1/ Nearly all of the nonbanking activities that have been approved by the Federal Reserve Board as permissible for BHCs are also permissible for national banks. Likewise, most of the activities that have been denied by the Board as permissible for BHCs are also impermissible for national banks. [10]

2/ The "coefficient of variation of activity profits" is defined as the variability of profits accruing to the activity, divided by the average profits earned on the activity.

decreased diversification of bank activities resulting from any such spin-offs increases the cyclical variation in bank earnings (due to imperfect correlation between the earnings variability of a spun-off activity and the activities remaining in the bank), bank risk exposure should be increased.1/

Second, such spin-offs raise the specter of financial loss to the bank due to the "non-arm's-length" relationship that exists between a bank and its nonbanking affiliates. The risk of such loss, hereafter referred to as "affiliation risk," has three dimensions.2/ First, there is the risk that if the affiliated company fails, the bank's "corporate veil" could be pierced and it could be held liable for the debts of the insolvent company. While there is debate on this question, the consensus of legal opinion seems to be that banks are generally protected from creditor claims and suits against the parent holding company or a sister subsidiary, provided that the bank and its affiliates are clearly operated as separate businesses and are portrayed as such to the public [6; 44; 51].

1/ These two dimensions of direct risk exposure are discussed in a somewhat different context in [13].

2/ Actually, affiliation risk for a bank already exists with respect to those activities that are conducted by corporate subsidiaries of the bank (to the extent that they are financed by outside borrowing). Indeed, one observer has noted that in the case of spun-off activities that were previously conducted by a subsidiary of the bank, affiliation risk to the bank may be somewhat reduced with these activities relocated in a nonbanking affiliate [44]. On the other hand, to the extent that the spun-off activities are operated in a riskier manner in an affiliated company than they were as a subsidiary of the bank, affiliation risk for the bank may be increased.

The second dimension of affiliation risk may be termed the "risk of association." Specifically, it is argued by many observers [6; 7; 38; 44; 48] that even if a parent holding company operates its subsidiaries as separate businesses, the fact that a bank and a financially troubled affiliate share common parentage (and perhaps similar names) may create uncertainty in the public's mind as to the bank's solvency. This, in turn, may precipitate a run on the uninsured deposits of the bank, possibly causing the failure of an otherwise sound bank.1/ Finally, because of the risk of association, BHC banks are generally thought to be subject to a third type of affiliation risk, namely, the risk that the parent holding company will use the resources of its bank subsidiary to try to rescue a failing affiliated company in order to protect the BHC from reputation damage a:

1/ For example, when Beverly Hills Bancorp, Los Angeles, encountered financial problems in 1974, its single bank subsidiary experienced a significant loss of deposits, resulting in the eventual forced merger of the bank [44; 50].

lawsuits [6; 38; 44]. 1/ 2/ While such a rescue operation might be successful, it could also backfire and result in the failure of the entire BHC, including the bank. 3/

The significance of affiliation risk is seen particularly in the fact that it may be increased or decreased once a spun-off activity is incorporated as a nonbanking affiliate. Nonbanking affiliates are unencumbered by geographical restrictions on their activities. To the extent, therefore, that capital flows between markets are less than perfect, expansion by a nonbanking affiliate into new geographic markets should smooth

---

1/ This risk is limited somewhat by statutory restrictions both on the amount of dividends that a bank can pay out as well as on the amount of financial transactions (e.g. loans and purchases of assets) that a bank can have with an affiliated company However, the restrictions on a bank s dividends do allow for full payout of each year s earnings so that capital accumulation by a subsidiary bank could be sacr ficed in order to channel funds to a troubled nonbanking affiliate. In addition current statutory restrictions on a bank's transactions with its affiliates are characterized by a number of significant "loopholes" 3 Finally there are no legal limitations on other avenues by which a BHC bank may aid a troubled affiliate (e.g. through the payment of excessive management fees o the bank s parent holding company) though the examination process may be expected to restrict such avenues to some extent.

In addition, severa BHCs may participate in a "back-scratching arrangement" to avoid lending limits by having their subsidiary banks provide back-up ine of credit to the nonbank subsidiaries of each other. In that case the failure of a nonbank subsidiary in one of the participating BHCs could impact adversely on the banks in the other BHCs [38].

2/ There is also the risk that because of the "non-arm's-length" relationship between the bank and its affi iated companies, the bank may lend to such companies at favored terms, even if an affiliated company is in sound financial condition [3; 44]. In addition, the bank could possibly aid an affiliate by lending to the affiliate's customers at preferred terms [12 Either course of action would impact adversely on the bank's financial condition.

3/ For example, Hamilton National Bank of Chattanooga failed in 1976 after having purchased a large amount of low quality mortgages from the mortgage banking subsidiary of its parent holding company [35].

out the affiliate's earnings variation somewhat. As a result, the direct risk exposure of the affiliate should be reduced, along with the affiliation risk of the bank(s) in the holding company.

At the same time, once an activity is spun off a bank, it is no longer subject to the same legal and regulatory apparatus applicable to banks.1/ Thus, unless equally stringent regulation is put in force for nonbanking affiliates, the spun-off activity may be conducted in a riskier manner than it was when it was lodged in the bank, thereby increasing affiliation risk to the bank.

Finally, changes in affiliation risk for the bank may result in compensating adjustments in the bank's direct risk exposure, e.g., the bank may be willing to take on more direct risk as an offset to reduced affiliation risk.

2. Acquiring Companies Engaged in Activities that are Permissible to Banks

A second route open to the BHC to expand its banking activities is to acquire on-going and/or de novo nonbanking companies that are engaged in activities already permissible to banks. This route suggests no effect on the direct risk exposure of the bank (except perhaps for adjustment effects following changes in bank affiliation risk, as noted above). However, to

---

1/ For a discussion of the differences between banks and nonbanking companies with respect to three activities -- consumer finance, commercial finance, and mortgage banking -- that are permissible to national banks as well as BHCs, see [8].

the extent that such acquisitions involve product-line and/or geographical diversification for the acquiring BHC,1/ the result should be to smooth out the earnings variation of the parent holding company, thereby lowering the parent's direct risk exposure, with an attendant reduction in the affiliation risk of the bank.

At the same time, once a nonbanking company is acquired by a BHC, the acquired company itself may be willing to take on more direct risk, for several reasons. First, access to the resources of its sister bank in times of financial strain may encourage the acquired company to increase its own risk exposure, depending on (1) the effectiveness of the various constraints on financial transactions between a bank and its affiliates and (2) the propensity of bank regulators to protect nonbanking affiliates so as to maintain confidence in the subsidiary banks.2/ Second, the management of the acquired company may act in a riskier manner under holding company control because there is greater "separation" between the management of the company and the ultimate owners (i.e., the stockholders of the BHC) in a holding company organization.3/ Finally, holding company managers may be more aggressive and less risk averse than managers of independent companies [22]. Indeed, the fact that the BHC form permits both geographical and product-line expansion, thereby facilitating growth maximization, suggests that the BHC form may itself be indicative of an aggressive managerial

---

1/ While an activity may be generally permissible to banks, it may not be engaged in by a particular bank. In that case, acquisition by the bank's parent company of a company engaged in that activity represents product-line diversification, much like that associated with BHC expansion into new activities, as discussed in the next section.

2/ The second point is discussed in some detail in [22].

3/ This hypothesis is discussed with respect to bank subsidiaries of a BHC and tested empirically in [37]. The analyst found supporting evidence in the fact that "...holding company banks react to monopolistic market situations by choosing riskier portfolios and by leveraging to a greater extent than their independent counterparts."

spirit [7; 16]. To the extent, therefore, that the acquired company increases its direct risk exposure, any reduction in bank affiliation risk due to greater diversification by the BHC should be attenuated.

B. Empirical Evidence

Empirical evidence pertaining to the risk effects of bank expansion via nonbanking affiliates is scanty. Four studies provide information in this area. Three of these studies [21; 43; 47] deal with the risk exposure of BHC-affiliated consumer finance companies (CFCs) and, in one instance, mortgage banking companies (MBCs) -- two activities that are permissible to both national banks[1/] and BHCs. Moreover, in each study the sample of BHC-affiliated companies is made up mostly, if not completely, of companies that were acquired from independent status (as opposed to being spun off a bank).[2/] The fourth study [22] provides evidence as to the effect of BHC nonbanking expansion on the direct risk exposure of affiliated banks.

1. Effect of BHC Affiliation on Nonbanking Company Risk Exposure

The first study in this area [47] examined the extent of financial leverage of BHC-affiliated CFCs and MBCs. The sample of affiliated companies included 14 major CFCs and 42 of the largest MBCs. The results suggest

---

1/ From 1960-67, over 50 MBCs were absorbed by banks [30].

2/ Where this point is not made clear in the text of a study, it was confirmed in discussion with the study's author(s).

that BHC-affiliated MBCs and CFCs tend to be more highly leveraged and, therefore, in a riskier posture than their respective industries. However, no statistical tests were performed, nor does the study examine whether the affiliated companies might have been highly leveraged prior to their status as BHC subsidiaries. In addition, no evidence is presented regarding asset risk of the affiliated companies.

The second study [43] examined risk differences -- as reflected in loan loss experience and leverage -- between 15 BHC-affiliated CFCs 1/ and 23 independent CFCs, all of small to medium size. Multiple regression analysis was used to compare affiliated and independent companies, both prior to acquisition as well as after acquisition. Pre-acquisition results indicate no differences in risk exposure; however, post-acquisition results show significantly higher leverage on the part of the affiliated companies indicating greater risk exposure.

The third study [21] used multiple regression analysis to compare risk differences between 14 BHC-affiliated and 15 independent CFCs, all of which were drawn from the 100 largest finance companies. Four measures of direct risk were examined, including capital adequacy, debt leverage, liquidity risk, and credit risk.2/ Results indicated a significantly lower

---

1/ Only 14 affiliated CFCs were available for the pre-acquisition test.

2/ Capital adequacy is measured by the ratio of equity capital/risk assets; debt leverage, by the ratio of nondeposit debt/gross capital; liquidity risk, by the ratio of cash assets/total assets; and credit risk, by the ratio of net loan losses/gross loans.

ratio of equity capital/risk assets for BHC-affiliated CFCs, a finding consistent with the two previous studies.

In sum, available empirical evidence points to greater risk taking, as reflected in greater leveraging, on the part of CFCs and possibly MBCs acquired by BHCs from independent status. This, in turn, suggests increased affiliation risk for the banks affiliated with these companies. Whether this result can be generalized to other nonbanking activities, however, is unclear. 1/ Nor is it known whether the acquisition of such companies resulted in any offsetting reduction in bank affiliation risk due to product-line and/or geographical diversification for the acquiring BHCs. Finally, there is no empirical evidence as to the risk effects of activities that may have been spun off from banks to nonbanking affiliates.

2. <u>Effect of BHC Nonbanking Expansion on Bank Risk Exposure</u>

The fourth study noted above [22] provides limited evidence as to the effect of BHC nonbanking expansion on bank direct risk exposure. In particular, the authors estimated several multiple regression equations, using data from 237 Federal Reserve member banks from New York and New Jersey, to determine if BHC banks are greater risk takers than independent banks. 2/ In so doing, they included as a possible explanatory variable, total nonbanking company assets as a percentage of total BHC assets, in order to see if the relative amount of nonbanking business of a BHC impacts on the direct

---

1/ One nonbanking activity that is permissible to both national banks and BHCs and that is generally credited with raising serious affiliation risk problems for BHC banks in recent years is the advising of real estate investment trusts (REITs). This activity is unique, however, in that the affiliation risk implications arise regardless of whether the bank or a [illegible] serves as the advisor, since the REITs themselves [illegible] entity.

2/ This study is discussed latter (p. 24) in the context of BHC multibank expansion.

risk exposure of the BHC's banks. (No attempt was made to distinguish between nonbanking activities that are permissible or impermissible to banks or between affiliates acquired from bank spin-offs or from independent status.) The results showed no significant effect of the nonbanking activities on any of the measures of bank risk exposure. This suggests that BHC bank direct risk exposure is unaffected by the extent of BHC expansion into nonbanking activities (including all types of such expansion). Of course, these findings say nothing about the effect of such expansion on bank affiliation risk.

II. BHC Expansion into New Activities

A. Theoretical Issues

A second avenue through which the flexibility of the holding company form may affect bank risk exposure pertains to BHC expansion into new activities, i.e., activities that are impermissible to banks.1/ Such expansion may occur through the acquisition of on-going and/or de novo nonbanking companies and may affect the risk exposure of the subsidiary bank in several ways.

1/ Only two activities approved by the Federal Reserve Board since the 1970 Amendments to the Bank Holding Company Act are impermissible to national banks -- industrial banking and underwriting credit life, accident, and health insurance [10]. However, prior to the 1970 Amendments, BHCs expanded into a number of activities that were impermissible to banks. (For a listing of the nonbanking activities of BHCs prior to the 1970 Amendments, see [40].) Depending on whether these activities were acquired by the BHC before or after June, 1968 (but in all cases prior to 1971), they are "grandfathered" either on a permanent basis or until 1981.

First, depending on whether the riskiness of a new activity (as measured by the coefficient of variation of profits of the activity) is greater or less than the average riskiness of the BHC's existing activities, the overall risk of the BHC organization could be increased or decreased. This, in turn, implies a change in the direct risk exposure of the parent holding company, with an attendant effect on the affiliation risk of the subsidiary bank.

Second, to the extent that the earnings variation of a newly acquired activity is less than perfectly correlated with that of existing BHC activities, such product-line diversification should smooth out the cyclical variation in BHC earnings. As a result, the direct risk exposure of the parent holding company should be reduced, along with the affiliation risk of its bank.

One important caveat should be mentioned. That is, pursuant to the 1970 Amendments to the Bank Holding Company Act, permissible nonbanking activities for BHCs are required to be "closely related to banking." As a result, the magnitude of the risk effects noted above from BHC expansion into new nonbanking activities depends on just how closely related the new activities are to banking. The more closely related they are, the less significant will be these risk effects.

Finally, the nonbanking companies themselves may take on more direct risk following BHC acquisition as a result of (1) any lowering of overall BHC risk exposure due to product-line diversification, (2) greater "separation" between the management of the nonbanking subsidiaries and the ultimate owners, and (3) less risk aversion on the part of holding company managers relative to that of managers of independent nonbanking companies. Any such increase in the risk exposure of BHC nonbanking subsidiaries should, in turn, increase the affiliation risk of BHC banks.

B. Empirical Evidence

Empirical evidence relating to the risk effects of BHC expansion into new activities is also scarce. Four studies [11; 13; 22; 24] have broached this area, and all four have limited their analysis to nonbanking expansion as a means of lowering overall BHC risk exposure; none has considered the implications of BHC acquisition on the direct risk exposure of either the acquired nonbanking companies or the affiliated banks. Moreover, all four studies have mixed activities that are both permissible and impermissible to banks and, in some cases, activities that are both permissible and impermissible to BHCs.1/

One study [13] looked at several activities in which one-bank holding companies were engaged prior to the 1970 Amendments. Using aggregate industry data and two measures of risk -- (1) the coefficient of variation of activity profits and (2) correlation of nonbanking activity profits with banking profits -- the study reported two findings. First, banking was found to be among the riskiest of activities in terms of the coefficient of variation of profits. This suggests that BHC expansion

1/ Two of the studies [13;24] included activities that were among those engaged in by one-bank holding companies prior to the 1970 Amendments, but which have since been ruled by the Federal Reserve Board to be impermissible for BHCs (except where "grandfathered" for specific BHCs). The third study [11] explicitly included some activities that have been denied by the Board as permissible activities for BHCs in order to see what might have been the diversification benefits for BHCs if the Board had ruled differently. The fourth study [22] lumped all nonbanking activities together without attempting to distinguish between activities that are generally permissible to BHCs and those that are "grandfathered" for particular BHCs.

into many of the examined nonbanking activities may have reduced parent company risk. Second, simple correlation of activity profits with banking profits yielded mixed results, with little diversification gain from BHC expansion into business or personal credit activities but some gain from expansion into various other activities.

The second study [24] looked at virtually the same group of activities (also using industry data) as covered in the first study, focusing on the "... risk-return characteristics of nonbank activities in combination with each other and with banking."1/ The findings of this analysis are generally similar to those reported in [13], both in terms of the riskiness of banking vis-a-vis other activities as well as the diversification gains from BHC expansion into each of the various nonbanking activities. However, further analysis of BHC expansion into all of the nonbanking activities combined, using portfolio simulation techniques, yielded coefficients of variation of profits (which incorporate total diversification benefits) for the simulated BHC well below those of banking alone. This suggests that there are indeed benefits to be gained by the parent holding company by combining banking with various nonbanking activities.

The third study [11] may be viewed as a further extension of the two previous studies in that it simulates different holding company portfolios combining banking with various activities that have been approved, denied, and not yet ruled on by the Board as permissible BHC activities.

1/ In addition to the variation of profits, this study also considered the variation of cash flows. Results were generally similar in both cases.

Using a very small sample of firms engaged in each activity (less than 10 firms in most cases) to estimate industry data, banking is again shown to be one of the riskiar activities (in terms of the coefficient of variation of profits).[1/2/] No specific data are presented as to the covariance of earnings between banking and the other activities. Simulation results based solely on permissible activities are particularly interesting in that two nonbanking activities--commercial finance and mortgage banking--do not show up in any of the "efficient" holding company portfolios.[3/] This, however, may be due to the fact that these represent lending areas that are already an important part of banking; hence, there may be little diversification gain from combining these activities with banking in a holding company system.

Finally, the fourth study [22] examined "... differences in the effect of diversification on the volatility of earnings flows between consolidated bank holding companies and independent banks." Using multiple regression analysis and a sample of 27 BHCs and 167 independent banks from two states--New York and New Jersey--the analysts tested (1) whether BHCs have a significantly lower coefficient of variation of profits than

1/ Actually, the author reports banking to be the least risky of the activities examined in terms of profit variability alone However, by dividing the profit variability data by the mean profit rate of the activity (which gives the coefficient of variation of activity profits), banking is seen to be a relatively risky activity.

2/ This finding holds not only with respect to activities that have been approved by the Board as permissible BHC activities but also with respect to activities that have been denied and not yet ruled on by the Board.

3/ "Efficiency" in this context implies maximization of expected return in conjunction with minimization of the variability of that return.

independent banks and (2) whether the relative amount of nonbanking business of the holding company impacts significantly on BHC earnings variability. Their results, however, confirm neither hypothesis. In part, this may be due to improper model specification: none of the independent variables was statistically significant. In addition, to the extent that holding company affiliation results in greater risk taking by the bank and nonbanking subsidiaries (as suggested in other sections of this review), the result may be to offset any reduction in BHC earnings volatility due to nonbanking diversification. In that sense, the insignificant statistical results reported above may in fact be indicative of a real diversification effect; otherwise, BHC earnings volatility might have increased as a result of greater risk taking by bank and nonbanking subsidiaries.

Taken together, these four studies provide limited evidence that BHC expansion into new activities may indeed reduce the overall risk exposure of the BHC organization as well as yield diversification benefits in some instances. However, the fact that industry data were used in three studies, rather than data from actual companies acquired by BHCs, is a serious shortcoming. Also, the fact that all four studies included some activities that are permissible to banks limits the usefulness of the results regarding the issue of BHC expansion into new activities. In fact, what is needed is an analysis of actual companies acquired by BHCs in new activities, looking at both the diversification effects of such expansion along with the post-acquisition risk exposure of the acquired companies.

III. Multibank Expansion

A. Theoretical Issues

A third avenue by which the flexibility of the holding company form may impact on bank risk exposure pertains to multibank expansion through the acquisition of on-going and/or de novo banks. To the extent that the acquired banks are located in different markets with imperfect capital flows among these markets, such geographical diversification should smooth out to some extent the variation in earnings for the group of affiliated banks, thereby lowering the direct risk exposure of the parent holding company, with an attendant reduction in the affiliation risk exposure of the individual bank subsidiaries.1/

As a result of this reduction in affiliation risk for the individual bank subsidiaries, these banks may be willing to take on more direct risk. In addition, other factors may contribute to increased risk taking by BHC banks (as they may for BHC nonbanking subsidiaries), including (1) greater "separation" between bank management and the ultimate owners2/ and (2) less risk aversion on the part of holding company managers relative to that of independent bank managers. Also, the "large" acquisition premiums that BHCs often pay for their bank subsidiaries may force a holding

---

1/ Moreover, this should occur even without a free flow of funds among the sister banks in a BHC system. (Presently, Section 23A of the Federal Reserve Act restricts transactions among sister banks within a BHC system in much the same way that it restricts transactions between banks and their nonbanking affiliates [3 ; 4].) Of course, to the extent the flow of funds among sister banks in a BHC group were freer, the benefits of geographical diversification would be more pronounced as the earnings of the individual bank subsidiaries would be increased and their direct risk exposure reduced.

2/ Refer to p. 8, note 3.

company to operate its acquired banks in a riskier manner in order to justify the high purchase price [37]. Finally, there is an incentive for the parent holding company to upstream as much of its subsidiary banks' earnings as possible (i.e., to minimize each bank's retained earnings and increase the bank's leverage) in order to have the earnings available to downstream quickly to any bank (or nonbanking) subsidiary that needs financial assistance [14].1/ Such upstreaming of bank earnings should increase the direct risk exposure of the bank whose earnings are upstreamed, but simultaneously reduce that bank's affiliation risk by making these earnings available (through the parent company) to protect other subsidiaries in the BHC system.

C. Empirical Evidence

To date, no empirical studies have focused on the geographical diversification aspects of multibank holding company expansion. On the other hand, numerous studies have examined the impact of BHC affiliation on subsidiary bank performance, including bank risk taking. Moreover, in recent years several studies have specifically addressed the question of BHC affiliation on subsidiary bank risk exposure. With one exception, however, all of these studies are subject to an important limitation. That is, they analyze the impact of BHC affiliation on bank risk exposure without explicitly taking into account in their statistical procedures the fact that part of any observed impact may be due to the nonbanking business of the holding company (as noted in previous sections).

1/ Under present law, national banks and state member banks are limited in the amount of dividends they can pay out in any year to the net profits of that year plus an amount equal to the retained earnings of the two previous years. State nonmember banks are also generally subject to some type of limitations on the amount of dividends they can pay out in a single year.

1. <u>General Performance Studies</u>

Performance studies may be conveniently divided into two groups, according to the statistical technique employed. Various early studies [26; 33; 34; 49; 53] compared samples of BHC-affiliated and independent banks drawn from a single state, a single Federal Reserve District, or the entire country. The statistical technique was univariate (means test) and involved comparing several financial ratios for affiliated and, in most cases, paired independent banks.1/ The results showed, in various studies, that BHC banks tend to have significantly more loans, particularly instalment loans, and state and local government securities and less U.S. Government securities and cash assets than their independent counterparts, all of which suggests riskier asset portfolios for BHC banks. Capital ratios, however, were found to be not significantly different between BHC-affiliated and independent banks in any of these studies. The statistical technique of three of the studies [26; 49; 53] corrected for possible pre-acquisition differences between affiliated and independent banks so as not to bias the results.2/ Still, this technique is plagued with several problems, the most serious of which is its univariate nature [23].

1/ Other recent studies have also used univariate techniques but only for purposes of comparing the results with the results obtained from multivariate analysis. Since multivariate results should be superior, other things equal, the univariate results obtained in these studies are not discussed; rather, discussion of the results of these studies is limited to the multivariate analysis.

2/ A separate study [52] of the characteristics of banks acquired by BHCs in a single state found that acquired banks (prior to acquisition) were not significantly different from non-acquired banks in terms of either their asset or capital structures. However, acquired banks were found to have a significantly lower ratio of loan losses/gross loans than their non-acquired counterparts, indicating possibly less risky loan portfolios for acquired banks.

More recently, four studies [19; 25; 29; 32] have used multivariate statistical techniques to look at performance differences between BHC-affiliated and independent banks. Samples were drawn from multiple states in all four studies, with paired samples of affiliated and independent banks used in three of the studies. One study [29] specifically limited the sample to _de novo_ banks chartered since 1965. Of the three studies [19; 29; 32] using multiple regression analysis, various ones found that BHC banks have significantly larger amounts of loans, especially residential mortgages, and municipal securities and smaller amounts of liquid assets than their independent counterparts. This finding is generally consistent with that of earlier univariate analyses and suggests riskier asset structures for BHC banks. In addition, one study [32] found BHC banks to have significantly less capital relative to risk assets than independent banks, again suggesting more risk for BHC banks. However, that study also reported BHC banks to have significantly lower loan losses relative to total loans than independent banks, which suggests relatively less credit risk in the loan portfolios of BHC banks. Finally, neither of the studies whose samples included banks acquired from independent status tested for pre-acquisition differences between affiliated and independent banks.

The fourth study [25], using multiple discriminant analysis, found that BHC banks tend to have relatively more loans and "other securities" (primarily municipals) than independent banks. In addition, this study tested the effects on performance of the length of the post-acquisition period. Using four performance ratios (capital/deposits, loans/assets, U.S. Government securities/ assets, and cash/assets), the analysts found that two years following acquisition, BHC banks registered significant changes in balance sheet structure with the most important changes being a decline in cash holdings and an increase in loans. Also evident was some decline in acquired banks' holdings of U.S. Government securities and capital. Over two more years of acquisition, the changes in asset structure continued so that after four years of acquisition. there were significant differences between affiliated and independent banks, as reflected in less cash especially as well as less U.S. Government securities, more loans, and less capital for affiliated banks. Moreover, pre-acquisition tests indicated no significant differences in the performance ratios. These results, too, are consistent with others, suggesting more asset risk for affiliated banks as well as possibly more risk exposure in the form of less capital.[1/]

2. Specific Studies Dealing with BHC Bank Risk Exposure

Four studies [14; 22; 36; 37] in recent years have focused specifically on the question of whether BHC affiliation adversely affects the direct risk exposure of subsidiary banks. All four studies have used multiple regression analysis.

One study [37] looked at both the asset structure and capital position of 384 affiliated and independent banks of relatively small size drawn from multiple states. The results indicated that BHC banks tend to leverage to a significantly greater extent than independent banks. In addition, BHC banks were found to hold more real estate loans and municipal securities than their independent counterparts. This study was followed by a second by the same analyst [36] to test whether small BHC banks had

---

1/ Two additional performance studies should perhaps be mentioned as they specifically looked for performance differences between BHCs. One study [15] compared affiliated banks held by two large Florida BHCs. Using univariate analysis, this study reported that acquired banks in only one BHC had significantly less cash and more loans than paired independent banks. However, there were still no significant differences in asset or capital structure between the banks of the two BHCs. The second study [12] used multiple regression analysis to look at various financial ratios of BHC banks in Ohio and Colorado. With all BHC banks aggregated in a state, affiliated banks were found to have significantly more cash and U.S. Government securities in Ohio but less equity capital in both states than their independent counterparts. With separate accounting for the various BHCs, the model performed better statistically; however, because of inter-company performance differences, it is difficult to generalize the effect of holding company affiliation on bank risk exposure.

capital ratios different from those of their independent counterparts prior to acquisition. In fact, the results indicate slightly higher pre-acquisition capital ratios for BHC banks relative to independent banks; however, the result is not strong statistically.

A third study [14] compared the capital ratios and rate of capital investment of a sample of 365 of the largest banks in the country. The results showed that BHC banks tend to have significantly lower capital/asset ratios, and add to capital at slower rates, than do independent banks. Moreover, these differences are sufficient to outweigh any pre-acquisition differences, indicating that BHC affiliation does increase bank leverage.

The last study [22] looked at four measures of bank risk exposure, including capital adequacy, debt leverage, liquidity risk, and credit risk.1/ Using a sample of 237 Federal Reserve member banks from two states -- New York and New Jersey -- the analysts found BHC banks in New York to have riskier balance sheet structures in terms of significantly less capital, higher leverage, and more liquidity risk than their independent counterparts.2/ Moreover, by including as a possible explanatory variable total nonbanking company assets as a percentage of total BHC assets, the analysts explicitly recognized that part of the impact of holding company affiliation on subsidiary bank risk exposure may be due to the nonbanking business of the BHC.3/ No attempt was made to look for possible pre-acquisition risk differences between affiliated and independent banks in the two states.

1/ Capital adequacy is measured alternatively by the ratios of equity capital/risk assets and gross capital/risk assets; debt leverage, by the ratios of long-term debt/gross capital and total debt/gross capital; liquidity risk, by the ratio of interest-sensitive funds/short-term assets; and credit risk, by the ratio of net loan losses/gross loans.

2/ However, BHC banks in New Jersey registered only significantly more liquidity risk, suggesting unexplained behavioral differences between banks in the two states.

3/ Refer to pp. 11-12 above.

In sum, results of studies of BHC bank risk exposure are generally consistent with the results of general performance studies in showing that BHC banks tend to have significantly riskier asset structures than independent banks, in terms of more loans and municipal securities and less U.S. Government securities and cash. 1/ Moreover, risk studies also suggest greater risk exposure for BHC banks in the form of lower capital ratios (greater leveraging), a finding that is much less obvious in the general performance studies. Of course, part of this differential in bank risk exposure may be due to the nonbanking activities of BHCs. However, the one study which attempted to correct for such nonbanking business still found BHC banks subject to greater direct risk exposure than their independent counterparts. Still, the question remains as to whether this increase in direct risk exposure is offset to any extent by less affiliation risk from geographical diversification through multibank expansion.

IV. Parent Company Leveraging

A. Theoretical Issues

The fourth avenue by which the flexibility of the holding company form may affect bank risk exposure is through parent holding company leveraging. Suppose that the parent holding company issues debt in order to provide additional funds for one of its bank subsidiaries. 2/ The result is an increase in both the debt/equity ratio of the parent company as well as the direct risk exposure of the parent. This, in turn, should increase the

---

1/ Of course, the social cost of this increase in asset risk for BHC banks must be weighed against the benefit of increased bank lending and greater bank financing of municipal debt.

2/ Such leveraging could also be used to acquire additional subsidiaries [42; 48] or to raise funds for nonbanking subsidiaries [28]. (Alternatively, nonbanking subsidiaries may raise funds by issuing their own debt with the parent company guaranteeing that debt [48].)

affiliation risk of the bank. However, if the proceeds of the debt issue are downstreamed to the bank in exchange for the bank's own debt, thereby increasing the bank's debt/equity ratio, the bank should assume the parent's direct risk exposure for the debt issue in exchange for a reduction in its affiliation risk. On the other hand, if the proceeds are downstreamed to the bank in the form of additional equity, 1/ the bank's direct risk exposure should be reduced unless it chooses to issue additional debt itself. In the latter case, the additional debt issued by the bank puts an added strain on the parent holding company to service its own debt [27]. As a result, the risk of failure of the parent should be increased with a further increase in the affiliation risk exposure of the bank. 2/

There are two possible sources of limitation to parent holding company leveraging. First, the Federal Reserve Board, as administrator of the Bank Holding Company Act, may impose limitations. Second, the market may function to limit such leveraging by raising the BHC's cost of debt and/or decreasing the price/earnings ratio of the BHC's stock. Some analysts, however, have expressed concern that the market may fail to regulate BHC leveraging, relying instead on the Board to set appropriate limitations [7].

1/ The practice of downstreaming borrowed funds to subsidiaries in the form of equity is generally referred to as "double leveraging" [5; 27].

2/ Likewise, if the proceeds of the parent's debt issue are channeled to a nonbanking subsidiary as equity, upon which the subsidiary issues additional debt, the risk of failure of the parent is increased, thereby increasing the affiliation risk exposure of the subsidiary bank. On the other hand, channeling the proceeds to a nonbanking subsidiary in the form of debt should have no additional effect on the affiliation risk exposure of the bank.

B. Empirical Evidence

Evidence indicates that during the 1970's BHCs have relied almost entirely on debt as a source of funds. In fact, one analyst [44] reports that of the total amount of new BHC financing (debt and equity securities) between 1971-75 ($7.9 billion), 92 percent was acquired through borrowing. Moreover, debt issuance by parent holding companies has resulted in a significant increase in parent company leveraging. Among the 50 largest holding company parents, the debt/equity ratio ranged from zero to 238 percent, as of year-end, 1973, with a weighted average ratio of 45 percent for the 50 parent companies [46]. Finally, parent companies have double leveraged in order to increase the equity of their subsidiary banks. Evidence compiled by one analyst [44] indicates that between 1971-75 total new BHC equity amounted to $597 million, most of which was issued by parent companies; however, during the same period BHCs injected $1.9 billion in new equity into their subsidiary banks.[1/] On the basis of these data, therefore, it would appear that there has been a significant increase in BHC bank affiliation risk as a result of parent company leveraging.

Whether there has also been an attendant reduction in direct risk exposure of BHC banks that received equity injections from their parent companies is less clear. Certainly, some banks have been aided in this way. However, in other cases it appears that BHCs have intentionally pushed down the capital ratios of their banks and then added more capital to these banks, through parent company leveraging, in order to ameliorate

---

1/ Similarly, another observer [16] notes that during 1972-73 the parent companies of the 25 largest BHCs issued only $256 million in new equity, but downstreamed $785 million in new equity to their subsidiary banks.

regulators' concerns [27]. In such cases, the result should not be viewed as one of reducing BHC bank direct risk exposure, since presumably the capital ratios of these banks would not have been pushed so low had the banks not been able to count on their parent companies for additional equity injections. Rather, the result should be viewed as equivalent to that of the theoretical situation described earlier in which the parent company initially downstreamed the proceeds of its debt issue to its subsidiary bank in the form of new equity, after which the bank issued additional debt. In that situation, the direct risk exposure of the parent company was increased, along with the affiliation risk of the bank. Finally, evidence presented in the previous section regarding differences in the capital ratios of BHC-affiliated and independent banks indicates that even with any equity injections from their parent companies, BHC banks as a group still tend to be more highly leveraged than their independent counterparts.

A few empirical studies have addressed the question of whether BHC leveraging impacts on the cost of borrowing of the parent company or the price/earnings ratio of the parent's stock. In all cases, the studies have used multiple regression analysis, with leverage generally measured on a consolidated holding company basis.1/ Four studies [1; 31; 41; 54] looked at the relationship between leverage and the parent's cost of long-term borrowing. Three of these studies [31; 41; 54] found no significant relationship; however, the fourth study reported the expected positive significant relationship in two of the three years examined. As for the relationship between holding company leverage and the price/earnings ratio of the parent's stock, one of the above

---

1/ Some studies have also experimented with parent company and lead bank leverage ratios.

studies [41] also addressed this question and found the expected negative significant relationship in two of the four years examined. However, another study [2] which looked at this issue found no significant relationship in any of the three years examined.[1/] Finally, one study [18] has approached the question using a simultaneous equation system to allow for the effect of leverage on the cost of both debt (including both short- and long-term debt) and equity, as well as to permit these costs to have a "feed-back" effect on the level of leverage. Again, the finding was no significant relationship between leverage and the cost of either debt or equity.

In sum, evidence indicates that BHCs have leveraged significantly, suggesting an attendant rise in affiliation risk for BHC banks. In many cases, this leveraging has provided equity funding for BHC banks. However, whether this additional equity has generally served to improve the direct risk exposure of these banks is unclear in view of the fact that many BHCs have apparently pushed down the capital ratios of their bank subsidiaries, relying on the ability of the parent company to issue debt and downstream the proceeds to the bank as needed. Finally, limited empirical evidence pertaining to the role of the market in regulating BHC leveraging is contradictory, though the majority of the research suggests that the market has failed to exercise significant discipline in this area.

1/ In addition, studies have looked at the relationship between BHC leverage and both the dividend yield as well as the price of parent company stock. Evidence indicates no significant relationship between dividend yield and leverage [2; 45]. On the other hand, a negative significan relationship was found between price and leverage for several of the years examined [2; 20]; however, the price-leverage model that was used has been sharply criticized [17; 18].

V. Summary and Conclusion

In recent years considerable concern has been evidenced regarding the stability of the American banking system, including the impact of the bank holding company (BHC) movement on bank safety and soundness. This study addresses the question of whether the BHC movement has served to weaken the stability of the banking system by increasing the risk exposure of BHC-affiliated banks. In particular, the study reviews four avenues by which the flexibility of the holding company form of banking organization may impact on the risk exposure of BHC banks. These include (1) expansion of banking activities via nonbanking affiliates, (2) BHC expansion into new activities, (3) multibank expansion, and (4) parent company leveraging. Each of these avenues is, in turn, examined for its implications for both the direct risk exposure of BHC banks (i.e., the risk associated with the bank's own activities) as well as the affiliation risk that such banks face as holding company subsidiaries. "Affiliation risk" refers to the risk of financial loss to the bank stemming from its holding company affiliation with a financially troubled company.

Of the four avenues listed above, the two dealing with nonbanking expansion by BHCs are perhaps the most difficult to assess. Suffice it to say that while such nonbanking expansion may impact on the direct risk exposure of BHC banks, the principal effect would appear to be with respect to the affiliation risk to which such banks are exposed. In that regard, nonbanking expansion facilitates geographical and product-line diversification for the BHC, which in turn implies a reduction in bank affiliation risk.

At the same time, BHC affiliation offers the opportunity for increased risk taking by acquired nonbanking companies and, therefore, greater affiliation risk for holding company banks. Empirical evidence is scanty in both areas. However, the little evidence that is available tends to support both of these arguments.

The third avenue by which the flexibility of the holding company form may impact on bank risk exposure pertains to multibank expansion. In that regard, theory suggests that BHC affiliation may result in increased direct risk exposure for subsidiary banks but less affiliation risk due to geographical diversification. Empirical evidence relating to direct risk exposure of BHC banks is substantial and suggests that BHC affiliation has indeed resulted in greater risk taking by subsidiary banks, as reflected in riskier asset structures and greater leveraging by BHC banks vis-a-vis independent banks. On the other hand, no empirical studies have focused on the geographical diversification aspects of multibank holding company expansion. Thus, it remains to be seen to what extent the observed increase in BHC bank direct risk exposure may be offset by less affiliation risk from multibank geographical diversification.

The last avenue through which BHC banks may experience a change in their risk exposure pertains to parent holding company leveraging. In that regard, evidence indicates that BHCs have leveraged significantly in recent years, suggesting a significant increase in affiliation risk for their banks. In many cases, this leveraging has provided equity funding for BHC banks. Whether such equity injections have generally reduced the direct risk exposure of the recipient banks is unclear, however, since these injections have often merely served to increase capital ratios that had been apparently pushed down intentionally by the parent holding company.

Moreover, even with such equity injections, BHC banks as a group still tend to be more highly leveraged than their independent counterparts.

In conclusion, available empirical evidence to date points to both increased direct risk exposure for BHC banks as well as significant affiliation risk due to extensive parent company leveraging. Still, there are important dimensions of the BHC movement--particularly relating to geographical and product-line diversification--that suggest possibly less risk exposure for BHC banks, but for which there is as yet little or no empirical evidence. Not until these latter areas are fully explored will the total impact of the BHC movement on bank risk exposure be unveiled.

REFERENCES

1. Beighley, H. Prescott. "The Risk Perceptions of Bank Holding Company Debtholders, Journal of Bank Research, 8, No. 2 (Summer 1977), pp. 85-93.

2. ______________, John H. Boyd, and Donald P. Jacobs. "Bank Equities and Investor Risk Perceptions: Some Entailments for Capital Adequacy Regulation," Journal of Bank Research, 6, No. 3 (Autumn, 1975), pp. 190-201.

3. Board of Governors of the Federal Reserve System. "A Discussion of Amendments to Section 23A of the Federal Reserve Act Proposed by the Board of Governors of the Federal Reserve System," 1978.

4. Carter H. Golembe Associates Inc. "Loans by Banks to Their Affiliates and Section 23A of the Federal Reserve Act." Report prepared at the request of the Association of Registered Bank Holding Companies, November 18, 1974.

5. Cates, David C. "Analyzing the Parent of a Bank Holding Company," The Magazine of Bank Administration, LII, No. 11 (November, 1976), pp. 42-45.

6. Chase Samuel B. Jr. "The Bank Holding Company -- A Superior Device for Expanding Activities?" Policies for a More Competitive Financial System, Proceedings of a Conference, Federal Reserve Bank of Boston, June, 1972, pp 77-87. An earlier version of this paper was published as "The Bank Holding Company as a Device for Sheltering Banks from Risks," Proceedings of a Conference on Bank Structure and Competition, Federal Reserve Bank of Chicago, 1971, pp. 38-49.

7. ______________ and John J. Mingo. "The Regulation of Bank Holding Companies " The Journal of Finance XXX, No. 2 (May, 1975), pp. 281-292.

8. Childs, Bradley D. "Bank Holding Company Acquisitions: The Role of Non-Banking Finance Affiliates," The Magazine of Bank Administration, LI, No. 8 (August, 1975), pp. 30-33.

9. Drum, Dale S. "MBHCs: Evidence After Two Decades of Regulation," Business Conditions, Federal Reserve Bank of Chicago, December, 1976, pp. 3-15.

10. ______________. "Nonbanking Activities of Bank Holding Companies," Economic Perspectives, Federal Reserve Bank of Chicago, March/April 1977, pp. 12-21.

11. Eisemann, Peter C. "Diversification and the Congeneric Bank Holding Company," Journal of Bank Research, 7, No. 1 (Spring, 1976), pp. 68-77.

12. Fraas, Arthur G. "The Performance of Individual Bank Holding Companies," Staff Economic Studies, No. 84, Board of Governors of the Federal Reserve System, August, 1975.

13. Heggestad, Arnold A. "Riskiness of Investments in Nonbank Activities by Bank Holding Companies," Journal of Economics and Business, 27 (Spring, 1975), pp. 219-223. A slightly modified version of this paper was also published as "Diversification, Risk, and the Bank Holding Company," The Bankers Magazine, 159 (Winter, 1976), pp. 109-112.

14. ______________ and John J. Mingo. "Capital Management by Holding Company Banks," Journal of Business, 48, No. 4 (October, 1975), pp. 500-505.

15. Hoffman, Stuart G. "A Florida Case Study: Performance of Holding Company Banks," Monthly Review, Federal Reserve Bank of Atlanta, December, 1975, pp. 202-205.

16. Holland, Robert C. "Bank Holding Companies and Financial Stability," Journal of Financial and Quantitative Analysis, X, No. 4 (November, 1975), pp. 577-587.

17. Humphrey, David Burras. "Review of The Financial Structure of Bank Holding Companies," Journal of Monetary Economics, 2 (1976), pp. 427-429.

18. ______________ and Samuel H. Talley. "Market Regulation of Bank Leverage," Research Papers in Banking and Financial Economics, Financial Studies Section, Division of Research and Statistics, Board of Governors of the Federal Reserve System, January, 1977.

19. Jackson, William. "Multibank Holding Companies and Bank Behavior," Working Paper 75-1, Federal Reserve Bank of Richmond, July, 1975.

20. Jacobs, Donald P., H. Prescott Beighley, and John H. Boyd. The Financial Structure of Bank Holding Companies, Association of Reserve City Bankers, 1975.

21. Jessee, Michael A. "Impact of Bank Holding Company Affiliation on Firm Risk," Research Paper No. 7708, Federal Reserve Bank of New York, February, 1977.

22. ______________ and Steven A. Seelig. Bank Holding Companies and the Public Interest: An Economic Analysis, Lexington, Mass.: D.C. Heath and Company, 1977.

23. Johnson, Rodney D. and David R. Meinster. "An Analysis of Bank Holding Company Acquisitions: Some Methodological Issues," Journal of Bank Research, 4, No. 1 (Spring, 1973), pp. 58-61.

24. ______________. "Bank Holding Companies: Diversification Opportunities in Nonbank Activities," Eastern Economic Journal, I, No. 4 (October, 1974), pp. 318-323.

25. ______________. "The Performance of Bank Holding Company Acquisitions: A Multivariate Analysis," Journal of Business, 48, No. 2 (April, 1975), pp. 204-212.

26. Lawrence, Robert J. The Performance of Bank Holding Companies, Washington D.C.: Board of Governors of the Federal Reserve System, June, 1967.

27. ______________ and Samuel H. Talley. "An Assessment of Bank Holding Companies," Staff Economic Study, Board of Governors of the Federal Reserve System, Federal Reserve Bulletin, 62, No. 1 (January, 1976), pp. 15-21.

28. Lerner, Eugene M. "Three Financial Problems Facing Bank Holding Companies," Journal of Money, Credit and Banking, IV, No. 2 (May, 1972), pp. 445-455.

29. Light, Jack S. "Effects of Holding Company Affiliation on De Novo Banks," Proceedings of a Conference on Bank Structure and Competition, Federal Reserve Bank of Chicago, 1976, pp. 83-106. A condensed version of this study is published as "Effects of Holding Company Affiliation on De Novo Banks," Business Conditions, Federal Reserve Bank of Chicago, July, 1976, pp. 11-15.

30. Martin, Michael J. "Bank Holding Company Acquisitions of Mortgage Banking Firms," Mergers and Acquisitions, Fall, 1975, pp. 19-25.

31. ______________. "Risk Premiums and Bank Investors," Atlantic Economic Journal, V, No. 2 (July, 1977), pp. 68-72.

32. Mayne, Lucille S. "A Comparative Study of Bank Holding Company Affiliates and Independent Banks, 1969-1972," The Journal of Finance, XXXII, No. 1 (March, 1977), pp. 147-158.

33. McCleary, Joe W. "Absentee Ownership -- Its Impact on Bank Holding Company Performance," Monthly Review, Federal Reserve Bank of Atlanta, August, 1969, pp. 99-101.

34. ______________. "Bank Holding Companies: Their Growth and Performance," Monthly Review, Federal Reserve Bank of Atlanta, October, 1968, pp. 131-138.

35. Milus, Peter, "How The Hamilton Failed," The Bankers Magazine, (Summer, 1976), pp. 79-82.

36. Mingo, John J. "Capital Management and Profitability of Prospective Holding Company Banks," Journal of Financial and Quantitative Analysis, X, No. 2 (June, 1975), pp. 191-203.

37. ______________. "Managerial Motives, Market Structures and The Performance of Holding Company Banks," Economic Inquiry, XIV, No. 3 (September, 1976) pp. 411-424.

38. ______________, Stephen A. Rhoades, and Benjamin Wolkowitz, "Risk and Its Implications for the Banking System," The Magazine of Bank Administration, (February, 1976), pp. 52-58, (March, 1976), pp. 43-47.

39. Nader, Ralph and Jonathan Brown. "Disclosure and Bank Soundness: Nonbank Activities of Bank Holding Companies," Public Interest Research Group, Washington, D.C., June 30, 1976.

40. "One-Bank Holding Companies Before the 1970 Amendments," Federal Reserve Bulletin, 58, No. 12 (December, 1972) pp. 999-1008.

41. Pettway, Richard H. "Market Tests of Capital Adequacy of Large Commercial Banks," The Journal of Finance, XXXI, No. 3 (June, 1976), pp. 865-875.

42. Piper, Thomas R. and Steven J. Weiss. "The Profitability of Bank Acquisitions by Multi-Bank Holding Companies," New England Economic Review, Federal Reserve Bank of Boston, September/October, 1971, pp. 2-12.

43. Rhoades, Stephen A. and Gregory E. Boczar. "The Performance of Bank Holding Company-Affiliated Finance Companies," Staff Economic Studies, No. 90, Board of Governors of the Federal Reserve System, August, 1977.

44. Schotland, Roy A. "Bank Holding Companies and Public Policy Today," Compendium of Papers Prepared for the FINE Study, U.S. House of Representatives, Committee on Banking, Currency, and Housing, 94th Congress, second session, Book I, June, 1976.

45. Silverberg, Stanley C. "Bank Holding Companies and Capital Adequacy," Journal of Bank Research, 6, No. 3 (Autumn, 1975), pp. 202-207.

46. Talley, Samuel H. "Bank Holding Company Financing," Proceedings of a Conference on Bank Structure and Competition, Federal Reserve Bank of Chicago, 1975, pp. 124-135.

47. ______________. "Bank Holding Company Performance in Consumer Finance and Mortgage Banking," The Magazine of Bank Administration, LII, No. 7 (July, 1976), pp. 42-44.

48. ______________. "Developments in the Bank Holding Company Movement," Proceedings of a Conference on Bank Structure and Competition, Federal Reserve Bank of Chicago, 1972, pp. 1-13.

49. ______________, "The Effect of Holding Company Acquisitions on Bank Performance," Staff Economic Studies, No. 69, Board of Governors of the Federal Reserve System, February, 1972.

50. "The Gang That Couldn't Bank Straight." Forbes, June 1, 1974, pp. 17-18.

51. Vojta, George J. "Capital Adequacy: A Look at the Issues," The Magazine of Bank Administration, XLIX, No. 9 (September, 1973), pp. 22-25.

52. Ware, Robert F. "Characteristics of Banks Acquired by Multiple Bank Holding Companies in Ohio," Economic Review, Federal Reserve Bank of Cleveland, August, 1971, pp. 19-27.

53. ______________. "Performance of Banks Acquired by Multi-Bank Holding Companies in Ohio," Economic Review, Federal Reserve Bank of Cleveland, March-April, 1973, pp. 19-28.

54. Weaver, Anne S. and Chayim Herzig-Marx. "A Comparative Study of the Effect of Leverage on Risk Premiums for Debt Issues of Banks and Bank Holding Companies," Research Paper No. 78-1, Department of Research, Federal Reserve Bank of Chicago.

Section VII

The Effect of Bank Holding Companies on Competition: A Review of the Evidence

Stephen A. Rhoades

I. Introduction

Significant structural or institutional changes in American industries often have implications for competition. Thus, the rapid conversion of the commercial banking industry to the bank holding company form of organization and the accompanying movement into nonbanking activities has raised the issue of its effect on competition in banking and nonbanking markets. Under Sections 3 and 4 of the Bank Holding Company Act (1956) as amended, the Federal Reserve Board is subject to legislative mandates to consider the competitive effects of proposed actions that it receives from the bank holding companies it regulates. This paper reviews studies that have developed empirical evidence regarding the effect of bank holding companies (BHCs) on competition in banking and nonbanking.

II. The Analytical Framework of The Review

The legislative concern with competition arises from a recognition that the economic concept of competition has implications for market performance. The basic theoretical models used to analyze competition are market models which suggest that the basic structure of a market will determine the economic performance of the market. According to these models, the economic performance of a market is reflected in the long run profit rate (price-cost margins) and, *ceteris paribus*, prices in the market.

A relatively high profit rate, or, ceteris paribus, price, in a market suggests that a monopolistic structure exists, while a relatively low profit rate, or price, suggests that a competitive structure prevails in the market. Therefore, in analyzing the competitive effects of BHCs, it is appropriate to focus on profit rates and prices as indicators of performance in these markets. 1/ Moreover, since theory suggests that market structure is a determinant of market performance, it is appropriate to focus on market structure. 2/

In order to rely on an established theoretical framework, this review will focus on studies that have found evidence on the effect of BHCs on market profit rates, prices, and structure. 3/ Before pursuing the empirical evidence on this issue, it is useful to note the argument for expecting BHC subsidiaries to have a unique effect on competition and to outline the social costs that may accompany the possible effects on competition.

BHCs might be expected to have a procompetitive effect on market performance for any of three reasons. First, with respect to banking, the

---

1/ While nonprice competition may be important in regulated industries, theory provides no basis for determining the effect on market performance of most forms of nonprice competition.

2/ There is a substantial body of empirical evidence indicating that market structure effects performance in banking and manufacturing industries. For a review of the evidence in banking, see Stephen A. Rhoades, "Structure-Performance Studies in Banking: A Summary and Evaluation," Staff Economic Studies, No. 92 (Federal Reserve Board, 1977). For manufacturing, see Leonard Weiss, "The Concentration-Profits Relationship in Anti-Trust" Industrial Concentration: The New Learning, eds. H.J. Goldschmid, H.M. Mann, and J.F. Weston (Boston: Little, Brown, and Co., 1974).

3/ Studies that have compared various elements of performance of individual firms do not directly suggest anything about the effect of BHCs on competition (as measured by profit rates, prices, and/or structure) in the market. Thus, they are not reviewed in this paper. They are, however, reviewed in this compendium by Timothy Curry.

BHC provides a mechanism for circumventing restrictive branching laws, i.e., legal barriers to entry. This should be conducive to new entry into local markets since established firms can expand throughout a state. Thus, there would be a procompetitive effect on market structure. Second, BHC banks may, perhaps, be able to operate more efficiently than other banks because of centralization of certain operations and because of superior management. To the extent that operational efficiency is achieved, there would be an effect on prices that would constitute a procompetitive effect on market performance. 1/ Third, basic behavioral characteristics of BHCs, such as relative aggressiveness in portfolio management or a preference for rapid growth may have a procompetitive effect on market structure and performance. Other things being the same, a procompetitive effect on market structure or performance must be regarded as a social benefit. In fact, however, if the procompetitive effects described above should materialize, they may be associated with social costs; both to competition and to bank safety and soundness. Thus, there may be anticompetitive effects due to the multi-market operations of firms. These effects may come about from the development of linked oligopoly and from certain facets of undue

1/ Available evidence does not suggest that BHC banks achieve significant gains in operational efficiency. For a discussion of the evidence on BHCs and efficiency, see the paper by Jim Burke elsewhere in this compendium.

concentration, such as unfair methods of competition. 1/ These possible anticompetitive effects may or may not offset the possible procompetitive effects of BHCs. But even if they do not, relatively risky behavior by BHCs is likely to be reflected in a risky portfolio and low levels of capital thereby reducing the safety and soundness of the banking system -- a clear social cost. 2/ In view of these considerations, it is apparent that any procompetitive effect of BHCs cannot, because of attendant developments, be regarded as an unambiguous social benefit.

This paper proceeds in two parts -- Section III is concerned with competition in banking markets and Section IV with competition in non-banking markets.

III. Competition in Banking Markets

There have been relatively few empirical studies of the effects of BHCs on competition in banking markets. All except one have focused on the market structure effects of BHCs. While there have been numerous studies that analyzed BHC effects on the performance of individual firms, none of these studies extended the analysis to examine the BHC effect on performance (in terms of prices and profits) throughout the market.

1/ The nonmarket and multimarket effects of BHCs are discussed by Cynthia Glassman and Robert Eisenbeis elsewhere in this compendium.

2/ The issue of safety and soundness is discussed by John T. Rose elsewhere in this compendium.

The studies that have analyzed the market structure effects of BHCs have examined either changes in market concentration (or an alternative measure of structure) or changes in market shares of individual BHC banks. Results of the concentration change studies have direct implications for competition and performance since theory and empirical evidence indicate a relationship between concentration and performance. Results of the market share studies, by indicating the relative growth of BHC banks, are suggestive as to changes in market concentration and the competitive behavior of the BHC Banks. These two types of studies are reviewed below in chronological order.

Concentration Change Studies

There have been seven empirical studies that have analyzed changes in market concentration. The first of these studies was conducted by Shull. 1/ Shull's study is unique in that his study attempted to determine the effects on local market structure from a relaxation of restrictions on multiple-office banking. The analysis focused on New York and Virginia where restrictions were lifted in 1960 and 1962 respectively. According to the author, most of the subsequent geographic expansion, through 1970, was attributable to BHCs. The analysis revealed that the rate of bank consolidations increased as did concentration at the state level. For the eleven local markets (SMSAs) used in the study, Shull found no systematic

---

1/ Bernard Shull, "Multiple-Office Banking and The Structure of Banking Markets: The New York and Virginia Experience," Conference on Bank Structure and Competition (Federal Reserve Bank of Chicago, October 1972).

change in the number of banking organizations or in the level of concentration. That is, the number of firms and concentration increased in about the same number of markets as they decreased. It is fair to conclude from the findings of this study that the adaptation to liberalized banking laws via the BHC device does not have a procompetitive effect on local market structure. While the studies provide no evidence of an adverse effect on market structure, developments at the state levels i.e., fewer firms and higher concentration, may have adverse effects.1/

The first of the more recent studies was conducted by Light. 2/ He focused on county and multicounty areas in three states which permit multi-BHCs -- Iowa, Michigan, and Wisconsin. This study attempts to determine to what extent concentration (measured by a Herfindahl index) has increased due to the "holding company effect." This effect "comes about only when a multibank holding company (or companies) acquires more than one bank in a banking district." The author constructs a standard Herfindahl index and a Herfindahl index adjusted so that the acquired banks are treated as independent organizations as of December 31, 1974. Results of the tabulations revealed that measurable increases in the Herfindahl due to

---

1/ As noted earlier, these issues are dealt with in the paper by Glassman and Eisenbeis.

2/ Jack S. Light "Bank Holding Companies - Concentration Levels in Three District States," Business Conditions (Federal Reserve Bank of Chicago, June 1975).

the "holding company effect" occured in very few of the 243 banking districts (markets), and these changes were typically small suggesting that BHCs have little affect on bank market structure.

A study by Ware analyzes concentration changes in local banking markets in Ohio from January 1970 through December 1974. 1/ The tabular analysis focuses upon 12 SMSAs and 18 non SMSA counties that contained two or more subsidiary banks as of the end of 1974. Changes in the three-bank concentration ratio and Herfindahl index exhibited slight declines in a majority of the 12 SMSAs. Concentration decreased in less than half of the county markets while the Herfindahl index decreased in half of these markets. These findings lead the author to conclude BHC banks have not had a detrimental effect on competition in local banking markets.

The third study of concentration changes was conducted by Whitehead and King. It also uses a tabular analysis of market structure changes and it focuses on local markets (based on Federal Reserve Board definitions) in three states -- Alabama, Florida, and Tennessee. 2/ The study measured changes in the three-firm concentration ratio and Herfindahl index from June 30, 1970 to December 31, 1974, in those 98 markets with at least three banking organizations and one multi-BHC as of December 31, 1974. Only about 10 percent of these markets experienced an increase in either

---

1/ Robert F. Ware, "Banking Concentration in Ohio," Economic Commentary (Federal Reserve Bank of Cleveland, November 24, 1975).

2/ David D. Whitehead and B. Frank King, "Multibank Holding Companies and Local Market Concentration," Monthly Review (Federal Reserve Bank of Atlanta, April 1976).

the concentration ratio or Herfindahl index. The author concludes that there is no evidence that multi-BHCs cause local market concentration to increase.

The fourth investigation of market concentration change covers a broader geographical area than the earlier studies and it uses a multiple regression model for testing purposes. It too, however, covers a relatively short time period. This study, by Heggestad and Rhoades, presents a cross section multiple regression analysis that attempts to explain changes in market structure from 1966-1972 in 228 SMSAs. 1/ The study uses a three-firm concentration ratio and a Herfindahl index as alternative measures of market structure. The regression model includes a binary variable to distinguish between SMSAs in states that permit multi-BHCs and SMSAs in states that do not. To account for factors other than BHCs that may affect market structure, the model includes the initial level of concentration, growth in market deposits, average bank size, number of mergers and acquisitions, and dummy variables to distinquish between SMSAs in unit banking, limited branching, and statewide branching states. Results of the analysis indicate that from 1966-1972 concentration increased more in SMSAs in states permitting multi-BHCs than in other SMSAs.

A different approach to analyzing concentration change focused on foothold acquisitions. Rhoades attempted to determine whether foothold acquisitions by BHCs between 1966 and 1972 had a systematic effect on market

---

1/ Arnold A. Heggestad and Stephen A. Rhoades, "An Analysis of Changes in Bank Market Structure," Atlantic Economic Journal (Fall 1976).

structure changes. [1/] The sample includes 58 SMSAs that experienced foothold acquisitions during the period, and 54 SMSAs that did not. Changes in three-firm concentration and the Herfindahl index are used as alternative measures of structure in a multiple regression model. A binary variable is included to distinguish between markets that experienced foothold acquisitions and those that did not. To account for factors other than foothold acquisitions that might affect market structure, the model includes growth in market deposits, deposits per banking office, the initial level of concentration, and dummy variables to indicate the year in which the first foothold acquisition occured in a market. Results of the analysis indicate that foothold acquisitions do not have a systematic effect on bank market structure. The relatively short time period covered may be especially important when analyzing foothold acquisitions which are, by definition, quite small, and therefore, it may take considerable time to be reflected in a structural change.

The most recent study of concentration change is a case study by Schweitzer and Greene. They sought to determine the effect of entry (1970-1972) by a large Colorado BHC into five banking markets. [2/] A tabular analysis reveals that market concentration declined subsequent to entry in the two markets that experienced entry by small scale acquisitions

---

1/ Stephen A. Rhoades, "The Impact of Foothold Acquisitions on Bank Market Structure," Antitrust Bulletin (Spring 1977).

2/ Paul Schweitzer and Joshua Greene, "Greeley in Perspective," Staff Economic Studies, No. 91 (Federal Reserve Board, 1977).

while concentration did not change in the three markets where entry by acquisition was on a larger scale. The authors conclude that the small scale of entry was responsible for the observed deconcentration.

This section has briefly reviewed seven studies that have developed empirical evidence on the effect of BHCs on market concentration. All of the studies are subject to important shortcomings. Thus, five of the seven studies employed a simple tabular analysis, and therefore, did not control for factors other than BHCs that may influence change in market concentration. In addition, the same five studies covered very limited geographical areas making generalizations hazardous. Finally, all seven studies analyze a relatively short period of time. Since market concentration tends to change very slowly, all of the studies may be biased against finding a change in concentration.

The findings of the studies on change in concentration are mixed. One of the studies found evidence that BHCs lead to increasing concentration in banking markets; one study found evidence of decreasing concentration; and five studies found no relationship between BHCs and bank market structure. Thus, based on existing evidence, it may be concluded that BHCs have no effect on market concentration.

Market Share Change Studies

The market share change studies focus on the growth of individual banks in relation to their markets. The relative growth of the banks is suggestive of their behavior.

In his study, Goldberg tests the hypothesis that banks acquired by BHCs increase their market shares because of alleged economies of scale. 1/ His analysis is based on the change in the share of market deposits of 71 banks acquired by BHCs between 1965 and 1970. The author used statistical tests to determine whether the 71 banks as a group experienced a statistically significant change in market share. The analysis used four different measures of market share and also analyzed the effects on market share changes due to acquisitions by big BHCs and by smaller BHCs. Results of the analysis revealed no statistically significant change in the market shares of acquired banks. These findings were confirmed by an unreported multiple regression analysis.

Hoffman conducted a case study of two Florida BHCs. 2/ He analyzed various performance measures, including market shares, of 13 pairs of affiliated and independent banks for each holding company both before and after acquisition. His tests for differences in group means revealed

---

1/ Lawrence G. Goldberg, "Bank Holding Company Acquisitions and Their Impact on Market Shares," Journal of Money, Credit and Banking (February 1976).

2/ Stuart G. Hoffman, "The Impact of Holding Company Affiliation on Bank Performance: A Case Study of Two Florida Multibank Holding Companies," Research Paper Series (Federal Reserve Bank of Atlanta, January 1976).

no significant difference in market shares between the affiliated and independent banks before or after acquisition for either of the BHCs.

A recent study by Burke analyzed the post acquisition market share change of 227 banks acquired by BHCs between 1962 and 1970. 1/ The author used a simple tabular analysis to examine the number of banks that experienced increases and decreases in market share and the extent of change over a short period and a longer period of time. In addition, market share changes for three different size classes of banks were examined. Statistical tests for differences in group means indicated that for all banks there was no systematic change in market share. The results, however, did reveal a tendency for the smaller banks to increase market share and the larger banks to decrease market share. These results would suggest that BHC entry, and perhaps non BHC entry, on a small scale may tend to have a procompetitive effect on bank market structure. This finding is consistent with the case study (Schweitzer and Greene) on concentration changes but not with the cross section study of the effect of foothold acquisitions (Rhoades) on concentration change. Nevertheless, this distinction between small and large scale entry appears to be worth pursuing in future research on concentration and market share changes by BHCs.

1/ Jim Burke, "Bank Holding Company Behavior and Structural Change," Journal of Bank Research (forthcoming).

The only study of the effect of BHCs on competition that has not focused on structural change is by Heggestad and Rhoades.[1/] They attempted to determine whether the degree of rivalry in a market can be explained by concentration in the market. The presence of BHCs in the market was one of the independent variables included in the multiple regression analysis covering 227 SMSAs. The study did find that market concentration had a consistent systematic effect on rivalry among banks in the market. The BHC presence variable had a significant effect on rivalry in some of the tests conducted. The authors conclude that these results suggest that small scale entry by BHCs "may have a procompetitive influence on rivalry at least in the short run." [2/]

As was the case with the results of studies on concentration change, the studies of market share change (including the rivalry study of Heggestad and Rhoades) yield mixed results. Two of the studies indicate that BHCs have no systematic effect on market shares of their affiliate banks, while the two others are at least suggestive of a procompetitive effect on market structure. In short, existing empirical evidence on market share changes provides no conclusive evidence that BHCs have a systematic effect (either favorable or unfavorable) on competition in banking markets.

1/ Arnold A. Heggestad and Stephen A. Rhoades, "Concentration and Firm Stability in Commercial Banking," Review of Economics and Statistics (November 1976). Rivalry is measured by the mobility and turnover, i.e., "churning about," among the largest banks in a market.

2/ Ibid., p. 450.

For research purposes, the available evidence leads one to question the *a priori* reasons (i.e., circumvention of legal barriers to entry, behavior or efficiency differences) for expecting BHCs to have any unique effects on competition. Moreover, in view of the few studies of this issue and their various weaknesses, additional research in the area seems warranted. The theory underlying the BHC-competition issue needs work and empirical studies should develop models that are specifically designed to get at the competition issue.

IV.. Competition in Nonbanking Markets

Under Section 4(c)(8) of the Bank Holding Company Act (1956) as amended in 1970, BHCs are permitted to enter those nonbank activities that the Board has decided are permissible under the legislation. To date, the Board has approved 17 nonbank activities as permissible for BHCs. Because of the substantial degree of entry by BHCs into some of these activities, most notably mortgage banking and consumer finance, it is important for policy purposes to understand the effect of BHCs on competition in nonbanking markets.

There have been only three systematic empirical studies that are relevant to the issue of the BHCs' effect on competition in nonbanking markets. This extremely limited body of research is attributable to the newness of the issue and the very limited data available for research purposes. In fact, the only three studies that are relevant have not, due to data limitations, focused on local markets even though local markets in these activities are most directly relevant to the issue of competition.

Thus, the results of these studies are suggestive of the BHC effect on competition only by way of inference.

The earliest systematic study investigated the hypothesis that mortgage banking firms affiliated with BHCs will grow faster than independent mortgage banking firms.[1/] The analysis, by Rhoades, is based on 16 affiliated and 16 independent firms and the growth rate of their servicing portfolio over the period December 1968 through December 1972. A multiple regression analysis, which accounted for firm size as well as affiliation status, found that mortgage banking firms affiliated with BHCs grew more slowly than the independent firms. These results suggest that BHC affiliates have not been particularly successful in the mortgage banking business. Thus, at least in the short run, it does not appear that BHCs will have a procompetitive effect in mortgage banking. Whether or not BHCs will have an adverse effect on competition through nonmarket actions (e.g., implicit tie-ins, provision of credit countercyclically, cross subsidization and credit rationing) are questions that remain to be investigated. Several shortcomings of the Rhoades study are notable. First, due to data limitations, it does not focus on markets and it uses growth in servicing instead of growth in originations. Second, it is based on a limited sample.

1/ Stephen A. Rhoades, "The Effect of Bank Holding Company Acquisitions of Mortgage Bankers on Mortgage Lending Activity" Journal of Business (July 1975).

A comparison of the group performance of BHC affiliates in mortgage banking and consumer finance with the respective industry averages was conducted by Talley. 1/ The performance characteristics used in the study are leverage and profitability for 1973 and 1974. Since profitability may be indicative of competitive performance, only this will be discussed. The data reveal that in 1973 and 1974, both mortgage banking and consumer finance affiliates of BHCs experienced substantially lower rates of return on equity capital than the respective industries as a whole. The implications of these findings for competition are not entirely clear. However, since the findings of the Rhoades study on mortgage banking found no evidence of more rapid growth by BHC affiliates, the low rate of return found in this study may be due to ineffective competition or inefficiency of the affiliates. 2/ This possibility is supported by the fact that, *ceteris paribus*, the greater riskiness of BHC affiliates (indicated by higher leveraging) should result in higher profit rates.

A recent study by Rhoades and Boczar compared various performance characteristics of 14 consumer finance companies that became affiliated with a BHC by December 31, 1974, and 23 companies that remained independent. 3/

1/ Samuel H. Talley, "Bank Holding Company Performance in Consumer Finance and Mortgage Banking," *Magazine of Bank Administration* (July 1976).

2/ If the low rate of return was attributable to aggressive pricing policies, the BHC affiliates should grow faster than independents.

3/ Stephen A. Rhoades and Gregory E. Boczar, "The Performance of Bank Holding Company-Affiliated Finance Companies," *Staff Economic Studies*, No. 90 (Federal Reserve Board, 1977).

The study used multiple regression analysis so that it could account for the effect of company size and loan size in addition to the effect of affiliation. Pre-acquisition and post-acquisition comparisons of performance between the two sets of companies were conducted. Results for three of the performance measures used in the study are suggestive as to whether their behavior will have a pro or anticompetitive effect. These are profitability, firm growth, and new offices opened.

Regression results indicate that prior to affiliation there were no differences in performance between the two sets of consumer finance companies. Subsequent to affiliation, however, the affiliated companies experienced a lower rate of return, a higher growth rate, and did not open more offices. 1/ The lower rate of return is consistent with findings of the Talley study. The additional finding of this study that the BHC affiliated consumer finance companies experienced a higher growth rate, might suggest that the lower profits are due to the BHCs emphasis on growth. Since this study found that the affiliated companies did not open more offices, the lower profits and higher growth are suggestive of procompetitive pricing policies.

Overall, there is very little evidence regarding the effect of BHCs on competition in nonbanking markets. The three existing empirical studies provide only indirect evidence. The tentative conclusion to be

---

1/ This study also found that affiliated companies are more highly leveraged than independents, subsequent to acquisiton.

drawn from this evidence is that BHCs may have a procompetitive effect in the consumer finance industry but do not in the mortgage banking industry. For research purposes, the problems of the existing studies indicates the need to formulate studies and attempt to construct market level data that focus specifically upon the competition issue.

V. Direction for Future Research on The Competition Issue

This review of studies on the effects of BHCs on competition in banking and nonbanking markets reveals that there has not been a great deal of research, but what there has been suggests that BHCs have little, if any, effect on market competition, and the findings are not conclusive. Because of the significance of the BHC as an organizational form in banking and its increasing role in nonbanking activities, it is important to achieve a better understanding of the competitive effects. Future research might be most productive if it proceeded along two general lines. One would employ the standard theoretical models as a basis for analysis while the other would focus on dimensions of competition that are not derived directly from traditional theoretical models.

There are two types of studies using a traditional theoretical framework that would reflect the impact of BHCs on market competition. One would be studies that attempt to determine whether and in which direction profit rates, prices, and structure in a market change as a result of entry (<u>de novo</u> or by acquisition) by BHCs. It would be important in this type of study to distinguish between short-run effects, which might reflect a disequilibrium situation, and long-run effects which would be more indicative of the likely influence of BHCs. The other type of study would be one that analyzes differences in market profit rates, prices, and structure between markets that have BHC banks and markets that do not. In studies of this type, it would be desirable to account for differences in cost conditions (e.g., general wage rates) between markets.

Another line of research would break away from the standard theoretical models especially in studying competition in nonbanking activities. Such studies would focus upon the competitive effects that have been uniquely associated with the phenomenon of diversification. Thus, such studies might, for example, develop working hypotheses from the major elements of Corwin Edwards' well-known conglomerate power hypothesis. His hypothesis holds that a diversified firm structure is conducive to tie-ins, cross subsidization, and linked oligopoly, which have significant implications for competition. Since so little evidence has ever been developed in this area, findings of studies on BHCs and their nonbanking activities would be relevant to public policy beyond the banking industry.

REFERENCES

Burke, Jim, "Bank Holding Company Behavior and Structural Change," Journal of Bank Research (forthcoming).

Goldberg, Lawrence G., "Bank Holding Company Acquisitions and Their Impact on Market Shares," Journal of Money, Credit and Banking (February 1976).

Heggestad, Arnold A. and Rhoades, Stephen A., "An Analysis of Changes in Bank Market Structure," Atlantic Economic Journal (Fall 1976).

Heggestad, Arnold A. and Rhoades, Stephen A., "Concentration and Firm Stability in Commercial Banking," Review of Economics and Statistics (November 1976).

Hoffman, Stuart G., "The Impact of Holding Company Affiliation on Bank Performance: A Case Study of Two Florida Multibank Holding Companies," Research Paper Series, (Federal Reserve Bank of Atlanta, January 1976).

Light, Jack S., "Bank Holding Companies-Concentration Levels in Three District States," Business Conditions (Federal Reserve Bank of Chicago, June 1975).

Rhoades, Stephen A., "The Effect of Bank Holding Company Acquisitions of Mortgage Bankers on Mortgage Lending Activity," Journal of Business (July 1975).

Rhoades, Stephen A., "The Impact of Foothold Acquisitions on Bank Market Structure," Antitrust Bulletin (Spring 1977).

Rhoades, Stephen A., "Structure Performance Studies in Banking: A Summary and Evaluation," Staff Economic Studies, No. 92 (Federal Reserve Board, 1977).

Rhoades, Stephen A., and Boczar, Gregory E., "The Performance of Bank Holding Company-Affiliated Finance Companies," Staff Economic Studies, No. 90 (Federal Reserve Board, 1977).

Schweitzer, Paul and Greene, Joshua, "Greeley in Perspective," Staff Economic Studies, No. 91 (Federal Reserve Board, 1977).

Shull, Bernard, "Multiple-Office Banking and The Structure of Banking Markets: The New York and Virginia Experience," Conference on Bank Structure and Competition (Federal Reserve Bank of Chicago, October 1972).

Talley, Samuel H., "Bank Holding Company Performance in Consumer Finance and Mortgage Banking," Magazine of Bank Administration (July 1976).

Ware, Robert F., "Banking Concentration in Ohio," Economic Commentary (Federal Reserve Bank of Cleveland, November 24, 1975).

Weiss, Leonard, "The Concentration-Profits Relationship in Antitrust," Industrial Concentration: The New Learning, eds. H.J. Goldschmid, H.M. Mann, and J.F. Weston (Boston: Little, Brown, and Co., 1974).

Whitehead, David D. and King, B. Frank, "Multibank Holding Companies and Local Market Concentration," Monthly Review (Federal Reserve Bank of Atlanta, April, 1976).

Section VIII

BANK HOLDING COMPANIES AND CONCENTRATION OF BANKING AND FINANCIAL RESOURCES: A REVIEW

by

Cynthia A. Glassman and Robert A. Eisenbeis

Since the early 1930s policy makers at both the state and federal levels have been concerned that the growth of multi-bank holding companies would result in the concentration of banking resources.1/ Similarly, in its deliberations on the 1920 amendments to the Bank Holding Company (BHC) Act of 1956, Congress was fearful that bank holding company expansion in the nonbanking areas would lead to an undesirable increase in the concentration of aggregate financial resources.2/ The Conference Report accompanying the legislation indicates this concern; "The danger of undue concentration of economic resources and power is one of the factors which led to the enactment of this legislation and constitutes a significant threat to the continued healthy evolution of our free economy."3/ As a result the 1970 amendments provide that under section 4(c)(8) of the amended BHC Act, one of the factors which the Federal Reserve Board must consider in acting on a proposed nonbanking acquisition by a BHC is whether it will result in an undue concentration of resources.4/

Implementation of this requirement, however, has proved difficult for the Board. This results because of the lack of

---

1/ See the discussion in another section by Savage as well as Willet (1930).

2/ This concern is encompassed by the Japanese term "Zaibatsu" problem which refers to money trusts. This term was first publicly applied to the BHC movement by Chairman Burns. Hearings on Bank Holding Company Act Amendments, House Committee on Banking and Currency, 91st Congress, 1st Session (1969) p. 36. See Schotland (1976) p. 233 fn.

3/ H.R. Report No. 91-1747, p. 17.

4/ No similar wording is contained in Section 3 governing bank acquisitions, but the principles embodied in interpreting the general anti-trust laws do apply.

guidance, either in economic theory and the related empirical work or in legislative and judicial deliberations, as to what types of acquisitions or what levels of concentration constitute "undue" concentrations of resources. This difficulty can be seen in the Board's statements relating to the application by BankAmerica Corporation to acquire GAC Finance:

> Congress did not provide specific criteria with respect to the size of acquisitions which should be disallowed to avoid undue resource concentration. Rather, it has pointed to the dangers involved, particularly those involving concentration of power relating to money and credit and has directed the Board to consider "all reasonable ramifications" in applying the standard of § 4(c)(8). 1/2/

Legislative discussions of "undue" concentration support any of three possible interpretations of the term:3/

(1) that it refers to concentration in particular geographic and product markets and/or defines combinations which might tend to create a monopoly in such markets;

(2) that it describes the evils inherent in the combination of banking and commerce to form economic power centers contrary to traditions of the U.S. banking industry.

1/ Board approval of the revised application of BankAmerica Corporation, San Francisco, California, to acquire GAC Finance, Inc., Allentown, Pennsylvania, August 14, 1973. Statement, p. 6.

2/ "As the majority statement indicates, the legislative history provides little guidance as to the meaning of the term 'undue concentration of resources.' Concurring Statement of Governors Mitchell, Daane, and Sheehan in the application of BankAmerica Corporation, San Francisco, California, to acquire GAC Finance, Inc., Allentown, Pennsylvania, September 5, 1973, p. 1.

3/ See Hearings on the Bank Holding Company Act Amendments, House Committee on Banking and Currency, 91st Congress, 1st Session (1969), HR. Reps. No. 91-387, 115 Cong. Rec. H 10559 (Nov. 5, 1969), Hearings on S. 1052, S.1211, S.1664, S. 3823, and H.R. 6778, Before the Senate Committee on Banking and Currency, 91st Congress, 2d Session, (1970), H.R. Rep. 91-1747, 91st Congress, 2d Session (1970).

(3) that it contemplates the aggregation of immense financial resources which creates private economic power so vast that its very existence offends the public interest.

The first interpretation focuses on the relationship between market structure as measured by concentration in specific markets and the possible effects on performance. The second deals with the maintenance of the separation between banking and commerce.[1/] The last reflects concern for the potential abuse of power, possibly extending beyond economic activity to encompass socio-political dimensions as well.

This paper focuses mainly on the first and third of these interpretations and examines the impact of the holding company movement on concentration of both banking resources as well as nonbanking resources. The remainder of this review is divided into three sections. The next section briefly outlines the economic and socio-political dimensions embodied in the concern about concentration. The third section examines the evidence on the extent to which the bank holding company movement has contributed to the concentration of financial resources. The last section contains the conclusions.

1/ The second is largely dealt with in the 1970 amendments which provide that bank holding companies are only permitted to engage in activities that are "closely" to banking.

II. Issues Concerning Concentration of Resources 1/

Economic Issues

The economic issues associated with the concentration of resources are related to the growth in the absolute size and power of a small number of firms. Concern is generally focused on the implications of such a trend for (1) behavior in particular markets including the effects on entry and exit, the type and intensity of competition, as well as on the basic behavioral motivations of firms, such as profit maximization and (2) the basic functions of an economic system--efficient resource allocation, market discipline, employment, etc.

Market Effects

The market effects of increasing concentration are of two types. The first relates to the level and changes in concentration within specific markets and the implications these may have for behavior, prices and performance. These issues and empirical evidence have been explored by Rhoades in another paper in this compendium. The second set of market effects relates to the implications that high statewide or nationwide concentration in various product lines or activities have for performance in particular markets.[2/]

1/ Much of this discussion is derived from Edwards (1955), Seelig (1976) and Rhoades (forthcoming).
2/ The state is often regarded as an important geographic area in analyzing banking because banks are limited by state law and the McFadden Act to individual states in establishing offices.

For example, if a few large banks operate in most of the local markets throughout a state then the theory of mutual forebearance, or linked oligopoly, suggests that behavior and performance in individual markets may be different from that indicated by the structure of the markets themselves.[1/] This theory implies that when firms face each other in several markets each firm is less likely to try to change the status quo in one market for fear of retaliation in other markets. In this way performances within given markets are "linked" together.

There are a number of possible advantages which may accrue to firms that operate in multiple markets, particularly if they are large and widely diversified. These may allow a relatively large firm to exert competitive influence and affect market behavior far beyond what might be suggested by its market share.[2/] In addition, competing in more than one market permits possibilities for cross subsidization of the operation in one market from the operations in other market. A firm may, for example, be able to sustain the offer of services at a price below the competitive market price, and perhaps at predatory levels, in an attempt to increase its share in a given market. In addition to placing existing smaller competitors at a disadvantage, the potential for cross subsidization may also increase perceived barriers to entry

1/ See Edwards (1955) and Solomon (1970) for discussions of the theory.
2/ See Whitehead (1977a), for an empirical test of the hypothesis that large multimarket firms have a competitive advantage in individual markets.

by others wishing to establish competing firms. The advantages of large size and operating in multiple markets extend beyond absorbing losses due to sales below competitive market prices in given markets and include: (1) easier access to capital markets, (2) the ability to take advantages of any existing scale economies, (3) obtaining favorable discounts from suppliers, (4) the capability to finance law suits arising from possible predatory pricing.

Economy-Wide Effects

The existence of a small number of large, dominant, diversified companies accounting for significant portions of the nation's economic activity, means that any adverse events which affect these firms may have serious ripple effects throughout the entire economy. For example, the possible failure of one of these firms may have perceived or real consequences so significant that the government may be reluctant to permit that failure to occur.[1/] Commercial banks are already afforded protection in the public interest because of their unique role in nation's economy. Entry is restricted to ensure profitable operations; bank examinations monitor performance and risk; deposit insurance protects small depositors; and

1/ The rescues of Penn-Central and Lockheed are examples of such governmental intervention. The Federal Reserve Board approved BankAmerica's partial acquisition of GAC partly out of concern that the weakened condition of GAC, and possible failure, might have adverse effects on the commercial paper market.

emergency lending facilities are available if needed in the form of access to the Federal Reserve discount window and loans from the FDIC. As a result of the protection afforded commercial banks, the expansion of BHCs into the nonbanking areas may tend to reduce the perceived risk of these new activities and stimulate investment that might otherwise not occur.

The end result of such a protectionist policy is to insulate these firms from the effects of market discipline. The ultimate consequence of this insulation is an adverse impact on resource allocation since such firms are no longer effectively accountable to investors through failure for unwise, lethargic, or risky operations. In addition, increased concentration tends to highten pressures to augment the economic objectives of the firm such as profit maximization, with noneconomic objectives. The result is interference with efficient market mechanisms and less than optimal resource allocation.

Lastly, it is also argued that increased concentration, particularly to the extent that it is associated with increasing diversification and size, tends to lead to the loss of information about performance in individual activities. Where products were once provided by independent firms with separate accounting reports, aggregation and concentration results in much of this information remaining either internal to the large diversified firms or submerged by consolidated reporting. The loss of this type of data deprives the market of accurate information on performance in specific activities which is so necessary to efficient resource allocation.

Socio-Political Issues

The long standing distrust of concentration of economic power in the American economy reflects the belief that such concentration bestows power transcending the economic system. In short, economic power may be translated into political power and the ability to influence public opinion and policies, cultural institutions and ultimately personal freedoms.[1/] Thus, the trend toward concentration of resources is thought by many to have significant and detrimental implications for the fabric and structure of the entire society.

III. Empirical Evidence

The lack of well specified theoretical frameworks has generally hampered direct tests of (1) hypotheses about the relationship between competition or performance in specific markets and concentration of resources in banks and bank holding companies or (2) broader hypotheses about the effects of "undue" concentration. The only relevant works to date test the linked oligopoly hypothesis as it applies to banking; there has been no work looking at the effects of aggregate BHC concentration in nonbanking activities. Heggestad

1/ For empirical tests of the effects of economic power on politics, see Salamon and Siegfried (1977) and Rose (forthcoming).

and Rhoades (forthcoming) looked at both branch banks and bank holding companies but did not differentiate between the two types of organizations. Using a broad sample of 187 SMSA markets, they found that the frequency of multi-market links had a statistically significant impact on competition in local markets. Consistent with the linked oligopoly theory their results suggest that the greater is the number of market links, the less competitive behavior seems to be. Moreover, the impact is greater whenever the firms are relatively more important in the other markets in which they operate. The second study by Whitehead (1977b) using a methodology identical to that of Heggestad and Rhoades focuses directly on the role of bank holding companies in testing the linked oligopoly hypothesis. Whitehead examined 47 banking markets in Florida in 1974. Since that state had unit banking, but permitted multibank holding companies, the holding companies served as the organizational form which linked the markets together. His results suggest that multi-market links through multibank holding companies tend to increase rather than decrease competition in Florida banking markets. Thus, contrary to Rhoades and Heggestad, Whitehead fails to find support for the linked oligopoly hypothesis. His results imply that bank holding company market links may have different behavioral implications from branch bank market links. However, due to the fact that the study was limited to one state and covered a limited time period during which bank holding companies were expanding very rapidly, it is not clear how generalizable this inference may be.[1/]

The paucity of empirical work precludes drawing more general conclusions about (1) whether banking is "unduly" concentrated, (2) whether the bank holding company movement has resulted in an "undue" concentration of financial resources or (3) the possible effects either might have on the economy. What is measurable, however, is the extent to which there has been a trend toward concentration of resources and the role that bank holding companies may have played in that trend.

Trends in Banking Concentration

National Level

Since the Great Depression there appears to have been a slow but steady decline in the aggregate concentration of banking resources at the national level. Data in Table 1, for example, indicate that the share of domestic deposits of the 100 largest U.S. banking organizations declined from 56.7 percent in 1934 (59.4 percent in 1940) to 45.0 percent in mid-1977. Similarly, the share of the 10 largest declined from 23.7 percent to 18.3 percent in this same period.[2/] Only Talley (1974) has examined the

---

1/ A third study by Graddy (1978) employed the 5 firm concentration ratio as a measure of market links, and found support for the linked oligopoly hypothesis. However, the measure of market links does not enable as direct a test of the hypothesis as the measures used by Heggestad and Rhoades or Whitehead.

2/ The top 25's share dropped from 31.9 percent in 1968 to 28.0 in mid-1977.

role that multi-bank holding companies have played in this trend. Talley examined the period between 1968 and 1973 and attempted to determine the impact that multibank holding company acquisitions had on the decline of the 100 largest organization's share of the nation's domestic deposits from 49.17 percent in 1968 to 47.0 percent in 1973. He adjusted the 1973 share of the 100 largest organizations for bank holding company acquisitions over the period. Talley concluded that 1973 nationwide concentration was 2.3 percentage points above the level it would have been had bank holding company acquisitions not been permitted. It should be noted that this figure probably overstates the effect of BHC acquisitions on concentration for the period since it is likely that BHCs would have expanded internally and by de novo acquisitions in many instances had they not been permitted to expand by acquisition of existing firms.

While there may not have been a trend toward increased concentration in banking among a few large firms, it is a fact--as noted by Senator Proxmire in introducing the Competition in Banking Act of 1977, S.72--that an increasing portion of the nation's banking resources have come under bank holding company control.[1/] However, recent expansion of bank holding companies' share of bank deposits has been due principally to conversion of existing banks to the holding company form and not to acquisitions by multibank holding companies.

1/ C.R.--S.272-3, January 10, 1977, 95th Congress, 1st. Session.

Fisher (1969), for example, showed that the share of commercial bank deposits held by multibank holding companies increased from 7.5 percent in 1956 to 13.8 percent in 1968.[1/] More recent data indicate that this percentage increased a couple of percentage points before dropping back to 34.2 percent in 1976.[2/] All registered bank holding companies including both one bank and multibank companies, share of domestic deposits increased from about 16 percent in 1970 to 70.8 percent in mid-1977, but approximately two-thirds of this increase resulted from the expansion of the coverage of the Bank Holding Company Act in 1971 to include more than 1,100 one bank holding companies.[3/] Equally important, all but about 8 percent of these deposits are in the lead banks of holding companies.

It appears that there has been a long and gradual decline in aggregate concentration in banking, despite the increase in bank resources coming under bank holding company control. The evidence suggests that the principal impact of the bank holding company on aggregate concentration has been to moderate what might otherwise been a slightly greater decline in concentration. It should be emphasized, however, that aggregate concentration changes very

1/ Boczar (1975) updated this series showing a growth to 34.2 percent by 1973.
2/ Federal Reserve Board, Annual Statistical Digest, 1972-1976.
3/ Rhoades (1974) indicates that the combined share of both one bank and multibank holding companies was 62.6 percent in 1970 and 68.1 percent in 1974.

slowly and the bank holding company movement in its present form is a relatively recent phenomenon.

Statewide level

The nature of the changes in statewide banking concentration over time is more complex than at the national level. As is indicated in Table 2, the three firm ratio declined over the 1960-76 period an average of 1.4 percentage points while the five firm ratio increased .9 percentage points. Both ratios declined over the first ten years and then increased slightly between 1970-1976. The greatest declines, however, occurred in the least concentrated and most concentrated states. For example over the 1960-76 period the three and five firm ratios declined in 77 percent of the 13 most concentrated states and in 95 percent of the 20 least concentrated states. In contrast, the three firm concentration ratios increased in 50 percent of the 18 moderately concentrated states and the five firm ratios increased in 72 percent of these states. Overall, it is hard to conclude that concentration has had an unfavorable trend at the statewide level over the 1960-76 period particularly in these states that were among the most highly concentrated. At the same time, the upward tend since 1970 signals a possible reversal in a trend and represents a situation that is of concern.

As was the case with nationwide concentration, Talley's study (1974) is the only one specifically examining the impacts of BHCs on trends in statewide concentration. Using the same procedures outlined previously, he adjusted the change in the five firm concentration ratios between 1968 and 1973 for acquisitions by multibank holding companies. As shown in Table 3, his results indicated that BHC acquisitions had a relatively small effect on concentration in states permitting statewide branching and almost no impact in highly concentrated states.1/ Increases in concentration due to BHC acquisitions were limited to low and moderately concentrated states. Overall, in all but 8 of these latter states, the effect of BHCs on increased concentration was limited to 5 percentage points or less; none was greater than 15 percentage points.

Similar results were obtained by Light (1975) who studied the effects of bank holding company expansion on concentration over a longer period (1957-1974) but in only three states--Iowa, Michigan, and Wisconsin.2/ By 1973 all of the largest banking organizations were bank holding companies, but the shares of the five largest firms were reasonably stable over the period, see Table 4. Therefore, Light concluded that BHCs had little effect on statewide concentration in those three states. Ware (1974) examined the impact of holding company activity in Ohio between 1969 and 1974 and concluded that bank holding companies resulted in some increase in statewide concentration. The three firm ratio increased from 22 to 24 percent

---

1/ Consistent findings for just Missouri and Tennessee are presented by Dwyer and Niblack (1974).

2/ The BHC laws were different in the three states. Wisconsin permitted BHCs since the 1920s, BHCs were not permitted in Michigan until 1971, and BHC laws were liberalized in 1972. During this period, Iowa was a unit banking state, Michigan had limited branching, and Wisconsin changed from unit banking to limited branching 1968.

and the 10 firm ratio rose from 44.1 to 52.5 percent.[1/]

Shull (1972) found that statewide concentration in New York and Virginia increased between mid-1961 and mid-1969 after these states liberalized their policies toward expansion.[2/] Most of the resulting expansion in the geographic operations of the states' larger banker organizations took place by way of bank holding company acquisitions. Over the period, the 3 and 10 firm concentration ratios in New York increased 2.4 to 5.1 percentage points respectively. In Virginia, the increases were more striking with the 3 firm ratio rising by 14.2 percentage points and the 10 firm ratio increased 26.1 percentage points.

As was the case at the national level, an increasing proportion of most states' banking resources has been held by affiliates of bank holding companies since 1957, see Table 5.[3/] Recently, however, most of this increase was due to conversion of existing organizations to the holding company form and not, in most instances, due to acquisitions.

1/ Unlike Talley (1974), Ware did not attempt to dissect how much of the change in concentration was directly a result of BHC acquisition and how much was due to mergers.

2/ In 1960 New York lifted a moratorium on bank holding company expansion that had been in effect since 1957. New York Banking Law, Act. 3, Sec. 105 (Supp. McKinney's 1970).

Virginia permitted statewide branching by merger in 1962 and state law seemed to encourage BHC expansion. Virginia, Code Annotated S6.1-39 (1966).

3/ Table 5 updates Fischer (1969). Kelley (1972) showed that in Texas in 1971, all BHCs held 41% of the State's deposits.

Hence, it is questionable whether this trend was economically significant with respect to issues related to concentration.

Local Levels

A comprehensive study of trends in local market concentration and structure was that by Talley (1977). He examined 446 local areas including 213 SMSAs and 233 counties (i.e. those not in SMSAs but with 1970 population in excess of 50,000) over the period 1966-1975. The study recognized the presence of BHCs and focused on independent banking organizations--either banks or bank holding companies rather than just banks--operating in the areas, but it made no attempt to isolate the changes in structure due to BHCs. The results suggest that the majority of these SMSAs and counties tended to become less concentrated and to exhibit a more competitive structure based upon an analysis of (1) changes in the number of organizations, (2) changes in the three firm concentration ratio, and (3) changes in the Herfindahl index. For example, in the SMSAs, the number of independent competitors increased in 153 SMSAs, declined in 31 and remained unchanged in 29. The three-firm concentration ratio declined in 184 SMSAs by an average of 6.5 percent points, from 75.8 to 69.3 percent, and the Herfindahl index fell in 183 SMSAs. In the counties examined, the number of firms increased in 123, declined in 41 and remained constant in 69. Moreover, three firm concentration also fell in 163 of the counties by an average of 2.8 percentage points from 81.2 to 78.4 percent. Finally, the Herfindahl declined in 178 counties. Equally important, the greatest degree of procompetitive changes occurred in the markets that were generally most concentrated in 1966 and, similarly, in those states with unit and branch banking. However, it is not known whether BHCs were responsible for these trends or served as a moderating force.

Light (1975) in his study of concentration in Iowa, Michigan and Wisconsin concluded that bank holding company expansion had little significant impact as of 1974 on local district concentration. Ware (1975) indicates that the three firm concentration ratios declined in 8 of 12 Ohio SMSAs between 1969 and 1974 and in 7 of 18 non-SMSA counties. The Herfindahl index declined in 9 of the SMSAs and in 9 of the counties. He concluded that bank holding company activity had little effect on local market concentration. Finally, Shull (1972) observed that the Virginia and New York experience indicated that multi-office banking had a mixed but probably favorable impact in local markets over the period studies. He noted that (1) the number of larger organizations operating in local markets increased and small organizations decreased with no overall systematic change in the number of institutions in local areas, (2) concentration declined in more local markets in New York than it increased but the opposite was true for Virginia, (3) entry by larger, outside firms had a deconcentrating effect, and (4) there was no appreciable decline in the pool of potential entrants.

<u>Trends in Non-Banking Concentration</u>

Section 4(c)(8) the 1970 amendments to the 1956 Bank Holding Company Act restrict the nonbank activities to those that the Federal Reserve Board finds are "... so closely related to banking or managing or controlling banks as to be a proper incident thereto."[1/] The Federal Reserve Board has approved 17 nonbanking activities as being permissible for bank holding companies--12 by rulemaking and 5 by order (See Table 6).[2/] Except for underwriting of credit life insurance and operating an industrial bank, all of the approved activities were essentially permissible for national banks, while those denied, excluding real estate brokerage and travel agencies, were not permissible for national banks.[3/] The effect of the provision in Section 4(c)(8) has been to maintain the separation between banking and commerce and to narrow the possibilities for bank holding company expansion that might lead to concentrations of financial resources across a broad range of activities.

To date there is little evidence to suggest that 4(c)(8) activities have resulted in a significant expansion of bank holding company resources. Nonbanking assets of BHCs still amount to less

1/ In National Carrier Association v. The Board of Governors of the Federal Reserve System, August 4, 1975, The U.S. Court of Appeals for the District of Columbia put forth guidelines for determining whether an activity is "closely related to banking." To qualify an activity must (1) have been generally provided by banks, (2) be functionally or operationally similar to banking services, or (3) be integrally related to bank services so as to require their provision in a specialized form.

2/ An additional 11 have been denied.

3/ Furthermore, in many cases, the scope of the activities permitted was severely limited to those that were bank or finance related, and in some instances, the services could only be provided to customers in connection with a bank related service.

than $55 billion and account for less than 4 percent of bank holding company assets. Moreover, more entry in the nonbanking area, at least in terms of number, has been *de novo* than by acquisition. Over 3,300 *de novo* nonbank notifications were received between January 1971--and December 17, 1977 whereas 670 applications for proposed acquisitions of existing firms were received in this period and 497 were approved.[1/] Most of the nonbanking acquisition activity has been in mortgage banking (83), consumer finance (123), and insurance agencies. Of these mortgage banking and finance companies together with leasing and factoring--all credit related leverage type activities--have accounted for the bulk of BHC acquired assets.

Although bank holding company expansion in the nonbanking area appears moderate in terms of the additional resources brought under bank holding company control, the possibility remains that bank holding company acquisitions within specific nonbanking activities may have resulted in increased concentration in those industries and/or significant domination of existing firms by bank holding companies in lieu of *de novo* entry. The remainder of this section looks at the four principle leveraged activities--mortgage banking, finance companies, leasing and factoring--to determine what impact BHC activity may have had on concentration in these industries.

1/ An additional 54 were denied and the remainder were either withdrawn or are still pending.

Mortgage Banking

The mortgage banking industry consists of more than 800 firms which are engaged principally (1) in originating construction loans, mortgages secured by 1-4 family residential properties and loans secured by income producing property and (2) in servicing mortgages for their own account and for others. Many of these firms are affiliated with other corporations including both banks and bank holding companies.[1/] In 1972 for example, 39 of the largest 100 mortgage services were affiliated with commercial banks or bank holding companies. Nineteen among the top 100 were subsidiaries of other diverse companies including Unimamerica, National Homes, General American Oil, Weyerhaeuser, Bowery Savings Bank, Transamerica, IDS, American General Insurance, and U.S. Steel.

Schotland (1976) reports that bank and bank holding company share of the mortgage banking business was 45.9 percent in 1975, up from 37.9 percent in 1971. Holland (1975) indicates that in 1974, bank holding companies and nonbank subsidiaries accounted for 32 percent of the volume of industry receivables in the top 100 mortgage banking firms. No data are readily available which permit estimates of what proportion of the industry totals are accounted for by bank holding companies.

1/ Banks may engage in mortgage banking activities directly and many banks are permitted to have mortgage banks as direct subsidiaries.

Between 1972 and 1976, ownership among the top 100 mortgage servicers did not change significantly; acquisitions of mortgage banking firms were approved by the Federal Reserve Board, but many of those did not involve firms in the top 100. By the end of 1976, 42 of the top 100 mortgage servicers were affiliated with banking organizations; 14 as subsidiaries of banks and 31 as affiliates of bank holding companies; 21 others were owned by other corporations. Of the top 10, two were subsidiaries of banks and 4 (including Advance Mortgage whose retention application by Citicorp was denied by the Board) were bank holding company subsidiaries. Table 8 indicates that among the top 50, 11 are subsidiaries of banks and 11 are subsidiaries of bank holding companies (of these 2 are indefinitely grandfathered, 5 need Board approval for retention rights before 1980 and 1 is held under Section 4(c)(5).) Although BHCs have had approval to acquire some rather large mortgage banking firms, these BHCs have not ranked among the top 20 U.S. banking organizations. The only instance where a top 20 BHC was granted approval to acquire a mortgage banking company among the 20 largest mortgage banking was Security Pacific's acquisition of Kassler Mortgage.[1/]

1/ The majority of the Board felt that Kassler could not maintain its competitive posit on without the acquisition (1974 Federal Reserve Bulletin, page 388). The Board denied an application by Manufactures Hanover to acquire Citizen Mortgage (1973 Federal Reserve Bulletin, page 532) and applications to acquire relatively modest size firms by Pi tsburgh National and Philadelphia National who already held sizeable mortgage banking firms.

Overall, it would appear that banks and bank holding companies have come to play an important role in the mortgage banking industry, either directly through the operations of banks and their subsidiaries or through bank holding company subsidiaries. However, the industry is not dominated by the nation's twenty largest banks and/or bank holding companies.

Finance Companies[1/]

The structure of the consumer finance industry has changed rapidly since 1960. The number of firms has declined from about 3,800 to 1,900 over the period, due in large part to failures and mergers. In addition, depository financial institutions have expanded into the consumer credit field providing increased competition to finance companies. This increased competition, combined with consolidation in the industry, has led to a decline in finance companies' share of consumer instalment credit from 49.7 percent in 1965 to 20.4 percent as of November 1977.[2/] In addition, as is shown in Table 7, bank holding companies have expanded into the industry both by significant de novo entry and by acquisition.[3/]

1/ Much of the discussion in this section is based upon Rhoades and Boczar (1976).
2/ Commercial banks are the largest suppliers of consumer instalment credit with 48.8 percent, Credit Unions have 17.2 percent, and retailers have 9.3 percent. Source, January, 1978 Federal Reserve Bulletin, A42.
3/ Table 7 overstates bank holding company acquisitions, since many acquired finance companies had incorporated affiliates that operated in separate states and each was coded as a separate acquisition when the parent company was acquired.

In general, banks and bank holding companies have not acquired the nations' largest finance companies to the same degree as they have mortgage banking firms.[1/] Table 9 shows that most of the nation's 100 largest finance companies have been acquired by industrial and other types of holding companies since 1968. Only 35 are independent, 2 are affiliated with banks, and 23 are affiliated with bank holding companies. Of the top 20 only one is affiliated with a bank holding company, 10 are independent, and 9 are subsidiaries of other types of companies. Of the top 50, two are bank affiliates and only 4 are subsidiaries of bank holding companies.

Overall, the evidence suggests that while there has been significant contraction and consolidation in the finance industry, bank holding companies have not been an important factor in that process. Holland (1975) estimates that as of 1974, bank holding companies and bank subsidiaries account for about 9 percent of finance company receivables. The bulk of bank related expansion in the consumer finance industry has been through direct bank competition.

Leasing

Bank holding company subsidiary activity in leasing is limited to full payout leases, most of which is on transportation equipment, computer equipment and other general equipment. Such leases are

1/ In many instances banks are permitted to own finance company subsidiaries.

the functional equivalent of a 100 percent secured term loan. The principal sellers of leases are leasing companies, sales finance companies, commercial banks, and the manufacturers and distributors of equipment.

There is little available data on the leasing business showing the extent to which bank holding companies have acquired a significant share of the business. Holland (1975) estimated that bank holding companies accounted for less than 10 percent of industry receivables in 1974. Thus, it would not appear that bank holding company activity has resulted in significant concentration or dominance to date.

Factoring

The factoring business involves the non-recourse purchase of accounts receivable. The bulk of the business is related to the textile, apparel and related fields. The industry is comprised of some 35 larger factoring firms, several smaller factors, and commercial banks.

Banks and bank holding companies have significantly increased their share of the factoring business from about 33.8 percent in 1970 to 56.1 percent in 1975, according to Schotland (1976). Bank holding companies or their bank subisidiaries controlled 17 of the top 20 factors and 19 of the 30 largest in 1976; at least one other, itself a factor, owns a bank. Most of this increase was due to acquisition of existing firms (See Table 10) by bank subsidiaries of bank holding companies. Thus, while bank holding companies have come to dominate the factoring business, this was largely accomplished through bank acquisition which could have taken place within the holding company organizational form.

Conclusions

Review of the evidence of the impact of bank holding company expansion on concentration indicates that bank holding companies have not significantly increased their control over aggregate financial resources in the economy as a whole. Nonbanking resources still account for less than 4 percent of bank holding company resources and only about 8 percent of bank holding companies' domestic deposits are outside lead banks.

Bank holding companies have also not significantly increased concentration in commercial banking at either the national, state or local levels. Nationally, concentration in banking has declined gradually, but steadily since 1934. It has been estimated that between 1968-1973 concentration is at most 2-3 percentage points above what it might have been if bank holding companies had not existed. Similarly, at the statewide level, concentration has declined on average between 1960 and 1976 (although it increased slightly since 1970) or at best remained stable, depending upon the measures used. The greatest declines, however, have been in the most and least concentrated states. Large increases in concentration directly attributable to bank holding company acquisition have been limited to the low and moderately concentrated states. Locally, no significant, systematic increases in concentration have been attributed to bank holding companies. In general, local markets have tended to exhibit more competition structures.

Within the more significant nonbanking industries--mortgage banking, finance companies, leasing, and factoring--in which bank holding companies have been permitted to expand, the picture is more mixed. Bank holding companies have not dominated the leasing industry. Significant consolidation and structural change have taken place among finance companies, and a number of the top 100 firms have been acquired by financial and nonfinancial companies, but banks and bank holding companies have not played an important role in this process. Bank holding companies are important holders of mortgage banking firms and now account for 42 of the top 100 mortgage servicers, but it does not appear that the industry has yet become controlled by the nation's 20 largest banking firms. Factoring is the one industry that now is most clearly dominated by banks and bank holding companies which now have about 56.1 percent of the factoring business and 17 of the top twenty firms. Most of these firms have been acquired since 1968.

Finally it is interesting to note that those industries which are least dependent on a local presence--factoring and to a lesser extent mortgage banking--and hence are most easily entered by holding company bank subsidiaries regardless of their location, are the ones that have seen the greater acquisition activity by bank holding companies. On the other hand, the finance industry, which is more local in nature and hence the most likely candidate for bank holding company acquisitions to escape geographical restrictions on direct participation by their bank subsidiaries, has seen relatively little acquisition activity by holding companies.

Bibliography

Boczar, Gregory E. "The Growth of Multibank Holding Companies: 1956-73" Federal Reserve Board. Staff Economic Studies, No. 85, 1975.

Dwyer, Gerald P. Jr. and Niblack, William C. "Branching, Holding Companies, and Banking Concentration in the Eight District." Monthly Review. Federal Reserve Bank of St. Louis, July, 1974.

Edwards, Corwin D. "Conglomerate Bigness as a Source of Power," in the NBER conference report, Business Concentration and Price Policy. Princeton: Princeton University Press, 1955.

Fischer, Gerald C. "Market Extention by Bank Holding Companies: History, Economic Implications, and Current Issues," in Proceedings of a Conference on Bank Structure and Competition. Federal Reserve Bank of Chicago, 1969.

Graddy, Duane B. "Service Pricing, Profitability, Expense-Preference, and Risk Behavior in Statewide Banking Markets." Conference Papers Series #30, Business and Economic Research Center, Middle Tennessee University, March, 1978.

Heggestad, Arnold A. and Rhoades, Stephen A. "Multimarket Interdependence and Local Market Competition in Banking." Review of Economics and Statistics, (forthcoming).

Holland, Robert C. "Bank Holding Companies and Financial Stability." Journal of Financial and Quantitative Analysis 10:4 (November, 1975).

Kelly, William H. "Consolidation of Banks Reshaping Texas Markets." Federal Reserve Bank of Dallas. Business Review, January, 1972.

Light, Jack S. "Bank Holding Companies - Concentration Levels in Business Conditions, June, 1975.

Rhoades, Stephen A. "Aggregate Concentration: An Emerging Issue in Bank Merger Policy." The Antitrust Bulletin, (forthcoming).

____________________. "Diversification, Competition, and Aggregate Concentration," in Proceedings of a Conference on Bank Structure and Competition. Federal Reserve Bank of Chicago, 1974.

____________________. "Extending Merger Analysis Beyond the Single Market Framework." Board of Governors of the Federal Reserve System, 1976. Staff Economic Studies, No. 86.

____________________ and Boczar, Gregory E., "The Performance of Bank Holding Companies Affiliated Finance Companies," Staff Economic Studies, 90, Board of Governors of the Federal Reserve System, 1976.

Rose, John T. "Aggregate Concentration in Banking and Political Leverage: A Note." Industrial Organization Review, (forthcoming).

Salamon, Lester M. and Siegried, John J "Corporate Political Influence and American Public Policy: An Empirical Analysis." American Political Science Review, September 1977.

Shotland, Roy A. "Bank Holding Companies and Public Policy Today." In Compendium of Papers Prepared for the Fine Study. Committee on Banking, Currency, and Housing. House of Representatives, 94th Congress, second session. Book I, June, 1976.

Seelig, Steven A. "Aggregate Concentration and the Bank Holding Company Movement." Working Paper in Financial Economics, No. 7602. Fordham University, New York, July, 1976.

Shull, Bernard. "Multiple - Office Banking and the Structure of Banking Markets: The New York and Virginia Experience." In Proceedings of a Conference on Bank Structure and Competition. Federal Reserve Bank of Chicago, 1972.

Solomon, Elinor Harris. "Bank Merger Policy and Problems: A Linkage Theory of Oligopoly." Journal of Money, Credit, and Banking, August, 1970.

Talley, Samuel H. "The Impact of Holding Company Acquisitions on Aggregate Concentration in Banking." Staff Economic Studies, No. 80, Board of Governors of the Federal Reserve System, 1974.

____________________. "Recent Trends in Local Banking Market Structure," Staff Economic Studies, Board of Governors of the Federal Reserve System, 1977.

Ware, Robert F. "Banking Concentration on Ohio." Federal Reserve Bank of Cleveland. Economic Commentary, November 24, 1975.

Whitehead, David D. "Banking Market Performance: An Empirical Test of the Linked Oligopoly Theory." Presented at the Southern Economic Association Meetings, 1977a.

____________________. "Holding Company Power and Market Performance: A New Index of Market Concentration." Working paper series, Federal Reserve Bank of Atlanta, December, 1977b.

Table 1

Share of the Deposits of the Largest Banking Organizations in the U.S. 1/

	Largest 100	Largest 10
Dec. 31, 1934*	56.7	23.7
Dec. 31, 1940*	59.4	26.9
Dec. 31, 1955	49.3	20.7
Dec. 31, 1957 3/	48.2	NA
Dec. 31, 1960	49.5	21.2
Dec. 31, 1961 3/	49.4	NA
Dec. 31, 1964	48.0	20.6
Dec. 31, 1966	49.3	NA
Dec. 31, 1968 3/	49.1	20.4
June 30, 1970	49.9	19.9
June 30, 1972	46.8	19.1
Dec. 31, 1973 3/	47.0	NA
Dec. 31, 1975 2/	48.1	20.9 4/
Dec. 31, 1976 3/	45.3	18.4
June 30, 1977 3/	45.0	18.3

*Continental U.S. Only

1/ FDIC Summary of Accounts and Deposits in all commercial banks, June 30, 1972 except where indicated.

2/ Peterson, Manferd O., "Aggregate Bank Concentration and the Competition in Banking Act of 1975," Issues in Bank Regulation, Summer 1977, p. 38.

3/ Call Report data, Board of Governors of the Federal Reserve.

4/ FDIC Summary of Accounts and Deposits in all commercial banks June 30, 1975.

NA--Not available.

Table 2
Statewide Concentration Ratios
for Commercial Banking Organizations

	1955 1/		1960 2/		1970 1/		1976 3/		Changes 1960-70		Changes 1960-76		Changes 1970-76	
	3 firm	5 firm	3 firm	5 firm	3 firm	5 firm	3 firm	5 firm	3 firm	5 firm	3 firm	5 firm	3 firm	5 firm
Highly Concentrated States														
Nevada	94.3	100.0	93.5	98.6	86.8	97.6	83.2	96.5	-6.7	-1.0	-10.3	-2.1	-3.6	-1.1
Arizona	90.4	95.6	95.8	98.3	90.6	96.9	86.8	94.7	-5.2	-1.4	-9.0	-3.6	-3.8	-2.2
Rhode Island	90.9	96.0	92.8	98.1	85.8	92.7	87.4	93.8	-7.0	-5.4	-5.4	-4.3	1.6	1.1
Delaware	73.4	84.4	79.8	92.3	74.2	91.5	76.9	92.5	-5.6	-0.8	-2.9	0.2	2.7	1.0
Hawaii	93.0	98.7	89.2	97.2	76.5	88.9	78.6	91.0	-12.7	-8.3	-10.6	-6.2	2.1	2.1
District of Columbia	63.4	74.0	74.0	87.3	69.7	90.2	70.4	89.4	-4.3	2.9	-3.6	2.1	0.7	-0.8
Idaho	75.6	83.7	74.5	83.8	77.5	86.3	75.3	88.4	3.0	2.5	0.8	4.6	-2.2	2.1
Alaska	58.2	71.8	68.2	86.7	69.3	85.3	67.5	84.5	1.1	-1.4	-0.7	-2.2	-1.8	-0.8
Oregon	89.1	91.1	86.7	88.8	83.6	86.3	78.3	84.3	-3.1	-2.5	-8.4	-4.5	-5.3	-2.0
California	61.9	75.5	65.7	77.7	60.9	77.5	60.4	76.6	-4.8	-0.2	-5.3	-1.1	-0.5	-0.9
Washington	58.8	72.1	61.1	73.7	60.0	73.1	61.7	75.8	-1.1	-0.6	0.6	2.1	1.7	2.7
Utah	57.0	70.6	65.6	77.8	59.1	71.5	60.5	73.0	-6.5	-6.3	-5.1	-4.8	1.4	1.5
Maine	25.7	36.8	34.7	49.0	35.3	51.8	46.6	71.6	0.6	2.8	11.9	22.6	11.3	15.[illegible]
Moderately Concentrated States														
North Carolina	33.1	42.5	46.8	56.9	51.0	66.8	49.2	65.0	4.2	9.9	2.4	8.1	-1.8	-1.8
Massachusetts	31.7	62.0	49.3	61.2	47.8	61.9	45.7	62.6	-1.5	0.7	-3.6	1.4	-2.1	0.7
South Carolina	38.2	45.7	42.4	51.5	46.6	59.2	42.8	61.4	4.2	7.7	0.4	9.9	-3.8	2.2
Maryland	36.3	49.0	42.7	58.3	42.6	60.3	44.6	61.2	-0.1	2.0	1.9	2.9	2.0	0.9
Connecticut	39.6	48.7	42.7	56.5	45.8	59.8	46.6	60.8	3.1	3.3	3.9	4.3	0.8	1.0
Vermont	20.8	30.0	25.6	35.2	37.5	49.5	44.0	60.5	11.9	14.3	18.4	25.3	6.5	11.0
New Mexico	45.1	56.0	43.0	54.0	45.5	52.1	46.0	59.9	2.5	-1.9	3.0	5.9	0.5	7.8
New York	39.9	54.5	40.0	55.4	40.7	56.2	40.0	56.1	0.7	0.8	0	0.7	-0.7	-0.1

1/ FDIC S.O.D. June 30, 1970
2/ FDIC S.O.D. June 30, 1972
3/ Call Report Dat

cont'd
Table 2
Statewide Concentration Ratios
for Commercial Banking Organizations

	1955 1/		1960 2/		1970 1/		1976 3/		Changes 1960-70		Changes 1960-76		Changes 1970-76	
	3 firm	5 firm	3 firm	5 firm	3 firm	3 firm	3 firm	5 firm	3 firm	5 firm	3 firm	5 firm	3 firm	5 firm
Moderately Concentrated States (cont'd)														
Alabama	34.4	43.9	31.2	40.6	23.2	31.3	37.5	52.8	-8.0	-9.3	6.3	12.2	14.3	21.5
Minnesota	56.6	60.6	58.6	63.7	53.7	57.3	51.6	55.8	-4.9	-6.4	-7.0	-7.9	-2.1	-1.5
Colorado	29.8	42.6	37.9	48.8	33.6	43.6	41.0	55.8	-4.3	-5.2	3.1	7.0	7.4	12.2
Montana	50.3	58.5	48.9	57.6	48.4	58.0	45.5	55.5	-0.5	0.4	-3.4	-2.1	-2.9	-2.5
Virginia	20.6	28.0	20.2	27.7	34.2	48.1	34.6	51.4	14.0	20.4	14.4	23.7	0.4	3.3
South Dakota	37.2	41.0	37.5	43.0	42.4	46.6	44.3	50.7	4.9	3.6	6.8	7.7	1.9	4.1
North Dakota	48.1	53.9	46.6	54.2	39.7	49.3	40.6	49.4	-6.9	-4.9	-6.0	-4.8	0.9	0.1
Wyoming	37.7	45.7	35.1	44.3	28.1	37.1	40.3	47.7	-7.0	-7.2	5.2	3.4	12.2	10.6
New Hampshire	20.9	29.3	24.3	33.7	30.5	38.9	33.6	45.6	6.2	5.2	9.3	11.9	3.1	6.7
Michigan	44.3	53.3	40.8	50.2	35.1	46.0	34.2	45.4	-5.7	-4.2	-6.6	-4.8	-0.9	-0.6
Low Concentrated States														
Georgia	48.8	57.5	48.6	56.9	41.9	49.5	37.8	44.6	-6.7	-7.4	-10.8	-12.3	-4.1	-4.9
Tennessee	29.3	43.8	28.7	40.9	26.6	39.9	28.8	42.4	-2.1	-1.0	0.1	1.5	2.2	2.5
Missouri	31.2	40.9	26.6	35.8	22.1	28.8	28.9	39.6	-4.5	-7.0	2.3	3.8	6.8	10.8
Illinois	38.1	45.3	35.5	42.2	32.0	38.3	31.8	37.3	-3.5	-3.9	-3.7	-4.9	-0.2	-1.0
Florida	20.6	27.9	17.9	23.2	15.7	21.3	24.5	35.2	-2.2	-1.9	6.6	12.0	8.8	13.9
Mississippi	21.1	25.2	24.9	29.0	28.6	33.7	27.7	34.5	3.7	4.7	2.8	5.5	-0.9	0.8
Ohio	26.6	35.8	24.2	33.1	21.9	30.8	24.6	34.4	-2.3	-2.3	0.4	1.3	2.7	3.6
New Jersey	16.3	22.5	16.8	23.5	14.5	22.3	22.2	33.3	-2.3	-1.2	5.4	9.8	7.7	11.0
Pennsylvania	28.2	36.9	27.9	38.8	25.1	35.5	22.9	32.5	-2.8	-3.3	-5.0	-6.3	-2.2	-3.0
Texas	19.0	25.7	21.1	27.9	14.7	21.0	20.5	31.7	-6.4	-6.9	-0.6	3.8	5.8	10.7
Wisconsin	30.4	34.1	31.4	33.8	27.2	31.3	27.4	31.5	-4.2	-2.5	-4.0	-2.3	0.2	0.2
Oklahoma	36.7	45.0	32.6	42.2	21.4	30.6	20.5	28.9	-11.2	-11.6	-12.1	-13.3	-0.9	-1.7
Nebraska	33.6	41.0	31.6	41.4	24.7	33.9	20.0	28.3	-6.9	-7.5	-11.6	-13.1	-4.7	-5.6

1/ FDIC S.O.D. June 30, 1970
2/ FDIC S.O.D. June 30, 1972
3/ Call Report Data

cont'd
Table 2
Statewide Concentration Ratios
for Commercial Banking Organizations

	1955 1/		1960 2/		1970 1/		1976 3/		Changes 1960-70		Changes 1960-76		Changes 1970-76	
	3 firm	5 firm	3 firm	5 firm	3 firm	5 firm	3 firm	5 firm	3 firm	5 firm	3 firm	5 firm	3 firm	5 firm
Low Concentrated States														
Kentucky	26.9	34.7	27.6	34.1	24.7	32.4	20.9	27.4	-2.9	-1.7	-6.7	-6.7	-3.8	-5.0
Louisiana	32.1	43.1	29.3	38.7	21.3	28.2	17.8	24.7	-8.0	-10.5	-11.5	-14.0	-3.5	-3.5
Indiana	21.9	28.1	23.8	29.4	22.7	27.2	18.0	22.5	-1.1	-7.2	-5.8	-6.9	-4.7	-4.7
Iowa	13.9	19.6	14.2	19.8	11.9	16.9	15.1	21.3	-2.3	-2.9	0.9	1.5	3.2	4.4
Arkansas	17.4	24.7	17.3	23.4	14.4	19.7	14.2	19.5	-2.9	-3.7	-3.1	-3.9	-0.2	-0.2
West Virginia	20.6	26.7	17.3	22.7	13.2	17.9	9.3	13.3	-4.1	-4.8	-8.0	-9.4	-3.9	-4.6
Kansas	16.5	20.6	14.3	18.7	11.7	15.7	9.0	12.7	-2.6	-3.0	-5.3	-6.0	-2.7	-3.0
Averages for All States	42.1	50.5	43.3	52.1	41.0	50.7	41.9	53.1	-2.3	-1.4	-1.4	0.9	0.9	2.3

1/ FDIC S.O.D. June 30, 1970
2/ FDIC S.O.D. June 30, 1972
3/ Call Report Data

Table 3[1/]
Impact of Holding Company Acquisitions
on Statewide Concentration, 1968-73

State	Actual Statewide Concentration in 1973	Adjusted Statewide Concentration in 1973	Impact of Holding Company Acquisitions on Statewide Concentration, 1968-73
Alabama (L)	45.1	30.5	14.6
Alaska (S)	87.9	87.9	--
Arizona (S)	94.7	94.7	--
Arkansas (U)	21.0	19.3	1.7
California (S)	75.6	75.6	--
Colorado (U)	47.6	39.9	7.7
Connecticut (S)	61.3	61.1	0.2
Delaware (S)	92.0	92.0	--
District of Columbia (S)	88.8	88.8	--
Florida (U)	31.7	16.9	14.8
Georgia (L)	47.7	47.7	--
Hawaii (S)	89.2	89.2	--
Idaho (S)	87.9	87.9	--
Illinois (U)	41.3	41.3	--
Indiana (L)	25.1	25.1	--
Iowa (U)	18.5	15.4	3.1
Kansas (U)	13.2	13.2	--
Kentucky (L)	29.7	29.7	--
Louisiana (L)	28.1	28.1	--
Maine (S)	69.9	56.7	13.2
Maryland (S)	61.3	59.4	1.9
Massachusetts (L)	62.9	61.2	1.7
Michigan (L)	46.9	42 6	4.3
Minnesota (U)	57.4	56.1	1.3
Mississippi (L)	33.4	33.4	--
Missouri (U)	32.8	22.3	10.5
Montana (U)	52 8	51.9	0.9
Nebraska (U)	31.8	31.8	--
Nevada (S)	97.0	97.0	--

Table 3 (continued)

State	Actual Statewide Concentration in 1973	Adjusted Statewide Concentration in 1973	Impact of Holding Company Acquisitions on Statewide Concentration, 1968-73
New Hampshire (L)	40.1	40.1	--
New Jersey (L)	29.3	20.5	8.[illegible]
New Mexico (L)	63.6	51.7	11.[illegible]
New York (L)	55.4	54.9	0.5
North Carolina (S)	68.1	68.1	--
North Dakota (U)	49.8	49.8	--
Ohio (L)	33.3	28.7	4.6
Oklahoma (U)	28.7	28.7	--
Oregon (S)	83.1	83.1	--
Pennsylvania (L)	33.4	33.4	--
Rhode Island (S)	92.7	92.7	--
South Carolina (S)	56.1	56.1	--
South Dakota (S)	49.3	47.9	1.4
Tennessee (L)	42.1	38.5	3.6
Texas (U)	25.3	20.8	4.5
Utah (S)	72.0	71.8	0.2
Vermont (S)	54.9	54.9	--
Virginia (S)	50.7	45.7	5.0
Washington (S)	76.2	76.2	--
West Virginia (U)	17.5	17.5	--
Wisconsin (L)	32.9	29.2	3.7
Wyoming (U)	45.0	34.4	10.6

U= Unit banking state
L= Limited branching state
S= Statewide branching state

SOURCE: Board of Governors of the Federal Reserve System

1/ Talley, 1974 p. 15-16.

Table 4

5 Firm Concentration Ratios
(percent)

State	Year			
	1957	1961	1968	1974
Iowa	20.8	19.2	17.4	19.8
Michigan	52.9	50.0	48.4	47.6
Wisconsin	31.5	33.3	31.9	33.4

Source: Light (1975)

Table 5
Bank Holding Company Groups' Deposits as a Percentage of All Commercial Bank Deposits for Selected Years 1957-1976

States in Which Groups Operate	Percentage of State's Deposits					
	1957	1962	1967	1970	1971	1976
Alabama	--*	--	--	--	26.4	60.3
Alaska	--	--	--	--	9.5	10.9
Arizona	38.2	35.7	33.6	32.9	54.4	53.6
Arkansas	--	--	--	8.0	19.2	20.2
California	7.0	10.5	9.1	9.7	75.9	92.5
Colorado	4.5	6.7	22.8	51.2	71.3	78.5
Connecticut	--	--	--	3.5	58.5	71.7
Delaware	--	--	--	--	19.2	23.9
District of Columbia	--	--	10.4	11.4	25.8	49.0
Florida	11.5	7.6	34.2	48.6	61.8	77.6
Georgia	34.7	34.1	34.5	33.0	53.0	49.0
Hawaii	--	--	--	--	--	69.9
Idaho	40.4	39.8	42.4	40.6	41.3	53.4
Illinois	0.9	0.5	1.2	0.2	50.9	55.5
Indiana	2.2	0.8	1.0	--	29.4	32.4
Iowa	7.6	8.2	9.0	10.8	38.3	45.8
Kansas	9.0	--	--	--	27.4	40.4
Kentucky	7.9	11.1	10.4	9.4	10.7	24.8
Louisiana	--	--	--	--	29.9	32.3
Maine	5.0	5.0	20.0	45.9	53.1	72.7
Maryland	--	--	2.9	7.5	27.5	72.0
Massachusetts	20.2	21.0	21.3	22.3	70.9	87.9
Michigan	--	--	1.1	--	6.7	69.5
Minnesota	6.7	61.1	58.7	59.7	69.7	68.8
Mississippi	--	--	--	--	25.3	27.6
Missouri	8.7	4.0	4.0	27.7	57.8	69.6
Montana	53.4	51.9	53.3	52.4	69.1	68.1
Nebraska	10.2	9.2	10.2	9.1	47.3	59.9
Nevada	74.9	70.1	59.3	62.5	69.7	64.8
New Hampshire	9.5	13.0	16.8	13.1	27.2	34.5
New Jersey	--	--	--	16.8	36.1	55.6
New Mexico	13.5	12.3	13.5	19.4	67.3	55.8
New York	5.4	5.9	19.6	23.9	89.4	86.4
North Carolina	--	--	--	2.3	66.0	69.4
North Dakota	37.8	40.9	38.4	39.7	44.8	44.3
Ohio	6.0	6.0	12.3	20.9	37.8	64.4
Oklahoma	0.1	--	8.7	--	41.1	52.0
Oregon	44.5	42.5	42.4	42.2	82.8	79.2

cont'd
Table 5
Bank Holding Company Groups' Deposits as a Percentage of All Commercial Bank Deposits for Selected Years 1957-1976

States in Which Groups Operate	Percentage of State's Deposits					
	1957	1962	1967	1970	1971	1976
Pennsylvania	--	--	--	--	40.3	51.5
Rhode Island	--	--	--	--	95.1	96.3
South Carolina	--	--	--	--	25.1	51.2
South Dakota	32.9	34.0	33.5	43.2	58.2	64.2
Tennessee	3.5	3.3	3.4	8.3	36.3	54.5
Texas	3.0	2.6	5.3	7.1	44.8	55.9
Utah	52.7	52.0	48.0	45.7	73.8	81.8
Vermont	--	--	--	--	8.5	25.9
Virginia	1.6	9.6	37.0	43.8	62.9	78.0
Washington	13.6	13.0	13.8	18.6	44.0	68.8
West Virginia	--	--	--	--	4.6	6.2
Wisconsin	20.9	34.6	35.2	43.4	49.5	49.7
Wyoming	17.1	17.4	16.4	21.7	45.4	60.0

*Blanks reflect changes in State banking laws and/or corporate law which affect bank holding companies.

Notes and Sources:

Source for 1957, 1962, and 1967 data Federal Reserve Bulletin, October 1958; July 1963; and August 1968 quoted in Fischer, 1969, pp. 66-67.

Source for 1970 data Board of Governors of the Federal Reserve System, Banking and Monetary Statistics 1941-1970, p. 458.

Source for 1971 and 1976 data Board of Governors of the Federal Reserve System, Annual Statistical Digest 1971-75 and 1972-1976 p. 267 and p. 311, respectively.

Note: Holding companies comprise the following: Those registered pursuant to the Bank Holding Company Act of 1956, and those so defined in the Bank Holding Company Act of 1956 as amended (except that in 1970 the figures do not include companies as a result of the "Bank Holding Company Act Amendments of 1970" approved December 31, 1970). The data for deposits are for those banks of which the bank holding companies owned or controlled 25 percent or more of the outstanding stock.

Table 6

Activities Ruled by the Board of Governors under Section 4(c)(8) of the Bank Holding Company Act, as of February 27, 1978

Permitted by regulation

1. Extensions of credit
   a. Mortgage banking
   b. Finance companies: consumer, sales, and commercial
   c. Credit cards
   d. Factoring
2. Industrial bank, Morris Plan bank, industrial loan company
3. Servicing loans and other extensions of credit
4. Trust company
5. Investment or financial advising
6. Full-payout leasing of personal and real property
7. Investments in community welfare projects
8. Providing bookkeeping or data processing services
9. Acting as insurance agent or broker--primarily in connection with credit extensions
10. Underwriting credit life, accident, and health insurance
11. Providing courier services
12. Management consulting for unaffiliated banks

Permitted by order

1. Issuance and sale of travelers checks
2. Buying and selling gold and silver bullion and silver coin
3. Issuing money orders and general purpose variable denominated payments instruments
4. Futures commission merchant to cover gold and silver bullion and coins
5. Underwriting certain federal, state and municipal securities

Activities denied by the Board

1. Insurance premium funding (combined sales of mutal funds and insurance)
2. Underwriting life insurance not related to credit extension
3. Real estate brokerage
4. Land development
5. Real estate syndication
6. General managemen consulting
7. Property management
8. Computer output microfilm services
9. Underwriting mortgage guaranty insurance[a]
10. Operating a savings and loan association[b]
11. Operating a travel agency

[a] Board orders found these activities closely related to banking but denied proposed acquisitions as part of its "go-slow" policy.

[b] Operating a thrift institutions, Rhode Island and New Hampshire only.

Nonbanking Acquisitions of
Bank Holding Companies
January 1, 1971--December 17, 1977

	De Novo Notifications Received	Proposed Acquisitions Processed by Board: Total Received	Approved	Denied
Fiduciary & Trust	60	15	14	1
Mortgage Banking	475	107	83	10
Leasing	403	30	17	3
Investment, Financial & Economic Advisory Services	196	17	13	3
Insurance Agency or Broker	956	177	129	15
Insurance Underwriting Credit Life, Accident & Health	66	65	50	--
Finance Company				
General	287 1/	7	4	--
Commercial	104 2/	7	13	--
Consumer	523 2/	123	96	9
Insurance Premium	6	6	5	--
Mobile Homes	--	5	2	2
Agricultural	6	4	3	1
Data Processing	130	30	20	1
Factoring	47	12	8	1
Community Development	20	5	--	2
Industrial Banking	59	21	15	3
Management Consulting for Banks	1	12	11	--
Savings and Loan Association	--	5	2	3
Other	16	22	12	--
Total	3,355	670	497	54

NOTE: These tabulations are unofficial estimates of the volume of activity. Source: Bank Expansion Quarterly, Volume XXI, fourth quarter, 1977.

1/ Prior to March 31, 1973 all finance company notifications were placed in a single category.
2/ Only notifications received since March 31, 1973; 123 notifications received prior to March 31, 1973 are included under "general".

Table 8

Bank Affiliated Mortgage Banking Firms Among the Top 50 Servicers in U.S.A.

U.S. Rank (12/76)	Mortgage Company	Servicing (millions $)	Notes 1/	Parent BHC (or bank)	BHC Domestic Total Assets (millions $ as of 6/77	U.S. Rank	BHC Domestic Total Assets (millions $ as 6/77	U.S. Rank
2	Advance	3,044	1980	Citicorp	27,658	3	17,884	3
3	Colonial	2,803	Bank Subsidiary	Phila. Nat'l Bank	3,599	34	2,322	43
4	Pennamco	2,548	1980	First Penn. Corp.	6,426	20	3,265	29
5	Cameron Brown	2,004	Indefinitely grandfathered	First Union (N.C.)	1,919	77	1,469	81
7	Kissel	1,878	Approved 1974	Pitts. Nat'l Corp.	3,268	40	2,367	41
16	Banco Mortgage	1,358	Indefinitely grandfathered	Northwest B' Corp.	8,477	14	6,769	15
18	Wells Fargo Mortgage	1,325	Approved 1973 Former Bank Subsidiary	Wells Fargo & Co.	11,985	12	9,835	10
19	Mortgage Assoc.	1,295	Approved 1974	Industrial Nat'l	1,892	79	1,403	89
20	First Mortgage Corp.	1,213	Bank Subsidiary	First & Merchant Bank	1,799	56	1,462	83
24	Security Pacific Mortgage	1,152	Approved 1974	Security Pacific	13,832	10	10,720	7
27	Citizens	1,104	Approved 1973	Manufacturers Hanover	20,950	4	16,891	4
28	Rainier Mortgage 2/	1,083	Approved 1972	Rainier Bancorp (Marine)	2,533	58	2,132	53
29	VNB Mortgage	1,079	Bank Subsidiary	Virginia Nat'l Bank	2,038	72	1,777	66
30	American Fletcher Mortgage	1,072	1980	American Fletcher	2,017	73	1,435	85
32	Latimer & Buck	1,039	1980	Fidelcor	2,239	65	1,569	73
38	Housing Invest. Corp.	969	Bank Subsidiary	Chase Manhattan Bank	28,046	2	20,260	2
39	Southeast Mortgage	960	Held Under 4(c)(5)	Southeast Banking Corp.	3,476	26	2,821	36
41	Wachovia Mortgage	886	1980	Wachovia Corp.	3,186	43	2,574	39
42	NBD Mortgage	871	Approval 1973	National Detroit Corp.	7,060	13	5,302	18
44	Mortgage Corp. of South 3/	861	Bank Subsidiary	First Nat'l Bank Boston	5,189	22	3,261	30
46	Galbreath Mortgage	817	Approved 1974	Chemical N.Y.	18,460	6	13,344	6
47	Citizens & Southern Mortgage	789	Approved 1973	Citizens & Southern Nat'l Bank	3,358	38	2,516	39
9		1,823		United California Bank	18,823	5	15,352	5
15		1,425		Jacksonville Nat'l Bank	129	791	101	875
33		1,034		Bank of America	43,373	1	33,058	1

1/ Affiliations which have been approved by Board order are so noted with the year of acquisition. Bank subsidiaries would need Board approval to become holding company affiliates and those firms with 1980 in the notes column must apply to the Board for indefinite grandfather rights prior to that year. Indefinitely grandfathered firms were acquired prior to June 1968 and may remain holding company affiliates unless those rights are terminated by the Board.

2/ Formerly Coast Mortgage.

3/ Formerly Cobbs, Allen & Hall, Inc., Birmingham, Alabama.

Warburg Paribas Becker

[illegible]

STATUS OF THE LARGEST 100 INDEPENDENT FINANCE COMPANIES AT DECEMBER 31, 1976(1)
COMPARED TO JUNE 30, 1977

Rank (2)	Company	Location	Sold/Merged Organized	Organized or Acquired by	Type of Merger
1	C.I.T Financial Corporation	New York, New York			
2	Household Finance Corporation	Chicago, Illinois			
3	Commercial Credit Company	Baltimore, Maryland	1968	Control Data Corporation	Industrial company
4	Beneficial Corporation	Wilmington, Delaware			
5	Associates Corp. of North America	New York, New York	1969	Gulf & Western Industries, Inc.	Industrial company
6	General Electric Credit Corp.	New York, New York	1932	General Electric Company	Industrial company
7	CAC Finance, Inc.	Allentown, Pennsylvania	1974	BankAmerica Corporation	Bank holding company
8	Walter E. Heller International Corp.	Chicago, Illinois			
9	Avco Delta Corporation	Newport Beach, California	1971	Avco Financial Services, Inc.	Intra-industry
10	Transamerica Financial Corp.	Los Angeles, California	1961	Transamerica Corporation	Insurance holding company
11	Avco Financial Services, Inc.	Newport Beach, California	1969	Avco Corporation	Industrial company
12	American Investment Company	St. Louis, Missouri			
13	James Talcott, Inc.	New York, New York			
14	Liberty Loan Corporation	St. Louis, Missouri			
15	American Finance System, Inc.	Wilmington, Delaware			
16	Westinghouse Credit Corporation	Pittsburgh, Pennsylvania	1954	Westinghouse Electric Corporation	Industrial company
17	Family Finance Corporation	Wilmington, Delaware			
18	American Credit Corporation	Charlotte, North Carolina			
19	ITT Aetna Corporation	St. Louis, Missouri	1974	ITT Financial Corporation	Intra-industry
20	General Finance Corporation	Evanston, Illinois	1969	CNA Financial Corporation (3)	Insurance holding company
21	Capital Finance Corporation	Columbus, Ohio	1969	Continental Corporation	Insurance holding company
22	Dial Financial Corporation	Des Moines, Iowa			
23	Borg-Warner Acceptance Corporation	Chicago, Illinois	1953	Borg-Warner Corporation	Industrial company
24	Credithrift Financial Corporation	Evansville, Indiana			
25	ITT Thorp Corporation	Thorp, Wisconsin	1969	ITT Financial Corporation	Intra-industry
26	Midland-Guardian Company	Cincinnati, Ohio			
27	Interstate Securities Company	Kansas City, Missouri	1977	Beneficial Corporation	Intra-industry
28	Economy Finance Corporation	Indianapolis, Indiana	1971	EIC Leasing Corporation (4)	Intra-industry
29	Southwestern Investment Company	Amarillo, Texas	1973	Company	Industrial company
30	Budget Finance Plan, Inc.	Los Angeles, California	1972	Associates Corp. of North America	Intra-industry
31	USLIFE Credit Corporation	Schaumburg, Illinois	1970	USLIFE Corp	[illegible]ing company
32	Mercantile Financial Corporation (5)	Chicago, Illinois	1973	[illegible] Ltd.	Industria[illegible]
33	Carte Blanche Corporation	Los Angeles, California	1976	Avco Financial Services, Inc.	Intra-industry
34	Diners' Club, Inc.	New York, New York	1970	Continental Corporation	Insurance holding company
35	Appliance Buyers Credit Corporation	St. Joseph, Michigan	1957	Whirlpool Corporation	Industrial company
36	A. J. Armstrong Co., Inc.	New York, New York			
37	Lane Wood, Inc. (6)	Dallas, Texas			
38	Postal Finance Company	Sioux City, Iowa	1969	St. Paul Companies	Insurance holding company
39	Public Loan Company	Binghamton, New York			
40	Iselin-Jefferson Financial Co., Inc.	New York, New York	1972	Manufacturers Hanover Trust Co.	Bank
41	John P. Maguire & Co. Inc.	New York, New York	1977	Irving Trust Company	Bank
42	Amsterdam Overseas Corp.	New York, New York	1971	Aetna Business Credit, Inc.	Intra-industry
43	Crompton-Richmond Company, Factors	New York, New York	1972	United Virginia Bankshares Inc.	Bank holding company
44	Oxford Finance Companies, Inc.	Philadelphia, Pennsylvania			
45	Heston Company, Inc.	New York, New York	1968	Leo National Corporation	Intra-industry
46	Industrial Finance & Thrift Corp.	New Orleans, Louisiana	1970	First Pennsylvania Corporation	Bank holding company
47	Fidelity Acceptance Corporation	Minneapolis, Minnesota			
48	Civic Finance Corporation	Milwaukee, Wisconsin	1946	Aetna Life & Casualty Company	Insurance company
49	Union Investment Company	Detroit, Michigan	1976(7)	Orbanco, Inc.	Bank holding company
50	Government Employees Corporation	Washington, D.C.	1973	Government Employ[illegible]	Intra-industry
51	Signal Finance Corporation	Pittsburgh, Pennsylvania	1973	Philadelphia National Corporation	Bank holding company
52	Kentucky Finance Co., Inc.	Lexington, Kentucky	1973	Kentucky Central Life Insurance Co.	Insurance company
53	Ritter Financial Corporation	Wyncote, Pennsylvania	1975	Manufacturers Hanover Corporation	Bank holding company
54	Sun Finance & Loan Company	Cleveland, Ohio	1975	Chemical New York Corporat	Bank holding company
55	Commercial Discount Corporation	Chicago, Illinois	1975	Associates Corp. of North	Intra-industry
56	Rosenthal & Rosenthal, Inc.	New York, New York			
57	Government Employees Financial Corp.	Washington, D.C.			
58	Local Finance Corporation	Marion, Indiana	1972	American Fletcher Corporation	Bank holding company
59	Century Acceptance Corporation	Kansas City, Missouri			
60	DAC Acceptance Corp.	Jacksonville, Florida	1976	Avco Financial Services, Inc.	Intra-industry

Note that factors are inclued on this list. American Banker also puts out a list like this but does not show affiliations.

rburg Paribas Becker

cont'd
Table 9

TRANSOUTH FINANCIAL CORPORATION ANALYSIS OF
BENEFITS OF NCNB CORPORATION'S OWNERSHIP
STATUS OF THE LARGEST 100 INDEPENDENT FINANCE COMPANIES AT DECEMBER 31, 1970(1)
COMPARED TO JUNE 30, 1977
(CONTINUED)

Rank(2)	Company	Location	Sold/Merged Organized	Organized or Acquired by	Type of Merger
61	Local Finance Corporation	Providence, Rhode Island	1977	Avco Financial Services, Inc.	Intra-industry
62	Stephenson Finance Company, Inc.	Florence, South Carolina	1969	NCNB Corporation	Bank holding company
63	Northwest Acceptance Corporation	Portland, Oregon	1969	Orbanco, Inc.	Bank holding company
64	Allied Finance Company	Dallas, Texas	1972	Republic Financial Services, Inc.	Insurance holding company
65	IDS Credit Corporation (8)	Minneapolis, Minnesota	1972	First Bank System, Inc.	Bank holding company
66	Commercial Alliance Corporation	New York, New York			
67	Nationwide Consumer Services, Inc.	Columbus, Ohio	1970	Nationwide Insurance Co.	Insurance company
68	Commercial Securities Co., Inc.	Baton Rouge, Louisiana			
69	Morris Plan Company of California	San Francisco, California	1971	Credithrift Financial Corporation	Intra-industry
70	Atlas Financial Corporation	Montgomeryville, Pennsylvania	1970	Trans East Air, Inc.	Industrial company
71	Century Industries Co., Inc.	New York, New York			
72	Georgia International Finance Corp.	Atlanta, Georgia	1972	Capital Holding Corporation	Insurance holding company
73	Southern Discount Company	Atlanta, Georgia	1973	Industrial National Corporation	Bank holding company
74	Finance Company of America	Baltimore, Maryland			
75	Federal Discount Corporation	Dubuque, Iowa	1977	Services Corp. of the Midwest	Bank holding company
76	Public Finance Service, Inc.	Bala-Cynwyd, Pennsylvania			
77	Bankers Investment Company	Hutchinson, Kansas	1976	Security Pacific Corporation	Bank holding company
78	Acceptance Finance Company	St. Louis, Missouri	1973	Citicorp	Bank holding company
79	Atlantic Discount Co., Inc.	Jacksonville, Florida	1976	First Am Corporation	Bank holding company
80	Crown Finance Corporation	St. Louis, Missouri	1973	First Tennessee National Corp.	Bank holding company
81	Investors Loan Corporation	Frederick, Maryland	1970	First Pennsylvania Corporation	Bank holding company
82	Inland Credit Corporation (9)	New York, New York			
83	Community Credit Company	Minneapolis, Minnesota			
84	Delta Loan & Finance Co.	St. Louis, Missouri			
85	Guardian Commercial Corporation	Roslyn Heights, New York	1976	CIT Financial Corporation	Intra-industry
86	Dixie Finance Co., Inc.	Atlanta, Georgia	1972	National Holding Corporation	Bank holding company
87	Fireside Thrift Company	Redwood City, California	1970	Teledyne, Inc.	Industrial company
88	Schenectady Discount Corporation	Albany, New York	1974	First Maryland Bancorp.	Bank holding company
89	Colonial Commercial Corporation	Valley Stream, New York			
90	M & J Financial Corporation	Shelby, North Carolina	1969	Northwestern Financial Corporation	Bank holding company
91	Petro, Inc.	Baltimore, Maryland	1969	U.S. Industries, Inc.	Industrial company
92	First Provident Co., Inc.	Sanford, North Carolina	1973	South Carolina National Corporation	Bank holding company
93	Peoples Financial Corporation	Marietta, Georgia			
94	Murdock Acceptance Corporation (9)	Memphis, Tennessee			
95	Great Western Finance Company	San Antonio, Texas	1977	Commercial Credit Company	Intra-industry
96	Girard Investment Company	Upper Darby, Pennsylvania	1976	Beneficial Corporation	Intra-industry
97	CULPCO Investment Group, Inc.	Marksville, Louisiana			
98	General Finance Service Corporation	Huntingdon, Pennsylvania	1973	Bank of Virginia Company	Bank holding company
99	Atlantic Company	New York, New York			
100	Carson Investment Company	Wellsboro, Pennsylvania			

(1) Source: American Banker, May 26, 1971.
(2) Ranked by total capital funds.
(3) Loews Corporation acquired approximately 50% of CNA Financial in 1974.
(4) MGIC Investment Corporation owns approximately 50% of CIC.
(5) Announced liquidation in 1977.
(6) Lane Wood & Company sold to First National Bank in Dallas in 1971.
(7) Pending.
(8) Liquidating in 1977.
(9) Substantially liquidated in 1973.

Table 10

Selected Factors Acquired by Banking Institutions:
A Comparison of Factoring Volume at the Time
of Acquisition vs. 1973 1/

Factor	Affiliation	Year Acquired	Percent of the Top 30 Factoring Volume: year acquired	1973
Coleman Factors	Bankers Trust	1968	1.79%	2.47
Dommerich	Chemical Bk.	1968	3.52	5.78
Southeastern Financial	Wachovia Bk	1969	2.68	4.26
Hubschuman Factors	First Nat. Ct. Bk.	1969	2.84	3.92
Rusch Factors	Bk. of Va.	1969	.73	1.66
Shapiro Bros.	Chase Man Bk.	1969	4.58	4.23
H.A. Caesar	First Union Bancorp.	1969	.55	.54
N.C.N.B. Fin.	N.C.N.B.	1970	.55	1.07
Ambassador Factors	Industrial Nat. Bk.	1971	1.05	1.25
Iselin-Jefferson Factors	Manufacturers Hanover	1971	3.01	3.41
J.P. Maguire	Provident Nat'l Bk	1971	4.70	5.10
Rawleigh Moses & Co.	Central Nat'l Bk	1971	.31	.49
Crompton-Richmond	United Va. Bksh.	1972	3.04	3.01

1/ Data was gathered from The Daily News Record, February 9, 1973; February 11, 1974 and The American Banker October 8, 1973.

Section IX

Convenience and Needs and Public Benefits
in the Bank Holding Company Act

Anthony Cyrnak

I. Introduction:

Among the provisions of the Bank Holding Company Act of 1956 was one in Section 3(c) which required the Federal Reserve Board to consider five factors while acting on any bank holding company proposal. These factors were clearly stated as part of the Act:

> (1) the financial history and condition of 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 area concerned; and (5) whether or not the effect of such acquisitions or merger or consolidation would be to expand the size or extent of the bank holding company systems involved beyond limits consistent with adequate and sound banking, the public interest, and the preservation of competition in the field of banking.

The focus of this paper is the fourth of these five factors -- "convenience and needs" -- and a related concept -- "public benefits." Although the 1956 Act merely required that the Board "consider" convenience and needs, subsequent amendments to the Act in 1966 and 1970 created more stringent requirements with respect to convenience and needs and the protection of the public interest. Part two of this study will trace the development of the convenience and needs standards of the Bank Holding Company Act of 1956 and subsequent amendments to this provision. Part three of this paper comprises a review of those studies that have attempted to assess the impact of the public interest requirements since the passage of the Act. The focus of this review will be to examine three general types of empirical studies: first, those that have examined and categorized public interest considerations in specific cases in order to determine what weight the Board has placed on these factors individually (group A); second, those studies which deal primarily with post-acquisition performance of subsidiaries but that are relevant to public interest considerations (group B); finally, a single study that attempts to compare, in individual applications, pre-acquisition intentions and post-acquisition implementation of public interest considerations (group C).

II. Development of Public Interest Standards

The 1956 Act required that the Board, in acting on each holding company proposal, consider the "convenience, needs, and welfare of the communities and the area concerned." Although present in the Act, the provision embodied no specific requirements as to the weight that must be given "convenience and needs." In light of this, the Federal Reserve Board adopted a policy of weighing this factor on a case-by-case basis. A clear statement of the Board's position with respect to convenience and needs factors appears in a 1962 statememt by Governor J.L. Robertson:

> ...these factors do not constitute a standard to govern the Board's actions, the only requirement is that consideration be given the factors named; the weight to be accorded to each is completely within the Board's discretion.

> The Board must decide which answer -- Yes or No -- will promote the general welfare of the country. This is the only 'standard' under the Act; the enumerated factors are matters that must be considered before the decision is made, but the evidence under each is to be given such weight -- much, little, or none -- as the Board regards as warranted. [1]

Thus, the 1956 Act provided the Board with little, if any, guidance in the matter of judging the importance of convenience and needs factors. While this lack of specificity accorded the Board wide discretion in the evaluation of convenience and needs, it also proved troublesome. For example, in 1958, as part of its requirement under the 1956 Act, the Board submitted a report to Congress in which the Board cited the difficulty of evaluating convenience and needs. Of particular concern to the Board was the question of "balancing" convenience and needs factors against expected anticompetitive effects that might result from an application. [2] The Board's report to Congress made clear the need for a "more precise statement of the purposes of the statute" with respect to the convenience and needs provision.

<u>1966 Amendments</u>

To some extent, the shortcoming of the 1956 Act in providing a balancing test between anticompetitive effects and convenience and needs was remedied by the 1966 amendments to the Bank Holding Company Act. Specifically, the 1966 amendments to the Bank Holding Company Act no longer merely instructed the Board to "consider" convenience and needs in evaluating a proposed multi-bank holding company acquisition of a bank. Rather, it instructed the Board to specifically deny:

> any other proposed acquisition or merger or consolidation under this section whose effect in any section of the country 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 it finds that the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served. [3]

Thus, the Board was instructed to deny an application, applying the same competitive standard as that of Section 7.of the Clayton Act, unless it found that the convenience and needs of the area affected would be sufficiently enhanced so as to outweigh any resulting anticompetitive effect.

<u>1970 Amendments</u>

Additional changes in the public interest requirements were made in 1970. The Board's responsibilities with respect to convenience and needs under Section (3) of the Act, however, did not change as a result

---

1/ The language placed in these amendments originated from the 1966 amendments to the Bank Merger Act of 1960. The purpose of amending the Bank Merger Act was to bring the competitive standards of the three Federal banking regulatory agencies into uniformity and to provide consideration for the Supreme Court's ruling in the Philadelphia National Bank and Lexington Bank cases.

of the 1970 amendments. The Board was still obliged to consider convenience and needs in every case and to deny a Section 7 Clayton Act violation of competitive standards unless it found outweighing convenience and needs considerations present.

The Board, however, did gain additional and important responsibilities for protecting the public interest under Section (4) of the Act. Among the primary aims of the 1970 amendments to the Bank Holding Act was to include one bank holding companies in the definition of a "bank holding company" and to prohibit holding company entry into non-banking fields. Section 4(c)(8) of the Act, however, did permit holding companies to own shares of those non-bank companies deemed appropriate by the Board. In determining which activities would be appropriate, the Board was required to decide if the activity was:

> ...so closely related to banking or managing or controlling banks as to be a proper incident thereto. In determining whether a partaicular activity is a proper incident to banking or managing or controlling banks the Board shall consider whether its performance by an affiliate or a holding company can reasonably be expected to produce public benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices.

Section (4)(8) of the Act, therefore, established the additional public interest requirement that the acquisition of non-banking companies must result, in all cases, in expected public benefits before approving any acquisition under this provision.

The practical effect of Section 4(c)(8), therefore, was to impose a more rigorous public benefits test on non-bank acquisitions than bank acquisitions. Under Section (3) cases, the Board is required to deny an application only if expected convenience and needs considerations do not outweigh an anticompetitive effect which is serious enough to be a Clayton Act violation. Lesser anticompetitive effects, presumably, need not be outweighed by convenience and needs factors. In contrast, the public benefits requirements of Section 4(c)(8) state that any and all applications must yield public benefits that exceed the expected anticompetitive effect, no matter how serious.

<u>Rationale for Section 4(c)(8) Standard</u>

Some researchers have claimed that the stringency of the Section 4(c)(8) public benefits test is "unique to bank holding company regulation." [4] Moreover, it is claimed that the bank holding company has been singled out as the bearer of an uncommon burden given that antitrust laws in general do not require that the outcome of a merger or acquisition produce a net public benefit but merely that the public interest not be harmed. [4] The rationale for the inclusion of so rigorous a requirement, therefore, would seem to deserve mention.

In seeking the rationale for this provision, it is pertinent to note that among the reasons that Congress changed the Bank Holding Company Act in 1970 was because of a serious concern over holding company entry into non-banking activities. Specifically, Congress viewed as potentially harmful the erosion of the traditional separation between banking and "business" that had been occuring in the years prior to 1970. In response, Congress wanted to insure that any possible harm that might be done to the public interest by permitting holding companies to enter non-bank activities was offset by probable benefits to the public. Thus, the provision that holding companies be required "in advance," as it were, to compensate for the future expected "costs" to the public of their ownership of non-banking firms, was a way in which the effects of any future damages to the public interest could be ameliorated. The outcome of Congressional efforts to insure this aim was the provision in Section 4(c)(8) which has become known as the "net public benefits" test.

III. Impact of Public Interest Standards -- Empirical Studies

Since the passage of the 1956 Act, there has been much discussion of the rationale and legal requirements of those portions of the Act, as amended, relating to convenience and needs and public benefits considerations. There has been, however, only a limited number of investigations attempting to analyze the impact that these two requirements have had in the bank holding movement. Of those that exist, they may be divided into three groups.

First, there are several studies (group A) which examine the role that these public interest considerations have had in actual Board decisions. In general, the method of these studies has been to examine Board decisions over some time period and to report on the types of convenience and needs and public benefits factors cited in mergers and acquisitions acted on by the Board. A general aim of these studies has been to attempt to identify the types of public interest considerations deemed important by the Board. A second group of studies (group B) attempts to determine, if in general, holding company control of banks and certain non-bank activities has actually resulted in specific benefits to the public. Finally, there has been one study (group C) of Board decisions that has attempted to match, through direct comparison in individual cases, those claimed or intended benefits with benefits actually derived from a particular affiliation. The remainder of this paper examines these three groups of studies.

Group A Studies -- Factors Cited by the Board as Important

To date, there have been very few studies that have systematically examined the types of public interest considerations cited by the Board in holding company acquisitions. The first such study, by Backman, was published in 1963 and basically attempted to identify the specific factors, including convenience and needs, given weight by the Board in multi-bank holding company proposals. [5] An additional concern of this study was to judge the consistency of Board actions in assessing bank holding company acquisitions. Baçkman's study covered the period from 1956 to December, 1962 and examined 61 Board decisions on applications involving the formation of new holding companies, the establishment of de novo banks and the acquisition of existing banks.

With regard to proposals to form new holding companies, Backman concluded that in none of the 12 applications did convenience and needs considerations appear to be a controlling factor in the Board's decision. Among the factors cited, however, was the ability to obtain capital more economically (5 cases), the ability to make additional or larger loans (6 cases), the ability to provide increased or new services and the ability to provide for management succession.

In his examination of Board decisions on de novo banks, Backman found that of the 12 such applications acted upon (8 approvals and four denials) from 1956 to year-end 1962, the Board did give primary emphasis to convenience and needs factors. Among the factors cited in the approved cases were "increased convenience" (5 cases). In the denied applications, the Board's findings with respect to convenience and needs considerations stated that either the need for a new bank in the community was not great or that another institution would satisfy existing needs (4 cases). Backman's overall conclusion from this portion of the study was that "the Board gives considerable weight to convenience, needs, and welfare. However, where possible the Board prefers to have those needs met by the establishment of new independent banks rather than by a new subsidiary of a holding company." [5]

Backman's study of convenience and needs also examined Board decisions on applications to acquire existing banks. During the study period, 37 such applications were acted upon by the Board. Of these, 30 were approved and seven denied. It is Backman's conclusion that in a clear majority of these cases, convenience and needs factors of any kind were not a decisive factor in the Board's decision. Management succession was most often discussed, however, being mentioned in 14 of the decisions.

The overall conclusion drawn by Backman in this first systematic look at the role of convenience and needs factors was that, except for applications involving _de novo_ banks, these factors played an unimportant role in the Board's decision-making process. This conclusion is straightforward and is not unexpected in light of the 1956 version of the Act. Afterall, there was, at the time of Backman's investigation, no formal balancing test in effect. The statute merely required the Board to consider this factor. Backman's effort is notable because it represents the first effort in this area. It was, however, as even the author noted, subject to several limitations -- all imposed by the necessity to rely on the Board's public statements as the sole source for his evidence.

The author correctly noted that identical statements can have different meanings in different contexts; that many decisions merely mention a convenience and needs factor without attaching any weight to it; that the decisions covered applications involving both newly formed banks and multi-billion dollar holding companies.

The only other attempt to relate public interest considerations and Board decisions on individual holding company applications was completed after both the 1966 and 1970 amendments had been enacted. Thus, Jessee and Seelig's study [6] of the public benefits test assessed the Board's behavior under a stricter and more comprehensive set of public interest considerations. As in Backman's study, an examination of Board decisions was conducted over a period of several years, in this case, from the beginning of 1971 to mid-year 1974, and covered both bank and non-bank cases. Reflecting the increased holding company activity of this period, this study included 434 approved bank acquisitions, 104 approved non-bank acquisitions, and 47 bank and non-bank applications that were denied.

Jessee and Seelig's study concluded that the public benefits cited in Board decisions could be generally classified into six broad categories. These included: "(1) improvements relating to convenience and needs of the community to be served, (2) increased competition, (3) improved operational efficiency, (4) expanded financial resources for the firm to be acquired and/or the holding company, (5) improved management for the acquired firm, and (6) other benefits unique to the particular case." [6]

The scope of Jessee and Seelig's study, therefore, is somewhat broader than Backman's in that it considers not only convenience and needs factors, but also other specific public interest considerations as well. Of course, this is not surprising since the 1966 and 1970 amendments to the Act expanded the criteria to be considered by the Board. With respect to convenience and needs, the Jessee-Seelig study concluded that the factors most often cited by the Board were similar to those of the Backman study. These included new or expanded financial services or an expansion in the geographic scope of the services offerred. Other public interest factors cited by the Board in numerous cases were increased competition, lower rates on loans and other services, the injection of equity capital, and economies of scale. Such factors were cited in both bank and non-bank cases.

The thrust of the Jessee-Seelig study is not only to determine what factors have been cited by the Board but also to determine what weight these factors have played in outweighing anticompetitive effects and providing a net public benefit. With regard to this second objective, Jessee and Seelig conclude that the Board's willingness to attach significance to a stated public benefit is inversely related to the severity of the competitive, financial, and managerial problems associated with the proposal. Specifically, when these factors were not serious the Board tended to accept an applicant's claim of probable benefits to the public and approved the acquisition. Jessee and Seelig maintain, however, that it is notable that the Board appears never to have found that the proposed public benefits of an acquisition were sufficient to outweigh the unfavorable effects of a substantial lessening of competition, unsound banking practices or an undue concentration of resources. [6] To the authors this suggests that increasingly substantial evidence of public benefits is needed to gain approval of cases, particularly in such instances when adverse effects are present.

The Jessee-Seelig study is more comprehensive in scope than Backman's study and deals with a larger number of decisions and involves both banks and non-banking firms. However, it too is limited in the validity of its conclusions with regard to the Board's intent on individual applications. This basic limitation derives from having to rely on more or less uniform statements about applications often involving vastly different circumstances. Thus, any conclusions regarding Board intent on individual applications must necessarily be limited.

The evidence presented in these two studies suggests that there have been a number of factors which have been repeatedly cited as public interest considerations which weigh in favor of approving a holding company application. Among these has been the ability to obtain additional capital, provide additional or new services, increase competition, and improve efficiency and managerial resources. Both studies, however, concluded that the presence of these benefits were not generally important in the Board's decision-making process, and in no case did these public benefit considerations serve to outweigh a serious anticompetitive effect.

Group B Studies -- Post-Acquisition Performance and the Public Interest

The first two studies examined in this review approached the question of convenience and needs and public benefits from the standpoint of reviewing Board statements about expected public interest considerations. These studies, however, make no mention of the follow-up or actual benefits derived from holding company affiliation. The bulk of the existing evidence of the actual benefits derived from affiliation is contained in a number of studies relating to the post-acquisition performance of holding company affiliates. These studies show the extent to which holding company affiliation, by altering the behavior of acquired banks and non-bank companies, may have benefitted the public. 1/

Performance studies of bank acquisitions, for example, have generally shown that banks acquired by holding companies often provide more credit to the local community than do non-affiliated banks [7, 8, 9, 10, 11,

---

1/ This compendium contains an article (written by Timothy Curry) in which all of these performance studies are reviewed.

12]. Affiliated banks have also been shown to pay higher interest on time and savings deposits than non-affiliated banks [8, 13].

Holding company affiliation, however, has also been shown to be a double-edged sword with respect to the public interest. Some performance studies of acquired banks, for example, have found that affiliated banks charge higher prices for demand deposits services [10, 13, 14] and that holding company affiliation has also generally led to lower capital ratios in acquired banks than in independent banks. Specifically, both total capital to total assets [6, 14, 15] and equity capital to total assets [6, 13, 16] have often fallen as a result of acquisition.

The public benefits that have arisen from holding company affiliation with non-bank firms have been more difficult to assess than for bank affiliation. The primary obstacle to assessing the actual benefits derived has been a lack of data. Nonetheless, a few studies have attempted to make statements regarding public benefits based on an examination of the post-acquisition performance of non-bank companies. Talley, for example, using a simple tabular analysis, found that affiliated mortgage banking firms were leveraged substantially more than non-affiliated ones and that affiliated firms exhibited lower capital ratios as well [17]. Talley's statistical methodology, however, consisted of a simple univariate test ("t" test for differences in group means). As such, the findings of the study must be regarded as tentative since <u>ceteris paribus</u> assumptions would have been compromised. Another study, by Rhoades [18], used a multiple regression analysis to examine the question of whether affiliated mortgage banking firms are able to enhance the flow of funds into the residential mortgage market to a greater extent than non-affiliated firms. Rhoades' technique to compare the growth of servicing volume between affiliated and non-affiliated mortgage banking subsidiaries, during the years from 1968 to 1972. Rhoades' findings indicated that affiliated firms did not grow faster and, thus, there is no basis for concluding that affiliation has increased the flow of money to the real estate market.

Several studies have also investigated performance-related public benefits flowing from holding company acquisitions of consumer finance companies. Talley, for example, examined the profitability of affiliated consumer finance companies vis-a-vis independent ones. [17] Profitability, it can be argued, may be a measure of how well holding companies can benefit their affiliates (and the public indirectly) by increasing the supply of and reducing the cost of loanable funds. Talley's comparison of a sample of affiliated and independent firms during the years from 1973 to 1974, however, found that the affiliated firms were, in fact, less profitable than the affiliated ones. Although Talley's results cover a very short post-acquisition period and did not adjust for pre-acquisition performance, the results suggest that affiliated consumer finance companies have been relatively poorer perfomrers than independent ones.

A subsequent study by Rhoades and Boczar [19], examining the same general question, employed a more sophisticated statistical technique (multiple regression) and adjusted for pre-acquisition performance. Using a sample of nearly 40 consumer finance companies in a pre- and post-acquisition comparison, these authors also foun that post-acquisition performance has been relatively poorer than pre-acquisition performance.

Thus, a summary of studies investigating performance-related public interest considerations would support the conclusion that, at least in the case of bank acquisitions, holding company affiliation has had some favorable effects on the public interest. The primary areas of gain have been in providing more credit to the local community. There is some evidence, however, that holding company affiliation has had some negative effects on acquired firms, especially as regards reduced capital ratios and poorer operating performance in the non-bank area. Generally, however, those studies that have deomonstrated that holding company affiliates have been poor performers, should be accepted conditionally because of the short time periods over which performance was measured.

Group C Studies: Intensions vs. Actual Benefits

The studies examined earlier in this paper have investigated the general question of public interest considerations by examining the factors cited by the Board in specific decisions or by studying post-acquisition performance. Ideally, however, to examine the question of whether holding company affiliation, in individual applications, does result in public benefits, one would have to compare pre-acquisition intentions with post-acquisition actions.

To date, only one study has taken this approach in analyzing the public benefits issue. Specifically, Rossman and King examined 109 applications involving 21 bank holding companies filed from June 1970 to December 1973 [20]. All of the applications involved attempts to acquire banks and were approved by the Board. The basic technique employed by Rossman and King's study was to systematically record the stated intentions of the applicant holding companies and categorize them as to type of public benefit. For example, the study noted whether the applicant intended to implement trust services, loan participations, data processing services, real estate loan operations and others. Although, in Rossman's and King's judgment, these services more directly benefited the acquired bank rather than the public, the authors included them as public benefits since they would result in an increase in "efficiency, responsiveness or reduce the bank's risk" [20].

The 21 holding companies were then asked to complete a questionnaire in which they were asked to indicate whether the pre-acquisition intentions had been fulfilled.

Rossman and King produced several findings. First, those public benefits most often proposed were ones which are closely identified with large bank operations. These included loan participations, data processing, and investment, marketing, and auditing advice. Second, in terms of fulfilling their intentions, Rossman and King found that the holding companies "took action in the vast majority of cases in which it was intended" [20]. In particular, holding companies were generally reliable in implementing "trust and data processing services, recruitment, and loan expansion." The respondent firms, however, were less successful in realizing intentions with respect to extending bank hours and providing industrial development assistance. Significantly, in no case was no action taken by a holding company.

The study, however, is subject to several limitations, three of which are mentioned by the authors themselves. First, the study does not question whether the holding company's actions would actually benefit the public. Second, because of obvious cost considerations the authors were not able to cross check questionnaire results but were forced to rely solely on the holding company's statements about implementation. Finally, no control group was used to determine if similar services would have been carried out in the absence of holding company affiliation. An additional but unavoidable problem of the study was the interpretation and categorization of holding company intentions. Few holding companies discussed proposed public benefits in terms of concrete proposals. Thus, the authors were forced, in some cases, to infer and surmise as to an applicant's exact intentions.

Conclusion

The subject of public interest standards in the Bank Holding Act is not, as this study demonstrates, one that has received widespread attention among investigators. Two studies, however, have systematically reviewed the Board's statements on this matter. Further, among those empirical studies which have made statements as to the actual benefits derived from affiliation, virtually all have had as their primary focus and concern the post-acquisition performance of affiliates rather than public benefits *per se*. In addition, another study has attempted to determine if public interest statements made in individual applications have actually been fulfilled.

Based on the nature and findings of these studies it is difficult to demonstrate that the public interest standards of the Act have had a substantial effect in fostering the public welfare. These studies do, however, demonstrate that the Board has continued to enumerate the types of public interest considerations that may be considered of benefit in holding company acquisitions. Performance studies, in addition, seem to indicate that there have been some benefits which have accrued to the public as a result of affiliation. Finally, available evidence indicates that holding companies have generally carried out those changes which, in pre-acquisition statements, were promised.

References

1. Federal Reserve Bulletin, Board of Governors of the Federal Reserve System, Washington, D.C., December, 1962, p. 1618.

2. "Report Under Bank Holding Company Act," Federal Reserve Bulletin, Board of Governors of the Federal Reserve System, Washington, D.C., July, 1958, pp. 776-796.

3. 80 Stat. 237 §3(c); U.S.C. Title 12, sec. 1841.

4. Jessee, Michael A. and Seelig, Steven A., Bank Holding Companies and the Public Interest, Lexington, Mass.: Lexington Books, D.C. Heath & Co., 1977, pp. 47-48.

5. Backman, Jules, "The Bank Holding Company Act," The Bulletin of the C.J. Devine Institute of Finance, Bull. 24-25, April/June, 1963.

6. Jessee, Michael A. and Seelig, Steven A., "An Analysis of the Public Benefits Test of the Bank Holding Company Act," Monthly Review, Federal Reserve Bank of New York, June, 1974, pp. 151-162.

7. Hoffman, Stuart G., "The Impact of Holding Company Affiliation on Bank Performance: A Case Study of Two Florida Multibank Holding Companies," Working Paper Series, Federal Reserve Bank of Atlanta, January, 1976. An earlier summary of this was published as "A Florida Case Study: Performance of Holding Company Banks," Monthly Review, Federal Reserve Bank of Atlanta, December, 1975, pp. 202-205.

8. Jackson, William, "Multibank Holding Companies and Bank Behavior," Working Paper 75-1, Federal Reserve Bank of Richmond, July, 1975.

9. Johnson, Rodney D. and David R. Meinster, "The Performance of Bank Holding Company Acquisitions: A Multivariate Analysis," Journal of Business, Vol. XLVIII, April, 1975, pp. 204-212.

10. Lawrence, Robert J., "The Performance of Bank Holding Companies," Board of Governors of the Federal Reserve System, June, 1967.

11. Piper, Thomas R., The Economics of Bank Acquisitions by Registered Bank Holding Companies, Research Report No. 48, Federal Reserve Bank of Boston, March, 1971.

12. Talley, Samuel H., "The Effect of Holding Company Acquisitions on Bank Performance, Staff Economic Studies, No. 69, Board of Governors of the Federal Reserve System, 1974.

13. Fraas, Arthur G., "The Performance of Individual Bank Holding Companies," Staff Economic Studies, No. 84, Board of Governors of the Federal Reserve System, 1975. A summary of this paper appeared in the Federal Reserve Bulletin, Vol. 61, 1975, pp. 472-473.

14. Mayne, Lucille S "A Comparative Study of Bank Holding Company Affiliates and Independent Banks, 1969-1972," The Journal of Finance, Vol. XXXII, No. 1, March, 1977, pp. 147-158.

15. Mingo, John J. "Managerial Motives, Market Structures and the Performance of Holding Company Banks," Economic Inquiry, Vol. XIV, No. 3, September, 1976, pp. 411-424.

16. Heggestad, Arnold A. and John J. Mingo, "Capital Management by Holding Company Banks," Journal of Business, Vol. 48, No. 4, October, 1975, pp. 500-505.

17. Talley, Samuel H., "Bank Holding Company Performance in Consumer Finance and Mortgage Banking," The Magazine of Bank Administration, LII, No. 7, July, 1976, pp. 42-44.

18. Rhoades, Stephen A., "The Effect of Bank Holding Company Acquisitions of Mortgage Bankers on Mortgage Lending Activity," Journal of Business, July, 1975.

19. Rhoades Stephen A. and Gregory E. Boczar, "The Performance of Bank Holding Company-Affiliated Finance Companies," Staff Economic Studies, No. 90, Board of Governors of the Federal Reserve System, 1977.

20. Rossman, Joseph E. and King, B. Frank, "Multibank Holding Companies: Convenience and Needs," Economic Review, Federal Reserve Bank of Atlanta, July/August, 1977, pp. 83-91.

**TESTIMONY OF JAMES A. MILLER,
PRESIDENT AND CHAIRMAN OF THE BOARD
AMERICAN SOCIETY OF TRAVEL AGENTS, INC. (ASTA)
ON S. 72
SENATE COMMITTEE ON BANKING,**

JUNE 23, 1978

My name is James A. Miller. I am a travel agent from East Lansing, Michigan, and also President and Chairman of the Board of the American Society of Travel Agents, Inc. (ASTA), the world's largest professional travel association, which is comprised of over 16,000 members in over 120 countries representing all facets of the travel and tourism industry. The Society's purpose is the promotion and advancement of the interests of the travel agency industry and the safeguarding of the traveling public against fraud, misrepresentation and other unethical practices. Members of ASTA in more than 8,000 travel agency locations throughout the United States arrange the travel plans of over 40 million American consumers annually who spend approximately $12 billion each year, in business and pleasure travel.

Mr. Chairman, I am grateful to have the opportunity to offer testimony in support of S. 72, a bill designed to abate the expansion of financial institutions into non-banking fields, a trend that has plagued travel agents for more than a decade.

When I originally accepted the Committee's offer to present testimony on S.72, I fully anticipated that my remarks would be largely devoted to a discussion of the long and arduous efforts of travel agents, the courts and Members of Congress directed toward the elimination of unfair competition from national banking institutions in the travel industry. Happily, however, this goal was finally achieved earlier this month when the Comptroller of the Currency ordered that national banks operating travel agencies divest themselves of such operations within three years. This order of the Comptroller--issued June 1, 1978 1/--coupled with a similar ruling of the Federal Reserve Board with respect to bank holding companies, 2/ removes the last vestages of this unfair competition from these important financial institutions regulated by the federal government.

The issuance of the Comptroller's recent directive, however, by no means obviates the need for S 72. Quite to the contrary: It serves to underscore the pressing necessity for passage of the pending legislation. For more than ten years, travel agents have fought for repeal of the 1963

1/ Banking Circular No. 108.

2/ The Federal Reserve Board's ruling was upheld by the U.S. Court of Appeals for the Seventh Circuit on January 23, 1978. Association of Bank Travel Bureaus, Inc. v. Board of Governors of the Federal Reserve System, 568 F. 2d 549 (7th Cir. 1978).

opinion of the Comptroller that travel agency operations were permissible activities for the national banks under the Comptroller's jurisdiction. The Comptroller refused to amend his action despite a series of court decisions to the contrary and despite a similar prohibition against bank holding companies engaging in such activities.

The pending bill would make clear the intent of Congress that uniformity is desired in federal banking laws regarding the permissible scope of non-banking activities in which national banks and bank holding companies may engage. Such uniformity will preclude the possibility that a single federal official such as the Comptroller can, in the future, unilaterally establish and maintain a policy that does not comport with a judicially-sustained ruling of the Federal Reserve Board.

Although the burden on the travel industry has been lifted by the Comptroller's order, several other industries are still in need of the relief provided by S. 72. Insurance agents, life underwriters, leasing, accounting and courier services, data processors and security marketing services all continue to face distorted competition from banking institutions. By limiting the scope of the non-banking services a bank holding company may offer, and by requiring that these activities be (1) directly related to banking and (2) provide significant public benefit outweighing possible adverse effects on competition, S.72 provides critical relief for these various commercial industries.

We see no need for federal financial institutions to engage in these non-banking activities. It is not necessary for the well-being of the banks, nor is it in the public interest. Since financial institutions, by the virtue of their deposit and credit services, possess leverage their commercial industry competitors do not, competition based purely on quality and price does not exist. Such a condition is unhealthy for these industries and ultimately unhealthy for the public.

Mr. Chairman, ASTA commends you and your Committee for your efforts to restrict the non-banking activities of banking institutions regulated by the federal government, and encourages the Congress to speedily enact the pending legislation. I am pleased to have had the opportunity to present ASTA's position on these matters.

In an effort to help compile a complete record for the Committee's undertaking, I am attaching hereto a history of national bank and bank holding company involvement in the travel industry. This history graphically illustrates the need for prompt reform in the regulation of federal banking institutions.

HISTORY OF BANK AND BANK HOLDING COMPANIES IN THE TRAVEL INDUSTRY

In 1963, without any hearing or notice, the Comptroller of the Currency promulgated and incorporated into his Manual for National Banks, an interpretive ruling which purported to authorize the operation of travel agencies by national banks. Paragraph 7475 of the Comptroller's Manual for National Banks (1963) which is now codified as 12 S.F.R. #7,7475 reads: "Incident to those powers vested in them under 12 U.S.C. 24th Seventh, national banks may provide travel services for their customers and receive compensation therefor. Such services may include the sale of trip insurance and the rental of automobiles as agent for local rental service. In connection therewith, national banks may advertise, develop, and extend such travel services for the purpose of attracting customers to the bank."

Following the promulgation of that ruling, which was adamantly opposed by independent travel agents throughout the Nation, large numbers of national banks entered the travel agency business, most often through the acquisition of existing travel agencies.

For example, in November of 1966, the South Shore National Bank of Quincy, Massachusetts, acquired by purchase the Wellesley Travel Service of Wellesley, Massachusetts.

Bank travel offices were thereupon established at three locations in the Boston vicinity, each located adjacent to or actually within an office of the South Shore Bank. Almost immediately, independent travel agencies in the area began to lose customers and business to the bank-funded South Shore travel agency operation.

On May 8, 1967, 42 independent travel agencies filed suit in the U.S. District Court for the District of Massachusetts seeking an injunction against the operation of a travel agency by the South Shore Bank and a declaratory judgment to the effect that Section 7,7475 of the Comptroller's Manual for National Banks was invalid under the National Bank Act.

The plaintiffs in that suit, (Arnold Tours, Inc. v. Camp) were provided with legal and financial assistance by ASTA. After five years of litigation on the threshold issue of legal standing, the case was remanded to the District Court, which ruled on February 22, 1972, that the operation of travel agencies by national banks was clearly illegal and that the Comptroller ruling was clearly invalid. That decision was affirmed by the Court of Appeals on December 13, 1972. The decision held that:

> ". . . . it is illegal for a national bank to operate a full-scale travel agency." "Since such an operation is not an exercise referred to in (12 U.S.C. 24th Seventh). For the same reason the district court did not err in determining that 12 C.F.R. #7475 is invalid to the extent that it is construed by the Comptroller as authorising a National Bank to operate a full-scale travel agency."

On September 19, 1973, Mr. Carl L. Helgren, then President of ASTA, appeared before the House Committee on Banking, Currency and Housing which was at that time considering bank regulatory reform legislation. After recounting the protracted history of the Arnold Tours litigation, Mr. Helgren expressed the following concern:

"Still, at this late date, the Comptroller has not complied with the clear mandate of the federal courts. No action has been taken to require national banks to divest themselves of all travel agency operation."

It was three months after that hearing on December 21, 1973 before the Comptroller issued an "invitation for comments" on the matter of banks in travel.

Another year and a half passed after the Arnold Tour court ruling without any action whatsoever on the part of the Comptroller's Office.

Finally, after exhausting every conceivable administrative and judicial avenue short of initiating more than 120 individual lawsuits throughout the nation, ASTA filed a new suit in the U.S. District Court for the District of Columbia on March 18, 1975. In that suit, ASTA sought the issuance of a writ in the nature of mandamus to compel the Comptroller to bring his manual into compliance with the National Bank Act as construed by the courts.

Ten days after the institution of ASTA's lawsuit, the Comptroller's Office issued a "proposed revised interpretive ruling." On May 18th, 1975, the Comptroller filed a motion with the U.S. District Court here in Washington, asking the court to dismiss ASTA's complaint.

On October 2, 1975, counsel for the Comptroller indicated that the Comptroller had still done nothing with respect to the matter of national bank involvement in the travel agency business. The court characterized the defendant's delay in this matter as "unbelievable," and instructed counsel for the Comptroller to tell his client "to resolve the matter in two weeks." A further status hearing was scheduled for October 17, 1975.

On that day, counsel for the Comptroller was obliged once again to inform the court that his client has failed to take any action whatsoever but that he had been authorized to represent to the court that final action would be taken by the Comptroller on or before November 28, 1975. The court thereupon issued the following order: "That the defendant Comptroller of the Currency shall either issue a revised interpretive ruling on travel services or repeal the existing ruling, on or before November 28, 1975 . . ."

On November 28, 1975, the Comptroller issued a "notice" in which he announced that "the Comptroller intends to issue a revised interpretive ruling on this subject.

Pending the issuance of such a ruling, national banks should consult with their own legal counsel as to the range of permissible travel services under applicable statutes."

After eleven years of expensive litigation, beginning with the Arnold Tours, Inc. case of 1967, the continued delay on the part of the Comptroller with respect to this matter was absolutely shocking.

In ASTA's view, the Comptroller of the Currency's blatant disregard for our federal courts does much to explain the public's loss of confidence in our bank regulators and emphasizes the urgent need to impose upon our financial institutions a new system or regulation which will be responsive to the Congress, the courts, and the needs of the public.

A discussion of bank holding company involvement is relevant at this point. As has been indicated, national bank involvement in the travel business was first declared to be illegal in February of 1972. That decision by the U.S. District Court for the District of Massachusetts was one in a long line of court decisions striking down the expansionist rulings which flowed from the Comptroller's Office in 1963.

It was largely as a result of those uniformly successful legal challenges by adversely affected competitors that national banks began to look to the one-bank holding company as a device by which to avoid judicial scrutiny of their involvement in a variety of non-bank activities. Indeed, the Comptroller of the Currency, Mr. Camp, emphasized this point in testimony before the Banking Committees of both the Senate and the House of Representatives at hearings held in connection with the 1970 amendments to the Bank Holding Company Act.

In testifying before the Senate Committee on Banking and Currency, Mr. Camp stated:

"Commercial banks, tiring of the continual harrassment from litigation, brought by a variety of non-bank competitors, attempted to devise an organization form which might be immune from such suits. The device of creating a parent holding company, under whose corporate umbrella a number of bank operations could be spun off as holding company subsidiaries, seemed to provide a possible answer."

As more and more bank holding companies became active in the travel business, the Federal Reserve Board was forced to consider the question of whether bank holding companies are permitted to engage in such non-banking activities.

On January 26, 1976, the Board of Governors concluded that the operation of a travel agency is <u>not</u> closely related to banking or managing or controlling banks, and therefor is <u>not</u> a permissible activity for bank holding companies under Section 4(c)(8) of the Bank Holding Company Act.

The ruling resulted from a First Bancorp Inc. application submitted on September 7, 1973, asking the Board's approval to continue operating a travel agency. A hearing was held three years later on January 26, 1976, when the Board decided not to adopt the operation of a travel agency as a permissible activity. The Board concluded: (1) the nature of travel services offered by present-day banks is significantly different from that offered a century ago to immigrants; (2) the number of banks currently providing travel agency services is only about 150 or less than one percent of all commercial banks in the United States, and they account for less than two percent of all travel agencies in the nation; (3) nearly two-thirds of all travel agencies affiliated with banks have been established within the past fifteen years.

During the rulemaking proceeding, the Board interpreted Section 4(c)(8) of the Bank Holding Company Act to include two distinct tests. First, the Board must determine whether an activity is "closely related" to banking. If the Board determines that the activity is closely related to banking within the meaning of the Act, it then must decide whether the activity is a "proper incident" to banking by weighing the benefits against the possible adverse effects. In the First Bancorp case the Board found that the activity of operating a travel agency was not closely related to banking and therefore they had no need to consider the second part of the test.

Petitioner, First Bancorp, contended that Section 4(c)(8) contemplates only one test rather than the two-tier test applied by the Board.

The Board noted that the two-tier test had been adopted and endorsed by every circuit court in considering the question.*/ Moreover, the Board's interpretation of the statute is supported by the legislative history.

The Court held that the findings of the Board were not arbitrary, capricious or an abuse of discretion which the petitioner had contended and consequently denied First Bancorp's appeal on January 12, 1978.

It is clear from this decision that the courts and the Federal Reserve Board are in complete agreement that it is unnecessary and illegal for the banking holding companies to be in the travel business. And it is clear from the Arnold Tours Inc. v. Camp case that it is illegal for national banks to be in the travel business. And yet, Comptroller of the Currency, John Heimann, refused to take action.

Last June, during the Comptroller confirmation hearing of John Heimann, the issue of national banks and bank holding companies in the travel business was discussed. Subsequently, an exchange of correspondence followed between Comptroller Heimann and Senator Proxmire on the subject. (Exhibit A)

*/ E.g., Alabama Ass'n of Insurance Agents v. Board, 533 F.2d 224, 235, 245-46 (5th Cir. 1976); National Courier Ass'n v. Board, 516 F.2d 1229, 1232-33, (D.C. Cir. 1975); Independent Bankers Ass'n of Georgia v. Board, 516 F.2d 1206, 1215-16 (D.C. Cir. 1975); Bank America Corp v. Board, 491 F.2d 985, 988 (9th Cir. 1974).

A) Additional letters from Senator Edward Brooke and Congressman Fernand St. Germain again brought these recent court decision and Board rulings to Mr. Heimann's attention, yet he still refuses to comply with the law. (Exhibit B) Consequently, over 70 national banks continue to own and operate travel agencies (Exhibit C) in an ever expanding way.

Finally, on June 1, 1978, John Heimann, Comptroller of the Currency, issued Banking Circular No. 108 which ordered that "all national banks which are currently operating travel agencies, thorugh a bank department or subsidiary, divest themselves of such travel agencies within a reasonable period of time not to exceed three years."

ASTA commends the Comptroller for finally acting in this matter. We anticipate that the Comptroller will take all steps necessary to assure that his directive is obeyed by the banks involved.

ASTA appreciates the chance to provide its views to your Subcommittee and would be happy to provide any additional data which you might find helpful. Thank you.

June 23, 1978

Exhibit A

United States Senate

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

WASHINGTON, D.C. 20510

October 4, 1977

The Honorable John Heimann
Comptroller of the Currency
409 L'Enfant Plaza
Washington, D. C.

Dear John:

This letter relates to a subject that you and I discussed when you appeared before my Committee on June 9, 1977, in connection with your nomination to be Comptroller of the Currency. At that time I raised the issue of non-banking activities in which some national banks have been engaged.

Specifically, I referred to court rulings to the effect that the operation of a travel agency is not necessary and incidental to the business of banking, and is therefore an impermissible activity for national banks under the National Banking Act. While you were at that time unfamiliar with the extent of such activities on the part of banks within your jurisdiction, you indicated a desire to acquaint yourself more completely with those activities, and to take action to assure that such activities would be discontinued in order to comply with the court decision.

The enclosed letter from Mr. McLeod raises once again the situation of a national bank engaging in the travel agency business in violation of law. Timely action on the part of your predecessors might have avoided this situation.

I would appreciate your advice on how you plan to correct the present situation in which some national banks are engaged in travel agency activities which are illegal under the National Bank Act. It would appear that timely action is needed.

Honorable John Heimann -2- October 4, 1977

In that connection, it would be helpful for this Committee to know: 1) How many national banks are presently engaged in the travel agency business, 2) which banks are they and where are they located, and 3) how large is their travel business and how many travel agencies does each bank operate?

I appreciate your continued cooperation with the work of this Committee.

Thank you for your expected cooperation.

Sincerely,

William Proxmire
Chairman

Attachment

NOV 1 0 1977

Dear Mr. Chairman:

I write in response to your letter of October 4, 1977, concerning the position of this Office in regard to national bank operated travel agencies. Enclosed in your letter was correspondence to you from Sheldon S. MacLeod, President of Your Travel Agent, Inc., in Cleveland, Ohio, concerning the operation of a travel department by the National City Bank in that city.

In responding to your letter, I should first clarify what I said at my confirmation hearing about travel agencies operated by national banks. According to the transcript of my hearing, I said that I was not really familiar with the details of the debate over travel agencies operated by national banks. I did not indicate a desire "to take action to assure that such activities would be discontinued in order to comply with the court decision." Nor did I agree with a statement attributed to you by Travel Weekly that it is illegal for national banks to run travel agencies.

Now that I have taken office and have had an opportunity to look into this issue further, I find the matter of the legality of national banks operating travel agencies to be quite complicated and unsettled. As indicated by the history outlined below, the courts have not resolved many questions surrounding this activity, and it does not appear that the Comptroller's Office can do so without generating more difficult questions and more lawsuits.

The performance of travel services has been a part of European banking from early times and two banks were operating travel agencies in this country as early as 1865, the year after the passage of the National Bank Act. By 1935 at least 32 national banks were acting as travel agents. In the same year, the Comptroller ruled that certain national banks whose travel services had been disputed by a Cincinnati travel agent were acting lawfully. Since that date, no contrary ruling has been

- :: -

issued by the Comptroller's Office. Indeed, in 1959, after making a special survey of national banks and with the benefit of a 22 page memorandum from the American Society of Travel Agents, the Comptroller promulgated what eventually became Paragraph 7475 of the Comptroller's Manual for National Banks. 12 CFR 7.7475. This ruling was consistent with the banking tradition of providing various travel services, such as selling travelers' checks, procuring foreign exchange, issuing travelers letters of credit, and providing introductions and advice with respect to foreign banks and businesses. It also recognized that state banks in some states have traditionally performed the function of travel agent.

In 1972, an appellate court held that 12 CFR 7.7475 is "invalid to the extent that it is construed by the Comptroller as authorizing a national bank to operate a full-scale travel agency." Arnold Tours v. Camp 472 F.2d 427, 438 (1st Cir. 1972). We note that this decision would have binding effect only in the First Judicial Circuit. The court did not define a "full-scale travel agency"; however, we believe the court had in mind the description of an ideal professional, modern travel agency operation set forth in footnote 4 of the court's opinion (at page 429).

While holding that the operation of a travel agency such as that of the defendant South Shore National Bank was not authorized by the National Bank Act, the court also indicated that such travel services as "acting as collection agent for a steamship, railroad or other company" (i.e. delivering tickets and placing the amount collected to the credit of the company); "the sale of travelers' checks and foreign currency"; "the making of travel loans"; "issuance of letters of credit"; "and providing gratis travel information" could lawfully be provided by national banks (472 F.2d at 434, 438).

On December 21, 1973, the Comptroller solicited the views of all interested parties on a possible revision of Interpretive Ruling 7.7475. 38 Fed. Reg. 35023. As a result of the comments received and staff analysis, the Comptroller published a proposed revision of Interpretive Ruling 7.7475 and invited additional comment. 40 Fed. Reg. 14767 (April 2, 1975). Extensive additional comments were received in response to the proposed revision. These comments raised a number of very complex problems relating to specific travel services which, unfortunately, were raised but not resolved by the court in the Arnold Tours decision.

While questions remain as to the propriety of certain specific travel services, the Comptroller of the Currency has stated in affidavits filed in the case of American Society of Travel Agents, Inc. v. Bank of America National Trust and Savings Association, 385 F. Supp. 1084 (N.D. Cal. 1974), that the Office will not accept any applications from national banks to establish an operating subsidiary to offer travel services. In a separate case, the Comptroller represented to the Court that the Office would, on or before November 28, 1975, either issue a revised interpretive ruling or repeal the existing ruling. In keeping with this representation, Interpretive Ruling 7.7475 was rescinded on November 28, 1975.

The Federal Reserve Board last year determined that the operation of a travel agency is not so closely related to banking or managing or controlling banks as to be a proper incident thereto. 41 Fed. Reg. 5134 (Feb. 4, 1976). The effect of the Board's ruling is to prohibit the operation of travel agencies by bank holding companies. However, the Board's decision has been appealed to the Seventh Circuit Court of Appeals, which heard oral argument last January, and no decision has been issued by that Court to date.

In January 1976, the Federal Reserve Board, based on data submitted by the Association of Bank Travel Bureaus, estimated that at that time the number of banks, both state-chartered and national, providing travel agency services numbered only about 150 or less than one percent of all commercial banks in the United States and less than two percent of all agencies in the nation. We note that some of those bank operated travel agencies have been closed since that time. For instance, in the late spring of this year Indiana National Bank divested its travel agency operation of more than 50 years, perhaps the largest travel department in the country at the time of divestiture.

I am sure that you appreciate that while only two percent of all travel agencies are banks (a great number of which are state-chartered), many of them have been in the travel business for a long time, and some offer the only travel services available in the community in which they are located. Therefore, this Office, if it were to revise the interpretive ruling, would have to consider not only such cases as <u>Arnold Tours</u>, but also the effect of such a ruling on small banks and the communities they serve. We mention also that many states have specifically allowed banks in the state to operate travel agencies; national banks would be put at a competitive disadvantage in such states if forced to divest or not allowed to institute the operation of travel agencies.

Based upon the wide variance in opinions in the comments submitted on our earlier proposals and the necessity of analyzing each travel service separately, we are not convinced that a new interpretation or guidelines on the subject of travel services should be issued by this Office. We believe that national banks generally are aware of the <u>Arnold Tours</u> decision and of the

- 4 -

Comptroller's position pursuant to the decision, that a travel agency such as that involved in the Arnold Tours case probably could not be established under the National Bank Act. In the absence of a new ruling, we have urged national banks to consult their own legal counsel on the range of permissible travel services under applicable statutes. Of course, the absence of an interpretive ruling does not immunize national banks from lawsuits, whether brought under the National Bank Act or other laws. In addition, as previously noted, the Comptroller's Office will not accept any applications from a national bank to offer travel services through operating subsidiaries pursuant to Interpretive Ruling 7.7376 (12 CFR 7.7376).

I might note in closing that the National City Bank Travel Bureau has been in operation for approximately forty-one years. Furthermore, the Ohio Legislature has specially granted banks the power to operate travel agencies. Refer to Ohio Revised Code §1107.31. National City Bank Travel Bureau is a registered Ohio Travel Agency under Ohio Revised Code §1333.96. It is our understanding that this bank operated travel agency does no advertising, has no new business division, and does not actively solicit business. We have also been informed by a representative of the bank that the General Electric Company-Lamp Business Group has been a customer of the bank and that this bank customer was unhappy with the services of Your Travel Agent, Inc., and contacted bank personnel concerning the travel agency services offered by the bank.

I trust the above will serve as a useful guide to the current status of the law vis-a-vis national banks in the travel agency area and will assist you in responding to your letter from Mr. MacLeod.

Very truly yours,

[Signed]

John G. Heimann
Comptroller of the Currency

The Honorable
William Proxmire
United States Senate
Washington, D. C. 20510

LNSMITH:hbw - 11/2/77 #01872

United States Senate
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
WASHINGTON, D.C. 20510

November 23, 1977

The Honorable John Heimann
Comptroller of the Currency
409 L'Enfant Plaza
Washington, D. C.

Dear Mr. Heimann:

Your letter of November 10, 1977 responding to my letter of October 4 was a severe disappointment.

At your confirmation hearings we had a colloquy concerning the enforcement of the law by the Office of the Comptroller. I raised this question because of this Committee's experience with the operation of the Office of the Comptroller by your predecessors. I specifically pointed out to you the illegality of national banks engaging in the travel agency business. In the context of the travel agency matter, I asked you whether you would take steps, if confirmed in the post of Comptroller of the Currency by the United States Senate, to assure that the Comptroller administers the law in an evenhanded manner. Your response then was a reasurring "Absolutely, Sir". Your letter of November 10 fails to carry out this reassurance on that precise issue.

There is no doubt at all under current law that it is unlawful for a national bank to engage in the travel agency business. Your letter acknowledges as much. But you indicate that national banks are aware of the Arnold Tours case and that your Office has advised national banks to consult their own legal counsel on the range of permissible travel services under applicable statutes. This position abdicates the enforcement responsibilities of your Office.

In my view administration of the law in an evenhanded manner with respect to the travel agency issue requires the Comptroller to do two things:

(1) develop the facts during the examination process of particular national banks relating to travel agency operations, and (2) proscribe by cease and desist order any such operations under a regulation which implements the Arnold Tours case. To do less will result in an encouragement by your Office to national banks to flout the law.

I would appreciate your providing this Committee with a list of all national banks which engage in travel agency activities which violate the Arnold Tours case. I thank you in advance for your continued cooperation with the work of this Committee.

Sincerely,

William Proxmire
Chairman

WP:lmg

Exhibit B

U.S. HOUSE OF REPRESENTATIVES

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION, REGULATION AND INSURANCE
OF THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
NINETY-FIFTH CONGRESS

WASHINGTON, D.C. 20515

March 23, 1978

The Honorable John G. Heimann
Comptroller of the Currency
490 L'Enfant Plaza East, S.W.
Washington, D.C. 20219

Dear Mr. Heimann:

I am writing in reference to the continued operation of travel agencies by certain national banks. As you know, this matter has generated substantial debate both prior to and subsequent to the decision of the Court of Appeals for the First Circuit in Arnold Tours v. Camp, 472 F.2d 427 (1972), which determined that this activity is not necessary and incidental to banking and is therefore illegal.

As a result of the recent decision of the Seventh Circuit upholding the determination of the Federal Reserve Board that such activities are not "closely related to banking," and therefore are prohibited under Section 4(c)(8) of the Bank Holding Company Act, there is no longer any question that the same proscription must apply to national bank activities under the National Bank Act. It is my understanding that you have informed President James A. Miller of the American Society of Travel Agents that you would carefully consider the Seventh Circuit's reasoning in that case when reexamining the policy of your office with regard to the operation of travel services by banks under your jurisdiction.

I strongly urge you to immediately and expeditiously undertake this reexamination, and proceed to declare bank travel agent operations of any magnitude to be prohibited activities. It is evident that national banks can no longer lawfully engage in activities that

Hon. John G. Heimann -2- March 23, 1978

bank holding companies are forbidden to pursue. I would appreciate learning precisely what steps you intend to take to assure that those national banks that continue to operate travel agencies discontinue that activity forthwith. I ask that you give my Subcommittee immediate assurance that you intend to enforce the provisions of the National Bank Act in accordance with the recent decision of the Seventh Circuit.

I look forward to receiving notice from you that appropriate action has been undertaken.

Sincerely yours,

Fernand J. St Germain
Chairman

FJStJ:bSp

Exhibit B

United States Senate

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
WASHINGTON, D.C. 20510

April 17, 1978

Honorable John G. Heimann
Comptroller of the Currency
Administrator of National Banks
Washington, D. C. 20219

Dear Mr. Heimann:

I am writing to inquire why your office has taken no action regarding the issue of national banks engaging in the travel business.

At your confirmation hearing, Senator Proxmire referred to two court rulings, namely, Arnold Tours v. William Camp and South Shore National Bank as well as American Society of Travel Agents v. Bank of America, which held that ". . . it is illegal for a national bank to operate a full-scale travel agency." You assured Chairman Proxmire, "that such activities would be discontinued in order to comply with the court decision." To date, so far as I know, you have done nothing and some 100 national banks are still owning and operating travel agencies throughout the U. S.

Recently, the Seventh Circuit Court of Appeals unanimously upheld the right of the Federal Reserve Board to bar bank holding companies from operating travel agency subsidiaries as an activity not closely related to banking. This ruling would seem to be a clear indication as to where the courts are on this issue.

This situation has dragged on for several years, and I believe it now deserves your prompt attention. Please advise me as to what steps you intend to take to see that the activities of national banks are brought into conformity with the spirit of recent judicial opinions.

Sincerely yours,

Edward W. Brooke

Exhibit C

Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219

June 2, 1978

Mr. John C. Bennison
Director
Washington ASTA Office
818 Eighteenth Street, N.W.
Suite 400
Washington, D. C. 20006

Dear Mr. Bennison:

This is in response to your letter of May 16, 1978, requesting a list of national banks which currently own or operate travel agencies.

We have not prepared such a list and therefore cannot provide you with the data you have requested for purposes of testimony before the Senate Banking Committee on June 5 and 6, 1978. Our best estimate is that about 70 of the more than 4,700 national banks across the country currently are engaging in travel agency-related activities.

We do not maintain a master list of the types of services provided by each national bank. These services are numerous and constantly changing in nature and scope. Of course, our examiners during the course of regular examinations review the full range of activities of each institution for safety and soundness considerations and to determine compliance with the law. National bank travel-related services are periodically assessed in this context.

I am sorry that I am unable to provide you with a list of specific national banks which operate travel agencies but hope that our estimate of the total number of banks engaged in such activity will be helpful as you prepare your testimony.

Very truly yours,

Charles B. Hall
Chief National Bank Examiner

Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219
June 1, 1978
Banking Circular No. 108

TO: All Presidents of National Banks, Regional Administrators, and Examining Personnel

SUBJECT: National Bank Travel Agencies

We hereby request that all national banks which are currently operating travel agencies, through a bank department or subsidiary, divest themselves of such travel agencies within a reasonable period of time not to exceed three years. The Air Travel Conference of America defines the term "bank travel department" as:

> ...a special department operated by a bank exclusively for the sale of passenger transportation and general travel services, such as tour itineraries, sightseeing arrangements, and hotel reservations, and which is open to the public for such services.

This banking Circular is limited to the type of travel agency business encompassed within the above definition and is not intended to limit in any way the provision of banking services to travelers.

We recognize that some banks, both state and national, have provided travel agency services for decades, that from 1963 to 1975 there was in effect a Comptroller's Interpretive Ruling (12 C.F.R. 7.7475) which sanctioned such activity on the part of national banks, and that even now there are some states which have statutes authorizing state banks to engage in the travel agency business. However, recent court decisions have made the legality of national bank travel agencies questionable.

In Arnold Tours, Inc. v. Camp, 472 F.2d 427 (1st Cir. 1972), the Court held that the operation of a full-scale travel agency was not within the incidental powers conferred on national banks by 12 U.S.C. 24(7). The court did point out, however, that its decision in no way limited banks in rendering banking services for travelers, "such as the sale of travelers' checks and foreign currency, the making of travel loans, issuance of letters of credit, and providing gratis travel information." Relying upon this decision, the U. S. District Court in San Francisco subsequently held that a national bank could not indirectly establish and control a travel agency. American Society of Travel Agents, Inc. v. Bank of America, NT&SA, 385 F. Supp. 1084 (N.D. Cal. 1974).

Following these decisions and attempts to clarify the law by additional rulemaking proceedings, the Comptroller's Office rescinded Interpretive Ruling 7.7475 and announced that no new travel agency operating subsidiaries would be approved under Interpretive Ruling 7.7376 (12 C.F.R. 7.7376). More recently, in Association of Bank Travel Bureaus, Inc. v. Board of Governors of the Federal Reserve System, 568 F.2d 549 (7th Cir. 1978), the Court of Appeals for the Seventh Circuit upheld the Federal Reserve Board's ruling that bank holding companies could not establish or acquire travel agencies as nonbank subsidiaries. The Federal Reserve Board determination was based on a finding that the activities of a travel agency are not "closely related to banking" within the meaning of the Bank Holding Company Act (12 U.S.C. 1843(c)(8)).

In view of these legal developments, we believe that the continued operation of a travel agency by a national bank is inappropriate and may expose the bank to a substantial risk of costly litigation. Accordingly, we request that national banks divest themselves of their travel agencies within a reasonable time. Divestiture plans of individual banks will be reviewed in the course of regular examinations.

John G. Heimann
Comptroller of the Currency

Committee of Banking Institutions on Taxation

This Committee consists of National and State Banks, Trust Companies, Private Banking Institutions and Agencies of Foreign Bankers. The members of its executive committee and its officers are selected from representatives of these institutions. Its objects are (a) to cooperate in assisting in the administration of tax laws; (b) to disseminate among its members information pertaining thereto; and (c) to act as a clearing house for communications to or instructions from Federal and State tax authorities.

Richard J. Bushalen, Chairman
John E. Eisinger, Vice Chairman
John Pretto, Secretary-Treasurer

Address all communications to
JOHN PRETTO
Blyth, Eastman Dillon & Co. Inc.
80 Pine Street
New York, New York 10005
Phone (212) 785 0179

May 22, 1978

The Honorable William Proxmire, Chairman
Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, D. C. 20510

Dear Senator Proxmire:

Enclosed is an extract from the April, 1978 issue of the National Public Accountant magazine, making an unabashed appeal to their membership to write to you in support of S 72 as it relates to the tax preparation activities of banks. The public accountants who oppose banks offering tax services made the following arguments:

1) Tax service is not bank related
2) Not within the purview of bank charters
3) Service offered at less than competitive rates
4) Bank personnel not technically qualified
5) Service not subject to regulation
6) Bank personnel not subject to ethical or behavioral codes

This reply to the above arguments is written on behalf of the 59 member banks of the Committee of Banking Institutions on Taxation as set forth in the enclosed membership list. We are an association of bank tax officers, fiduciary and corporate. Our primary concern is with the preparation of the bank's own tax return and the tax returns for those estates, trusts, guardianships, committeeships, conservators and custodians where the bank acts in a fiduciary capacity. We presume no one can fault the banks for preparing their own returns. We also believe that since in a number of our membership institutions that the volume of the returns prepared run into the thousands, that some evidence of technical qualification can also be presumed.

1) It is the practice of many of our member banks to offer these tax preparation services to their customers on a fee basis. Typically these customers are customers of our Trust Department for whom we render the aforementioned fiduciary services as well as agency services for their investment portfolios. Since most of their investment

records are already with the bank, it has been a natural evolution over many years that we then prepare their tax returns and the returns for their family and staff. Clearly this long standing practice of tax return preparation has its origins in the bank relationship and is demonstrably bank related.

2) Most bank charters are broad enough in their scope to encompass activities such as tax preparation as activities incidental to banking. One of our members was originally chartered as a water company but its current charter is equally broad.

3) Compensation for tax service varies with the institutions and is as competitive as the rates among any other tax preparers. We can only draw the conclusion that the Public Accountants would deny the tax preparation field to all commercial tax preparers if less than competitive rates is to be a criteria for authorization to perform tax preparation work. This argument would not appear to be in the public interest.

4) Having made the point in the introductory paragraph that we prepare significant numbers of returns in a fiduciary capacity, some qualification must be presumed. In fact most of our staff either have academic or on the job training to qualify them as tax preparers and they are full time career oriented employees solely employed in this work in the larger institutions.

5) Tax preparation within a bank is subject to the same regulations as any other banking activity and typical annual examinations are made by either State or Federal banking auditors, the Certified Public Accountants who audit the bank, the bank's own audit staff and the internal audit of the Tax Department itself. If anything, the banks are over regulated.

6) Bank personnel are held to the same degrees of ethical and behavioral codes as the Public Accountant. We conform to the same regulations governing tax preparers including those states and cities that have enacted their own codes. In terms of responsibility for our activities, banks as a whole offer more protection to the general public than any other professional preparer, including attorneys, certified public accountants or commercial tax preparation firms, as we place the reputation and assets of our parent banks at risk in support of our activities.

Without expressing a view on the merits of S 72, as an Association we are prepared to say that tax preparation services are bank related activities and in the best interest of our customers and the United States Treasury which has an interest in properly prepared tax returns.

Thank you for the opportunity of presenting our views.

Sincerely yours,

John E. Eisinger
Chairman

Enclosure

CLEARY, GOTTLIEB, STEEN & HAMILTON
1250 CONNECTICUT AVENUE, N. W.
WASHINGTON, D. C. 20036

(202) 223-2151

CABLE CLEARGOLAW WASHINGTON
TWX 7108220100

ROBERT C. BARNARD
FRED D. TURNAGE
R. MICHAEL DUNCAN
DONALD L. MORGAN
CHARLES D. MAHAFFIE, JR.
J. EUGENE MARANS
DOUGLAS E. KLIEVER
KENNETH L. BACHMAN, JR.
CHARLES F. LETTOW
RICHARD deC. HINDS
RESIDENT PARTNERS

MATTHEW HALE
WASHINGTON COUNSEL

SARA D. SCHOTLAND
ERIC SCHWARTZ
JOHN S. MAGNEY
HENRY J. PLOG, JR.
EDWARD G. MODELL
RICHARD R. GARDNER
LEE C. BUCHHEIT
JOHN W. WILMER, JR.
EUGENE M. GOOTT
PRICE O. GIELEN
O. ANN HORN
ROBERT L. GLICKSMAN

GEORGE W. BALL
COUNSEL

NEW YORK OFFICE
ONE STATE STREET PLAZA
NEW YORK 10004

PARIS OFFICE
41, AVENUE DE FRIEDLAND
75008 PARIS, FRANCE

BRUSSELS OFFICE
RUE DE LA LOI 23, BTE 5
1040 BRUSSELS, BELGIUM

LONDON OFFICE
WINCHESTER HOUSE
77 LONDON WALL
LONDON EC2N 1DA, ENGLAND

April 24, 1978

Hon. William Proxmire
Chairman
Committee on Banking, Housing
and Urban Affairs
5300 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

During the hearings on S. 72, on March 7, 1978, Assistant Attorney General Shenefield testified in support of the amendment to the Bank Merger Act (Section 18(c)(5) of the FDIC Act; 12 U.S.C. §1828(c)(5)) which appears on page 4, lines 13 through 23 of S. 72. This amendment apparently is intended to reverse the decision in Washington Mutual Savings Bank v. FDIC (347 F.Supp. 459; 482 F.2d, 459; 1973). Mr. Shenefield stated that the effect of the Washington Mutual decision was as follows:

> "The effect is that a merger which is neutral with respect to 'banking factors', but anticompetitive and thus overall adverse to the public interest must be approved."

You will recall that under the Bank Merger Act of 1960, the basic test a banking agency was to apply to a bank merger was whether it finds the transaction to be in the public interest, taking into consideration both banking factors and competitive factors, with the benefit of the views of the Antitrust Division on competitive factors in all but emergency cases. Your amendment to S. 1698 in 1965, adopted by the Banking and Currency Committee and by the Senate, would have left this public interest provision of the Bank Merger Act in effect but would have given the Antitrust Division 30 days to bring an action under the Clayton or Sherman Act before any further merger could take effect. The 1966 Bank Merger Act Amendments, as finally enacted, required that the responsible banking agency should in every case take into consideration the convenience and needs of the community to be served (another way of referring to the public interest), and more specifically prohibited certain anticompetitive mergers unless their anticompetitive effects were outweighed in the public interest by the benefits to the convenience and needs of the community to be served.

Throughout the entire legislative history of the Bank Merger Act from 1959 to 1966, it has always been the position of the Senate and House Banking Committees and the Senate and the House that a merger should not be approved if its overall effect was adverse to the public interest.

If the Washington Mutual case has the effect that a merger adverse to the public interest must be approved, the decision is either incorrect under the Bank Merger Act, or the Act should be amended. However, I do not think that this is a correct statement of the effect of the Washington Mutual case.

I enclose a memorandum which discusses the background and effect of the Washington Mutual case, including the proceedings before the FDIC and the court opinions. This memorandum takes the position that the "banking factors" were not considered by the FDIC or the courts to be "neutral", and the position that the proposed merger was not considered "anticompetitive" by the Antitrust Division in 1970.

I also enclose copies of the Antitrust Division letter of August 13, 1970, commenting on the competitive effects of the proposal, the statements concerning the merger in the FDIC Annual Reports for 1970, 1971 and 1973, and the opinions in the District Court and Court of Appeals.

My memorandum concludes by restating the effect of the Washington Mutual case as follows:

> The effect is that a merger which is favorable with respect to banking factors (even though the improvements may be considered as not "significant" or "decisive" and even though the improvements might be obtained in other ways), and which has not been found by the Antitrust Division to be immediately or potentially anticompetitive, is in the public interest and must be approved.

Hon. William Proxmire

(If the views of the District and Circuit Courts alo
considered, the parenthetical reservations could be
and the merger should be considered simply as favora
banking factors and neutral as to competitive factor

On the basis of the findings in the Washin
case with respect to the banking factors and the com
factors, it seems to me that the merger was properly
in the public interest. Accordingly, the approval d
the Courts does not seem to me to provide a sound ba
the proposed change in the standards established by
Congress in 1966.

I am sending a copy of this letter and my
to Mr. Shenefield. I believe it would be helpful to
this letter and the enclosures in the hearing on S.

Respectfully submi

Matthew Hale

April 18, 1978

MEMORANDUM

Re: Testimony of John H. Shenefield, Assistant Attorney General on S. 72 given March 7, 1978

At page 12 of his prepared statement on S. 72, Mr. Shenefield made the following statement:

> "The Washington Mutual case did not receive Supreme Court review, and we doubt the wisdom of its rationale. The effect is that a merger which is neutral with respect to 'banking factors', but anticompetitive and thus overall adverse to the public interest must be approved."

If this statement is correct--if the Washington Mutual case holds that a bank merger which has an overall effect contrary to the public interest must be approved--the purpose and intent and provisions of the Bank Merger Act Amendments of 1966 have indeed been frustrated. However, I do not think the facts of the Washington Mutual case support this statement of its effect. I question, in particular, the word "neutral" as applied to "banking factors" and the word "anticompetitive".

I.

"Neutral"

The Court of Appeals opinion stated (482 F.2d. 459, 465):

> "In the case before us the FDIC found the banking factors favorable and improperly rejected the merger on the basis of alleged anticompetitive effects."

The District Court's opinion pointed out that on the basis of the banking factors (and the competitive factors) the merger had been approved by the State Supervisor of Banking, and approval had been recommended by the FDIC Examiner in charge, and the FDIC Division of Research and the FDIC Board of Review, the latter two citing improvements in services offered to the community and elimination of a management succession problem, resulting in more agressive management. (347 F.Supp. 790, 794 and 482 F.2d. 459, 460-1) The District Court appeared to agree with the plaintiff's statement that the FDIC Board (347 F.Supp. 790, 800):

> "has already found, from its review of the banking factors, that the area concerned would benefit from a merger."

The FDIC's statements in its 1970 and 1971 Annual Reports, representing the conclusions of its Board, are less favorable, taking the position that the additional services were already available in the community and the management succession problems were not critical, and that both of these points could be solved otherwise than by the proposed merger. The FDIC's conclusion in its 1970 Annual Report were that:

> "No finding, accordingly, can be made that there would be significant improvements in banking service in the Aberdeen-Hoquiam area or that these improvements can be achieved only by S&L's merger with Washington Mutual." (Page 143).

> "While the financial and managerial resources of both institutions are consistent with approval, they lend no decisive weight to a determination on the application." (Page 144).

The FDIC Board seems to have recognized that the merger would result in improvements in banking services (even if not "significant", and even if these benefits could be achieved in other ways) and that there were benefits from the correction of the management succession problem (even if not of "decisive weight").

Under these circumstances, it seems to me less than an accurate and complete statement of the situation to describe the proposed merger merely as "neutral with respect to 'banking factors'".

II.

"Anticompetitive"

The District Court summarized the reports of the Attorney General, the Federal Reserve Board and the Comptroller of the Currency to FDIC on the competitive factors of the proposed merger as follows (347 F.Supp. 790, 794):

> "Each of these agencies submitted its report as requested, none finding any significant anticompetitive factors, either present or potential."

The Court of Appeals used the expression "reported favorably" with respect to the comments of those three agencies (482 F.2d 459, 460-1).

The text of the Antitrust Division's report of August 13, 1970, on the competitive factors involved, was as follows:

UNITED STATES DEPARTMENT OF JUSTICE

WASHINGTON, D.C. 20530

August 13, 1970

DIB:CLW
-111-1964

Aug 14 9 34 AM '70

Honorable Frank Wille
Chairman
Federal Deposit Insurance
Corporation
Washington, D. C. 20429

Dear Mr. Chairman:

This is in reply to your letter of June 19, 1970, requesting a report pursuant to Section 18(c) of the Federal Deposit Insurance Act, on the competitive factors involved in the proposed consolidation of the Washington Mutual Savings Bank, Seattle, Washington and a mutual savings bank created by the conversion of the Grays Harbor Savings and Loan Association, Aberdeen, Washington.

1. The Banks

Washington Mutual Savings Bank ("Bank"), organized in 1889, operates 22 branches throughout the State of Washington. As of December 31, 1969, it had total deposits of $725 million and net loans and discounts of $629 million. Its net operating income in 1969 was $6 million; its average net operating income in 1964-8 was $3.8 million.

The Grays Harbor Savings and Loan Association ("Association") was organized in 1924. It has submitted an application to the Washington State Supervisor of Banking to convert to a mutual savings bank. As of December 31, 1969, its one office had total deposits of $4.74 million and net loans and discounts of $4.35 million. Its net operating income in 1969 was $43,000; its average net operating income in 1964-8 was $37,000. It is the smallest of three savings and loan associations located in Aberdeen.

2. The Community

Aberdeen is a town of 19,300 people in Grays Harbor County, which lies to the southwest of the Seattle-Tacoma area on the Pacific Ocean.

3. Effect on Competition

Aberdeen is about 40 miles west of Olympia, the location of the nearest office of Bank. Bank currently obtains an insignificant portion of its deposits from the service area of Association.

4. Effect on Potential Competition

Bank could enter the Aberdeen area by opening a new office (RCWA 32.04.030). Association is the smallest of the three serving the Aberdeen area, and it has less than 8 per cent of the deposits in all such associations in Aberdeen. Hence, this consolidation is not likely to have any significantly adverse effect on potential competition.

A summary of this report is attached.

Sincerely yours,

RICHARD W. McLAREN
Assistant Attorney General
Antitrust Division

By: Donald I. Baker
Deputy Director of Policy Planning

	Resources (in thousands of dollars)	Banking offices: In operation	Banking offices: To be operated
Washington Mutual Savings Bank Seattle, Washington	807,335	22	
to consolidate with			
Grays Harbor Savings and Loan Association Aberdeen	5,148	1	

Summary report by Attorney General, August 13, 1970

Aberdeen is about 40 miles west of Olympia, the location of the nearest office of The Washington Mutual Savings Bank ("Bank"). Bank currently obtains an insignificant portion of its deposits from the service area of The Grays Harbor Savings and Loan Association ("Association").

Bank could enter the Aberdeen area by opening a new office (RCWA 32.04.030). Association is the smallest of the three serving the Aberdeen area, and it has less than 8 per cent of the deposits in all such associations in Aberdeen. Hence, this consolidation is not likely to have any significantly adverse effect on potential competition.

Basis for Corporation denial, December 18, 1970

Washington Mutual Savings Bank, Seattle, Washington ("Washington Mutual"), an insured mutual savings bank with total deposits of $744,000,000, has applied, pursuant so Section 18(c) and other provisions of the Federal Deposit Insurance Act, for the Corporation's prior approval to consolidate with Grays Harbor Savings and Loan Association, Aberdeen, Washington ("S&L") which has total withdrawable balances of $4,700,000. The institutions would consolidate under the charter and title of Washington Mutual and the only office of S&L would become a branch of Washington Mutual, increasing the number of its offices to twenty-three. Five of these branches resulted from mergers approved in 1964 and 1965.

Competition. Washington Mutual is an ably and aggressively managed savings bank. It is, by a substantial margin, the largest mutual thrift institution today in the State of Washington, holding approximately 22.9 percent of the total deposits held by such institutions—a percentage share which has increased steadily over the past seven years from the 17.9 percent share held at year-end 1963.[1] The next largest mutual thrift institution in the State is a savings and loan association, headquartered in Tacoma, less than one-third the size of Washington Mutual, holding approximately 6.8 percent of the total deposits held by such thrift institutions. Only two other thrift institutions exceed $100 million in deposit size, while the remaining 71 range from very small institutions up to $85 million in deposit size.[2]

Savings banks and savings and loan associations in Washington may branch *de novo* or by merger throughout the State. Mutual savings and loan associations under State law may become mutual savings banks and the two types of institutions may merge with one another following such a conversion.

Washington Mutual operates twenty-two offices throughout the State, and has three additional offices authorized but unopened. Its office nearest to Aberdeen, where S&L is located, is in Olympia, the State capital, fifty miles to the east. Neither institution derives more than a nominal amount of business from areas presently served by the other, and their proposed merger, accordingly, would not eliminate any meaningful existing competition.

S&L is the fourth largest of five mutual thrift institutions serving approximately 62,500 people in the Aberdeen-Hoquiam area. The three larger mutual thrift institutions have, respectively, $30 million, $17 million and $9 million in withdrawable shares. Because of its limited resources and the distances involved, S&L is unlikely to branch *de novo* into areas now served by Washington Mutual but Washington Mutual has a proven capability and success in opening *de novo* branches, and could in the normal course enter the Aberdeen-Hoquiam area in this way if the proposed merger is denied. The proposed merger would eliminate this potential for increased competition between Washington Mutual and S&L in the Aberdeen—Hoquiam area.

More importantly, the proposed merger would establish a significant precedent for the approval of additional mergers in highly concentrated markets in the State of Washington and elsewhere, among commercial banks as well as mutual thrift institutions, with the cumulative effect of further concentrating the banking resources of a given market in the largest institutions which operate there. As such concentration continues, the public's choice of alternate sources of banking services is likely to diminish. Given the fact that Washington Mutual is more than three times the size of the next largest mutual thrift institution in the State and that it already controls 22.9 percent of total thrift institution deposits on a Statewide basis, approval of the proposed merger could easily lead to other merger proposals on the part of Washington Mutual

---

1 For the reasons stated in its October 1, 1970, statement accompanying the denial of the application of United Mutual Savings Bank, Tacoma, to merge with State Mutual Savings Bank, Tacoma, the Corporation considers the *decisive* line of commerce for assessing the competitive implications of the proposed merger to be "thrift institution banking" as offered by mutual savings banks and mutual savings and loan associations in the State of Washington.

2 Commercial banking is similarly concentrated in the State of Washington. Only two commercial banks exceed Washington Mutual in size and they hold 53.0 percent of total commercial bank deposits. Six other commercial banks exceed $100 million in deposit size, representing in the aggregate an additional 30.0 percent of total commercial bank deposits. Some 93 smaller commercial banks hold the balance.

to extend its branch system into new areas by the merger route rather than by the establishment of *de novo* branches, thus losing successive opportunities for increasing the public's choice of banking alternatives in each area. A denial of the proposed merger, on the other hand, would encourage S&L to seek out a different merger partner from among the State's 73 other mutual thrift institutions, thereby also preserving the possibility of more effective competition against Washington Mutual in the future from among the State's other thrift institutions.

The Corporation believes that the Bank Merger Act as amended requires consideration of the long-term competitive implications of a proposed merger as well as its short-term effects. In situations where one of the institutions involved in a proposed merger already has such a large share of its potential market as Washington Mutual, the Corporation further believes that additions by merger to its existing strength should be avoided unless (i) significant improvements in banking service can be achieved only by consummation of the proposed merger or (ii) the condition of the institution to be merged is such that an immediate resolution of its problems appears to be necessary to prevent a failure.

Convenience and Needs of the Community to be Served. The proposed merger would bring to S&L's customers certain services not presently offered by S&L: FHA and VA mortgage loans, home improvement loans, limited personal trust services, student loans, and certain other types of personal loan services, all of which Washington Mutual can and does offer in accordance with State law. No claim is made, however, that any banking needs of the public in the Aberdeen-Hoquiam area are going unmet today, and each of these services appears to be available at one or more of the mutual thrift institutions or commercial banks with offices in the area. S&L and Washington Mutual, moreover, pay the same rate of interest on regular deposits, i.e., the highest permitted under current Federal ceilings, and S&L also offers 5¼ percent and 6 percent certificates. The slight benefit in convenience of having one more local source for the services offered by Washington Mutual but not by S&L could also be achieved by S&L's merger with a number of the other mutual savings banks in the State. No finding, accordingly, can be made that there would be significant improvements in banking service in the Aberdeen-Hoquiam area or that these improvements can be achieved only by S&L's merger with Washington Mutual.

Financial and Managerial Resources; Future Prospects. The Corporation's examination of S&L as of the close of business July 13, 1970 disclosed a conservatively run association with no classified assets, minimal depreciation in the securities account, decent earnings, adequate surplus, and a record of slow deposit growth over the years. The only weakness in S&L's current condition involves the advanced age of its two principal operating officers (both of whom have been with S&L since 1924) and a lack of management depth. While the management succession problem could be resolved by the proposed merger, it could also be resolved by merger with a less dominant mutual thrift institution. The record, moreover, indicates no effort by S&L to recruit the successor management it claims to need or any inability on its part to pay the salaries needed to attract such management. In these circumstances, it cannot be said that the condition of S&L is such that an immediate resolution of its problems appears to be necessary to prevent a failure.

While the financial and managerial resources and future prospects of both institutions are consistent with approval, they lend no decisive weight to a determination on the application.

On these facts, the Corporation concludes that approval of the proposed merger is not warranted.

	Resources (in thousands of dollars)	Banking Offices	
		In operation	To be operated
Washington Mutual Savings Bank Seattle, Washington	807,335	22	
to consolidate with			
Grays Harbor Savings and Loan Association Aberdeen	5,148	1	

Statement upon reconsideration, July 30, 1971

Washington Mutual Savings Bank, Seattle, Washington ("Washington Mutual"), an insured mutual savings bank with total deposits of $744,000,000,

[7] Because the Corporation's original decision discounted the likelihood of competition arising between Citizens and Lycama-Kenly through increased *de novo* branching, the Board considers the lower-than-average population per commercial bank office which exists in Johnston, Wilson, and Nash counties to be irrelevant to its reconsideration of the application. Moreover, since regulatory policy is or should be directed toward the deconcentration of highly concentrated local banking markets, the fact that Citizens' share of total deposits in the three-county area has shown a modest decline since 1966 provides no affirmative basis for reversing the Corporation's earlier decision.

was denied on December 18, 1970, the Corporation's prior approval to consolidate with Grays Harbor Savings and Loan Association, Aberdeen, Washington ("S&L"), an FSLIC-insured institution with total withdrawable balances of $4,700,000. Washington Mutual and S&L then petitioned the Corporation to reconsider its original denial. The Corporation's Board of Directors, having done so, affirms its original denial with the following additional statement.

The applicants requested reconsideration on essentially three grounds: (1) that the Corporation improperly utilized a line of commerce limited to mutual savings banks and savings and loan associations in assessing the competitive impact of their proposed merger; (2) that the Corporation made certain errors of fact with regard to the potential competition issues presented by the application; and (3) that in any event the likely benefits to the convenience and needs of the community to be served and the resolution of S&L's management succession problem are such as to warrant approval of the application.

Line of Commerce. Whether or not commercial bank time deposits under $100,000 should be included with thrift institution deposit totals in assessing the competitive impact of a merger between thrift institutions under the Bank Merger Act is a much-debated question among lawyers, economists, bankers, and public officials. The Corporation recognizes, of course, that commercial banks and thrift institutions are all deposit-type institutions and that in a sense they can all be said to compete in seeking to attract the savings of individual members of the public. The Corporation also recognizes that no definitive answer to this question has yet been given by the United States Supreme Court in its decisions under the Bank Merger Act as amended in 1966, all the decided cases having involved mergers of commercial banks.

One thing at least is clear. The United States Supreme Court, with apparent finality, has determined that commercial banking constitutes a separate "line of commerce" for purposes of analyzing the competitive aspects of commercial bank mergers,[8] despite the arguments presented to it that deposit and loan competition from financial institutions other than commercial banks should also be considered. Its exclusion of thrift institution deposits was particularly striking in the *Phillipsburg* case, where the bulk of each bank's total deposits represented time deposits under $100,000 and where the bulk of each bank's total loans were real estate loans and mortgages—an asset and liability mix not too dissimilar from that of mutual savings banks and savings and loan associations. The Supreme Court expressly found error in the District Court's view that since the activities of the merging banks made them much more like savings institutions than like so many of the larger commercial banks, attention had to be given in the competitive analysis to different groupings of products and services within the more general line of commerce denoted by the term "commercial banking."

In its original denial of this application, the Corporation determined to exclude commercial bank time deposits from its analysis of the competitive effect of the proposed merger, looking instead solely to the deposits of mutual savings banks and the withdrawable shares of savings and loan associations. The Corporation cited its earlier decision involving the proposed merger of United Mutual Savings Bank and State Mutual Savings Bank, both headquartered in Tacoma, Washington, wherein it had said:

> In the State of Washington, where mutual savings and loan associations have the option to become mutual savings banks (State Mutual converted at the end of 1969), where both types of institutions may pay interest on deposits below $100,000 at the same rates and each at rates higher than commercial banks, where at least some differential in interest rates has persisted between thrift institutions and commercial banks at almost all times throughout the post-World War II period, where both types of institutions are identified by the public as thrift institutions engaged primarily in mortgage lending, where both by statute have very similar powers, privileges, restrictions, and liabilities, it would appear that the *decisive* line of commerce for assessing the competitive implications of a proposed merger of mutual savings banks should be "thrift institution banking" as offered by savings banks and savings and loan associations. As indicated, in the State of Washington, savings banks and savings and loan associations are uniquely able to compete for deposits under $100,000 and are generally considered interchangeable alternatives for thrift-type deposits and for deposit institutions emphasizing home mortgage lending.

The Corporation adheres to this view of the appropriate "line of commerce" for purposes of the proposed merger of Washington Mutual and S&L.

There is no doubt that in the State of Washington as elsewhere, commercial banks, especially those in major metropolitan areas, aggressively advertise their offering of so-called consumer time deposits, which carry a rate of interest higher than the rate of interest paid on regular savings accounts. A member of the public interested in the highest return available to him at a deposit-type institution, however, is likely to turn to a mutual savings bank or savings and loan association, which, since the end of World War II, have generally paid higher rates of interest than commercial banks on the same type of account. Under Federal regulations currently in force, these types of thrift institutions may offer a regular savings account, increasingly available on a "day-of-deposit-to-day-of-withdrawal" basis, at a maximum rate of interest of 5 percent per annum (compared with a 4½ percent maximum rate at commercial banks) and a rate of interest on time deposits ¼ percent higher than the maximum rate payable by commercial banks on accounts of less than $100,000 but of the same maturity.

Mutual savings banks and savings and loan associations, moreover, compete for the public's savings under operating rules that are different, in many basic respects, from those under which commercial banks operate. Besides their legal ability to offer higher maximum interest rates than commercial banks on comparable deposits, they are not required to maintain minimum reserves against their savings deposits, they have no holders of common stock to whom regular dividend payments must be provided, and they are permitted to set aside substantially higher tax-free reserves for loan losses than commercial banks. These differences in operating rules assist mutual thrift institutions to pay the higher rates of interest authorized by Federal regulation, to resist disintermediation, and to continue their role as the nation's principal source of residential mortgage money. The fact that legislature and public agencies treat mutual thrift institutions quite differently from commercial banks supports the view that they should be considered a separate line of commerce from com-

---

[6] *United States* v. *Philadelphia National Bank*, 374 U.S. 321 (1963); *United States* v. *Phillipsburg National Bank*, 399 U.S. 350 (1970). See also *United States* v. *First National Bancorporation*, Civil No. C-2413 (D. Colo., filed July 12, 1971).

mercial banks for purposes of the Bank Merger Act.

Members of the public may, of course, wish to limit their banking business to one institution and may, for this reason, deliberately forego the additional increment of interest available at mutual savings banks or savings and loan associations, depositing even their excess savings at the commercial bank they also utilize for checking accounts or loans which the more restricted thrift institutions cannot offer. The rapid growth of time deposits at mutual thrift institutions, including those in the State of Washington,[9] and the stability of their regular savings deposits, make it clear, however, that the incremental interest advantage offered by such institutions is a meaningful difference to a substantial portion of the public and that such people will overcome any inconveniences involved to deposit their savings in a thrift institution rather than a commercial bank. Savings accounts at commercial banks and savings accounts at thrift institutions are not, therefore, interchangeable products for a significant portion of the public.

In summary, the Corporation believes that the unique ability of mutual thrift institutions to offer a higher rate of interest than commercial banks on consumer savings, the differences in the rules under which such institutions operate, and the differentiation between them which is made by a substantial portion of the public all warrant the treatment of mutual thrift institutions as a separate "line of commerce" for purposes of the Bank Merger Act.[10] The Corporation further notes that an agency determination to include commercial bank time deposits under $100,000 with the deposits of mutual thrift institutions in the same market would make the merger rules for thrift institutions demonstrably more lenient than the merger rules applicable to commercial banks.[11] The Corporation knows no reason of public policy why this [illegible] should be encouraged.

Potential Competition. In its original denial of the application, the Corporation indicated that neither Washington Mutual nor S&L derives more [illegible] a nominal amount of business from areas presently served by the other, and that their proposed merger, accordingly, would not eliminate any meaningful existing competition between them. The Corporation further found, however, that the proposed merger would eliminate the possibility of future competition between the two institutions (i) through *de novo* branching into the Aberdeen-

---

[9] Fixed-maturity time accounts and other special accounts jumped from 1.3 percent of total deposits at mutual savings banks in Washington in January 1970 to 13.7 percent of their total deposits in January 1971. See May 1971 *Annual Report* of the Executive Vice President, National Association of Mutual Savings Banks, table 3, page 9.

[10] The Corporation recognizes that the powers of mutual thrift institutions have been expanding in a number of respects that bring them increasingly into competition for both loans and deposits with commercial banks, and that additional changes in interest rate ceilings and operating conditions may obliterate the distinctions upon which its determination of the appropriate "line of commerce" in these cases rests. If future changes in operating conditions make the division of commercial banks and mutual thrift institutions into separate lines of commerce factually untenable, it will be timely then to reconsider the proper line of commerce for both types of institutions.

[11] This point can be illustrated by a geographic market containing five commercial banks and five thrift institutions of equal deposit size. Each commercial bank would be considered as having 20 percent of the market in its "line of commerce" under Supreme Court decisions, while each thrift institution would be considered as having a much lower percentage (possibly as low as 10 percent) of the market in its line of commerce if commercial bank time deposits under $100,000 could be included.

Hoquiam area on the part of Washington Mutual, and (ii) through an alternative merger on the part of S&L with another mutual thrift institution which would not have Washington Mutual's 22.9 percent share of all thrift institution deposits in the State of Washington and which would preserve the possibility of more effective competition against Washington Mutual in the future from among the State's other thrift institutions.

A review of Washington State supervisory policy in authorizing *de novo* branches for mutual savings banks, together with such pertinent facts as the stabilized economy of the Aberdeen-Hoquiam area, its slow growth rate and lower than average income levels, and the present population (approximately 7,300 persons) per thrift institution office already serving that area, has caused the C[illegible]oration to revise its opinion that Washington Mutual "could in the n[illegible]urse enter the Aberdeen-Hoquiam area" by *de novo* branching if the p[illegible] merger is denied. There appears to be little likelihood of such entry i[illegible] immediate future if S&L merges with a mutual savings bank other than W[illegible]ington Mutual, although the longer range possibilities of *de novo* entry cannot be totally discounted.

The Corporation's earlier conclusion on this point was not, however, the principal reason for its denial of the application. That reason was stated in the original *Basis for Corporation Denial* as follows:

> More importantly, the proposed merger would establish a significant precedent for the approval of additional mergers in highly concentrated markets in the State of Washington and elsewhere, among commercial banks as well as mutual thrift institutions, with the cumulative effect of further concentrating the banking resources of a given market in the largest institutions which operate there. As such concentration continues, the public's choice of alternate sources of banking services is likely to diminish.

As the Corporation's original denial pointed out, Washington Mutual has more than 22 percent of all thrift institution deposits in the State, a percentage share three times larger than the second-ranking thrift institution.[12] Where institutions in the same line of commerce may branch or merge on a statewide basis, the Corporation believes that the entire State should be considered one of the relevant geographic areas in assessing the likely competitive impact of a proposed merger. It further believes that if institutions with 22 percent of a statewide market are permitted to make further acquisitions without compelling reasons based on public convenience and needs, two related results are likely: (1) more such mergers would be encouraged both among thrift institutions and among commercial banks, thus concentrating even further the banking resources of a given State into fewer and fewer hands, and (2) effective competition with such dominant institutions would become increasingly difficult as possible merger partners and their offices are acquired by the dominant institution itself, rather than by a smaller institution which could hope in time, by successive mergers, aggressive *de novo* branching or both, to offer significant competition to the former throughout wide areas of the same State. Indeed, even if Washington Mutual is denied any further mergers, only three or four

---

[12] Its percentage share of statewide deposit totals, if commercial bank time deposits under $100,000 are also included, would be slightly over 13 percent—a percentage share significantly lower than 22 percent, but one that would still raise a serious question as to the disposition of this application.

other thrift institutions of a size approximately equal to that of Washington Mutual could be created from all the thrift institution deposits in the State of Nashington.

The adverse precedent which the proposed merger might establish, because of the share of the potential statewide market already held by Washington Autual, can best be illustrated by noting that only 72 commercial banks in the ountry, out of a total approaching 14,000, have 10 percent or more of the otal commercial bank deposits in their respective States and only 29 have ercentage shares exceeding 20 percent of the total commercial bank deposits their respective States. Even fewer mutual thrift institutions would have a milar share of statewide thrift institution deposit totals.

The Corporation is not persuaded by any of the material submitted on consideration that S&L is limited to a very few merger alternatives and that ashington Mutual is the most logical of these. There are 79 other mutual rift institutions in the State of Washington, including some 70 savings and an associations, from which S&L may legally seek a merger partner. Their pacity to absorb S&L's mortgage portfolio may vary, because of statutory or gulatory restrictions, but the effect of these restrictions has changed even ithin the past year. The Corporation is confident that S&L's directors can id a satisfactory alternative to the merger proposed if it is again denied.

Finally, the Corporation would reiterate the view expressed in its original nial:

> The Corporation believes that the Bank Merger Act as amended requires consideration of the long-term competitive implications of a proposed merger as well as its short-term effects. In situations where one of the institutions involved in a proposed merger already has such a large share of its potential market as Washington Mutual, the Corporation further believes that additions by merger to its existing strength should be avoided unless (i) significant improvements in banking service can be achieved only by consummation of the proposed merger or (ii) the condition of the institution to be merged is such that an immediate resolution of its problems appears to be necessary to prevent a failure.

Public Convenience and Needs: S&L's Management Succession Problem. The orporation has reviewed again and affirms its earlier findings on the benefits the public which may be expected to occur if this application is approved id also its findings with respect to S&L's management succession problem. It ntinues to differ with the applicants as to the weight which should be assigned these findings in reaching an overall conclusion on the application.

Based on the foregoing, the Corporation's Board of Directors again concludes that approval of the proposed merger of Washington Mutual and S&L is ot warranted and should, accordingly be denied

24-934 O - 78 - 52

	Resources (in thousands of dollars)	Banking Offices	
		In operation	To be operated
Washington Mutual Savings Bank Seattle, Washington	1,258,554	29	30
to consolidate with			
Grays Harbor Savings and Loan Association Aberdeen	6,250	1	

Summary report by Attorney General, August 13, 1970

Aberdeen is about 40 miles west of Olympia, the location of the nearest office of The Washington Mutual Savings Bank ("Bank"). Bank currently obtains an insignificant portion of its deposits from the service area of The Grays Harbor Savings and Loan Association ("Association").

Bank could enter the Aberdeen area by opening a new office (RCWA 32.04.030). Association is the smallest of the three serving the Aberdeen area, and it has less than 8 per cent of the deposits in all such associations in Aberdeen. Hence, this consolidation is not likely to have any significantly adverse effect on potential competition.

Basis for Corporation approval, October 15, 1973

Washington Mutual Savings Bank, Seattle, Washington, an insured mutual savings bank with total deposits of $1,122,759,000 as of June 30, 1973, has applied, pursuant to Section 18(c) and other provisions of the Federal Deposit Insurance Act, for the Corporation's prior approval to consolidate with Grays Harbor Savings and Loan Association, Aberdeen, Washington, which had total deposits of $5,300,000 as of March 31, 1973. The institutions would consolidate under the charter and title of Washington Mutual Savings Bank, and the only office of Grays Harbor Savings and Loan Association would become a branch of Washington Mutual Savings Bank. Prior to the consolidation, Grays Harbor Savings and Loan Association proposes to convert to a mutual savings bank.

The Corporation denied the subject application on December 18, 1970, and, upon reconsideration, affirmed its denial on July 30, 1971. The reasons for those actions are fully detailed in the original Basis for Corporation Denial (1970 FDIC *Annual Report* 141), the Statement Upon Reconsideration (1971 FDIC *Annual Report* 164), and in the briefs submitted by the Corporation to the U.S. District Court for the Western District of Washington (347 F. Supp. 790) and the U.S. Court of Appeals for the Ninth Circuit (Civil Action No. 72-2972).

In view of the adverse decisions of those two courts and the determi[illegible]tion of the Solicitor General of the United States not to petition the Supre[illegible]urt of the United States for a writ of certiorari, the Corporation is rec[illegible] to comply with an order to approve the said merger issued October 25, [illegible], by the U.S. District Court for the Western District of Washington, the ef[illegible]tiveness of which was stayed through October 10, 1973, pending completion of various appellate steps but which is now fully effective.

The merger is, accordingly, approved.

parative negligence. Jeter was familiar with the condition of the dock. Yet, at the time of his accident, he was wearing a pair of *unlaced* tennis shoes. It is unclear whether the soles of the shoes were smooth or had treads. It is clear, however, that on at least two occasions on the day in question Star's vice-president warned Jeter prior to his accident that his shoes were unsuitable for walking on fish slime, that he should change into a pair of shoes with cleats for better footing, and that if he continued to walk on the pier in the shoes he was wearing he was going to hurt himself. These warnings went unheeded. On remand, the district court is directed to make findings of fact and conclusions of law regarding Jeter's comparative negligence.

With regard to the district court's judgment of maintenance and cure to Jeter and the award of attorneys fees, we have carefully reviewed the record and find Star's contentions to be without merit. In this respect, the court's judgment is affirmed.

The case is remanded for further proceedings consistent with this opinion.

Affirmed in part, reversed in part, and remanded with directions.

WASHINGTON MUTUAL SAVINGS BANK and Grays Harbor Savings & Loan Association, Plaintiffs-Appellees,

v.

FEDERAL DEPOSIT INSURANCE CORPORATION, Defendant-Appellant.

No. 72-2972.

United States Court of Appeals, Ninth Circuit.

July 12, 1973.

Suit for declaratory judgment seeking review of decision of FDIC denying approval of proposed consolidation of two thrift institutions. The United States District Court for the Western District of Washington, Morell E. Sharp, J., 347 F.Supp. 790, entered order enjoining the FDIC from withholding its approval of bank merger, and the FDIC appealed. The Court of Appeals, Choy, Circuit Judge, held that FDIC does not have power under Bank Merger Act of 1966 to deny a merger application on basis of competitive standard more stringent than antitrust laws of the United States.

Affirmed.

1. Banks and Banking ⟹283

Principal aim of Bank Merger Act of 1966 was to curtail discretion of banking agencies. Federal Deposit Insurance Act, §§ 2[18] (c)(2), (2)(C), (4, 5), 12 U.S.C.A. §§ 1828(c)(2), (2)(C), (4, 5).

2. Monopolies ⟹20(12)

Congress, in enacting Bank Merger Act of 1966, intended that all bank merger applications are first to be subjected to traditional antitrust analysis. Federal Deposit Insurance Act, §§ 2 [18] (c)(2), (2)(C), (4, 5), 12 U.S.C.A. §§ 1828(c)(2), (2)(C), (4, 5); Sherman Anti-Trust Act, § 1 et seq., 15 U.S.C.A. § 1 et seq.; Clayton Act, §§ 1 et seq., 7, 15 U.S.C.A. §§ 12 et seq., 18.

3. Banks and Banking ⟹283

FDIC does not have power under Bank Merger Act of 1966 to deny a merger application on basis of competitive standard more stringent than antitrust laws of the United States. Federal Deposit Insurance Act, §§ 2[1] et seq., 2[18] (c)(2), (2)(C), (4, 5), 12 U.S.C.A. §§ 1811 et seq., 1828(c)(2), (2)(C), (4, 5); Sherman Anti-Trust Act, § 1 et seq., 15 U.S.C.A. § 1 et seq.; Clayton Act, §§ 1 et seq., 7, 15 U.S.C.A. §§ 12 et seq., 18.

Payne Karr (argued), Martin T. Crowder, of Karr, Tuttle, Koch, Campbell, Mawer & Morrow, Seattle, Wash., J. William Via, Jr. (argued), Edward

Bransilver, Gen. Counsel, Eric F. Kaplan, Atty., Fed. Deposit Ins. Corp., Washington, D. C., Arnold & Porter, Washington, D. C., for defendant-appellant.

John D. Hawke, Jr., Washington, D. C. (argued), Louis H. Pepper, of Ashley, Foster, Pepper & Riviera, Seattle, Wash., for plaintiffs-appellees.

Before CARTER, CHOY and GOODWIN, Circuit Judges.

CHOY, Circuit Judge:

The Federal Deposit Insurance Corporation (FDIC) appeals from an order enjoining it from withholding its approval of a bank merger. We affirm.

I. THE CASE.

Washington Mutual Savings Bank is the largest thrift institution [1] in the State of Washington holding $744 million or 22.9% of the deposits as of June 30, 1970. Washington Mutual has its main offices in Seattle and twenty-two branches throughout the state, principally in the Seattle area.

Grays Harbor Savings & Loan Association is one of the smallest thrift institutions in Washington holding $4.7 million or 0.15% of the deposits. Grays Harbor is the fourth largest of five thrift institutions in Aberdeen, Washington and is located fifty miles from Washington Mutual's nearest branch. Because of a management succession problem, Grays Harbor sought out Washington Mutual as a merger partner in 1970. After entering into a merger agreement both banks sought approval from state and federal banking authorities.

Washington law requires the approval of the State Supervisor of Banking. 12 U.S.C. § 1828(c)(2)(C) requires the written approval of the FDIC when the acquiring bank is a nonmember insured bank.[2] Federal law also requires the FDIC to request reports on the competitive factors involved in a bank merger from the Attorney General and the two other banking agencies.[3]

The Washington State Supervisor of Banking approved the proposed merger on August 14, 1970. The FDIC field examiner, Division of Research and the FDIC Board of Review all reported

1. Thrift institutions in Washington are mutual savings banks and savings and loan associations.

2. 12 U.S.C. § 1828(c)(2) provides as follows:

No insured bank shall merge or consolidate with any other insured bank or, either directly or indirectly, acquire the assets of, or assume liability to pay any deposits made in, any other insured bank except with the prior written approval of the responsible agency, which shall be—

(A) the Comptroller of the Currency if the acquiring, assuming, or resulting bank is to be a national bank or a District bank;

(B) The Board of Governors of the Federal Reserve System if the acquiring, assuming, or resulting bank is to be a State member bank (except a District bank);

(C) the Corporation if the acquiring, assuming, or resulting bank is to be a nonmember insured bank (except a District bank).

A nonmember insured bank is one insured by the FDIC but is not a member of the Federal Reserve System nor a national or District bank.

3. 12 U.S.C. § 1828(c)(4) provides as follows:

In the interests of uniform standards, before acting on any application for approval of a merger transaction, the responsible agency, unless it finds that it must act immediately in order to prevent the probable failure of one of the banks involved, shall request reports on the competitive factors involved from the Attorney General and the other two banking agencies referred to in this subsection. The reports shall be furnished within thirty calendar days of the date on which they are requested, or within ten calendar days of such date if the requesting agency advises the Attorney General and the other two banking agencies that an emergency exists requiring expeditious action.

favorably [4] on the proposed merger, as did the Antitrust Division of the Department of Justice, Comptroller of Currency and Federal Reserve Board. Despite these unanimous recommendations of approval, the FDIC Board of Directors, by a vote of 2–1, disapproved the proposal on December 18, 1970. After reconsideration, the Board affirmed its denial on July 30, 1971. The Board determined that although banking factors were consistent with approval and the proposed merger would not violate the antitrust laws of the United States, the merger would be a significant precedent for approval of additional mergers in highly concentrated markets. The Board's decision to apply a competitive standard stricter than the antitrust laws was grounded on the Bank Merger Act of 1966, 12 U.S.C. § 1828(c)(5).[5]

Washington Mutual and Grays Harbor commenced an action to compel the FDIC to approve the merger and sought a declaratory judgment that the Board's action was arbitrary, capricious and not in accordance with the law. Summary judgment for the banks was granted on July 21, 1972. The district court's decision [6] was based primarily on the FDIC's failure to apply relevant factors under the antitrust laws as Congress had intended in enacting the Bank Merger Act of 1966. On remand to the FDIC, the Board confirmed that the proposed merger did not violate the antitrust laws of the United States, but refused to approve the merger, alleging discretionary power to impose stricter standards. The district court, on October 25, 1972, enjoined the FDIC from continuing to withhold its approval and this appeal ensued.

The parties raise a number of issues, only one of which we need discuss in detail: Did the district court err in holding that the FDIC does not have the discretionary power under the Bank Merger Act of 1966 to deny a merger application based on a competitive standard more stringent than the antitrust laws of the United States?

Prior to reaching this issue, a review of the history of bank mergers and the antitrust laws and the role of the FDIC is necessary.

II. HISTORICAL BACKGROUND

a. *Pre-1960.* Although this country repeatedly suffered from unregulated and uncontrolled competition in the field of banking,[7] there was no effective regulation of bank mergers through the antitrust laws prior to 1950. The Sherman Act had been considered inapplicable to all but the most serious restraints, while the Clayton Act was a dead letter so far as bank mergers were concerned. Section 7 of the Clayton Act proscribed stock acquisitions by corporations, but bank mergers were normally accom-

4. The district court did not abuse its discretion in ordering production of the FDIC's "internal file" after its *in camera* inspection.

5. 12 U.S.C. § 1828(c)(5) provides as follows:

The responsible agency shall not approve—

(A) any proposed merger transaction which would result in a monopoly, or which would 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, or

(B) any other proposed merger transaction whose effect in any section of the country 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 it finds that the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served.

In every case, the responsible agency shall take into consideration the financial and managerial resources and future prospects of the existing and proposed institutions, and the convenience and needs of the community to be served.

6. 347 F.Supp. 790 (W.D.Wash.1972).

7. S.Rep.No.196, 86th Cong., 1st Sess. 16–18 (1959).

plished without an "acquisition" of "stock."[8] To reach undue concentrations of economic power or monopoly in their incipiency, Section 7 was amended in 1950 extending the statute's reach to any "corporation subject to the jurisdiction of the Federal Trade Commission."[9] Since banks were not subject to the Commission's jurisdiction, the prevalent view was that bank mergers had successfully eluded the grasp of the antitrust laws.[10] Congress became increasingly concerned with this problem in the 1950's.[11]

The Federal Deposit Insurance Corporation was created in 1933 to insure depositors against loss resulting from bank failures and to restore public confidence in banks.[12] The Federal Deposit Insurance Act was amended in 1950 and for the first time the FDIC was required to approve all mergers and consolidations between insured and noninsured banks.[13] But the standard for approval was a purely mechanical one without any guidance as to the significance to be attributed to the anticompetitive effects of a proposed union. The upshot of congressional concern over the increasing concentration of banking resources and the absence of standards for the bank supervisory agencies was the short-lived Bank Merger Act of 1960.[14]

b. *The Bank Merger Act of 1960.* The 1960 Act was intended to effect greater control over bank mergers by requiring pre-merger approval by one of the three federal banking agencies. Seven factors were to be balanced by the appropriate agency with no controlling effect given to any one factor.[15] There were six "banking factors": financial history and conditions of each bank, adequacy of capital structure, future earnings prospects, general character of management, convenience and needs of the community to be served, and consistency of a bank's corporate powers with the purposes of the Federal Deposit Insurance Act.[16] The seventh factor was the effect of the transaction on competition. In the interest of uniform regulation and to preserve the integrity of the dual banking system, the Attorney General and the other two banking agencies, Comptroller of Currency and Federal Reserve Board, were required to submit reports on the competitive effects of a proposed merger.[17]

Congress determined that since banks had traditionally been the subject of special regulation and a bank failure was a community disaster, the strict rule of section 7 of the Clayton Act was inappropriate.[18] An anticompetitive merger could be approved under the 1960 Act if, on balance, public interest demanded it.[19]

The 1960 Act not only failed to accomplish its purpose of curtailing the number of bank mergers,[20] but prevented uniform application by the banking agencies because of the absence of guidelines for balancing the seven factors.[21] Then, in a surprising deci-

8. Lifland, The Supreme Court, Congress, and Bank Mergers, 32 Law & Contemp. Prob. 15, 16 (1967).

9. Clayton Act, § 7, 15 U.S.C. § 18 (1964).

10. Comment, The 1966 Amendment To The Bank Merger Act, 66 Colum.L.Rev. 764, 766–67 (1966).

11. United States v. Philadelphia Nat. Bank, 374 U.S. 321, 377, 83 S.Ct. 1715, 10 L.Ed.2d 915 (1963) (Harlan, J., dissenting).

12. Randall, The FDIC: Regulatory Functions and Philosophy, 31 Law & Contemp.Prob. 696 (1966).

13. 64 Stat. 892 (1950).

14. 74 Stat. 129 (1960).

15. S.Rep., *supra* note 6, at 21, 22.

16. S.Rep., *supra* note 6 at 2, 22.

17. S.Rep., *supra* note 6, at 2; H.R.Rep. No.1416, 86th Cong., 2nd Sess. 12 (1960).

18. S.Rep., *supra* note 6, at 20.

19. S.Rep., *supra* note 6, at 20.

20. Comment, *supra* note 9, at 770.

21. Legislation, The 1966 Amendment to the Bank Merger Act: Economic Perspective and Legal Analysis, 20 Vand.L. Rev. 200, 219 (1966).

sion, the United States Supreme Court nullified the Act almost completely.[22]

c. *The Philadelphia Bank Decision.* The draftsmen of the 1960 Act had operated from the premise that Section 7 did not apply to banks. Indeed, the Sherman and Clayton Acts were left intact as Congress sought to provide administrative rather than judicial control over bank mergers.[23] *Philadelphia Bank* undermined both the provisions and the theory of the 1960 Act by holding that Section 7 did apply to bank mergers. The Court criticized the absence of a requirement to give particular weight to the competitive factor in the 1960 Act.[24] A bank merger that violated the antitrust laws could not be saved despite favorable weight attributed to banking factors.[25]

d. *The Bank Merger Act of 1966.* The 1966 Act was a direct response to the *Philadelphia Bank* decision and an attempt to reconcile the goals of the 1960 Act with the antitrust laws. The 1966 Act provides that a single set of standards for bank mergers be uniformly applied by the banking supervisory agencies, the Department of Justice and the judiciary.[26] The standards are the Sherman and Clayton Acts.[27] The exact language of the principal antitrust laws was incorporated into the 1966 Act, not by coincidence, but to draw on the seventy-five year history of their judicial construction.[28]

The Supreme Court's application of the antitrust laws to banks was thus retained, but Congress made an exception for certain bank mergers. If a proposed merger would violate Section 7, the banking factors, represented by "convenience and needs of the community to be served," are to be balanced against the competitive factor.[29] In contrast to the 1960 Act, competition is preeminent.[30] If the anticompetitive effects are outweighed by the convenience and needs of the community, the merger can be permitted.

The requirement of reports from the Attorney General and the two other banking agencies on competitive factors involved was retained to insure uniformity and avoid a particular agency's being either too lenient or too strict.

The Supreme Court has had several opportunities to construe the provisions of the 1966 Act. In United States v. Third Nat. Bank, 390 U.S. 171, 88 S.Ct. 882, 19 L.Ed.2d 1015 (1967), the Court noted that the 1966 Act was designed to make substantial changes in bank merger law. Regarding the application of the 1966 Act, the Court stated:

> We find in the 1966 Act, which adopted precisely that § 7 Clayton Act phrase [substantially to lessen competition] as well as the 'restraint of trade' language of Sherman Act § 1, no intention to adopt an 'antitrust standard' for bank cases different from that used generally in the law. Only one conclusion can be drawn from the exhaustive legislative deliberations that preceded passage of the Act: Congress intended bank mergers

22. United States v. Philadelphia Nat. Bank, 374 U.S. 321 (1963).

23. H.R.Rep., *supra* note 16, at 9.

24. Philadelphia Nat. Bank at 351–52.

25. Philadelphia Nat. Bank at 371.

26. H.R.Rep.No.1221, 89th Cong., 2nd Sess. 1, U.S.Code & Admin.News 1966, p. 1860; 112 Cong.Rec. 2440 (1966) (Remarks of Congressman Smith).

27. 112 Cong.Rec. 2441 (1966) (Remarks of Congressman Patman); Comment, Bank Mergers: A New Standard of Evaluation?, 46 Texas L.Rev. 81, 85 (1967); Edwards, Bank Mergers And The Public Interest: A Legal and Economic Analysis of The 1966 Bank Merger Act, 85 Banking L.J. 753, 756 (1966).

28. 112 Cong.Rec. 2444 (1966) (Remarks of Congressman Reuss); 20 Vand.L.Rev., *supra* note 20, at 223.

29. H.R.Rep., *supra* note 25, at 5; 112 Cong.Rec. 2444 (1966) (Remarks of Congressman Reuss).

30. 112 Cong.Rec. 2441 (1966) (Remarks of Congressman Patman); 112 Cong. Rec. 2444 (1966) (Remarks of Congressman Reuss).

first to be subject to the usual antitrust analysis; if a merger failed that scrutiny, it was to be permissible only if the merging banks could establish that the merger's benefits to the community would outweigh its anticompetitive disadvantages. (at 181–182, 88 S.Ct. at 889).

Although there has been vigorous disagreement on the Court as to whether a particular bank merger violates the antitrust laws, the Justices have been unanimous that Congress intended the two-pronged approach enunciated in *Third National* Bank. United States v. Phillipsburg National Bank, 399 U.S. 350, 353, 90 S.Ct. 2035, 26 L.Ed.2d 658 (1970). *See also Phillipsburg* at 374, 90 S.Ct. 2035 (Harlan, J., dissenting).

III. ANALYSIS.

The scope of our review in this case is limited. There is no dispute that the FDIC acted within the scope of its authority. Therefore, we must determine whether the FDIC's action was arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law. 5 U.S.C. § 706(2)(A). Citizens To Preserve Overton Park v. Volpe, 401 U.S. 402, 416, 91 S.Ct. 814, 28 L.Ed.2d 136 (1971).

The FDIC offers a number of arguments in support of its claims of discretionary power to deny a merger application on the basis of alleged anticompetitive effects which do not violate the antitrust laws of the United States. The FDIC argues: (1) the Bank Merger Act of 1966 did not replace the 1960 Act and thereby divest the banking agencies of any discretion they had under the 1960 Act; (2) the 1966 Act cannot be interpreted so as to make the antitrust laws the sole competitive standards; and (3) the 1966 Act authorizes the banking agencies to consider the convenience and needs of the community in every case, that concept including anticompetitive effects which do not violate the antitrust laws. In light of legislative history and Supreme Court decisions, we disagree.

[1] The principal aim of the 1966 Act was to curtail the discretion of the banking agencies. There had been significant variances in the application by the agencies of the seven factors in the 1960 Act and agency-shopping was feared. Congress sought the uniform application of a single set of standards by both agencies and the courts. Reports from the Attorney General and the two other banking agencies on the competitive factors involved in a merger were to insure uniformity. Acceptance of the FDIC position would make uniformity fortuitous and though it is a possible interpretation of the 1960 Act, would directly contravene the thrust of the 1966 Act.

[2] Legislative history and subsequent Supreme Court interpretation of the 1966 Act indicate that all bank merger applications are first to be subjected to traditional antitrust analysis. If a violation of either the Sherman or Clayton Act is discerned, a balancing of banking factors and anticompetitive effects is made. Congress specified that the antitrust laws be the sole competitive standard not only to insure uniformity, but also to afford the banking agencies a discernible body of law upon which to base their decisions. The FDIC's contention that a competitive standard more stringent than the antitrust laws can be applied is not acceptable.[31] While it is true that the

31. Contrary to the contention of the FDIC, there has been disagreement among the bank supervisory agencies as to the proper application of the Bank Merger Act of 1966. In United States v. First National Bancorporation, 410 U.S. 577, 93 S.Ct. 1434, 35 L.Ed.2d 507 (1973), Northwest Bancorporation, —— Fed.Res.Bull. —— (Feb. 26, 1973) and First Florida Bancorporation, —— Fed.Res.Bull. —— (February 16, 1973), the Federal Reserve Board evaluated the proposed bank mergers in terms of the Sherman and Clayton Acts. In United States v. Marine Bancorporation, Civil No. 237–7102 (W.D.Wash. January 31, 1973), the Comptroller of Currency applied a standard based on the antitrust

1966 Act specifies a stricter competitive standard than the 1960 Act, the overall effect of the 1966 Act is to afford banks special treatment, less rigorous than the dictates of the antitrust laws, by allowing bank mergers where anticompetitive factors are outweighed by banking factors.

Convenience and needs of the community has traditionally been regarded as a banking factor. Congress lifted the term out of prior regulatory legislation for the 1960 Act.[32] By 1966, Congress regarded the traditional banking factors as archaic and substituted "convenience and needs of the community" for all of them in the 1966 Act. Certainly in the broadest sense, the convenience and needs of the community concerns competition.[33] But the history of the bank merger provisions indicates that banking factors and anticompetitive effects are to be separated and balanced against each other.

The final paragraph of § 1828(c)(5) recognizes that the FDIC retains its traditional role of evaluating banking factors. All bank supervisory agencies can reject merger applications if the banking factors are unfavorable whether or not a potential antitrust violation is present. In the case before us the FDIC found the banking factors favorable and improperly rejected the merger on the basis of alleged anticompetitive effects.

[3] The FDIC does not have the power under the Bank Merger Act of 1966 to deny a merger application on the basis of a competitive standard more stringent than the antitrust laws of the United States. The decision of the district court is affirmed.

laws while the FDIC, Federal Reserve Board and Antitrust Division of the Department of Justice advocated a standard more stringent than the antitrust laws. Therefore, not only is there interagency conflict but inconsistent treatment administered by the individual agencies.

Joseph Anthony MEEKS, Appellant,
v.
Walter CRAVEN, Warden, Appellee.
No. 72-2221.

United States Court of Appeals,
Ninth Circuit.
July 20, 1973.

Petition for habeas corpus was denied by the United States District Court for the Northern District of California, Charles B. Renfrew, J., and petitioner appealed. The Court of Appeals, Alfred T. Goodwin, Circuit Judge, held that petitioner was not entitled to relief where judge permitted petitioner to represent himself for purposes of making certain motion and where, in response to question of judge, after motion was denied, as to whether petitioner still wanted to represent himself, petitioner's answer "I think I will" did not constitute the necessary unequivocal demand to proceed pro se.

Affirmed.

Trask, Circuit Judge, concurred and filed opinion.

1. Criminal Law ⟹641.4(1), 1166.11

A defendant has a constitutional right to represent himself, and complete denial of such right in a federal trial is, per se, reversible error.

2. Criminal Law ⟹641.4(1)

Federal statute providing for pro se representation of a defendant has no application to validity of state convictions. 28 U.S.C.A. § 1654.

3. Criminal Law ⟹641.4(1)

An unequivocal demand of a defendant to proceed *pro se* should be, at the

32. Comment, *supra* note 9, at 769.

33. The FDIC can draw some support for its position in several law reviews. Comment, *supra* note 9, at 784–85; 20 Vand. L.Rev., *supra* note 20, at 226–27.

such a requirement in the statute conferring jurisdiction on federal district courts. Probably most accurate, however, is the conclusion that cases dealing with aspects of section 205(g) other than the "final decision" requirement are simply irrelevant to the issue presently before this court.

This court's considered judgment that review by the Appeals Council on the merits of a claim is not, per se, required to establish jurisdiction does not rest upon mere technical subtleties of language and analysis. Rather, it springs from what appears to be one of the first judicial efforts to meaningfully interpret the intent and purpose beneath the "final decision" requirement of section 205(g), 42 U.S.C. § 405(g). After extended deliberation, this court is resolved that that requirement is functionally designed to insure that a claimant has fully explored and exhausted administrative channels of redress before coming to the federal courts. Absent a deliberate effort to disregard or avoid established procedures necessary to efficient and orderly administrative action, no timeliness element can reasonably be inferred from the statutory requirement of a "final decision."

[8] In this case, plaintiff has asserted and the government has acknowledged that an administrative hearing has been conducted, that the Appeals Council has been asked to reverse a decision of a Hearing Examiner, that the Appeals Council has denied relief to plaintiff and explicitly designated the Hearing Examiner's decision as "the final decision of this Department," and plaintiff has promptly moved to secure judicial review of that adverse decision. Given the facts that plaintiff and her counsel have earnestly pressed for full administrative consideration of her claim and that plaintiff has caused no excessive procedural delay as well as all the other facts and circumstances of this case apparent from the record, this court is satisfied that plaintiff has never deliberately bypassed any administrative procedure or body and has not purposely disregarded any administrative rule or regulation. Therefore, defendant's Motion to Dismiss is hereby denied. Defendant shall produce for the court and counsel for plaintiff a complete administrative record so that the court may proceed to review the merits of plaintiff's claim for disability benefits.

It is so ordered.

WASHINGTON MUTUAL SAVINGS BANK
and
Grays Harbor Savings & Loan Association, Plaintiffs,
v.
FEDERAL DEPOSIT INSURANCE CORPORATION, Defendant.
No. 45-71C3.

United States District Court, W. D. Washington.
July 21, 1972.

Suit for declaratory judgment seeking review of decision of Federal Deposit Insurance Corporation denying approval of proposed consolidation of two thrift institutions. The District Court, Sharp, J., held that it was arbitrary to apply a competitive test utilizing the entire state as the relevant geographic market for determining possible antitrust effects of proposed consolidation of the largest thrift institution in the state, which institution has 21 branches, and institution which had approximately 0.15% of statewide deposits in thrift institutions and which did not compete in same geographic market; fact that state banking law would allow acquiring institution to branch statewide did not make the entire state a relevant market. The Court also held that determination that approval of merger might be precedent encouraging statewide concentration of thrift institution resources was arbitrary where institution to be acquired had a serious management succession problem and would have to merge to survive and possibility of acquiring institution branching de novo into the latter's service area was remote due to economic condition of area and present population per institution.

Reversed and remanded.

1. Banks and Banking ⟹503

Judicial review of disapproval of requested consolidation of institutions subject to Bank Merger Act of 1966 is substantially more limited than review of approval; the court should apply the guidelines provided for review under the Administrative Procedure Act. Federal Deposit Insurance Act, § 2 [18] (c), (c) (7) (A), 12 U.S.C.A. § 1828(c), (c) (7) (A); 5 U.S.C.A. § 701 et seq., 706 (2) (A–D).

2. Banks and Banking ⟹503

Judicial review of consolidation of financial institutions under the Bank Merger Act of 1966 is to be made on the entire administrative record that was before the responsible agency. Federal Deposit Insurance Act, § 2 [18] (c), (c) (7) (A), 12 U.S.C.A. § 1828(c), (c) (7) (A); 5 U.S.C.A. §§ 701 et seq., 706(2) (A–D).

3. Monopolies ⟹20

Distinguishing between thrift institutions and commercial banks as separate lines of commerce in assessing competitive effects of bank mergers under the Bank Merger Act of 1966 accords with accepted antitrust principles. Federal Deposit Insurance Act, § 2 [18] (c), (c) (7) (A), 12 U.S.C.A. § 1828(c), (c) (7) (A).

4. Monopolies ⟹20

Where banking activities are the subject of proposed merger or consolidation the relevant market for antitrust purposes is generally defined as the area served by the acquired bank; such limitation is due to the localized nature of banking activities. Federal Deposit Insurance Act, § 2 [18] (c), (c) (7) (A), 12 U.S.C.A. § 1828(c), (c) (7) (A).

5. Monopolies ⟹20

Compliance with established antitrust principles is necessary in passing on requests for merger or consolidations under the Bank Merger Act, first and fundamentally, in order for there to be uniformity between the agencies charged with applying the Act, and, secondarily, in order for businesses to make enlightened decisions in the area of merger transaction. Federal Deposit Insurance Act, § 2 [18] (c), (c) (7) (A), 12 U.S.C.A. § 1828(c), (c) (7) (A).

6. Monopolies ⟹20

It was arbitrary to apply a competitive test utilizing the entire state as the relevant geographic market in determining possible antitrust violations of proposed consolidation of the largest thrift institution in the state, which institution had some 21 branches, and institution which had approximately 0.15% of statewide deposits in thrift institutions and which did not compete in same geographic market; fact that state banking law would allow acquiring institution to branch statewide did not make entire state the relevant market. Federal Deposit Insurance Act, § 2 [18] (c), (c) (7) (A), 12 U.S.C.A. § 1828(c), (c) (7) (A).

7. Banks and Banking ⟹503

Determination that approval of merger of two thrift institutions might be precedent encouraging statewide concentration of thrift institution resources was arbitrary where institution to be acquired had a serious management succession problem and would have to merge in order to survive and possibility of acquiring institution branching de novo into the latter's service area was remote due to economic condition of area and present population per institution. Federal Deposit Insurance Act, § 2 [18] (c), (c) (7) (A), 12 U.S.C.A. § 1828(c), (c) (7) (A).

8. Banks and Banking ⟹563

Where Federal Deposit Insurance Corporation failed to apply relevant factors based on established principles under antitrust laws in denying request for consolidation of two thrift institutions, reviewing court was required to remand notwithstanding that it might have been of the opinion that only proper decision on basis of files and records was approval of consolidation. Federal Deposit Insurance Act, § 2 [18] (c), (c) (7) (A), 12 U.S.C.A. § 1828(c), (c) (7) (A).

Ashley, Foster, Pepper & Riviera, Louis H. Pepper and Richard E. Keefe, Seattle, Wash., Arnold & Porter, John D. Hawke, Jr., Washington, D. C., for plaintiffs.

Karr, Tuttle, Koch, Campbell, Mawer & Morrow, Payne Karr, Seattle, Wash., William E. Murane, Gen. Counsel, J. William Via, Jr., Counsel, F. D. I. C., Washington, D. C., Ford R. Paulson, Regional Counsel, F. D. I. C., San Francisco, Cal., for defendant.

MEMORANDUM OPINION AND ORDER

SHARP, District Judge.

This is a suit for declaratory judgment filed by the plaintiffs, seeking review of a Federal Deposit Insurance Corporation decision denying approval of a proposed consolidation between the two named plaintiffs. The matter is submitted to this court on motions for summary judgment by both plaintiffs and defendant.

[1] The case is one of first impression under the Bank Merger Act of 1966 [12 U.S.C. § 1828(c)], as it deals with *disapproval* rather than approval of a requested consolidation.[1] In the case of an *approved* merger, the reviewing court is specifically required under the Act to review de novo the determination of the responsible agency [12 U.S.C. § 1828(c) (7) (A)]. However, the Act is silent on the method, standards and scope of review where the agency denies a merger. In this court's opinion, the review is substantially more limited and the court should apply the guidelines provided for review under the Administrative Procedures Act (5 U.S.C. § 701 et seq.). As stated by this court in its oral opinion of March 3, 1972, the scope of review is limited to the standards set forth in 5 U.S.C. § 706(2) (A–D), which provides:

> To the extent necessary to decision and when presented, the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action. The reviewing court shall—
>
> . . . . . .
>
> (2) hold unlawful and set aside agency action, findings, and conclusions found to be—
>
> (A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law;
>
> (B) contrary to constitutional right, power, privilege, or immunity;
>
> (C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right;
>
> (D) without observance of procedure required by law;
>
> . . . . . .

These standards were discussed recently by the United States Supreme Court in Citizens to Preserve Overton Park v. Volpe, 401 U.S. 402, 413–415, 91 S.Ct. 814, 822–823, 28 L.Ed.2d 136, 151–152 (1971). There, the court directed the reviewing court to engage in "substantial review," a "thorough, probing, in-

1. The court notes that according to Chairman Sprague of the FDIC, this litigation is welcomed by the FDIC in order to decide certain issues deemed important to future considerations of bank mergers and consolidations, including the question "whether the regulatory agencies may deny merger applications even though violations of Section 7 of the Clayton Act are not found." FDIC News Release, November 6, 1971.

depth review." The reviewing court should first determine whether the responsible agency acted within the scope of its authority, which determination requires a delineation of the scope of that authority and discretion. If the agency acted within the scope of its authority, then the reviewing court must determine whether the choice made was "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A). In making this latter determination,

> . . . the court must consider whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment. *Overton Park, supra*, 401 U.S. at 416, 91 S.Ct. at 823-824.

[2] The review must be based upon the entire administrative record that was before the responsible agency. *Id.* at 420, 91 S.Ct. at 825.[2] From this record, the court must make its determination of the propriety of the FDIC's decision to disapprove the proposed consolidation.

> Although this inquiry into the facts is to be searching and careful, the ultimate standard of review is a narrow one. The court is not empowered to substitute its judgment for that of the agency. *Overton Park, supra*, 401 U.S. at 416, 91 S.Ct. at 824.

With the above standards for review in mind, the court now turns to the application of these standards in the present case.

Washington Mutual Savings Bank is the largest thrift institution[3] in the State of Washington, holding some $744 million in deposits comprising 22.9 percent of the deposits in such institutions. It has its main office in Seattle and operates some 12 branch offices in the Seattle area, and 9 more in various locations throughout the state. Its nearest branch to Grays Harbor Savings & Loan is in Olympia, 50 miles to the east of Grays Harbor Savings & Loan's offices.

Grays Harbor Savings & Loan (S&L) is a small savings and loan institution located in Aberdeen, Washington. It is one of the smallest thrift institutions in the state, having only some $4.7 million in withdrawable balances, or about 0.15 percent of the statewide deposits in thrift institutions. It has no branch offices and is fourth in size out of five thrift institutions, all savings and loans, serving the Aberdeen-Hoquiam area.[4]

On June 10, 1970, Washington Mutual filed with the FDIC an application for approval of its proposed consolidation with Grays Harbor Savings & Loan. Shortly thereafter, as required except in exceptional circumstances by 12 U.S.C. § 1828(c) (4), the FDIC requested reports on the competitive factors involved in

2. In response to a prior discovery motion of plaintiffs, this court, over the objection of the FDIC, required disclosure of nearly all of the record which was before the FDIC at the time of its consideration of this application. The court reasoned that it would be impossible to determine whether the Board considered all of the relevant factors without examining the material the Board considered. This record, consisting of a so-called "public file" and an "internal file," will be referred to herein by the initials "PF" and "IF" respectively.

3. Thrift institutions, as used in the context of this opinion, refers to mutual savings banks and savings and loans, as opposed to commercial banks.

4. Comparative market shares of thrift institutions serving the Aberdeen-Hoquiam market area:

	Deposits	Market Percent
1. Aberdeen Fed. S & L	$30 million	47.1%
2. 1st Fed. S & L of Aberdeen	17 million	26.7
3. 1st Fed. S & L of Hoquiam	9 million	14.1
4. Grays Harbor S & L	4.7 million	7.4
5. Capitol S & L	3 million	4.7

the proposed consolidation from the Attorney General, the Federal Reserve Board, and the Comptroller of the Currency. Each of these agencies submitted its report as requested, none finding any significant anticompetitive factors, either present or potential.[5] For example, the Comptroller of the Currency stated in his report:

> The size of the Grays Harbor Savings and Loan Association is its basic limiting factor as a competitive force. The addition of $4.6 million in assets to the charter bank will have no significant effect on concentration of banking resources in the state. The effect of the consummation of the proposed transaction will be in the Aberdeen-Hoquiam area where it will introduce a bank more able to compete with the other institutions in the area and better able to meet the needs of the community. PF at 60.

The State Supervisor of Banking for the State of Washington submitted his approval of the proposed consolidation agreement on August 14, 1970. PF at 92. Competing institutions were contacted by the FDIC Examiner in Charge, and no adverse comment received.

As the FDIC (unlike the Comptroller of Currency) provides no hearing procedure, the processing of proposed consolidations or mergers consists of staff investigations, with recommendations to the Board of Directors of the corporation. These findings and recommendations seem particularly important when there is no opportunity for interested parties to be heard. In his investigation report, the Examiner in Charge for the FDIC stated:

> . . . Its already significant share of the state mutual savings bank business would not be materially affected by this proposal. The resulting bank would be the smallest unit of the thrift institutions in the Aberdeen-Hoquiam service area. The proposed consolidation would have no adverse effect on competition. IF at 19.

Further, he states:

> The resulting bank would make available to the residents of the Grays Harbor area certain types of time deposits not presently offered by S&L. Also, other loans and services not being provided by S&L, either by design or statutory limitations, would be available at the resulting bank. The residents of the Grays Harbor area should benefit from more aggressive management responsive to the needs of the community. IF at 16.

In conclusion, the Examiner recommended the application be approved, and the regional director for the FDIC concurred in his recommendation.

The FDIC Division of Research, in recommending approval and finding that positive benefits as to the convenience and needs of the community to be served would result from the merger, stated:

> Merger of the applicants would have a positive effect in terms of convenience and needs and other banking considerations. Most importantly, a savings bank with its full line of services and higher limits on time deposit interest rates would operate in the Grays Harbor market for the first time. In addition, the management succession problem which presently exists for Grays Harbor Savings and Loan would be eliminated. IF at 29.

On November 9, 1970, the FDIC Board of Review voted in favor of approval of the proposed consolidation, submitting a proposed order to the Board for its approval.

The Board of Directors for the FDIC issued its order December 18, 1970, denying approval of the proposed merger.[6]

5. References to reports from other agencies as contained in FDIC General File:

Attorney General	Page 59
Comptroller of Currency	Page 61
Federal Reserve Board	Page 54

6. Two of the three members of the Board voted on the application. The third member (The Comptroller of Currency) abstained inasmuch as his approval, as quoted above, had already been registered.

In its opinion, after finding that the proposed consolidation would not eliminate any meaningful competition but could eliminate some potential competition by de novo branching of Washington Mutual into the Grays Harbor service area, the FDIC states:

> More importantly, the proposed merger would establish a significant precedent for the approval of additional mergers in highly concentrated markets in the State of Washington and elsewhere, among commercial banks as well as mutual thrift institutions, with the cumulative effect of further concentrating the banking resources of a given market in the largest institutions which operate there. As such concentration continues, the public's choice of alternate sources of banking services is likely to diminish. Given the fact that Washington Mutual is more than three times the size of the next largest thrift institution in the State and that it already controls 22.9 percent of total thrift institution deposits on a Statewide basis, approval of the proposed merger could easily lead to other merger proposals on the part of Washington Mutual to extend its branch system into new areas by the merger route rather than by the establishment of de novo branches, thus losing successive opportunities for increasing the public's choice of banking alternatives in each area. A denial of the proposed merger, on the other hand, would encourage S&L to seek out a different merger partner from among the State's 73 other mutual thrift institutions, thereby also preserving the possibility of more effective competition against Washington Mutual in the future from among the State's other thrift institutions. PF at 104.

Thereafter, on December 29, 1970, Washington Mutual sent a letter request to the FDIC for reconsideration. On January 6, 1971, a similar request was made by Grays Harbor Savings & Loan. Subsequently, the FDIC granted Washington Mutual the opportunity for an oral presentation of its application for reconsideration. An informal hearing was held, during which presentations were made by certain officers of the two banking institutions, and written memorandums were submitted by the Washington State Supervisor of Banking.

On July 30, 1971, the FDIC issued its opinion again denying approval of the proposed consolidation. In this second opinion, the FDIC discussed the "line of commerce" question distinguishing between "thrift institutions" and "commercial banks." It also withdrew part of its prior decision, acknowledging there was little likelihood of Washington Mutual's branching de novo into the Grays Harbor service area due to the area's slow growth and present population per banking institution. The opinion then acknowledges that this fact was not the reason for the denial of approval, but, in fact, the main reason was that the merger would be a significant precedent for the approval of other mergers in highly concentrated markets, as quoted above from the first opinion.

August 27, 1971, the complaint in the present action was filed seeking judicial review by declaratory judgment of the actions of the FDIC.

The authority of the FDIC to approve or disapprove consolidations or mergers between certain insured banking institutions is provided by the Bank Merger Act of 1966, 12 U.S.C. § 1828(c) (2), which provides:

> No insured bank shall merge or consolidate with any other insured bank or, either directly or indirectly, acquire the assets of, or assume liability to pay any deposits made in, any other insured bank except with the prior written approval of the responsible agency, which shall be—
>
> . . . . . .
>
> (C) the Corporation if the acquiring, assuming, or resulting bank is to be a nonmember insured bank (except a District bank).

Washington Mutual Savings Bank is a nonmember insured bank.

Section (c) (5) of the Act provides:

The responsible agency shall not approve—

(A) any proposed merger transaction which would result in a monopoly, or which would 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, or

(B) any other proposed merger transaction whose effect in any section of the country 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 it finds that the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served.

In every case, the responsible agency shall take into consideration the financial and managerial resources and future prospects of the existing and proposed institutions, and the convenience and needs of the community to be served. 12 U.S.C. § 1828(c)(5).

This Act was passed in 1966, and amended, in fact replaced, the Bank Merger Act of 1960. The purpose of the 1966 Act, as stated in the House Committee Report #1221, 1966 USCAAN 1860:

Your committee has attempted to furnish both the agencies and the courts with more definite guidelines for dealing with the foregoing problems. Existing law (the sixth sentence of sec. 18(c) of the Federal Deposit Insurance Act) provides that in the case of a merger transaction the "agency shall also take into consideration (in addition to the so-called banking factors) the effect of the transaction on competition (including any tendency toward monopoly) and shall not approve the transaction unless, after considering all such factors, it finds the transaction to be in the public interest."

The intended legal effect of the bill is to modify the foregoing provision in three respects:

First, it is intended to make clear that no merger which would violate the antimonopoly section (sec. 2) of the Sherman Antitrust Act may be approved under any circumstances.

Second, the bill acknowledges that the general principle of the antitrust laws —that substantially anticompetitive mergers are prohibited—applies to banks, but permits an exception in cases where it is clearly shown that a given merger is so beneficial to the convenience and needs of the community to be served—recognizing that effects outside the section of the country involved may be relevant to the capacity of the institution to meet the convenience and needs of the community to be served—that it may be in the public interest to permit it.

Third, the bill provides that this rule of law is to be applied uniformly, in judicial proceedings as well as by the administrative agencies. 1966 USCAAN at page 1862.

Congress, in enacting the bill, was concerned with the applicability of antitrust law to bank mergers, and the Act was aimed at delineating the scope of their application, with emphasis on consistency between the various arms of government dealing with such mergers. Congressman Reuss of the Committee on Banking and Currency, in explaining the purpose and intent behind the 1966 Act, stated:

The inclusion of the very language used in the Clayton Act section 7, and the Sherman Act section 1, in H.R. 12173 was not merely a coincidence. This language was intentionally used so as clearly to indicate to the bank supervisory agencies and to the courts that the antitrust standards which have been developed over the last 75 years on the basis of case law definition of these statutory provisions are intended to be incorporated in the application of the proposed act. We are not establishing new standards which depart from well developed antitrust standards. We are, on the contrary, stating that these antitrust standards should continue to apply to bank mergers . . .

> . . . this bill would make the competitive factor as defined by the antitrust laws, the primary factor to be used both by the bank supervisory agencies and the courts in determining whether to approve a merger. 112 Cong.Rec. at page 2444.

It is apparent from the opinions of the FDIC that it has determined it has the authority to devise tests of the anticompetitive effects or "implications" of a merger never contemplated by the Congress in enacting this legislation, nor by the courts in their 75 years of devising standards applicable to antitrust. As the Supreme Court stated two years after the 1966 Amendments:

> Only one conclusion can be drawn from the exhaustive legislative deliberations that preceded passage of the Act: Congress intended bank mergers first to be subject to the usual antitrust analysis . . . . United States v. Third National Bank in Nashville, 390 U.S. 171, 182, 88 S.Ct. 882, 889, 19 L.Ed.2d 1015, 1024 (1968).

The FDIC's determination was ostensibly aimed at what it considered a necessary basis for curtailing possible anticompetitive tendencies in their incipiency, which is precisely the direction in which antitrust principles under the Clayton Act, § 7, are aimed:

> Having determined the relevant market, we come to the ultimate question under § 7: whether the effect of the merger "may be substantially to lessen competition" in the relevant market. Clearly, this is not the kind of question which is susceptible of a ready and precise answer in most cases. It requires not merely an appraisal of the immediate impact of the merger upon competition, but a prediction of its impact upon competitive conditions in the future; this is what is meant when it is said that the amended § 7 was intended to arrest anticompetitive tendencies in their "incipiency." United States v. Philadelphia National Bank, 374 U.S. 321, 362, 83 S.Ct. 1715, 1741, 10 L.Ed.2d 915, 944 (1963).

These standards were placed in the act to insure compliance by the banking industry with the policies embodied in the antitrust laws, with an exception allowed due to recognition of the type of industry which banking is and the effect of bank failures on the communities served. The banking agencies have no peculiar expertise in the area of competition and antitrust. Their area of expertise is in what is termed the "banking factors," i. e., convenience and needs of the community to be served and the strength and ability of the banks in that community to serve those needs. In this regard, while the Board found the financial and managerial resources and future prospects of both institutions consistent with approval, the Board opined that these factors are outweighed by its determination as to anticompetitive effects of the merger.

> The Corporation has reviewed again and reaffirms its earlier findings on the benefits to the public which may be expected to occur if this application is approved and also its findings with respect to S & L's management succession problem. It continues to differ with the applicants as to the weight which should be assigned these findings in reaching an overall conclusion on the application. PF at 243.

The Bank Merger Act of 1966, as did the Act of 1960, provides that "[in] the interests of uniform standards" the responsible agency will request reports on the competitive factors involved in the proposed merger from the other two banking agencies and the Attorney General. In the legislative history behind this provision in the 1960 Act, it was stated:

> Your committee agrees that every effort must be made to avoid a situation where one Federal agency is "tough", about mergers and another one is "easy", where there might be an inducement to arrange mergers so as to result in the kind of bank where approval could be easily obtained. To help guard against this kind of development, the bill provides that the agency having jurisdiction over a proposed merger shall request a report from the other two banking agencies on the competitive factors involved, unless it must act immediately to prevent a bank failure . . . 1960 USCAAN 1995, 2005.

Common sense dictates that the only way to have uniform application of the Act to the mergers sought is to apply uniform standards, which standards were set forth by Congress in this instance as the standards embodied in the antitrust laws. When an agency applies entirely unprecedented standards, having no basis in logic or reason, as in this case, uniformity of standards, and their application, is impossible.

[3] In its statement on reconsideration, the FDIC dwells initially with the "relevant line of commerce," distinguishing between "thrift institutions" and "commercial banks" as separate lines of commerce. In this determination it relies upon the decisions of the Supreme Court closest to the subject. These cases have held that commercial banks are a distinct line of commerce from thrift institutions in assessing the competitive effects of bank mergers. Such delineation is generally accepted due to the differences in services offered by the two types of institutions and different regulations controlling their activities and lending limits. United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 83 S.Ct. 1715, 1737, 10 L.Ed.2d 915 (1963); United States v. Phillipsburg Nat'l Bank, 399 U.S. 350, 90 S.Ct. 2035, 2041–2042, 26 L.Ed.2d 658 (1970). These determinations by the agency were based on accepted antitrust principles and will not be disturbed by this court.

[4–7] However, without apparent reason, the FDIC proceeded to apply its competitive test utilizing the entire State of Washington as the relevant geographic market affected by the proposed consolidation. There may well be situations in the antitrust context in which an entire state is the relevant market area affected. However, where banking activities are involved the relevant market has generally been defined as the area served by the acquired bank due to the localized nature of banking activities. U. S. v. Phillipsburg Nat'l Bank, *supra*, 399 U.S. at 359–362, 90 S.Ct. at 2041–2042; U. S. v. Philadelphia Nat'l Bank, *supra*, 374 U.S. at 357–358, 83 S.Ct. at 1738. The mere fact that Washington State banking law would allow Washington Mutual to branch statewide does not make the entire state the relevant market.

> Permissive statewide branching merely extends the political boundaries in which a bank may open branches, local units, to operate in local markets. It does not bring to any particular bank or banking unit depositors or borrowers from all over the state. "Individuals and corporations typically confer the bulk of their patronage on banks in their local community; they find it impractical to conduct their business at a distance." [citing Philadelphia, *supra*]. United States v. Crocker-Anglo National Bank, 277 F.Supp. 133, 173 (N.D.Cal.1967).

The effect of the FDIC opinion in this case is that Washington Mutual may not, by "foothold" acquisition, offer its services to customers in the Grays Harbor Savings & Loan service area because it might be a precedent encouraging statewide concentration [7] of thrift institution resources.[8]

The record before the Board contains data for a further breakdown of the relevant market concentration. 1970 figures show that of Washington Mutual's $740.1 million market share, it derived $643.1 million from the Seattle-Everett service area, or approximately 87 percent of its statewide deposits.[9] Statewide, exclusive of the Seattle-Everett area, Washington Mutual holds only 6.5 percent of deposits in such institutions, and Grays Harbor Savings & Loan, which has no market area outside the Aberdeen-Hoquiam area, has 0.3 percent. The merger of the two would then raise Washington Mutual's share of this market to 6.8 percent. These figures show the inaccuracy and unreasonableness of applying simple gross percentages to determine market concentration and competitive effect. While it is true that Washington Mutual is the largest thrift institution in the state with 22.9 percent of the deposits, this figure by itself does not truly indicate the competitive impact of Washington Mutual on the thrift institution markets in the State of Washington.

> . . . We pointed out in *Philadelphia Bank*, *supra*, at 362, that a prediction of anticompetitive effects "is sound only if it is based upon a firm understanding of the structure of the relevant market; . . ." U. S. v. Phillipsburg Nat'l Bank, *supra*, 399 U.S. at 365–366, 90 S.Ct. at 2044.

It is therefore the opinion of this court that the FDIC failed to take into account truly relevant factors upon which a rational opinion as to competition could be based in line with the established principles of antitrust law as written by Congress into the Bank Merger Act. Such compliance with established principles is necessary, first and fundamentally, in order for there to be uniformity between the agencies charged with the responsibility of applying the provisions of the Act, and, secondarily, in order for businesses to make enlightened decisions in the area of such merger transactions.

In addition, even were this court to accept the relevance of the statewide percentages used by the FDIC, the

7. One of the bases for the FDIC opinion is that there exists a highly concentrated market in the State of Washington. Market concentration is relative to establishment of the relevant market affected by such merger. The merger in this instance would be what is termed a conglomerate merger, since the two institutions are not actual competitors and are in different geographic markets. (Neither has any real services extending into the product area of the other.) The concern becomes one then of "potential competition" under Department of Justice merger guidelines, and this one is far below any set up by that agency. Note: Dept. of Justice Merger Guidelines, set forth in part 9, pages 20–23, of Plaintiffs' Exhibits to Memorandum.

8. Counsel for the FDIC stated to this court on oral argument that the net effect of this decision is that Washington Mutual is precluded from any further mergers, except in dire circumstances of imminent collapse, because it is the largest thrift institution in the state. The only conclusion to be drawn from this statement is that in the eyes of the FDIC, "bigness" is per se "bad," and this, in itself, is *the* relevant factor in determining merger applications.

9. As shown on the map included as a part of the required information on the application for the merger to the FDIC, Washington Mutual's branches are located in certain defined areas:

1.	Seattle proper	Eight (8) offices
2.	Bellevue	One (1) office
3.	Renton	One (1) office
4.	Auburn	One (1) office
5.	Federal Way	One (1) office
6.	Everett	One (1) office
7.	Spokane	Three (3) offices
8.	Pullman	One (1) office
9.	Yakima	One (1) office
10.	Grandview	One (1) office
11.	Kennewick	One (1) office
12.	Vancouver	One (1) office
13.	Olympia	One (1) office

Of the above set-out locations the first six would comprise the Seattle-Everett area, making thirteen offices in the one area. The Spokane area has three offices, and the remaining six offices are spread throughout the state.

rationale of its opinion escapes this court. The opinion states that:

> . . . approval of the proposed merger could easily lead to other merger proposals on the part of Washington Mutual to extend its branch system into new areas by the merger route rather than by the establishment of de novo branches, thus losing successive opportunities for increasing the public's choice of banking alternatives in each area. . . . PF at 104.

This statement, incorporated in both the original and final opinions of the FDIC, not only disregards its own continuing control over future merger proposals, but overlooks the facts in this case. The Board, as well as everyone else concerned, recognizes that Grays Harbor Savings & Loan has a serious management succession problem and will undoubtedly have to merge with another institution to relieve the difficulty. Therefore, whether this application is granted or denied, there is going to be one less thrift institution in the State of Washington and the same number in the Aberdeen-Hoquiam area. The Board, in its second opinion, recognizes that the possibility of Washington Mutual branching de novo into the Grays Harbor service area is quite remote due to the economic condition of the area and its present population per institution. To claim, then, that the approval of this merger would be a significant precedent for future mergers is not logical, since this is not a case of de novo branching versus merger, but a case where the only potential realistic possibility is the entry of some outside firm by merger with S & L. In future situations which may arise, de novo branching may be an actual viable possibility, which raises the question of potential competition and may be dealt with under established antitrust principles. A determination such as the Board's in this case must be set aside as arbitrary where there is no logical connection between the facts and the conclusions reached and where the reasoning behind the decision is without a truly rational basis.

The only question remaining at this point is the proper remedy. Plaintiffs assert that this court should issue its order compelling the FDIC to approve the merger, pointing out that the record is thorough and complete, and the Board has already found, from its review of the banking factors, that the area concerned would benefit from a merger. The FDIC contends the proper remedy is to remand to the agency for consideration of the proposed consolidation in conformity with the opinion of this court.

The guiding principle, as stated by the Supreme Court, is

> that the function of the reviewing court ends when an error of law is laid bare. At that point the matter once more goes to the [agency] for reconsideration. FPC v. Idaho Power Co., 344 U.S. 17, 20, 73 S.Ct. 85, 87, 97 L.Ed. 15, 20 (1952).

The court's decision in this case is based primarily upon the failure of the FDIC to apply relevant factors based on established principles under the antitrust laws, as intended to be applied by the Congress in enacting the Bank Merger Act.

[8] While this Court may be of the opinion that only one decision is proper on the basis of the files and records relevant to a determination in this case, it is not the province of a reviewing court to make the final judgment once the law is determined. Instead, the remedy is to remand the matter to the responsible agency for determination in light of the court's construction of the governing legal principles.

1978 FEB 23 AM 9 51

OFFICE OF THE EXECUTIVE VICE PRESIDENT-ECONOMIST

March 17, 1978

Honorable William Proxmire
Room 5241
Dirksen Senate Office Building
Washington, D. C. 20510

Dear Senator Proxmire:

RE: S. 72 - The Competition in Banking Act

The Conference of State Bank Supervisors appreciates the opportunity to comment on several aspects of the above bill. The interest o the Conference arises in part from the fact that certain sections of the bill would undermine the authority of the states, including state banking departments to establish policy on matters of diverse local interest without a showing that overriding national considerations warrant such action.

For the sake of brevity, the Conference would like to focus on the following three provisions of the bill which cause considerable concern to the Conference whose supervisory members constitute the primary chartering and examination authority of the Nation's nearly 10,000 state-chartered commercial and mutual savings banks.

(1) The 20 Percent Limitation

The bill s prohibition against any merger or bank holding company acquisition that would result in a single banking institution controlling more than 20 percent of the banking assets in one state appears to be motivated by two assumptions: first, that there is an unhealthy, nationwide trend toward concentration in the banking industry and second that a single, arbitrarily selected percentage limitation is appropriate for all states.

Both assumptions appear weak. The second assumption seems particularly unfounded, because it is clear that banking cond tions and the public interest differ substantially from state to state Because of th s some states have deemed it desirable to place diverse percentage limitations on bank expansion (e.g., Tennessee, Iowa,

1015 EIGHTEENTH STREET, N.W. • WASHINGTON, D.C. 20036 • (202) 296-2840

MAR 2 3

Missouri, New Hampshire and New Jersey). To the extent these standards conflict with the 20 percent federal limitation proposed in this bill, these states' actions would presumably be overridden. In other states, out-of-state banks have a significant share of the banking business and render any statewide limitation meaningless. In any event, statewide concentration figures are not necessarily relevant measures of banking competition.

The law as it presently exists allows states in a meaningful way to influence and control their own banking structures, based upon local conditions and the local public interest. CSBS believes this situation is desirable and should not be altered in such a way as to dilute state authority or to permit the federal bank regulatory authorities to determine the banking structure in a state. It is the position of CSBS that state banking authorities as the primary regulators of state-chartered banks should make banking structure decisions, including subject percentage limitations, with respect to banks they charter.

(2) The Power to Deny "Anti-Competitive" Mergers and Acquisitions Not Violative of Specific Statutory Controls

This proposal, as set forth in Section 201, would grant extraordinary powers to the federal banking agencies and, to a greater extent even than the 20 percent limitation, would undermine the ability of states to regulate their banking structures.

A useful illustration of the problems which could arise under this proposal is contained in the factual background of the well-known Washington Mutual case. Washington Mutual Savings Bank v. Federal Deposit Insurance Corporation, 482 F.2d 459 (9th Cir. 1973). That case involved a proposed merger between Grays Harbor Savings and Loan Association, the smallest of four thrift institutions in the Aberdeen-Hoquiam area of Washington, and the Washington Mutual Savings Bank, which is headquartered 80 miles away in Seattle. Grays Harbor was typical of many small financial institutions in the country which face acute management problems at the end of their first generation of operations. Its two executive officers had been with the institution since its founding in 1924, and neither officer wished to continue in an active management role. For this reason, and because he deemed the merger pro-competitive, the Supervisor of Banking in Washington approved the merger.

The FDIC's regional officials on the West Coast reached conclusions consistent with those of the Washington Banking Department, and five of eight members of the FDIC's staff-manned board of review in Washington concurred. The FDIC Board, however, denied the Grays Harbor application on the ground that, while it did not violate the Sherman and Clayton Act standards embodied in the Bank Merger Act, it was potentially anti-competitive. This action barred the merger, which state and regional officials had deemed to be in the public interest, until the Court of Appeals for the Ninth Circuit stepped in to reverse the FDIC's action. The ground for the Court's decision was that the FDIC had exceeded its statutory authority.

Sections 101 and 201 would now remove all limitations on the authority of the federal banking agencies in acting upon merger and acquisition applications. If enacted, the proposed amendments inevitably would lead to the kind of anomalous situation evidenced in Washington Mutual--where federal regulators in Washington, D.C. sought to displace the judgment of state officials on an issue of local banking structure.

(3) Power to Regulate Bank Capital Indirectly Through Holding Company Regulation

For several years the Federal Reserve Board has sought, with varying degrees of success informally to regulate bank capital through its regulation of holding companies. This effort to usurp the authority of the primary regulators (i.e., the Comptroller and the state bank supervisors) has clearly been disruptive of the efforts of the primary regulators, and beyond the authority of the Board.

This overreach by the Fed was a principal point in the First Lincolnwood Corporation case. First Lincolnwood Corp. v. Board of Governors of the Federal Reserve System, 560 F.2d 258 (7th Circuit) (1977). This case involved a proposed acquisition by the First Lincolnwood Corporation, an Illinois corporation, of 80% of the stock of the First National Bank of Lincolnwood, Illino Because the Board was concerned over a possible weakened capital position of the Bank a ter acquiring the Bank's stock, and limitations upon First Lincolnwood's ability to resolve "any unforeseen problems that may arise at Bank" the Board denied the proposa as not being in the public interest.

The Court noted in this case that the proposed acquisition did not tend to undermine the financial structure of the bank nor was there any anticompeting tendency present. The Court in setting aside the denia by the Board of the acquisition of the Bank and First Lincolnwood ruled that

> But we do not find any indication that Congress meant the Board to go beyond this inquiry, and to consider questions of bank soundness and public need apart from how these would be altered by formation or enlargement of a bank holding company. These matters were already reserved to the Comptroller of the Currency in the

case of national banks, or to various state agencies in the case of local banks. (Underlining added)

Section 501 now proposes formally to extend to the Board authority to do what it has unsuccessfully sought to do in the past in this area. The Conference of State Bank Supervisors is supportive of the above judicial decision that the authority to regulate the capital of banks does now, and should continue to reside with the primary regulators of banks, the Office of the Comptroller of the Currency for national banks and state banking departments for state-chartered banks.

Sincerely,

Lawrence E. Kreider
Executive Vice President-Economist

LEK:drj

National Consumer Law Center Inc.
Eleven Beacon St.
Boston, MA 02108
(617) 523-8010

1978 APR 22 PM 4:01

Mark E. Budnitz
Executive Director

Robert A. Sable
Deputy Director

April 19, 1978

Senator William Proxmire
Chairman
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

I am very troubled by the failure of the Federal Reserve Board to administer the Bank Holding Company Act appropriately as it concerns the activity of selling or underwriting consumer credit insurance. I am well aware of your longstanding interest in credit insurance and the Federal Reserve Board. Therefore I hope you will do whatever you can to stop the Board's outrageous practice of sanctioning millions of dollars in credit insurance overcharges.

As you know, the Board is called upon from time to time to approve bank holding company activities of reinsuring credit insurance policies or of selling credit insurance as an agent or broker in connection with the extension of consumer credit. These activities can be approved only after the Board considers whether they will benefit the public. Nevertheless, the Board routinely approves applications to engage in these activities in which no public benefit exists and which actually exacerbate overcharging practices.

The worst examples of improper Board practices include the following:

1. The Board approves credit insurance rates that sometimes are among the highest in the country although insurance is readily available at much lower rates. In many instances the same holding company (through its subsidiaries) may already be selling credit insurance at lower rates at a very healthy profit. In <u>all</u> instances, highly reputable insurance companies in the market can provide the same coverage at less cost. The Board does not even require a justification of the excessive rates.

2. The Board makes no inquiry into competitive rate structure, the phenomena of reverse competition, the tie-in nature of the product, creditor benefits, or consumer benefits and nevertheless routinely approves application which promise the sale of credit insurance at only 3% to 13% below statutory maxima. Yet it is hardly a public benefit to sanction such overcharging on the grounds that it is negligibly less excessive than before. In fact, the application generally promises an expansion of business so that more, not less, overcharging is forecasted.

3. The Board routinely sanctions credit insurance rates generating loss ratios of 20% to 40%. This means that 60% to 80% of each premium dollar is absorbed by the creditor or insurer instead of paid as benefits to the purchaser! The National Association of Insurance Commissioners has recommended a minimum 50% loss ratio, and since the several states have established substantially higher ratios.

4. The Board never requires a showing that the applicant has made any effort whatsoever to provide credit insurance at lower cost to the consumer. When the Board amended Regulation Y to permit bank holding companies to act as insurance agent or broker in connection with consumer credit, it explicitly expressed the "expectation" that the company will "exercise a fiduciary responsibility...by making its best effort to obtain the insurance at the lowest practicable cost to the customer." Yet traditionally no such showing of any kind has been required. In fact, much lower cost insurance is readily available in the market and frequently within the bank holding company structure itself.

5. The Board always approves without discussion the sale of excess, unneeded, non-usable insurance. For example, since consumers have little range of choice in credit insurance matters, bank holding company subsidiaries regularly sell credit insurance not only on the amount of the loan but also on the unearned finance charge and on the premium itself. The consumer reasonably believes he is buying only the coverage necessary to pay off the debt. He has no use for insurance on unearned charges. If the consumer dies, the "pay off" is always computed by subtracting the unearned interest from the total of unpaid payments. The sale of insurance on unearned charges can drastically raise the cost of credit insurance without any increased benefit to the customer.*

---

*While the Board has forbidden the sale of level term insurance on installment credit because the excess coverage is unrelated to the extension of credit, it apparently has never addressed other more pervasive forms of excess insurance.

I am aware that from time to time you consider new legislative approaches which are needed to correct the abuses associated with credit insurance. However, the Federal Reserve Board presently has the authority and the responsibility to address some of these problems as they occur among the activities of bank holding companies. This constitutes a large segment of national credit insurance business. So far the Board has failed to exercise its authority in this regard in a responsible manner and must share the blame for millions of dollars of credit insurance overcharges each year.

I hope that you can obtain the proper administrative attention from the Board which those credit insurance activities require. Because the abuses are so commonplace and expensive it is a matter of some urgency. Thank you for your attention.

Sincerely,

Willard P. Ogburn

WPO:jsz

BEFORE THE BOARD OF GOVERNORS OF THE

FEDERAL RESERVE SYSTEM

In re: Application of Manufacturers Hanover Corporation for Prior Approval on Acquisition to Acquire First Credit Corporation and First Credit Corporation of Georgia	)))))	SUPPLEMENTAL FILING IN SUPPORT OF PROTEST BY GEORGIA LEGAL SERVICES PROGRAM, INC

Of Counsel:
WILLARD P. OGBURN
National Consumer Law Center
Eleven Beacon Street
Boston, Massachusetts
Tel. 617-523-8010

PAUL E. KAUFFMANN
Georgia Legal Services
Program, Inc.
P.O. Box 176
Columbus, Georgia 31902
Tel. 404-571-7456

INTRODUCTION

On November 1, 1977, Georgia Legal Services Program, Inc. (Protestant) protested the application of Manufacturers Hanover Corporation (Applicant) to acquire First Credit Corporation and First Credit Corporation of Georgia. At the same time Protestant submitted a statement of facts to be elicited from the Applicant. Since then counsel has informed Protestant by telephone that it is Applicant's position that Protestant has raised no issues requiring Board action, and that as a result of taking this position, did not believe at that point it would be in a position to supply Protestant with any information regarding this matter. Since that telephone conversation, a letter was sent to Applicant making Protestants request for information more direct and specific but no response has been recieved by Protestant as of this date. The information requested is essential to establish the extent of any public benefit (or lack of public benefit) and possible adverse effects arising from the proposed application pursuant to 12 U.S.C. §1843(c)(8)(§4(c)(8)). Protestant reserves all rights to seek access to information within control of Applicant relevant to to application. A renewed request for a hear ing is also being submitted seperately. In the meantime, Protestant sets forth herein for protesting this acquisition on the basis of information publicly available[1] so that the Board may act accordingly. As noted in the Protest, information available to Protestant concerns First Credit Corporation of Georgia only. Similar information concerning the North Carolina company should be available to the Board.

PROTEST

The Application in its present form should be denied. The public benefits claimed for the proposed application are illusory and in some instances constitute a continuation and exacerbation of detrimental practices. In proposing to engage in consumer financing activity, the applicant claims greatly increased efficiency and plans to increase the amount of total outstanding loans which is nearly risk free but proposes no reduction in the cost of credit to consumers. In proposing to offer to sell credit insurance coverages as an agent and to underwrite such insurance as reinsurer, the applicant plans a continuation and expansion of patterns of overcharging and overreaching. Moreover, Applicant has ignored entirely the Board's expectation that applicant "make its best effort to obtain the insurance at the lowest practicable cost to the customer." 36 Fed. Reg 15525 (August 17, 1971). Finally, there is enough evidence to suggest staff inquiry into applicants intent and ability to effectuate the reductions of rates pledged in the application.

I. The Applicant Will Not Reduce Finance Charges Despite Projected Savings.

The application is based in large part on the promise that the proposed acquisition will result in a substantially mor efficient consumer loan operation in Georgia. The efficiency presumably will arise from an increase in the size of the average loan, an increase in the volume of business, and an infusion of economic resources from Ritter Financial Corporation(Ritter). These savings are, of course, cited as a public benefit, so one might expect that they would be passed on to the customer in the form of reduced Finance Charges. In fact, the applicant does promise to lower rates by 4% in North Carolina. However, although the efficiencies planned for the Georgia offices are described in the exact same language as those for the North Carolina Offices, no reduction of finance charges is anticipated in Georgia. No explanation is offered for the failure to allow Georgia consumers the benefit of savings arising from the proposed acquisition in the form of reduced credit charges.

Moreover, industrial loan finance charges in Georgia are amoung the highest in the country. Applicant has pledged itself to a small (4%) reduction of charges in every other state in which Ritter does business. 1975 F. R. Bulletin 42 (Dec 10, 1974). Maximum statutory rates in eaxh of those states is substantially lower than Georgian rates. (Chart on following page)[2] Nevertheless, no public benefit in the form of less expensive credit will accrue to Georgia consumers from the proposed application, and no explanation is provided for the proposed continuation of the very high loan rates. In this respect the application is deficient.

The Applicant apparently plans to continue financing certain nearly risk free portions on consumer loans at maximum rates. When a creditor such as Ritter sells credit insurance to consumers, the entire cost of the insurance is added to the amount of the loan and financed at the same very high (in Georgia) rates. High rates for small consumer loan companies are justified

MAXIMUM SMALL ONE YEAR LOAN ANNUAL PERCENTAGE RATES
IN GEORGIA AND STATES WHERE RITTER DOES BUSINESS

Amt. of Loan	Georgia Ind. Loan	Connecticut Ind. Bank	Connecticut Small Loan	New Jersey	North Carolina	Pennsylvania	Virginia Ind. Loan	Virginia Add-on	West Virginia Ind. Loan	West Virginia Small Loan
$200	43.41%	16.25%	30.03%	24.00%	36.00%	24.16%	14.61%	30.03%	16.25%	36.00%
500	37.47	15.34	25.94	24.00	32.45	23.78	14.65	30.03	15.72	31.14
1000	30.98	13.45	22.84	23.42	26.50	22.67	14.67	26.64	15.72	26.78
1500	28.75	12.84	21.80	23.03	23.95	22.15	14.68	24.35	15.72	
2000	27.64	12.53		22.47	15.00	21.89	14.67		15.72	
2500	26.97	12.33		21.89	15.00	21.74	14.67		15.72	
3000	26.53	12.21			15.00	21.63	14.68		15.72	

Source: Financial Publishing Co., <u>Cost of Personal Borrowing in the United States</u> (1977 ed.).

traditionally by the high risks involved in this type of loan. However, virtually no risk is involved in making a loan for the amount of credit insurance premiums. This is because any unearned premium will always be rebated by the insurer upon a customers default.[3] Nevertheless, under proposed terms of the acquisition, the cost of credit insurance will be financed at some of the highest loan rates in the country.

The amount of nearly risk-free financing at high rates by First Credit Corporation of Georgia (FCCG) is hardly negligible. In 1976, FCCG extended only 3039 Industrial Loans but with a total of $254,143.03 Gross credit life and accident and health premiums financed![4] Moreover, the applicant proposes to increase the size of the average loan more than 49%[5] and to increase the volume of business as well. Thus, more insurance of minimum (if any) risk will be financed at rates of 30% and 40% and higher and more people will be subjected to this unfair practice.

The acquisition should not be permitted without a pledge of a substantial reduction of finance charge rates on consumer credit transactions. In addition, the Board should scrutinize other unsupported calims of expanded capacity, service, product expansion, and diversification, and increased competition.

II. Proposed Credit Insurance Practices Are Not A Public Benefit And Do not conform to Regulation Y.

The Applicant seeks approval to conduct business through its subsidiary by acting as agent for sale of credit insurance and by acting as reinsurer of that credit insurance. Reg. Y

§§225.4(a)(9)(ii)&(a)(10). However, the application fails to demonstrate any public benefit from either proposed activity. Instead, the proposals are adverse to the public in several respects.

A. Credit Insurance Marketing

Although credit insurance is big business, it is not an issue about which consumers have much knowledge. It appears as a relatively small part of credit transactions. and although it is theoretically voluntary, the consumer is usually presented with a complete contract which includes credit insurance charges and financing and is told to "sign here, here, and here."

Studies by the Federal Trade Commission show that many loan companies sell credit insurance with virtually all of their loans. The way they do it is by giving the customer no real choice. As one loan company executive put it praising his two best managers:

> They both state quite simply regarding life and A&H that they include it automatically on the loan (both types) They only retract or switch after making every attempt to sell the customer on accepting it in the loan as it is. They do not soft pedal it or give the customer a chance to turn it down before it is even written into the loan. Their approach is automatic and positive.[6]

The consumer has no choice of where to buy, and because his attention is focused on the main transaction, the loan or the sale, the consumer has little opportunity to consider whether he wants insurance or wants it at the price being sold. In fact, a study done by Ohio University, financed by creditors and insurance companies, showed that even though though the purchase is theoretically voluntary, 25% of small loan customers who had purchased credit insurance thought it was required and 9% of all purchasers were not even aware that they had bought it.[7] Although consumers are demonstrably uninformed about credit insurance, it is of crucial importance to the creditor. First, the creditor is the beneficiary of this insurance. I decreases bad debt losses or increases the value of the paper it assigns. In fact, credit insurance was once generally provided free to customers and still today some banks and most credit unions offer it without a seperate charge. Second, the creditor selling credit increases the size of the loan and finances the premium. Third, and most importantly, the creditor directly or indirectly recieves substantial compensation for every sale of credit insurance.[8] In 1976, more than 1/4 of FCCG's gross income was compensation for the sale of insurance.[9]

This financial stake in the credit insurance sale combined with the relative inconspicuousness of credit insurance leads to the worst abuse in this field, reverse competition. Creditors have a stake in seeking the most expensive insurance on which they can earn the greatest amount of money.

The phenomenon of reverse competition is well-documented and well accepted. The United States Department of Justice recently concluded that:

> ...competitive forces cannot be relied upon to control the price of credit life and health insurance. The problem is similar to that experienced in title insurance--reverse competition.[10]

Virtually every other study of credit insurance, including the definitive NAIC Staff Study of Credit Insurance, several Congressional hearings, court cases, and administrative reviews, has reached the same conclusion: because of reverse competition, extraordinary efforts are necessary to prevent abuses and to keep prices at a fair level.

The Board was fully aware of the problems caused by reverse competition when it ruled that the activity of actin as insurance agent in connection with extensions of credit by holding companiee or their subsidiaries was closely related to banking under §4(c)(8) of the Bank Holding Company Act. To counteract the pressures caused by reverse competition, that is to assure that credit insurance would be sold as a public benefit and not primarily as a creditor benefit, the Board stated that credit insurance provided by or through a bank holding company must be sold at the lowest practicable rates. Specifically, the Board stated:

> (The Board expresses) the expectation that any holding company or subsidiary that acts as an insurance agent on the basis of the new regulatory provision will exercise a fiduciary responsibility--that is, by making its best effort to obtain the insurance at the lowest practicable cost to the consumer.

36 Fed. Reg. 15525-6 (Aug. 17, 1971)

B. Applicant Proposes to Overcharge Consumers for Credit Finance.

Applicant states that it will charge consumers for credit life insurance at 70¢ per $100 per annum and for credit accident and health insurance $2.91 per annum per $5.00 monthly benefit or 4.85% of the face amount of the loan irregardless of term. These are very high rates and barely less than the maximum permitted. It is hardly in the public interest to promis to overcharge only slightly less than before.

Absolutely no showing (or even claim) is made that applicant has made its best effort to obtain the insurance at the lowest practicable cost to the consumer. 36 Fed. Reg. 15526 (Aug. 17, 1971). For this reason alone, the application should be denied.

A 70¢ per 100 dollar per annum cannot be the lowest practicable rate available. In fact, the applicant sells similar credit insurance at less than a discounted 50¢ per $100 per annum through Ritter's Pennsylvania offices.

SINGLE PREMIUM RATES PER $100

Term(months)	Pennsylvania Maximums[11]	Georgia proposals
6	$ .27	$ .35
12	.50	.70
18	.72	1.05
24	.95	1.40
30	1.16	1.75
36	1.38	2.10

These Pennsylvania maximum rates are higher than those actually charged by Ritter. If Ritter can provide credit life insurance at one rate to its Pennsylvania customers, there is no reason the same rate cannot be used in Georgia.

Another means of comparing rates is to compare loss ratios. As long ago as 1959, the National Association of Insurance Commissions stated that the minimum loss ration for credit life insuranc should be 50%. NAIC Proceedings-1961 Vol. I, p. 300; see also NAIC Proceedings-1968 Vol. II, p. 575. Since then, many states have adopted higher loss ratios. Pennsylvania employs a 60% loss ratio and California has proposed a 70%(80%for credit unions) loss ratio. In 1976, FCCG had a loss ratio of only 21.49%.[12]

The loss ratio for FCCG in 1976 was only 31.5%[13] on the basis of perhaps the highest rates in the country. This again falls considerably short of even the minimum NAIC standard and more so compared with other states. Applicant has not divulged loss ratios and other credit insurance experience for Ritter in each of the states in which Ritter currently operates. However, it is clear that the proposed rates are totally unjustified. They fail to meet the expectations for an agent selling credit insurance Reg. Y §225.4(a)(9)(ii) or the minimal public benefits under §225.4(a)(10). moreover, applicant's promise to increase the size of the average loan and to deal with more borrowers only suggests greater overcharges for more of the public.

C. Applicant Should Not Be Permitted to sell excess, unneeded Insurance

Consumers have little choice in credit insurance matters and one resultant abuse has been the sale of excess coverage. Ritter and FCCG regularly sell credit insurance not only on the amount of the loan but also on the unearned finance charge and on the premium itself. The consumer has no need for insurance on unearned charges. If a person dies, the amount need to pay off the debt is always computed by subtracting the unearned interest. This practice also creates the possibility of one other abuse--the failure to pay the amount of coverage of unearned charges to the second beneficiary or the insured's estate.

The question of excess credit insurance coverage was brought before the Board once before, on the issue of selling level term insurance on installment loans. In that situation, the consumer is offered insurance of a fixed amount for the duration to the loan even though the amount of indebtedness decreases with each monthly installment. The Board clearly stated that such practice is no permissable under Regulation Y:

> (The Board) does not regard the sale of level term life insurance in connection with an installment lending as directly related to an extension of credit under §225.4(a)(9)(ii) of Regulation Y.

In Re: Fidelity Corporation Application to Acquire Local Finance Company, 1973 F.R. Bulletin 472-3. Applicant has said it will not sell level term insurance, but has not said it will provide coverage of only the amount financed.

Consumers purchasing credit insurance believe they are buying only the coverage necessary to pay off the debt. Few, if any, understand the subtle difference between amount financed and total of payments coverage. None have a need to insure the unearned charges. Such excess coverage, like that associated with level life insurance, is unrelated to the extension of Credit under Regulation Y and is an abuse of the public rather than a public benefit.

A clear example of excess coverage proposed by the would occur in loans with a cash advance of less than $100 repayable in 6 months or less, the applicant could sell the consumer a policy with a monthly benefit of from 1 1/2 to 3 times the monthly payment depending on the circumstances.[14] This too is excess coverage unrelated to the extension of credit and an abuse of the public rather that a public benefit.

D. Applicant Will Sell Only 3-Day Retroactive Credit Accident and Health Insurance when more reasonable Coverage is Available.

Applicant proposes to sell credit accident and health insurance (A&H) with a three day retroactive waiting period. Such coverage is rarely allowed in other states and the practice has been described as "archaic".[15] Even 7-day retro is not allowed in many states. However, these are the only two types of coverage available in connection with small loans in Georgia.[16]

A disability as long as seven days is unlikely to greatly affect the consumers ability to make his monthly payment due to likelihood of sick pay and other resources to cover that small loss of work time, and it is hard to visualize a circumstance in which a disability of less than seven days would work a hardship on the borrowers ability to pay.

"The most popular policy...among small loan lenders (is) 14 day retro which normally accomplishes its purpose well by replacing all loan payments in a case over 14 days and considering a shorter disability trivial."[17] In fact, many states do not allow a waiting period of less than 14 days on salee of A&H.

Throughout the state of Georgia sales of A&H in connection with industrial loans under the high rates then applicable resulted in a loss ratio in 1974 of 28.1%[18] and in 1975 of 29.9%[19]. Clearly Applicants slight reduction in rates will not bring it close to an acceptable loss ratio or change the useless nature of the policy and if applicant continues to propose such sales the application should be denied.

E The Proposed Sale of Joint Life Credit Insurance is not a PUBLIC BENEFIT.

Joint credit life insurance is rarely need by a consumer. It is sold primarily to increase the compensation to the creditor. When a married couple borrows money, often only one of them is working. It is that person's income which is needed to make the payments and it is that person who might need credit insurance. There is no need to provide insurance for a non-working spouse.

Moreover, Protestant believes that a proper interperatation of Georgia law and regulations is that the sale of Joint Life Insurance would constitute a violation of the Gerogia Industrial Loan Act.

F. Level Term Life Insurance Should Not be Provided In Conjunction With Any Installment Loan

Applicant has indicated that it has no plans to sell level term insurance and, as noted above, the Board has clearly limited the right to sell this insurance. Nevertheless, a general prohibition of level term life insurance has sometimes implicitly excepted the sale of such insurance as a matter of "convenience" and in communities of 5000 population or less. As the earlier discussion noted, level term coverage is inappropiate for any decreasing consumer indebtedness. Any acceptance of this aspect of the application should explicitly state that level term credit insurance will not be written in connection with any installment consumer loan.

G. There Is a Possibility That Applicant Is Compelling Consumers To Purchase Credit Insurance

Applicant has not provided any information concerning the manner in which it markets credit insurance and the percentage of loans in which credit is sold. The 1976 annual Report filed by FCCG, however, indicates that credit life insurance was sold on 3006 of 3039 loans (98.9%) and credit A&H on 2997 loans (98.6%). Protestant submits that any penetration rate of over 90% creates a presumption that the sale of the insurance in compulsory rather than a public benefit. In addition, the compulsory sale of credit insurance while excluding it from the Finance Charge violates Truth in Lending as well. E.G. FTC v. Jorgenson, 5 CCH Consumer Credit Guide ¶98,594 (D.D.C. 1975). The application should not be approved until the penetration rates of Ritter are made known and the voluntariness of Credit Sales is Established.

III. The Board Should Carefully Scrutinize The Applicant's Ability to fulfill Its Stated Intentions

When applicant applied for approval of its acquisition of Ritter, it indicated that its future expansion would be via *de novo* offices and the Board relied on this in approving the application. 1975 F.R. Bulletin 42. Now it is seeking to expan into Georgia by acquiring an on-going concern presently owned by another bank holding company.

Board approval was based in part on applicant's commitment to lower interest rates 4% to all borrowers without being more restrictive in its credit standards and to reduce the rates charged by Ritter's lending offices for credit insurance. 1975 F.R. Bull. 42.

Thereafter, unautherized reinsurance activities were commenced in North Carolina and Pennsylvania apparently without reduced rates. 1977 F. R. Bulletin 590.

Now Protestant has come across a contract issued by Ritter after its açquisition by applicant in which no reduction in either the finance charge or the insurance premium was made. The loan, attached as exhibit U, was for $678.69 amount financed over 24 months. Ritter charged the exact maximum permissable finance charge under Connecticut law, $185.31.[21] Similarly Ritter charged the full amount permitted in Connecticut for credit life insurance.[22] Protestant has been unable to learn from applicant about Applicant's practices and procedures in this regard so that only one side of the story is know. However, the Board is urged to make a careful inquiry into commitments made by Applicant.

Respectfully Submitted, this 17 day of December, 1977

Of Counsel
WILLARD P. OGBURN
National Consumer Law Center
11 Beacon Street
Boston, Massachusetts
Tel. 617-523-8010

Paul E. Kauffmann
PAUL E. KAUFFMANN
Georgia Legal Services
Programs, INC.
P.O.BOX 176
Columbus, Georgia 31902
Telephone 404 571 7456

FOOTNOTES

1. Protestant does not waive its right to expand upon or supplement this filing as new materials and information are made available.

2. See also, Exhibit "R"

3. If any risk at all is involved, it is minimal. A standard policy provides that insurance lapses if the consumer is in default for 60 days.

4. Exhibit "J", Schedule "F"

5. Application, p. 56 The increase could be even greater since the present average includes nonregulated mortgages and the new average does not

6. Letter to Governor Jeffrey M. Bucher, Board of Governors of the Federal Reserve System, November 29, 1974, from Charles H. Tobin, Secretary , Federal Trade Commission reprinted in Hearings on Consumer Information Before the Subcommittee on Consumer Affairs of the House Committee on Banking Currency and Housing, 94th Congress, 1st Session at 51-53

7. College of Business Administration of Ohio University, Consumer Credit Life and Disability Insurance (hubbard, ed. 1973) 75,77

8. One Study showed that small loan companies recieved a third of their net income from credit insurance. In Re Determining the maximum Rates of Charge and Amount of Loan Cieling to be Permitted Small Loan Companies, Virginia State Corporation Commission Case #19401, Exhibits MVI 18-20 (1974)

9. Exhibit "J", Schedule C

10. U.S. Dept of Justice. The Pricing and Marketing of Insurance, (January, 1975) at 275

11 Exhibit "T"

12. Exhibit "J", Schedule F

13 ibid

14Exhibit "Q", REG. 120-1-11-.03(1)

15 Exhibit "S", p.89

16. Exhibit "Q", Reg. 120-1-11-.03

17. Exhibit "S"

FOOTNOTES, CONT

18. Exhibit "O", Schedule F

19. Exhibit "P", Schedule F

20. Exhibit "Q"

21. $17/$100/annum on first 300 dollars,
$11/$100/annum on remainder

22. Life insurance rate $.50/$100/annum

BEFORE THE

SENATE COMMITTEE ON BANKING, HOUSING,
AND URBAN AFFAIRS

SENATE BILL No. 72

STATEMENT OF

NATIONAL ASSOCIATION OF CASUALTY AND SURETY AGENTS

Submitted by:

Mr. Bruce T. Wallace
Executive Vice President
National Association of Casualty
and Surety Agents
5225 Wisconsin Avenue, N.W.
Washington, D.C. 20015
(202) 362-0101

OF COUNSEL:

Stephen F. Owen, Jr.
Henry Ashton Hart
LOOMIS, OWEN, FELLMAN & COLEMAN
Suite 800, 2020 K Street, N.W.
Washington, D.C. 20006
(202) 296-5680

Date: June 21, 1978

NATIONAL ASSOCIATION OF CASUALTY AND SURETY AGENTS

The National Association of Casualty and Surety Agents (NACSA) is an organization comprising over three hundred of the larger property and casualty insurance agencies and brokerages in the United States accounting for better than 22 percent of the total property/casualty insurance industry's premiums. NACSA appreciates the opportunity to provide these written comments on S.72, the "Competition In Banking Act Of 1977".

S.72 narrows somewhat the area of permissible insurance activities of bank holding companies. By requiring insurance activities which are conducted by bank holding companies to produce substantial benefits to the public which clearly and significantly outweigh possible adverse effects, S.72 strengthens the current standards set forth at Section 4(c)(8) of the Bank Holding Company Act of 1956 and 12 C.F.R. Section 225.4(a)(9). However, S.72, like the current law, is still a general standard.

The past seven years have shown that the Federal Reserve Board is unwilling under a general standard to effectively limit the insurance activities of bank holding companies. NACSA, therefore, urges your Committee to go further in S.72 to specifically prohibit all forms of insurance except for a few specific forms of insurance such as credit life, credit health, and credit accident insurance and insurance sold in towns of 5,000 inhabitants or less. 1/

I. THE FEDERAL RESERVE BOARD HAS FAILED TO EFFECTIVELY LIMIT INSURANCE ACTIVITIES OF BANK HOLDING COMPANIES UNDER A "GENERAL STANDARD"

In 1970, Section 4(c)(8) of the Bank Holding Company Act was amended to its current form which prohibits bank holding companies from engaging in insurance activities unless the Federal Reserve Board finds such activities to be so closely related to banking as to be a proper incident thereto, and further finds that public benefits outweighing possible adverse effects can reasonably be expected to result. For the past seven years the Federal Reserve Board has interpreted this "general standard" in the most expansive sense, and while expending a great amount of time and resources, has allowed bank holding companies to engage in almost all forms of property and casualty insurance.

In 1971, citing Section 4(c)(8) of the Bank Holding Company Act as authority, the Federal Reserve Board promulgated 12 C.F.R. Section 225.4(a)(9). This regulation allows bank holding companies to engage in, among others,

---

1/ This approach has been taken by two bills currently pending in the Congress. On May 16, 1978, S.3087 was introduced in the Senate by Senators Durkin and Hathaway and referred to this Committee. On March 10, 1978, H.R.11456 was introduced in the House and referred to the House Committee on Banking, Finance, and Urban Affairs. This latter bill was re-introduced in the House on May 10, 1978 as H.R.12614. On June 6, 1978, the following broad categories of insurance:

1.) Any insurance directly related to an extension of credit by a bank or to the provision of other financial services by a bank; and

2.) Any insurance sold as a matter of convenience to the purchaser so long as this portion of the insurance activity of the bank holding company is insignificant.

Under this extremely broad standard, the Federal Reserve Board has allowed numerous forms of insurance activities. These activities include the following forms of insurance where such insurance has been issued to protect property in which the bank has a security interest or to protect the bank holding company's ability to obtain repayment of loans:

1.) Fire, theft, and other perils
2.) Comprehensive insurance
3.) Collision insurance
4.) Marine insurance
5.) Liability insurance
6.) Property floater insurance
7.) Homeowner's insurance
8.) Boiler and machinery insurance
9.) Surety bonds

1/ (cont.) The House Subcommittee on Financial Institution Supervision, Regulation, and Insurance, by near unanimous endorsement, added the language of H.R.12614 as an amendment to Title XIII of H.R.9600 ("The Safe Banking Act of 1977").

10.) Performance bonds, and

11.) Credit life, credit accident, and credit health insurance issued to cover the debtor. 2/

Furthermore, the Board has also allowed bank holding companies to engage in numerous forms of insurance, such as automobile insurance, when sold as a matter of convenience to the purchaser. 3/

The recent decision of the Fifth Circuit in Alabama Association of Insurance Agents, Inc. v. Board of Governors of the Federal Reserve System 4/, further demonstrates the Federal Reserve Board's ineffective handling of this issue. The Court was able to reach a final decision only after it had issued two re-hearing opinions, each of which significantly modified the Court's prior position. The great difficulty which the Fifth Circuit had in deciding the Alabama Association case was due largely to the failure of the Federal Reserve Board to set forth, as is required by the Administrative Procedure Act, a full statement of the basis and purpose of its regulations. Had the Board, at the time it promulgated 12 C.F.R. Section 225.4(a)(9), set forth the basis for its conclusion that the broad range of insurance activities

---

2/ Alabama Financial Group, Inc., 39 Fed. reg. 25548 (1974); First National Holding Corporation, 39 Fed. Reg. 33411 (1974).

3/ Id.

4/ 533 F.2d 224 (5th Cir. 1976); re-hearing denied, 558 F.2d 729 (5th Cir. 1977); cert. denied 46 U.S.L.W. 3539, No. 77-668, February 27, 1978.

allowed by the regulation were closely related to banking and likely to benefit the public, the Fifth Circuit would have been able to more effectively review the actions of the Board. However, the Board failed to do this, and consequently, the Fifth Circuit was significantly hampered.

In its final decision in the Alabama Association case, the Fifth Circuit, while disallowing forms of insurance sold for the convenience of the purchaser, did allow bank holding companies to engage in any insurance activity directly related to an extension of credit by a bank or to the provision of other financial services by a bank. In so doing, the Fifth Circuit left open the door for bank holding companies to engage in numerous forms of insurance, including all those specifically listed at page 3 herein (except for convenience insurance).

On April 10, 1978, the Federal Reserve Board promulgated a proposed amendment to 12 C.F.R. Section 225.4(a)(9) in order to conform that regulation to the final decision in the Alabama Association case.

In summary, over the past seven years the Federal Reserve Board has applied the general standard of Section 4(c)(8) of the Bank Holding Company Act of 1956 so as to accomplish three things, all of them contrary to the public interest and the intent of Congress:

1.) It has expended a great amount of time and administrative resources;

2.) It has acted in such an arbitrary and confusing manner as to prevent effective judicial review of its actions; and

3.) It has allowed bank holding companies to engage in an extremely broad range of insurance activities, and has thereby left open the potential for bank holding companies to impose undue economic coercion upon the business of insurance.

II. REASONS FOR THE FAILURE OF THE FEDERAL RESERVE BOARD TO EFFECTIVELY LIMIT INSURANCE ACTIVITIES OF BANK HOLDING COMPANIES UNDER A "GENERAL STANDARD"

A.) The Federal Reserve Board Has Been Susceptible To The Pressure Brought To Bear Upon It By The Bank Holding Companies

Since the promulgation in 1971 of 12 C.F.R. Section 225.4(a)(9), the Federal Reserve Board has been barraged with numerous applications by bank holding companies for permission to engage in an extremely broad range of insurance activities. In addition to those numerous forms of insurance mentioned earlier for which bank holding companies successfully filed, bank holding companies also attempted, albeit unsuccessfully, to engage in the following forms of insurance:

1.) Business interruption insurance

2.) Fidelity insurance

3.) Level term life insurance

4.) Loss of rent insurance, and

5.) Mortgage guarantee insurance. 5/

Furthermore, encouraged by the Alabama Association case, the bank holding companies have continued to pressure for permission to engage in still other forms of insurance. On May 1, 1978, the American Bankers Association filed its comments upon the Federal Reserve Board's proposed amendment to 12 C.F.R. Section 225.4(a)(9). The bulk of these comments were aimed at amending the regulation further to allow bank holding companies to issue extensions or renewals upon credit related insurance even though the loan which is related to the insurance has been paid in full. Of course, in such an instance, the issuance of the renewal insurance cannot be said to be "closely related" to banking since the renewals are to be issued at a time when the loan which was the basis for the original issuance of insurance has been paid. This position of the American Bankers Association implies that the bank holding companies feel that the Federal Reserve Board, whose members have a strong banking

---

5/ Alabama Financial Group, Inc., 39 Fed. Reg. 35548 at 25550 (1974); First National Holding Corporation, 39 Fed. Reg. 33411 at 33412, 33413 (1974); Barnett Banks of Florida and Chase Manhattan of New York, 40 Fed. Reg. 44260 at 44622, 44624 (1974); Pan American Bankshares, Inc. Miami, Florida, 40 Fed. Reg. 44630 at 44632 (1975).

background, will be susceptible to an argument that almost any form of insurance is "closely related" to banking.

Another example of this attitude on the part of the bank holding companies is reflected in the recent application of NCNB Corporation, which application asked the Federal Reserve Board to approve the retention by NCNB Corporation of its subsidiaries which were engaged in the actual underwriting (i.e., they bore the ultimate risk) of property and casualty insurance related to extensions of credit by affiliates of NCNB Corporation. By Order of May 12, 1978, the Federal Reserve Board denied the application; however, the fact that one Governor on the Board voted against rejecting the application indicates that the Board was not entirely unsusceptible to the idea of bank holding companies underwriting property and casualty insurance.

In reliance upon a broad general standard and upon the sympathetic views of Federal Reserve Board members towards the banking industry, bank holding companies have applied for permission to engage in nearly every form of insurance and have in most instances, been successful in obtaining this permission. Only a law which specifically prohibits all but a few specific forms of insurance will put a stop to this phenomenon.

B.) The Federal Reserve Board Has Failed To Give Due Consideration To The Potential Of Bank Holding Companies To Exert Economic Coercion In Placing Insurance Business

The pro-banking attitude of the Federal Reserve Board has caused it to give insufficient consideration to the potential of bank holding companies to exert economic coercion in the placement of insurance with their subsidiaries. This shortcoming of the Federal Reserve Board was amply demonstrated in the proceedings leading up to the Alabama Association case.

In that case, the Fifth Circuit was reviewing the orders of the Federal Reserve Board in two case dockets involving applications by bank holding companies to engage in the insurance agency business. The Board in turn had issued its orders in response to the Recommended Decisions of an Administrative Law Judge. The Administrative Law Judge, who issued the Recommended Decision in both dockets, was not assigned to the Federal Reserve Board, but rather was borrowed from another agency for the purpose of conducting administrative proceedings with respect to the two dockets.

In both dockets, the Administrative Law Judge made a finding that the economic concentration of the applicant bank holding companies seriously threatened insurance agents, and that a substantial possibility of voluntary tying of insurance sales to loans existed. 6/

6/ January 14, 1974 Recommended Decision of the Administrative Law Judge, F.R.B. Docket IA-8 (First National Holding Comp and February 7, 1974 Recommended Decision of the Administr Law Judge, F.R.B. Docket IA-10 (Southern Bankcorporation).

In the Southern Bankcorporation proceeding, the Administrative Law Judge, finding the Applicant to have as high as 46.7 percent of deposits in some markets, concluded that the Applicant "... would have a dominant position in terms of captive clientele which could be influenced to divert from local existing independent insurance agencies. While coercive tying of insurance sales to lending is illegal under Section 106 of the Act, 'voluntary' tying through subtle influencing particularly in times of tight money is a distinct possibility despite protestations of TAFG witnesses to the contrary" 7/

In the First National Holding Company proceeding, the Administrative Law Judge, finding two of the applicants to control 52.8 percent of the Atlanta market, concluded that "... their combined economic power would represent a formidable threat to the independent agencies by reason of the banks' advantage in terms of a very large built-in clientele of borrowers and that consequently ... the independent commission agents would have difficulty surviving" 8/.

As a result of these findings in both dockets, the Administrative Law Judge recommended that the major bank holding companies involved be denied the right to engage in

---

7/ February 7, 1974 Recommended Decision of the Administrative Law Judge, F.R.B. Docket IA-10 (Southern Bankcorporation).

8/ January 14, 1974 Recommended Decision of the Administrative Law Judge, F.R.B. Docket IA-8 (First National Holding Company).

all forms of insurance, except for proprietary and employee insurance and for credit life, credit health, credit accident and mortgage redemption insurance. 9/

The Federal Reserve Board, having reviewed these "alarming" findings of the Administrative Law Judge, nevertheless in large part rejected the Recommended Decision of the Administrative Law Judge and allowed the Applicant bank holding companies to engage in many types of insurance which the Administrative Law Judge had found to be contrary to the public interest. In rejecting the Recommended Decisions of the Administrative Law Judge, the Board merely stated that it had found no actual evidence of the bank holding companies using their economic power to coerce. This insistence by the Board that there be a showing of actual abuse of economic power ignores the clear intent that the Board consider not only actual abuse of economic power, but also the potential for such abuse. This intent of Congress was clearly manifested in the Conference Report to accompany the 1970 amendments to Section 4(c)(8) of the Bank Holding Company Act of 1956:

> "But the dangers of 'voluntary' tie-ins and reciprocity are basically structural and must be dealt with by the Board in determining the competitive effects of bank holding company expansion into fields closely related to banking when considering applications under Section 4(c)(8). These will be difficult questions, for assurances of good faith and the intention

---

9/ Supra at n.6

> not to engage in tie-ins and reciprocity by the Applicant bank holding companies will largely be irrelevant to the just as serious dangers of 'voluntary' tie-ins and reciprocity. The Board must, in any case, consider these problems in carrying out its responsibilities under the Act." (emphasis supplied) 10/.

This insistence of the Board that there be a showing of actual abuse of economic power by the banks is also inconsistent with the long-held view in this country that monopoly power in itself is an evil, regardless of whether that power is in fact exercised by its holder 11/.

Given a general standard with which to work, the Federal Reserve Board will continue to ignore this serious problem of potential abuse of economic power by bank holding companies. Only a specific standard which prohibits bank holding companies from engaging in all but a few specific forms of insurance will protect the public against this threat of abuse of economic power by bank holding companies.

C.) The Federal Reserve Board Does Not Understand Or Appreciate The Highly Specialized Nature Of The Operation Performed By Property And Casualty Insurance Agents

In allowing bank holding companies to engage in an extremely broad range of insurance activities, the Federal Reserve Board has given an overly broad interpretation of the term "closely related to banking". The Board has

---

10/ H.R. Report No. 91-1747, p. 18, December 16, 1970.

11/ "So it is that monopoly power, whether lawfully or unlawfully acquired, may itself constitute an evil and stand condemned under Section 2 [Sherman Act] even though it remains unexercised." (brackets added). U.S. v. Griffith, 334 U.S. 100 (1948).

applied the "closely related" test in a manner which allows bank holding companies to engage in numerous forms of property and casualty insurance. This interpretation of the Board reflects a lack of understanding on its part of the specialized nature of the job performed by a property and casualty insurance agent.

A member of the staff of the Federal Reserve Bank of Atlanta, writing in 1971, identified two factors as relevant to the determination of whether an activity is closely related to banking: (1) whether the activity may be functionally integrated to banking and (2) whether it may be operationally integrated to banking 12/. When one understands the specialized nature of the job of the property and casualty insurance agent, it becomes readily apparent that the sale of property and casualty insurance can not be functionally or operationally integrated into the loan transaction.

Unlike credit life, health, and accident insurance which is generally written under a blanket policy issued to the lender without underwriting of individual applicants, the sale of property and casualty insurance necessitates the tailoring of the policy to the specific needs of the client. The agent must be fully familiar with the client's business or personal situation, and the risks which are presented to

---

12/ Sally, Charles D., "What Is Closely Related To Banking?", 59 Monthly Review, Federal Reserve Bank Of Atlanta, 98 (June 1971).

his client as a result of that situation.

Few loan officers will have the necessary understanding of the numerous forms of property and casualty insurance policies which are available for their client, and few loan officers will be able to spend time to fully familiarize themselves with their client's personal or business insurance needs. This necessitates the creation of a totally unrelated insurance department of the bank and the hiring of insurance specialists to staff that department. In short, the sale of property and casualty insurance may not be functionally or operationally integrated into a loan transaction.

Yet another factor, which has been relied upon by bank holding companies as a justification for their claim that an insurance activity is closely related to banking, is the <u>need</u> of the bank holding company to engage in the insurance activity.

While banks clearly have a need to assure that the assets in which they have a security interest are insured, they do not have a need to <u>sell</u> such insurance. A bank needs numerous goods and services in order to function. However, this does not mean that the bank needs to sell those goods and services. For example, while a bank may need to use computer systems in its accounting branch, it does not necessarily follow that the bank needs to go into the business of selling computers.

As has been explained above, property and casualty insurance agents are much better qualified than a bank loan officer to select insurance which will adequately protect assets in which a bank has a security interest; and these property and casualty insurance agents can perform this job in a better manner, which will be most helpful to the debtor as well as the lending bank. Consequently, bank holding companies have no need to engage in the business of the sale of property and casualty insurance.

It is clear that the Federal Reserve Board intends to allow bank holding companies to engage in numerous forms of property and casualty insurance under a "general standard", even though such activities are not in fact closely related to banking. Only a specific standard which prohibits bank holding companies from engaging in all but a few specific forms of insurance will remedy this situation.

III. CONCLUSION

While S.72 correctly recognizes the need to further limit the insurance activities of bank holding companies, the approach taken by S.72 is unlikely to achieve that goal. Although S.72 would strengthen somewhat the current standard governing permissible insurance activities of bank holding companies, the standard of S.72 is still a general standard.

24-934 O - 78 - 56

The past seven years have clearly shown that the Federal Reserve Board, left with a general standard, will not effectively limit the insurance activities of bank holding companies.

The Federal Reserve Board, having a strong banking background, has been highly susceptible to the continued pressure of bank holding companies to expand the scope of insurance activities in which they may engage. Furthermore, the Board has shown an indifference to the very real potential of bank holding companies to exert undue economic coercion with respect to the insurance business. Lastly, failing to appreciate the specialized nature of the sale of property and casualty insurance, the Board has allowed bank holding companies to engage in numerous forms of property and casualty insurance even though the sale of such insurance is not in fact closely related to banking and is beyond the expertise of most loan officers or bank personnel.

The net result of the Federal Reserve Board's actions in this area under a general standard is a negative one. While expending a great amount of time and administrative resources in the area, the Board has failed to effectively limit the insurance activities of bank holding companies and the economic evils which result from the conduct of an expanding range of insurance activities by bank holding companies. A specific standard is required in order to effectively limit the insurance activities of bank holding companies. Consequently, NACSA urges this Committee to adopt a specific standard which prohibits bank holding companies from engaging in all but a few specifically stated forms of insurance such as credit life, credit health, and credit accident insurance and insurance sold in towns of 5,000 inhabitants or less.

Respectfully submitted,

Bruce T. Wallace

Bruce T. Wallace
Executive Vice President
National Association of Casualty and Surety Agents

OF COUNSEL:

Stephen F. Owen, Jr.
Henry Ashton Hart
LOOMIS, OWEN, FELLMAN & COLEMAN
Suite 800, 2020 K Street, N.W.
Washington, D.C. 20006
(202) 296-5680

Date: June 21, 1978

TESTIMONY OF JOHN M. DELANY

BEFORE THE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

RE S.72 - "A Bill to Amend the Bank Holding Company Act and the Bank Merger Act to restrict the activities in which registered bank holding companies may engage and to control the acquisition of banks by bank holding companies and other banks."

Mr. Chairman and Members of the Banking, Housing and Urban Affairs Committee. My name is John M. Delany. I am Group Senior Vice President and General Counsel of Purolator Services, Inc. I thank you for this opportunity to present views in support of provisions of S.72 with which the armored car and courier industries are concerned.

The experience of the armored car and courier industries under the Bank Holding Company Act Amendments of 1970 emphasizes the need for this legislation insofar as it relates to standards for bank holding company entry into bank-related activities and to administrative procedures and judicial review. Our industries, of course, have had no involvement in mergers of banking institutions and I am not qualified to address myself to those provisions of S.72.

You have asked that testimony be directed to seven highly pertinent questions relating to the appropriate scope of activities which should be permitted to bank holding companies under Section 4(c)(8) of the Bank Holding Company Act and to procedural provisions designed to assure due process in the administration of the Act. I shall be pleased to express my views on those questions.

At the outset I would point out that I am particularly impressed with the statement of Findings and Purposes of S.72 that bank holding companies have extended their services into product markets beyond those directly related to banking, thereby eroding the line between banking and commerce in the Nation. Courier services are specifically named as an example of such an inappropriate extension of Bank Holding Company activities.

In order that the Committee may fully appreciate the impact of the Bank Holding Company Act upon our business, I believe that it will be useful if I give you a brief description of the nature of the courier and armored car industries.

I.

DESCRIPTION OF THE COURIER INDUSTRY

Courier companies furnish essential transportation service of time-critical commodities and items. These commodities consist of cash letters for banks; data processing for banks and business concerns; radiopharmaceuticals for laboratories and those destined to hospitals; exposed and processed film for major processing laboratories; computer repair parts and other repair parts requiring expedited delivery; and a myriad of other small package items, all required to move on precise and rapid transportation schedules. In order to meet the needs of the public utilizing this service, deliveries must usually be completed within 12 hours or less, on a door-to-door basis, from point of origin to point of destination. This service includes the movement of courier material between the East Coast and the West Coast within a 12-hour period. This is accomplished by coordinating ground and air services performed and undertaken by courier companies.

Cash letters involve the daily movement of checks in the process of collection. This service is essential to any small bank in shipping its deposits to a larger bank; for collection service on behalf of the small bank; and for credit to that bank's deposit account when collection has occurred. Rapid and reliable courier service enables banks to earn interest through the investment of such funds for longer periods. This is a matter of substantial economic importance, particularly in tight money markets, when as much as or more than $250 a day in interest, per one million dollars, can be earned.

Courier service is usually provided during the evening hours, with pickup after the close of the business day and, in most instances, delivery before the opening of business the next morning. In the courier service provided to banks, cash letters and data processing material must frequently be delivered to or from a large bank within a period as short as three or four hours.

Ground courier operations between the states may be regulated by the Interstate Commerce Commission, while service within any given state may be governed by that state's regulatory agency. For service provided in conjunction with air operations, courier companies are regulated by the Civil Aeronautics Board.

The basic unit of any courier service operation is the route, that is, the cluster of banks and other customers served by the same vehicle. The economic existence of a courier service company is directly and essentially related to the profitability of the structure of its route or routes. By maximizing the number of customers who can be served on any given route, the cost and availability of service to all are enhanced.

It should be noted that the courier service industry is relatively young. Its existence dates from about the early 1950's when a number of individual companies came into being to provide the expedited transportation service required for certain important documents and commodities.

II.

DESCRIPTION OF THE ARMORED CAR BUSINESS

Armored car companies conduct a specialized transportation business involving the safeguarding and transfer of valuables of every nature. They provide a for-hire transportation and safekeeping service. The commodities transported by armored car companies consist of cash and currency, coin, silver, bullion, stocks and bonds and various other articles of unusual value which require a high degree of care in handling and transportation, such as precious metals and dangerous drugs. The armored car industry provides service, generally, to the following types of customers: banks, chain and retail stores, brokerage offices, currency exchanges, industrial plants (particularly in the delivery of their payrolls) and amusement parks and sporting arenas. Operations are conducted in armored cars, which are constructed of bullet-resistant steel plate and bullet-proof glass and which are equipped with built-in safes and grills. Armored car companies must maintain terminals where specially constructed vaults of various types have been installed in order to provide service for overnight storage and the protection of valuables.

Armored car companies operate in all of the major metropolitan areas of the Nation, as well as from, to, and/or between these areas. In considerable measure, operations of an interstate nature are regulated by the Interstate Commerce Commission while intrastate service may be regulated by state agencies. In order that armored car companies may render the most convenient and economical service, they dispatch their trucks on a scheduled basis or route. By service of as many customers as possible on a route and apportionment of the total cost among them, the cost to each customer can be maintained at a level sufficiently low for use by most small businesses. The economic importance of having as many customers as possible on the route is such that usually only in the Nation's larger cities is there sufficient demand to support more than a limited number of armored car companies.

By necessity, because of the great value of the commodities being handled, armored car companies must be reliable and must be well managed. Entrance into the armored car field requires a major investment in highly specialized armored vehicles at a cost in the range of from $10,000 to about $20,000 per unit, depending upon size and the equipment built into the unit. In addition, operating terminals, which are, by and large, suitable only for a single purpose, are quite expensive due to the high cost of vault installation for overnight storage and the construction of highly specialized security areas which must be equipped with the latest and most sophisticated electronic alarm systems.

III.

You have asked for an expression of views on the allied questions of (1) the necessity to restrict bank holding companies to activities "directly" related to banking and those activities within the courier and armored car industries which I would consider "directly" related to banking; and (2) the kinds of activity in these industries now permitted by the Federal Reserve to bank holding companies under the existing "closely" related test.

On the basis of action taken to date by the Federal Reserve Board in determining that bank affiliates may engage in certain courier service on the basis of Section 4(c)(8) as it now reads, * I believe that the statutory change to be accomplished by restriction of bank holding companies to activities "closely and directly" related to banking is a required one. In that same connection, I also consider that the proposed amendment in S.72 which would change "a proper incident thereto" to "a proper and necessary incident thereto" (p. 10, line 16) is highly useful.

On November 15, 1973, the Federal Reserve Board determined that bank holding companies should be permitted to engage in certain types of courier service. This ruling was based upon the language of the present Section 4(c)(8), with the Board determining that these courier services were (a) closely related to banking and (b) that this relationship was such as to make these courier services a proper incident to banking.

* Under Section 4(c)(8), as enacted in the 1970 Amendments, the criteria for approval of a non-banking activity are that it be found by the Board "to be so closely related to banking... as to be a proper incident thereto" and that "[i]n determining whether a particular activity is a proper incident to banking...the Board shall consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public such as greater convenience, increased 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."

The Federal Reserve Board, in its interpretation of Section 4(c)(8), has undoubtedly related its rulings to the views expressed by its then Chairman Burns during legislative consideration of the 1970 Amendments. His position was that the banking system has become very innovative and that the language of Section 4(c)(8) should not be framed or interpreted in a manner to hamper this innovation. In support of the Board's ruling that certain courier services may be engaged in by subsidiaries of bank holding companies, the Federal Reserve Board argued that the legislative purpose of the 1970 Amendments was to grant the Board "greater flexibility in determining what non-banking activities***are to be permitted bank holding companies." (Board's Brief in United States Court of Appeals in National Courier Association et al. v. Board of Governors of the Federal Reserve System, 516 F.2d 1229 (D.C. Cir. 1975), p. 61.)*

With this background of the "greater flexibility" philosophy of the Federal Reserve Board, the language utilized

---

* In its ruling on appeal from the decision of the Federal Reserve Board in National Courier Association, the United States Court of Appeals modified the Board's decision insofar as the Board had permitted bank holding company subsidiaries in some circumstances to engage in the courier transportation of non-financially related materials. Nonetheless, in permitting bank holding company affiliates to engage in certain courier activities, the Court of Appeals seems clearly to have been influenced by the legislative history resulting in the Congressional determination to use the words "closely related to banking". 516 F.2d at 1236-37.

in S.72, at Section 301 in amending Section 4(c)(8), accomplishes an essential objective. Rather than authorizing activities "closely related to banking", S.72 provides that the activities shall be "closely and directly related to banking" (underscoring supplied), which is obviously a more restrictive test.

In approving certain courier activities for bank holding company subsidiaries, the Board followed its "greater flexibility" approach and in doing so clearly moved into an area which is not "closely and directly related" to the banking business. The Small Business Administration, in commenting to the Federal Reserve Board upon the proposed courier regulation, stated that "now, for the first time, we see what may be a dangerous development for small business creeping up in...a proposed rule on armored car and courier services. That is, we see a switch in concept from expanding a service already being provided by the bank to proposing to engage in a service that has traditionally been received by the bank. In other words, the argument that is being made is that because we, the bank holding company, need a certain housekeeping service, it is closely related to banking and a proper incident thereof." (underscoring supplied).

The facts are that armored car and courier services are completely unrelated to the business of banking.

Armored car and courier services are basically the business of transportation of property by motor vehicle (and sometimes by plane) whose scope is in considerable measure subject to utility regulatory statutes. Laying out armored car and courier routes and schedules in an efficient and economical manner demands specialized skills. Management of a complex armored car or courier system, frequently calling for close coordination of ground and air service, requires a high degree of transportation and allied expertise, having nothing at all to do with banking skills or experience.

On the other hand, the business of banking

> "...consists in the issue of notes payable on demand intended to circulate as money where the banks are banks of issue; in receiving deposits payable on demand; in discounting commercial paper; making loans of money on collateral security; buying and selling bills of exchange; negotiating loans, and dealing in negotiable securities issued by the government, state and national, and municipal and other corporations." Mercantile Bank v. New York, 121 U.S. 138, 156 (1887).

In the circumstances, I would respectfully suggest that legislative reports on S.72 put to rest once and for all the Federal Reserve Board concept that a "flexible approach" should be adopted to Section 4(c)(8).

The answer, therefore, to the question of whether there is a necessity to restrict bank holding companies to activities "directly" related to banking is "yes". As to the question of what activities within the armored car and courier industry should be considered "directly" related to banking, the logical answer is plainly "none" since, as noted earlier, these are transportation businesses calling for specialized skills completely unrelated to banking. It should, however, be noted that Section 4(c)(1)(C) of the Bank Holding Company Act, as amended, 12 U.S.C. Sec. 1843(c)(1)(C), provides an exemption to a bank holding company for the "furnishing [of] services to or performing services for such bank holding company or its banking subsidiaries."

You have asked the kinds of activity in the courier and armored car industry now permitted by the Federal Reserve Board to bank holding companies under the existing "closely" related test. Activities so permitted in the courier industry are the following (in addition to "the internal operations of the holding company and its subsidiaries", which the Court of Appeals found to be expressly permitted by Section 4(c)(1)(C), <u>supra</u>):

> 1. checks, commercial papers, documents, and written instruments (excluding currency or bearer-type negotiable instruments) as are exchanged among banks and banking institutions; 2. audit and accounting media of a banking or financial nature and other business records and documents used in processing such media.

The Board to date has authorized no bank holding company activity in the armored car industry. The fact is, however, that armored car services also remain in jeopardy under the present language of Section 4(c)(8). In the armored car and courier service hearings, the Board found that "the record is virtually devoid of evidence in support of the proposed amendment [as to armored car service]". Despite this determination, the Board specifically left the way open for a bank holding company to make application to engage in armored car services. (Order of Federal Reserve Board, November 15, 1973, amending Regulation Y, Part 225, p. 14).

IV.

Your next question relates to the necessity to consider unfair competition, undue concentration of resources and conflicts of interest in permitting particular activities under Section 4(c)(8). My response is that it is essential that anticompetitive activities be given great weight in passing upon the right of bank holding companies to engage in non-banking activities. I believe that the revised language of Section 4(c)(8)(B) in S.72, substituting "is likely to produce substantial benefits to the public which clearly and significantly outweigh possible adverse effects" (p.10, lines 17-19) for "can reasonably be expected to produce benefits to the public" is a major improvement in approach.

In terms of unfair competition and conflicts of interest, the absence of these standards in the statute would leave open such possibilities as that the bank holding company would make no direct charge for courier or armored car service but instead would recover the costs by adjustments in the compensating balance of the correspondent bank using the service; that in some cases no charge at all would be made for the service and in others a non-compensatory charge would be made; that the bank holding company would pick and choose those who would receive the not-for-profit service, offering it to those who would furnish the greatest correspondent banking revenue; and that solicitation for the courier or armored car service would be made not by the subsidiary company's employees but by marketing officers of the bank and other affiliates of the bank holding company. Additionally, with respect to conflicts of interest any bank-affiliated courier firm which also served rival banks and data processing firms in the same area would be torn between its purpose to provide superior service for its own facilities and the need to provide service for its competitors. It seems plain that a holding company, with bank and data processing subsidiaries, which also operates the only courier service in the area could use this service to the severe detriment of its competitors. Since a holding company derives the great preponderance of its profits from its banking and data processing services, it would have a compelling economic incentive to provide its courier service in such a way as to favor its affiliates and their customers over the requirements of direct competitors. As the Department of Justice pointed out in the Board's courier proceeding, "[w]hen a holding company controls its own courier service it has the potential to structure that service in ways which most advantageously meet the needs of its banking subsidiaries and its correspondent banking customers".

The inherent advantage which a bank holding company has over its independent courier and armored car competitors would appear inevitably to produce undue concentration of economic resources. Thus, as the then head of the Antitrust Division of the Department of Justice stated in testifying on the 1970 Amendments:

> "Bank expansion in other areas permits the carryover of economic power into such endeavors. There is, of course, the obvious danger of overt reciprocity or tying arrangements, as well as general favoritism of bank affiliates, particularly in times of tight money. Also, and perhaps more important in terms of the need for present legislation, there are dangers which are of a more structural nature--adverse competitive effects that would tend to develop naturally without actual overt use of the economic power carried over from the banking sphere" (Hearing before the Senate Committee on Banking and Currency, 91st Cong., 2d Sess., pt. 1, at 239).

Before leaving Section 4(c)(8)(a) of S.72, I would make certain suggestions respecting its language:

1. That at p. 10, lines 17-18, the words "is likely to produce substantial benefits to the public" be revised to read "will probably produce substantial benefits to the public". I believe that, in terms of a competitive test such as this one, the word "probably" has a more well-defined meaning than "likely". For the same reason, I would suggest that at p. 11, line 11, the words "is likely to" be changed to "will probably."

2. That at p.10, lines 20-21 and lines 24-25, the words "(i) the term 'substantial benefits to the public' <u>includes</u> increased competition..." and "(ii) the term 'adverse effects' <u>includes</u> undue concentration..." be revised to read "(i) the term 'substantial benefits to the public' <u>refers to</u> increased competition..." and "(ii) the term 'adverse effects' <u>refers to</u> undue concentration..." (underscoring supplied).

V.

The fourth question relates to the necessity to prohibit a national bank from engaging in activities which have been ruled to be not "directly" related to banking. The reasons which should bar a non-bank subsidiary of a bank holding company from engaging in activities not "directly" related to banking should all the more so prevent the bank itself from engaging in those activities. Under 12 U.S.C. Sec. 24 (Seventh), a national bank has power "[t]o exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking." The statutory limits already placed upon national banks are far more stringent than those imposed by Section 4(c)(8) upon non-banking subsidiaries of a bank holding company.

VI.

Your fifth and sixth questions relate to (1) the necessity to require rulemaking proceedings under Section 4(c)(8) to be conducted on the record after opportunity for hearing and full cross-examination and (2) the necessity for the procedural provisions in the Act to protect the public interest.

Section 601(a) of S.72 includes a new Section 9 to the Bank Holding Company Act which provides, at subsection (b), that "[a]ll Board determinations (whether by order or regulation) under section 4(c)(8) shall be made on the record after opportunity for hearing, and the provisions of sections 556 and 557 of title 5 of the United States Code shall apply with respect thereto."

In the light of the position taken by the Federal Reserve Board in prior proceedings under Section 4(c)(8), it appears important that this language be enacted into law. Thus, in the Hearings Regarding Courier and Armored Car Services, the Board stated:

> "In the Board's judgment, the regulatory actions under consideration in the subject proceedings do not constitute an order subject to the judicial review provisions of section 9 of the Bank Holding Company Act. Further, the Holding Company Act does not require a formal hearing on the record with respect to such regulatory actions; and no considerations or arguments have been presented to the Board that, in the Board's judgment, warrant a formal hearing on the issues involved in the hearings, as a matter of Board discretion. Accordingly, the motions for formal hearings are denied." (Order of the Board of Governors, January 12, 1972, p.3).

Under existing law, the Federal Reserve Board thus took the position that such a basic procedural safeguard as the right to cross-examination that may be required for a full and true disclosure of the facts is a matter of grace, which may or may not be granted by the Board to a participant in a Section 4(c)(8) proceeding. This situation should be corrected.

In the language I have just quoted, it will also be noted that the Federal Reserve Board ruled that hearings conducted under Section 4(c)(8) of the Act to determine if particular non-banking activities are closely related to banking are not subject to appeal to the United States Court of Appeals under Section 9 of the Bank Holding Company Act (12 U.S.C. Sec.1848). As a result, I believe it is essential that Section 601(b) be enacted into law. This amendment provides that "regulations" as well as "orders" may be appealed to the appropriate Court of Appeals. I would also suggest that any legislative report analyzing the provisions of S.72 make it plain that any person aggrieved by a decision of the Federal Reserve Board on a proposal relating to determination whether a non-banking activity is closely related to banking shall be permitted to go to the United States Court of Appeals as a matter of right.

Section 601(a) of S.72, in adding the new Section 9(d), provides that, in any proceeding under Section 4(c)(8) to which the requirements of the Administrative Procedure Act relating to hearings on the record are applied, an interested party may call for any information or documents, not privileged, for purposes of discovery or for use as evidence. Experience under the present law emphasizes the need for this amendment.

The Federal Reserve Board, in Section 4(c)(8) proceedings, has expressly denied access by participants to material which has appeared clearly to be relevant to a proper determination of such matters by the Board. In the hearings related to granting Bank Holding Companies the right to engage in armored car and courier activities, the National Courier Association, the National Armored Car Association and the Independent Bankers Association requested access to intra-agency memoranda considered by the Board in deciding to announce its proposed rulemaking regarding courier and armored car services. The Board denied this request, asserting, as its basis, that Section 552 of Title 5 of the United States Code specifically exempts from public inspection inter-agency or intra-agency memorandums or letters which would not be available by law to a party other than an agency in litigation with the agency. (Order of the Board of Governors, January 12, 1972, p.3) In the circumstances there presented, it clearly would have been in the public interest to permit all participants to review these memoranda and to submit for the consideration of the Federal Reserve Board material, data and the product of experience which would clarify, rebut, supplement or support the underlying data and conclusions of those internal Board memoranda.

Directly applicable to this provision of S.72 is the statement made by the United States Court of Appeals for the District of Columbia in National Courier Association v. Board of Governors of the Federal Reserve System, 516 F. 2d 1229 at 1241. In commenting upon the efforts of the Federal Reserve Board to prevent the disclosure of certain internal memoranda, the Court said:

> "Private parties and reviewing courts alike have a strong interest in fully knowing the basis and circumstances of an agency's decision. The process by which the decision has been reached is often mysterious enough without the agency's maintaining unnecessary secrecy. To be sure, the agency may have a strong interest of its own in keeping internal documents from public view, but it will normally be far easier for the agency to establish its interest in suppressing such documents than for the private litigants to establish their interest in exposing them to judicial scrutiny. The proper approach, therefore, would appear to be to consider any document that might have influenced the agency's decision to be 'evidence' within the statutory definition, but subject to any privilege that the agency properly claims as protecting its interest in non-disclosure."

I would suggest that the following language be substituted at page 16, lines 7-12:

"any interested party may call upon and shall be entitled to receive from" (1) the Board,

> or (2) in the case of the consideration of an application, the applicant, for any information or documents, not privileged, for purposes of discovery or for use as evidence." (underlined words would be inserted).

For all of the reasons which favor enactment of the amendments contained in S.72, I believe that there should be made available to the public the right to petition for issuance, amendment or revocation of an order or regulation promulgated under the authority of Section 4(c)(8). It seems particularly important that, if a regulation or order under Section 4(c)(8) is not serving the function for which it was issued or is producing anticompetitive effects, then the regulation or order should be revoked or appropriately modified. The fundamental purpose of Section 4(c)(8) is to insure that the public interest is preserved. When it becomes apparent that the regulation or order is not serving the public interest, then assuredly there should be a statutory provision which makes possible the prompt repeal or revision of the offending regulation or order.

VII.

Your final question treats with the adequate capitaliz tion of bank holding companies and their subsidiaries and the fact that no loans should be made to affiliates which discriminate against competitors. On this subject, I am particularly concerned that bank holding companies, possessing as they do major financial and economic resources, do not carry over their power from one industry into other industries (in our case, into the armored car and courier industries). If a bank holding company or its banking subsidiary makes a loan which discriminates against competitors of one of its subsidiaries, then an alien factor has been introduced into the competitive process. The hallmark of the Sherman Act, the Clayton Act and the Robinson-Patman Act is that competition shall be fair and that anticompetitive discrimination shall not be practiced. The threat that a bank holding company or its banking subsidiary will subsidize another of its subsidiaries by making discriminatory loans runs directly counter to the public interest at the heart of Section 4(c)(8). In that connection, I would recommend the following:

That Section 4 of the Bank Holding Company Act of 1956 as amended by Section 501(a) of S.72 be revised at page 14, lines 9-14, as follows:

"...(2) bank <u>and</u> <u>other</u> subsidiaries of bank holding companies refrain from discriminating in favor of their parent holding company or their affiliated subsidiaries in the making of loans or in the establishing of terms and conditions of credit or in the performance of services in the course of engaging in a non-banking activity." (underscoring is of words proposed to be added).

I would also respectfully suggest certain other matters related to S.72 for the consideration of your Committee.

On the subject of "tie-ins", I note that S.72 makes no amendment to Section 106(b) of the 1970 Amendments (12 U.S.C. Sec. 1972), which bars a bank from engaging in tie-in activities. In limiting itself to anti-competitive conduct by banks, the statute fails to deal with such activities on the part of other subsidiaries of a bank holding company. While this void has been filled in part by the Federal Reserve Board in its Regulation Y (12 CFR 225, Sec. 225.4 (c)), it would be my recommendation that this deficiency in Section 106(b) be corrected by S.72.*

*Section 225.4(c) provides in pertinent part that "[e]xcept as otherwise provided in an order in a particular case, the following conditions shall apply with respect to every acquisition consummated or activity engaged in on the authority of section 4(c)(8) of the Act: (1) the provision of any credit, property or services involved shall not be subject to any condition which, if imposed by a bank, would constitute an unlawful tie-in arrangement under section 106 of the Bank Holding Company Act Amendments of 1970..."

Turning to another provision of S.72, I observe that it provides at Section 301(b)(1) that a bank holding company may continue to engage in activities in which it was lawfully engaged on and since November 1, 1975, "except that such a bank holding company shall not permit the scope or size (in terms of volume of business) of those activities to expand to any significant degree." I believe that an amendment of this nature is essential in light of the Federal Reserve Board's position with respect to a "grandfather" provision in the 1970 Amendments (Section 4(a)(2), 12 U.S.C. Sec. 1843). There, in responding to a petition lodged against the expansion of the courier activities of a bank holding company's subsidiary on an intrastate basis and into domestic and international air freight forwarding, the Board stated that "Congress has...indicated...that expansion of grandfathered activities through internal growth would have a favorable competitive effect and, accordingly, did not place restrictions upon such method of expansion." (Letter of Board to counsel for Purolator Courier Corp., dated November 15, 1974). The effect of this position of the Federal Reserve Board is that a courier subsidiary holding grandfather rights and engaging in the most limited service could expand from state to state and internationally on a geographic basis and could expand the number and type of commodities carried by it with no limitation or supervision by the Board.

I consider that Section 301(b)(1) would make it clear to the Federal Reserve Board that limited "grandfather" rights may not be used as a springboard for unlimited expansion. I would recommend that the "scope or size" language of the Section be recast to state that the limitation there imposed encompasses both geographic expansion and increase in the nature of commodities carried by the "grandfathered" subsidiary.

I am grateful for the opportunity to appear before this Committee in its consideration of this significant and important legislation.

O

DATE DUE			