BANK HOLDING COMPANY REGULATION*

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I. INTRODUCTION

American history is replete with public debate about the form, scope and regulation of banking enterprises. With less fervor the controversy continues. One of the current issues is the role and regulation of bank holding companies. Present public policy towards holding companies will be reviewed here and some changes suggested.

A bank holding company is a corporation, business trust or similar firm exercising control of an independently incorporated bank or banks on the basis of ownership of all or part of the stock of the bank or banks.[1] Bank holding companies must be distinguished from "registered bank holding companies" or those systems regulated by the Board of Governors of the Federal Reserve System. Bank holding companies must also be distinguished from chain banking which is the combination of separately chartered banks under common ownership but without vesting control in a corporate unit.[2] Holding companies also differ from branch banks as the former are comprised of more than one corporate entity. Therefore, registered bank holding companies—the focus of this paper—are a subset of the larger set of bank holding companies. Bank holding companies comprise only a portion of all multiple-corporation-banking organizations that are included in the larger universe of all multiple-office banking organizations.

Bank holding companies have characteristics both of banks and correspondent relationships. For analysis of banking markets, however, the common ownership and control means that they are properly regarded as a more decentralized form of branch banking.[3]

II. THE BACKGROUND OF REGULATION

The prevalence of unit banking and State laws restricting branching has resulted in a long history of ownership ties

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[1] Some authorities restrict the term "holding company" to the parent organization and refer to the entire system as a bank group. W. Ralph Lamb, *Group Banking* (New Brunswick, Conn.: Rutgers University Press, 1962), p. 58. However, here "holding company" will refer to the entire organization of parent and subsidiaries.

[2] An example of a chain banking group would be the ownership of two banks by a single individual. If he owned a corporation which in turned owned the banks, the group would be a holding company. For information on chain banking as well as holding companies see: U. S. Congress, House of Representatives, Select Committee on Small Business, *Chain Banking*, 87th Congress (Washington, D.C.: U. S. Government Printing Office, 1963).

[3] There is a controversy about whether holding companies are properly regarded as a form of branch banking or whether the subsidiaries are comparable to unit banks. Space precludes analysis of this issue. However, even though management of holding companies is decentralized the ownership link makes holding companies comparable to branch banks in terms of competitive relationships. Cf: Gerald C. Fischer, *Bank Holding Companies* (New York: Columbia University Press, 1961), pp. 138–139; Irving Schweiger and John S. McGee, "Chicago Banking," *Journal of Business of the University of Chicago*, July 1961, pp. 203–366; Donald Jacobs and Eugene Lerner, "Chicago Banking: A Critical Review," *Ibid*, October 1962, pp. 414–419. Irving Schweiger "Reply to 'Chicago Banking: A Critical Review'," *Ibid.*, October 1962, pp. 420–433; Gerald C. Fischer, "Bank Holding Company Affiliates: Branches or Unit Banks?" *Ibid.*, January 1964, pp. 47–48.

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among banks in the United States.[4] However, Federal regulation of ownership links has been minimal until recently. Holding company regulation may be dated from the Banking Act of 1933 which was amended in 1935.[5] That law applied to holding companies with 50 per cent ownership or control of a bank, but only if the bank were a member of the Federal Reserve System and only if the holding company applied for permission to vote the stock it owned. Therefore, few holding companies registered. In 1954, the Board of Governors identified 114 bank groups of which only 18 were registered holding companies.[6]

The objective of the 1933 statute was supervision of reserve, dividend and other financial policies in order to protect depositors. From 1938 on, a series of bills was introduced into Congress to broaden the scope and purpose of regulation. The Federal Reserve System forcefully supported increased regulation on the ground that existing regulation was ineffective. The Board argued that effective control of a bank might not require a majority of the stock. Also, a holding company could avoid regulation by exercising control without voting its stock. More serious, the only regulatory weapon of the Board was cancellation of registration thus depriving the company of voting rights.[7]

The Board concluded that, although past activities had been only occasionally undesirable, holding companies were potentially dangerous.[8] Some holding companies had both banking and non-banking subsidiaries which the Board held to be axiomatically wrong. Also, holding companies were a method of escaping State laws against branch banking. Third, unregulated expansion of holding companies gave them an "... unfair and overwhelming advantage" over other banks.[9] Interestingly, the "unfair" activities cited were damage to the interests of local managements and minority stockholders, the support of markets for holding company stocks and trading profits for participants.[10] The possibility of holding companies lessening competitive vigor received little attention in early statements.

When the bills which finally resulted in the Bank Holding Company Act of 1956[11] were debated in Congress, these arguments as well as the need to protect the public from monopoly and "concentration of economic power" figured prominently. The committee reports and debates indicate that Congress had four objectives—protection of: (1) banks and the public from fraudulent financial transactions, (2) the "dual banking system" which allows States to determine the extent of branching, (3) the "accepted rules of law" which prohibit banks from engaging in other financial or industrial activity, (4) the public from undesirable expansion by holding companies.[12]

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[4] For histories of bank holding companies and their regulation see: Lamb, *op cit.*, pp. 12–40; and Fischer, *Bank Holding Companies*, *op. cit.*, pp. 1–85.

[5] Public Law No. 66; 12 U. S. C. Sec. 61, 161, 221.

[6] However, the registered companies accounted for 46 per cent of the total deposits held by the 114 groups. U.S. Congress, House of Representatives, Committee on Banking and Currency, *Bank Holding Company Act of 1955*, 84th Cong. 1st Sess. (Washington D.C.: U.S. Government Printing Office, 1955), p. 8,

[7] Board of Governors of the Federal Reserve System, *Thirteenth Annual Report* (Washington, D.C.: Board of Governors, 1943), pp. 34–36.

[8] *Ibid.*

[9] *Ibid.*, p. 36.

[10] *Ibid.*, p. 37.

[11] Public Law 511, 84th Congress, (12. U. S. C., 1842) Hereafter cited as B.H.C.A.

[12] For the legislative background of the B.H.C.A. see: Lamb, *op. cit*; Fischer, *Bank Holding Companies, op. cit.;* Note, "Bank Charter, Holding Company and Merger Laws; Competition Frustrated," *Yale Law Review*, January 1962; U.S. Congress, Senate, Committee on Banking and Currency, *Report on Control of Bank Holding Companies*, Report No. 1095, 84th Congress, 1st Sess. (Washington, D.C.: U.S. Government Printing Office, 1955), pp. 2–5; Benjamin J. Klebaner, "The Bank Holding Company Act of 1956," *Southern Economic Journal*, January 1958, pp. 313–314.

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Partly as a result of the diversity and vagueness of these goals and partly as a result of legislative logrolling the 1956 legislation was ill-designed. The only unambiguous achievement was to prohibit interstate expansion by holding companies and so assure States the ability to determine the extent and form of multiple-office banking. In addition to the limited achievements of the law, it has side-effects which seriously hamper the ability of holding companies to perform socially desirable functions.

The Bank Holding Company Act requires a holding company to register with the Board of Governors if it owns 25 per cent or more of the stock of two or more banks. There are a number of exemptions such as: any company registered under the Investment Company Act of 1940, non-profit, religious, charitable and educational organizations. The result is that many—probably a majority—of holding companies are not registered.[13]

Three activities are regulated. Section 3 gives the Board authority to approve or deny applications to form holding companies or to acquire banks. Section 4 makes it illegal for a bank holding company to own non-banking subsidiaries. There are a number of statutory exemptions to this rule. Also, a holding company may own a non-banking subsidiary performing services "closely related" to banking activities, subject to Board approval. Section 6 deals with intra-holding company transactions. It prohibits "upstream loans" and also regulates "downstream" loans and inter-affiliate dealings such as loan participations.

The ineffectiveness of the Bank Holding Company Act stems partly from its coverage and partly from confusion about what regulation is to accomplish. Consider first, the prevention of fraud. In the debates on the Act, the near or actual bankruptcy of three suburban Chicago banks was often cited as evidence of need for regulation. The banks had been acquired by interests who used them to dispose of poor quality paper acquired by small loan companies they also owned.[14] However, anyone wishing to engage in such an operation does not need two banks, one is sufficient. Therefore, the definition of regulated bank holding companies means that the Act is a poor bulwark against such dealings. If empirical evidence is required, several banks in 1964 failed (or came close to bankruptcy) because of practices similar to those which led to difficulties with the Chicago banks in 1953.[15] Nevertheless, a change to a one-bank definition of registered holding companies would not solve this problem. An individual or group wishing to use bank ownership for financial manipulation need not vest control in a corporate entity. A chain banking relationship is as effective and less likely to attract attention.

The holding company law also deals with intra-system transactions and, as electric utility history demonstrates, fraudulent manipulations are possible with holding companies. The restrictions placed on intra-system dealings by the 1956 legislation, however, make it difficult for bank holding companies to perform their main function, the facilitation of loan participations and other joint credit transactions. At present, it is sometimes easier for correspondent banks than for holding company affiliates to take joint action.

Turning to the second goal, protection of the "dual banking system," it must be conceded that here the Act is a success. Ironically, as reported out of the committees, the Bank Holding Company Act did not prohibit interstate expansion. On

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[13] Klebaner, *op cit.*, pp. 313–326, presents a detailed and helpful discussion of the Act and the impact of the exemptions.

[14] *Congressional Record*, June 13, 1955, pp. 6813–6814.

[15] See "Bank Failures and the Problem of Ownership Changes," *American Banker*, August 26, 1964, pp. 1-2.

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the floor of the Senate, however, Senator Douglas successfully proposed an amendment which provided that a holding company may not acquire a bank outside the State of its principal office unless the laws of the State in which the acquired bank is located specifically authorize such a transaction, "...by language to that effect and not merely by implication." As no State had or has such a law, the result is that holding companies can not expand across State lines.

Banking markets do not conform to State boundaries. Correspondent relationships partly overcome the lack of trade area banking firms. One of the advantages of holding companies is to permit financial transfers without use of correspondent relationships. The 1956 legislation can be regarded as removing the possibility of holding companies achieving trade-area banking organizations. The need for some form of trade-area organization has been recently cited by several public groups.[16] The Douglas Amendment, however, is not a matter of economic logic, but part of the theology of "dual banking." As long as Federal policy towards banking structure is subordinated to State policy, consistency implies that interstate expansion by holding companies be restricted. This problem is so much larger than holding company regulation that it will merely be noted and we shall pass on to other topics.

The third goal of the Act was the separation of banking and non-banking activities. Here the exemption of single bank holding companies is a commanding loophole. Many corporations such as W. R. Grace and Company and Minnesota Mining and Manufacturing Company own banks. Many of the banks in conglomerate holding companies are larger than regulated holding company systems. For example, Transamerica, now an unregulated firm, only recently agreed to divest Citizens National Bank of Los Angeles. At the time of the agreement, Citizens had $700 million in deposits and was the 43rd largest bank in the United States.[17]

In addition to the general exemption of single-bank companies, specific exemptions allow considerable conglomeration. A law simply forbidding the combination of bank and non-bank activities in one corporate body would not have passed in 1956. Nevertheless, the divestiture provisions adopted are both ineffective and inequitable.

The final goal was control of size and/or power—the language is ambiguous—and here the deficiency is less one of coverage than of standards. Because formation of a two-bank holding company is subject to approval, the two-bank definition of a holding company is not important. The 25 per cent rule in some cases has been used to avoid coming under jurisdiction. For example, the Howard Corporation-Republic National Bank of Dallas group in 1962 had interests in eleven banks ranging from 20.0 to 24.9 per cent each and a 37.0 per cent interest in another bank. It is not a registered company.[18]

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[16] Commission on Money and Credit, *Money and Credit: Their Influence on Jobs, Prices and Growth* (Englewood Cliffs, N. J.: Prentice-Hall, 1961), p. 166; Advisory Committee on Banking to the Comptroller of the Currency, *National Banks and the Future* (Washington, D.C.: U.S. Government Printing Office, 1962), pp. 50-51.

[17] For more on the divestiture agreement see footnote 22.

[18] U.S. Congress, House of Representatives, Committee on Banking and Currency, *Bank Holding Companies: Scope of Operations and Stock Ownership*, 88th Congress (Washington, D.C.: U.S. Government Printing Office, 1963), pp. 36–37. The 1956 legislation did not cover mergers of affiliates with non-affiliate banks. The Bank Merger Act of 1960 [Public Law 86–463 (12 U. S. C. 1828 (c))] requires all bank mergers to be approved by one of the three Federal banking agencies so presumably this loophole for holding company expansion was closed. The extent to which the Comptroller of the Currency and the Federal Deposit Insurance Corporation do or should consider holding company aspects of bank mergers remains unclear. Nevertheless, this problem seems to be of much less magnitude than the problem of the criteria for judging socially desirable expansion.

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The Board must assess whether a holding company formation or acquisition would "... expand the size or extent of the bank holding company system involved beyond limits consistent with adequate and sound banking, the public interest and preservation of competition...."[19] It is unclear whether Congress wished to control the total amount of banking resources in the holding company sector, the absolute size of individual companies, the size of companies relative to their markets, or the ability of individual companies to influence the performance of their markets.

In short, the statutory basis of holding company regulation is incomplete, inequitable, illogical and ambiguous. The impact of any regulation, however, is only partly determined by legislation; of equal or greater importance is the administration of the law, the next topic to be considered.

III. THE BOARD OF GOVERNORS' POLICIES

In 1956 there were 42 domestic corporations registered under the Bank Holding Company Act, controlling 421 banks with $15 billion in deposits. On December 31, 1963 there were 44 registered domestic companies with 447 banks, 1,263 branches and $22 billion in deposits.[20] The growth of the registered holding company sector has not been large, though the aggregate figures conceal many changes within the sector. Fifty-six domestic companies have at one time or another been registered.

Three types of cases will be considered. They are: non-bank subsidiary proceedings, formation requests and applications to acquire banks.

Non-bank subsidiaries. In general, a registered bank holding company may not own a non-bank subsidiary offering services to the general public unless the Board determines that the subsidiary's activities are "... so closely related to the business of banking or of managing or controlling banks as to be a proper incident thereto. ..."[21] The Board has used two tests of "proper incident," the degree of integration of banking and non-banking activities, and regional practice.

The first test was established in the *Transamerica-Occidental* case.[22] The subsidiary at issue, Occidental Life Insurance Company of California, was the largest life insurance company in the West and one of the largest in the United States. Transamerica also owned more than half the stock of 25 banks with 288 offices and deposits in excess of $2.8 billion, and more than 25 per cent of another bank with $487 million of deposits. Besides Occidental, it owned six insurance companies, two industrial concerns, and real estate and finance companies.[23]

Transamerica asserted that Occidental's activities were "closely related" for three reasons. First, life insurance and banking activities closely resemble each other, have the same basic nature and share many common elements. Second, certain underwriting, loan and investment activities of Occidental were functionally related to or involved servicing Transamerica's banking affiliates. Third, the management and

[19] B.H.C.A., Sec. 3 (c).

[20] Information provided by Board of Governors. Tabulations of the number and size of holding companies and the Board's decisions are available from: Banking Markets Unit, Division of Research and Statistics, Federal Reserve Board, Washington, D.C. 20551.

[21] B.H.C.A. Sec. 4 (c) (b).

[22] "Application of Transamerica Corporation relating to Occidental Life Insurance Company of California," *Federal Reserve Bulletin*, September 1957, pp. 1014–1035. This proceeding is a landmark for several reasons. It was the first decision under the new law. Also, it involved Transamerica Corporation and it was an open secret that the Bank Holding Company Act was directed at the largest and most diversified holding company. After this decision, Transamerica was reorganized and its banking subsidiaries except for Citizens National Bank were held by the Firstamerica Corporation (later Western Bancorporation). At the time of approval of the merger between Crocker-Anglo National Bank and Citizens National Bank, Western Bancorporation agreed to disposal of its interest in Citizens.

[23] *Ibid.*, pp. 1020–1021.

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supervision of both activities were similar and Occidental provided strength and stability to the banking subsidiaries.[24]

The hearing examiner rejected these claims because of insufficient functional integration. He stated that:

...Congress must have expected something more than a showing of common traits or normal business consanguinity as a predicate for a "closely related" exemption. The key to what more was expected is to be found, I think, not alone in the statute's requirement for a "proper incident" finding, but also its requirement that a "closely related" exemption, if it is to be allowed, must be found by the Board to be in harmony with the purposes of the Act. Divestiture exemption of non-banking companies can be reconciled with the legislative objective of keeping bank ventures in a field of their own only if the "closely related" provision is construed as limited in its application to companies whose activities are so functionally integrated with or required for banking operations as to make them in effect part of the parcel of such operations.[25]

The Board endorsed this reasoning. It held that while similarities exist, there are important differences which bring the combination of insurance and banking under the scope of the law. As for Occidental's direct relations with the banking subsidiaries, because these were relatively small parts of the businesses of both Occidental and the banking affiliates, Occidental did not qualify for exemption.[26]

The second test was developed in a series of cases involving banks in the upper midwest.[27] The Board has exempted several insurance agencies closely connected with holding company banks. The agencies typically were managed by bank personnel on bank premises and primarily wrote crop insurance and similar policies for bank customers as an "adjunct to loans." The Board emphasized, however, that the physical and personnel connection, though important, was not decisive. More important was that the integration accorded with common regional practice. If the *Transamerica-Occidental* test is met, area practice will determine permissible conglomeration. Partly as a result of the clarity and definitiveness of the criteria there have been only seventeen cases involving holding company subsidiaries.

Holding company formations. By the end of 1963 the Board had approved 11 applications to form holding companies and denied four. Table I shows, however, that the four denials accounted for 85 percent of the total banking resources involved in holding company formation applications. In fact, had two denials been approved, they would have increased the total deposits controlled by holding company affiliates by more than $12 billion compared with the $2.1 billion added to the holding company sector by all approved applications. Table I indicates that requests involving small banks have a good chance of receiving approval and applications involving large banks do not. This impression is reenforced by examination of

TABLE I

Holding Company Formation Decisions, 1956–1963

	Number of cases[1]	Total banks involved	Total deposits involved[3]	Total deposits held by largest bank involved in each case[3]
Total applications	15[2]	53	14,830.1	12,275.0
Applications denied	4	17	12,686.5	10,403.7
Applications approved	11	36	2,143.6	1,871.3

[1] Also the number of systems involved as each case involved only one company.

[2] Does not include application to form New York Holding Company, White Plains, New York which was postponed indefinitely.

[3] Measured in millions of dollars of deposits. Figures were estimated when not given in decisions.

Source: *Federal Reserve Bulletin; Polk's Bank Directory.*

[24] *Ibid.*, pp. 1021–1022.

[25] *Ibid.*, pp. 1029–1030.

[26] *Ibid.*, pp. 1017–1018.

[27] An example is "First Bank Stock Corporation," *Federal Reserve Bulletin*, August 1959, pp. 917–954.

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the Board's opinions. "Size" is the most important consideration, although "size" has been measured in a variety of ways. To illustrate this point, two denials involving large banks will be briefly discussed.

The first illustration is the *First New York Corporation* case.[28] The proposal would have created a holding company more than twice as large as the then largest system. However, of the over $7 billion deposits in the system, $6.6 billion would have been accounted for by one affiliate, the First National City Bank of New York. The other two banks involved, though much smaller, were large relative to their rivals. County Trust Company, White Plains, was the 74th largest bank in the United States with deposits of $351 million, 39 offices, and almost 49 per cent of the total deposits in Westchester County. City Bank Farmers Trust Company, the other bank involved, was a subsidiary of National City and essentially its trust department. Farmer's deposit business was primarily a service provided fiduciary customers.[29]

The Bank Holding Company Act requires the Board to consider five "factors" in any formation or acquisition case. These are:

> (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.[30]

The Board began its decision by pointing out that Congress had not regarded holding companies as *per se* evil and had wished all facts pertinent to the five factors to be evaluated. In any particular case, according to the Board, one factor might be found to outweigh all other factors.[31]

The decision centered on factors 4 and 5. For the fourth factor, the Board distinguished between two types of benefits from a holding company. There may be benefits to the banks concerned which indirectly benefit the community. These, the Board decided, are irrelevant. The appropriate benefits are those which directly benefit the community through making available desired additional services, facilities to meet forseeable demands and like improvements. While the Board felt the proposed holding company would lead to some improvement in locally available services in Westchester County, the possibility of obtaining such services through correspondents and the ability of County Trust to expand internally to meet forseeable demands meant that factor 4 considerations did not lend much affirmative weight.[32] The decision hinged on "size" and "competition."

"Size" was measured both by total assets and also by the position of the banks in their respective geographical areas. The size of the holding company system was held to be a distinct matter from the size of the banks involved. In the Board's words:

> ...the size of the proposed holding company system would be attributable to the size of the three subsidiary banks, particularly that of City Bank. However, the language of the fifth statutory factor refers not to the size of the banks involved but to the size of the bank holding company system. The Act is not concerned with regulation of the expansion of individual banks; it is aimed at control of expansion of bank holding companies.[33]

It would appear that the Board, in this passage was thinking of size in the absolute sense, i.e., total deposits or assets. However, the percentage of regional deposits

[28] "Application of First New York Corporation et. al to Become Bank Holding Companies," *Federal Reserve Bulletin*, August 1958, pp. 902–929.
[29] *Ibid.*, pp. 911, 921.
[30] B.H.C.A., Sec. 3 (c).

[31] Application of First New York Corporation . . . , *op cit.*, p. 909.
[32] *Ibid.*, pp. 909–912.
[33] *Ibid.*, p. 912.

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held by County Trust figured importantly in the opinion. Holding company affiliation would not have changed the relative size of any of the banks in its local area. Therefore, while the distinction between the size of the banks and the size of the system may be meaningful when examining absolute size, for measurement of concentration or relative size it is a non-sequitur.

The analysis of the competitive impact is also confusing. Five points were made: (1) The overlaps between the customers of the banks were small percentages of the total business of each bank but the absolute amounts were "substantial." (2) The independent existence of the banks created potential alternative choices for consumers that because of commuting patterns and trends in regional integration was important for potential competition. (3) "... the degree of banking power that would be held by the proposed holding company system, even though not dominate, would be considerable." (4) The advantages that County Trust would receive from First National, such as data processing and similar services would give it competitive advantages not enjoyed by other Westchester banks. Finally, (5) approval of the application would lead to more holding company proposals involving Westchester County.[34]

The *Morgan New York State*[35] case also involved a large New York City bank, Morgan Guaranty Trust Company of New York, proposing to affiliate with upstate banks. The six other banks were all relatively large. Most were the largest or second largest in their areas. The Board's decision was in accord with *First New York State*, but with some additional elements.

The Board held that approval was "essential" under the fourth factor only if existing bank services were inadequate. It concluded that: "It has not been demonstrated to the Board's satisfaction that the existing banking structure is presently inadequate, and there seems to be little basis for assuming that the Banks in question, let alone area banks generally, cannot progress to meet future challenges."[36]

The claim that a new holding company was needed in New York State to compete with Marine Midland Corporation, a holding company with $2.6 billion in assets, was rejected. The Board held that Marine Midland already faced sufficient competitive pressure. And, even if the affiliated banks would be able to offer a broader range of service and thereby be more effective competitors, little if any need had been shown for increased amounts of such services.[37]

Three considerations led the Board to conclude that the proposal failed the fifth test. First, the percentage overlap was "small" but the absolute amounts involved were "substantial." Second, each of the upstate banks was large relative to its rivals. Third, affiliation with Morgan would give the upstate banks advantages not enjoyed by its rivals.[38]

[34] *Ibid.*, pp. 912–915. Interestingly, in other cases the Board has rejected the relevance of the fifth point for its decisions. See, for example, "First Oklahoma Bancorporation, Inc., Oklahoma City, Oklahoma," *Federal Reserve Bulletin*, December 1962, pp. 1608–1620. In logic there seems to be no more reason why approval of an acquisition should require approval of further acquisitions than approval of a charter implies approval of further charters.

[35] "Morgan New York State Corporation, Albany, New York" *Federal Reserve Bulletin*, May 1962, pp. 567–582.

[36] *Ibid.*, p. 573.

[37] *Ibid.*, p. 574.

[38] *Ibid.*, p. 577. The inconsistency between the finding that no additional services were needed and the finding that affiliation would allow banks to take business from their rivals because the subsidiaries could offer more and better services seems not to have been noticed by the Board. The same inconsistency appears in *First New York State*. The relative importance of the fact that the upstate banks were all relatively large in the *Morgan New York State* case should soon be clarified. Chase Manhattan Bank has proposed to form a holding company with three upstate banks, each of which is the third or fourth largest bank in its area. "Reaction is mixed on Chase Bank Bid," *New York Times*, July 16, 1964, p. 43.

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TABLE II

Size of Acquired Banks Involved in Holding Company Acquisition Decisions, 1956–1963

Size of Bank*	Number
Proposed	16
.1–2.0	4
2.1–5.0	16
5.1–8.0	8
8.1–12.0	3
12.1–25.0	6
25.1–50.0	7
50.1–100.0	1
100.1–500.0	2
500.1 and over	1
Total	64

* Size figures are from last Condition Report for which data are available and in some cases are approximate estimates. (In millions of dollars of deposits.)

Source: *Federal Reserve Bulletin;* Association of Registered Bank Holding Companies, "Decisions of the Federal Reserve Board Under the Bank Holding Company Act" (mimeographed); *Polk's Bank Directory.*

TABLE III

Size of Holding Companies Involved in Bank Acquisition Cases, 1956–1963

Size of Holding Companies*	Number
0–50.0	9
50.1–100.0	5
100.1–300.0	11
300.1–500.0	13
500.1–750.0	4
750.1–1500.0	6
1500.1–2000.0	10
2000.1 and over	3
Total	61

* Size figures are from last Condition Report for which data are available and in some cases are approximate estimates. (In millions of dollars of deposits.)

Note: A holding company is counted each time it proposed an acquisition. A given company may therefore fall in more than one class as its size changes through growth. Only 22 companies applied during this period for approval.

Source: *Federal Reserve Bulletin;* Association of Registered Bank Holding Companies, "Decisions of the Federal Reserve Board Under the Bank Holding Company Act" (mimeographed); *Polk's Bank Directory.*

The same criteria have been applied in most of the formation cases. Rather than analyze the Board's position here, acquisitions will be described. As formation and acquisition policies have similar features they can be discussed together.

Acquisitions. Most acquisition requests have involved small banks. As Table II shows, of the 64 banks involved in applications, 36 were either proposed new banks or had $5 million or less in deposits. Only 4 banks had $50 million or more in deposits. Also, most of the holding company systems concerned were relatively small. In nine of the 61 cases, as shown in Table III, the acquiring system had $50 million or less in deposits. Twenty-five cases involved systems with less than $300 million. Forty-six of the 61 applications were approved and 15 denied.

All of the formation tests discussed have also figured in acquisition cases. Two additional considerations have received special attention, however. One is the impact of the acquisition on the size of the holding company sector. The second is the effect of the acquisition on competitors' market shares.

Two of the many decisions that might be cited will be presented here as illustrations. The first case is the *Pipestone* decision.[39] Northwest Bancorporation which controlled 77 banks proposed in 1961 to acquire the First National Bank, Pipestone, Minnesota, with deposits of about $7.5 million. The only other bank in Pipestone was owned by a large holding company and had deposits of about $3.2 million.

Northwest had no subsidiary in the Pipestone area. Its nearest affiliate was 25 miles away. While the overlap of customers between the bank and the holding company was trivial, the Board held that it was necessary to consider future competition and how the acquisition might affect the position and growth of other banks in the area.[40]

[39] "Northwest Bancorporation," *Federal Reserve Bulletin*, April 1961, pp. 408–411.
[40] *Ibid.*, p. 410.

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The Board stressed that First National was the largest of eleven banks in the area and the acquisition would give Northwestern Bancorporation nearly 28 per cent of their total deposits. Competition with savings and loan associations was held to be irrelevant.[41]

The Board emphasized that the only other bank in Pipestone was an affiliate of a large holding company. Established policy was cited as follows:

The Board has recognized the adverse effect upon the public interest and preservation of competition that may follow from control of a large proportion of the banking resources of a community by relatively large bank holding companies. When Northwest sought to acquire a proposed new bank in Rochester, Minnesota, the Board noted that two of the three existing banks in Rochester were ... [holding company] subsidiaries. ... Northwest controlling two of these four [banks], "presumably would be in a strong position to increase its relative proportion of the banking business of the community."[42]

Three facts seem to have led to denial of the application. First National was the largest bank in the region even though there were eleven other banks. Second, all the deposits in Pipestone and a large proportion in the area generally would be controlled by holding companies were the acquisition to be approved. Third, affiliation with a holding company might enable First National to grow faster than its rivals.[43]

The second illustration is the *Wisconsin State Bank, Milwaukee* case which was first denied and then approved. The Marine Corporation was a relatively small holding company with about $255 million in deposits and six banks.[44] It proposed to acquire Wisconsin State Bank with deposits of about $37 million. The decision hinged on the fifth factor. The acquisition would have increased Marine's percentage of Milwaukee County deposits from 13 to 15 per cent. The denial was based, however, on the relative shift between the independent bank sector and the holding company sector. The Board's arithmetic follows:

The three holding companies operating in Milwaukee controlled about 75 per cent of total commercial bank deposits in the County at December 31, 1960. Of this amount Marine controlled 13 per cent as against 41 per cent for First Wisconsin Bankshares Corporation, the largest of the three. The acquisition would shift more than 8 per cent of the total deposits of all independent banks in the County to Marine.[45]

And:

The acquisition would give Marine control, through [Wisconsin State] Bank, of total deposits equal to 85 per cent of those held in all the remaining independent banks in [Wisconsin State] Bank's primary service area, and [Wisconsin State] Bank is approximately twice as large as the next largest independent bank in such area.[46]

Two Governors voted for approval. They reasoned that as Marine was the smallest holding company operating in Milwaukee, approval would increase rather than lessen competition.[47]

Four months later, in October 1961, the decision was reversed.[48] One reason was a changed view of the fourth factor. The bank's locality was changing from residential to commercial and the Board reasoned that Marine would be in a position to assist Wisconsin State Bank in meeting the new banking needs. It continued:

On the other hand, affiliation would not materially increase Bank's advantage in competition for the type of accounts that the smaller banks are equipped to serve. These banks have themselves all shown substantial growth in recent years, and there is no evidence that holding company competition in the area has been overly restrictive. In this light, and since none of these banks has ex-

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[41] *Ibid.*, p. 410.

[42] *Ibid.*, citing "Northwest Bancorporation," *Federal Reserve Bulletin*, January 1958, pp. 11–13.

[43] *Ibid.*, p. 411.

[44] "The Marine Corporation," *Federal Reserve Bulletin*, July 1961, pp. 763–67.

[45] *Ibid.*, p. 765.

[46] *Ibid.*

[47] *Ibid.*, p. 767.

[48] "The Marine Corporation," *Federal Reserve Bulletin*, October 1961, pp. 1179–82.

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pressed views adverse to the acquisition, we conclude that it would not have a significant adverse effect on the smaller banks.[49]

The Board also changed its mind on the benefits from strengthening Marine's position in the market. Further, it distinguished between eliminating competition between two banks where there are a number of other banks and eliminating competition where only two banks exist. The *Wisconsin State Bank* case was held to fall in the first category.

One Governor objected to the removal of a "growing, independent competitor." Another dissenter objected to any increase in the amount of banking resources in Wisconsin controlled by holding companies.

To review, the Board's position on holding company formations and acquisitions has four parts. First, benefits to the banks concerned receive little weight. Second, benefits to the communities involved have been strictly interpreted and have received relatively little weight. The availability of services from any bank or banks in a region rather than from the banks involved has been the test. Third, competition is evaluated primarily by examining the impact of the proposal on competing banks. Fourth, "size" is measured in four ways: (1) the absolute amount of overlap of customers between banks, (2) the absolute amount of deposits involved, (3) the relative position of the banks involved in their local markets, and (4) the amount of resources in an area controlled by all holding companies and not just applicants.

It would appear that the basic policy of the Board could be summed up in two sentences. Any holding company expansion which would not materially change the existing structure of a banking market will be approved. Any proposal which would significantly change the role of holding companies in a local area will be disapproved.

This policy probably carries out the intent of Congress. However, it does not necessarily protect the public from possible abuses of holding companies. At the same time it may prevent holding companies from increasing the efficiency of the banking system.

While there can be little objection to the Board's treatment of the first four factors,[50] considerable criticism can be directed against its policy regarding the fifth factor. The Board has not distinguished between efficiency and monopoly. It has regarded competition as protection of the market shares of existing banks rather than as a means of protecting consumer interests. To illustrate by the *First New York Corporation* case, the Board felt that because the affiliation with County Trust would allow the latter to offer more and better services and lower costs to the detriment of its rivals, competition would be lessened. Of course, a bank may be disadvantaged either because a rival is more efficient or because he has a monopoloid position. However, the distinction between these two situations should be a basic part of any public policy towards corporate expansion.

The result of the Board's focus on the absolute size of the banks and holding companies involved in applications has meant that the Act has become a bulwark of the *status quo* against change. While size can often be translated into market power, the Board has attempted to make size a criterion separate from competitive impact. This position contrasts with antitrust policy. In recent Clayton Act cases, size has been used as a proxy for market power.[51] While this practice is open to

[49] *Ibid.*, p. 1180.

[50] For a contrary view see, Jules Backman, "The Bank Holding Company Act," *C. J. Devine Institute of Finance, Bulletin No. 24-25*, April–June 1963. See also: Marcus Nadler and Jules I. Bogen, *The Bank Holding Company* (New York: New York University Press, 1959).

[51] E.g. *United States v. Brown Shoe Co.*, 370 U. S. 294 (1962); *United States v. Philadelphia National Bank*, 374 U. S. 321 (1963); *United States v. Aluminum Company of America*, et al. ——— U. S. ——— 32 LW 4446.

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challenge, it is far superior to the Board's approach which makes size a *per se* measure of legality.

Of course, bank holding company policy deals with a situation different from merger policy in the industrial sector. The basis of present Clayton Act policy is that, in general, internal expansion is more socially desirable than external expansion.[52] Bank holding company expansion, on the other hand, takes place under conditions where internal expansion by banks is severely limited or prohibited. Were unlimited *de novo* branching permitted, there would be few bank holding companies. It should also be noted, that many applications have involved establishment of new banks and so are more comparable to internal industrial growth than to industrial mergers. Therefore, the choice of criteria for bank holding company expansion cannot be settled by simple analogy to industrial merger policy and resolved in favor of maximizing the percentage of internal to total growth. Instead, some analysis of the relationship of size to market performance is required.

Bank holding company expansion might have serious consequences for public welfare. The Bank Holding Company Act has not been applied, however, in a manner to distinguish between that expansion which would benefit and that which would damage the public. The relevant issue now becomes how holding company regulation might be changed. The next section will discuss currently proposed legislation and present an alternative approach.

IV. PROPOSED REVISION OF HOLDING COMPANY REGULATION

In 1958, the Board's annual report to Congress on the Bank Holding Company Act discussed four problems.[53] These were: (1) how to balance factors 4 and 5 when each indicated a different course of action, (2) how to define the terms in factor 5, (3) how to relate State regulation to Federal policy, and (4) how to deal with intra-holding company transactions. The Board made twenty-five specific recommendations for amendment. Some of these have been embodied in proposed legislation. The most recent, H.R. 10872, sponsored by the Board, would make four changes. One-bank holding companies would come under regulation. The exemption of agricultural, religious and similar non-profit organizations would be removed. Section 6 would be repealed and Section 23A of the Federal Reserve Act would be amended to cover inter-subsidiary transactions. Section 23A[54] deals with permissible transactions among Federal Reserve members and the effect of the proposed change would be to replace the specific restrictions of the Bank Holding Company Act with general criteria of sound inter-bank dealings. The last change would be repeal of pre-1956 holding company legislation which the Board feels was always of dubious usefulness and now is obsolete.

H.R. 10872 would "tidy up" holding company regulation but would make only one substantive change, a new approach to inter-subsidiary dealings. The impact of regulation would be more uniform, but no improvement would be made in the standards applied to regulation. And, it is the standards which are the basic problem, not the coverage.

Consequently, a modest alternative is proposed here. The Bank Holding Company Act should be repealed. The Federal Reserve Act should be amended, as the Board desires, to apply present principles of dealings among Federal Reserve mem-

[52] *United States v. Philadelphia National Bank*, 324 U. S. at 369; William H. Orrick, Jr., "The Impact of the Federal Antitrust Laws on Corporate Mergers." Speech before the Association for Corporate Growth, Inc., New York, May 12, 1964.

[53] "Report Under the Bank Holding Company Act," *Federal Reserve Bulletin*, July 1958, pp. 776–96.

[54] 12 U. S. C. 611.

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bers to intra-holding company dealings. A statute, such as the one proposed by the Federal Deposit Insurance Corporation, that would require notification of change in bank ownership should be enacted. Finally, the Bank Merger Act of 1960 should be amended to require the Board of Governors to apply to all holding company formations and acquisitions the standards now applied to bank mergers.

Consider this proposal in light of the four objectives of the 1956 legislation. The first was the prevention of fraudulent financial manipulations. As previously discussed, it is ownership of a bank and some other financial intermediary and not the holding company device which permits fraud. The appropriate method of dealing with this problem, therefore, is passage of a law which would require reporting of ownership changes to the regulatory authorities, and allow them to be alert for dangerous portfolio policies.[55]

The second objective was protection of the "dual banking system." The revision proposed here would allow interstate expansion and therefore would be counter to present policy. Those who feel protection of "states rights" in banking to be more important than the development of regional banking organizations might wish a separate law re-enacting the Douglas Amendment.

The third objective was the separation of ownership of banking and non-banking firms. The present proposal would allow such integration. Under certain circumstances vertical or conglomerate integration may permit the extension of market power. It is dubious that any bank holding company has, had, or could achieve the necessary conditions such that market power could be increased or extended from one market to another. The existing prohibition is based on the proposition that the combination of banking and non-banking activities is "axiomatically" undesirable. If it is undesirable, the existence of a large number of unregulated one-bank holding companies which combine banking and non-banking activities should provide convincing evidence that separation is necessary. In the absence of such a case being made by supporters of the present policy, there seems little basis for prohibition of conglomeration. Conversely, diversification might permit holding companies to offer customers finance programs combining a variety of financial intermediary services and tailored to specific consumer desires. It there is a demand for such "packaging" it seems reasonable to allow it to be met.

The final goal is control of expansion. Incorporating holding company regulation into the Bank Merger Act would not solve all problems of determining appropriate standards. It would not solve the need to balance the "convenience and needs" criterion with the competitive impact. It would not solve the problem of the conflict between Bank Merger Act and Clayton Act standards. It would have two commanding advantages, however. The standard in the Bank Merger Act equivalent to factor five of the Bank Holding Company Act is: "...the appropriate agency shall also take into consideration the effect of the transaction on competition (including any tendency toward monopoly)...." Applying this standard to holding company expansion would eliminate the problem of trying to define "size" and focus attention where it should be, on the impact of the expansion on the present or future market power of the holding company. Incorporating holding company expansion into the Bank Merger Act would also have the advantage of allowing a unified treatment of multiple unit expan-

[55] Such a bill is now before Congress. See: 88th Cong. H. R. 12267; "Congress seen Receptive to Barr Proposal on Bank Control Changes," *American Banker*, July 24, 1964, pp. 1, 11; "Text of Bank Control Bill," August 14, 1964, pp. 1, 3.

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sion by branching and by holding company growth.[56]

Separate treatment of bank mergers and holding company expansion is more a result of historical accident than logic. The competitive impacts are in all important respects identical.[57] The choice between mergers and a holding company for expanding banks is primarily determined by state laws.[58] The difference in decentralization between branch systems and holding companies is relevant for public policy but it would be best treated in evaluating the impact of a proposal on the "convenience and needs" of the areas involved. It should be noted, that even if the proposal advanced here were accepted, holding company expansion would still be subject to challenge under the Clayton and Sherman Acts. The conflict between banking legislation and the antitrust laws is a vital issue beyond the scope of this paper. It does not, however, affect the merits of unified treatment of bank mergers and holding company expansion.

V. CONCLUSION

The Bank Holding Company Act of 1956 was, when passed, both inequitable and ill-designed. Administration of the Act has not corrected its faults. Current proposals for change would improve its coverage but would not deal with the fundamental issue. This issue is: What aspects of holding company activities should be regulated and what standards should be applied?

The proposal advanced here would eliminate divestiture of non-banking subsidiaries as a goal. It would permit more intra-holding company transactions, and it would treat expansion under the Bank Merger Act of 1960.

This proposal is a modest one. It does not deal with the conflicts between the banking legislation and the antitrust laws, between Federal and State regulation of banking structure, between the "convenience and needs" and "competitive impact" criteria, or between the policies of the three Federal banking agencies. Nevertheless, the proposal would increase the contribution of holding company regulation to protecting the public from increases of market power in banking markets and it would also assist in making the banking system more efficient.

If it has no other result, it is hoped that this proposal will lead to discussion of the rationale of bank holding company regulation. Such a re-examination and analysis is needed.

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[56] As almost all acquired banks become branches it is legitimate to view mergers and holding company expansion as equivalents. For discussion of the problems encountered in regulation of bank mergers see: Charles L. Thiemann, "The Bank Merger Act of 1960," unpublished Ph.D. Dissertation, Indiana University, 1964; George R. Hall and Charles F. Phillips, Jr., *Bank Mergers and the Regulatory Agencies* (Washington, D.C.: Federal Reserve Board, 1964); David A. Alhadeff, "Bank Mergers: Competition Versus Banking Factors," *Southern Economic Journal*, January 1963, pp. 218–30. Alhadeff emphasizes the conflicts between the "convenience and needs" and the "competitive impact" criteria.

[57] Cf: Fischer, "Bank Holding Company Affiliates: Branches or Unit Banks," *loc. cit.*

[58] Harmon H. Haymes and Charles F. Phillips, Jr., "Banking in Virginia: The 1962 Legislation," *Washington and Lee Law Review*, Spring 1964, pp. 48–69.

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