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Working Paper

The Regulation and Supervision of Bank Holding Companies: A Historical Perspective

Working Paper, No. 116

Provided in Cooperation with:
Levy Economics Institute of Bard College

Suggested Citation: Phillips, Ronnie J. (1994) : The Regulation and Supervision of Bank Holding Companies: A Historical Perspective, Working Paper, No. 116, Levy Economics Institute of Bard College, Annandale-on-Hudson, NY

This Version is available at:
https://hdl.handle.net/10419/186799

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The Regulation and Supervision of Bank Holding Companies: An Historical Perspective

by

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Working Paper No. 116

May 1994

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I. Introduction

Who should regulate bank holding companies? The recent Treasury proposal to consolidate the federal banking agencies would require that the Federal Reserve give up the power to regulate bank holding companies (BHCs) that it has had since the passage of the Bank Holding Company Act of 1956. The Federal Reserve has argued that it needs to regulate bank holding companies in order to protect against systemic risk; however, this argument was not used when the Act was passed, and in fact, the Federal Reserve was indifferent to which agency should regulate bank holding companies.

Scholars have generally concluded that the assigning of the BHC responsibilities to the Fed in 1956 was primarily based on the historical precedent of the Clayton Act and the Banking Act of 1933 which granted some powers to the Federal Reserve with respect to bank holding companies. This explanation is not sufficient because bank holding company bills had been introduced since 1930 and it is only after 1943 that the Federal Reserve is designated as the regulatory agency for BHCs. Why was there a change?

There are three factors which together explain why the Federal Reserve was selected as the regulatory agency. The first, and probably most important, was in the legislative response to the public outcry over the abuses of bank affiliates. The bank affiliates and holding company issues were intertwined, and the outcome of the Banking Act of 1933 had important implications for the future regulation of BHCs. If the separation of commercial and investment banking had not occurred, the OCC would quite likely have been the regulatory agency for BHCs. It was recognized that a system of universal banking (national banks with affiliates) required a single regulator. Second, legislation proposed by Marriner Eccles and the Federal Reserve in 1943 to

control BHCs specified the Federal Reserve as the regulatory agency, despite the fact that at the time there was little rationale for this. However, the bill introduced in 1943 became the BHCA of 1956. Third, the Comptroller of the Currency in 1956, Ray Gidney, believed that BHCs promoted efficiency in banking and needed little regulation. Those members of Congress who believed that BHCs should be tightly controlled, or abolished, had little incentive to entrust the regulation and supervision of BHCs to Gidney. If the Comptroller of the Currency at the time had been a strong opponent of the expansion of BHCs, then there might have been reason to change the legislation.

A reexamination of the reasons for granting regulatory power over BHCs to the Federal Reserve is of direct policy relevance today: Should we retain our multiagency regulatory structure if the U.S. moves toward some form of universal banking? The history of bank holding company regulation provides guidance in answering these questions.

II. Bank Regulation from 1863-1927

Before discussing the regulation of bank holding companies it is necessary to provide a brief background on the history of, and rationale for, banking regulation in the U.S. Though the First and Second Banks of the U.S. each had national charters and issued a national currency, after the expiration of the charter of the Second Bank of the United States in 1836, the U.S. entered a period known as the "Free banking." Banks were chartered by the states and subject to regulation by the state banking authorities and there was little uniformity in bank regulation. Because of the plethora of monies available, there were substantial costs associated with determining whether a banknote would be redeemed, and therefore banknotes only circulated at par-value within a small geographic region. Though the development of a clearinghouse system helped to reduce the costs associated with clearing notes, and extended the par exchange area for banks, no banknotes circulated at par-value throughout the entire country during the Free Banking era. One way to deal with the high social and private costs of non-par clearance would be to have a government issued money, and by the 1860s such proposals abounded. Instead of a single national bank, as had been previously been established, the National Banking Acts of 1863 and 1864 established a national banking system, a national currency, and a federal chartering and

regulatory authority, the Office of the Comptroller of the Currency.

Banks could now be chartered either by individual states, and subject to their regulations, or by the Comptroller of the Currency, and therefore subject to national bank regulations. The national banks could issue banknotes, but were required to hold $111.11 in government bonds for each $100 of banknotes issued. The national banknotes, though not legal tender, were convertible into Greenbacks or gold. National banks also held short term commercial loans.

The national currency was created at a time when Congress had suspended the convertibility of Greenbacks (issued by the Treasury) into gold; thus, it was not a foregone conclusion that national banknotes would circulate at par-value. The banknotes would be issued by individual banks, and the OCC guaranteed that the Treasury would redeem them at par-value. For the government to guarantee par-value implies the same requirements that would be put on any private bank which would guarantee the par clearance of banknotes. The Treasury would have to the difference between the market value and par for any national banknotes. In order to do this, the Treasury needed information on the national banks. This was accomplished by imposing limits on the asset holdings of national banks (national banks could not make real estate loans, for example) and specifying that national banks would be subject to regular examinations by the Office of the Comptroller of the Currency (OCC). This was to both assure the public and to protect the Treasury. Because of the requirement on the holding of government securities, it was unlikely that the Treasury would ever incur a loss in the event of a national bank failure. *The fundamental rationale for bank regulation was to provide for a national currency that would circulate at par-value, and would be issued by banks with a very low probability of failure, and whose liabilities were effectively guaranteed by the federal government.*

Though the government now guaranteed that national banknotes would clear at par, it did not guarantee that bank checking accounts would clear at par. We thus had a situation with respect to bank checking accounts that had previously existed with banknotes.[1] The quantity of

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[1]As Cyril James observed, "the National banking Act failed to attain its purpose for reasons similar to those that had prevented the attainment of the aims of the Currency School under the Bank Charter Act of 1844" (James 1940, 198). The Bank Charter Act divided the Bank of England into lending and issuing departments. However, the creation of alternatives to Bank of England notes undermined the attempts to regulate the money supply through the establishment of a par value monopoly for the Bank.

national banknotes was also restricted by the requirement that only $90 in national banknotes could be issued for every $100 of assets (government debt) held. Though this restriction was later relaxed, the scarcity of government debt resulted in the inability of the national banking system to provide an adequate currency. As early as 1888, the Comptroller of the Currency had recommended that national banknotes be issued against commercial paper, and this proposal was warmly endorsed by the *Bankers Magazine* a few years later (James 1940, 199). The limitations on the supply of national banknotes and the increase in checking accounts undermined the national banking system. Things continued with national currency and checking accounts co-existing, but the panic of 1907 led to a re-examination of the banking system, and legislation to create a national clearinghouse.

The focus of the legislation passed in the wake of the Panic of 1907 was the "elasticity" of currency. By this it was meant that there should be a mechanism established whereby the money supply expanded and contracted with the needs of commerce. The function of Federal Reserve notes was to provide a ready convertibility of demand deposits into currency, i.e., to function as a "lender of last resort." The Federal Reserve would act passively with respect to monetary policy by its willingness to convert other banknotes into its own liabilities. This would presumably provide an alternative, in times of crisis, to the conversion of outstanding bank money into specie. The primary tool of the Federal Reserve was the discount mechanism whereby each Federal Reserve Bank re-discounted loaned reserves to the private banks in its region. The aim of the Federal Reserve Act of 1913 was to reduce correspondent banking and "pool reserves in regional reserve banks where they could be used to make rediscounts to member banks" [White 1983: 64].

At the time, the OCC was the only government agency concerned with banking regulation and supervision. The Federal Reserve had some regulatory power over member banks by virtue of the needs of its discount window, however, the Federal Reserve did not have many bank examination personnel and typically relied upon the OCC bank examiner reports, or those of the state banking departments.

A Congressional report summarized bank examination responsibilities of the various agencies and said of the Federal Reserve examinations:

> Such examination is less formal, and usually much less complete, than in the case of the examinations prescribed by statue for the legally-constituted authorities already referred to [those prescribed to Federal or State statute]. This is a natural consequence of the fact that the Federal Reserve examination is designed in the main to determine the soundness of rediscounts or advances secured by United States Government bonds made by the reserve bank to its members, as well as the soundness of the member institutions in relation to the activities of the Federal Reserve Bank as collecting agent for out-of-town checks (*Senate Hearings* 1931, 1069).[2]

Two issues which reappeared after the creation of the Federal Reserve System were branching and permissable activities of national banks. Though the National Banking Acts had originally been interpreted as prohibiting branches, this was gradually relaxed. The Federal Reserve Board in its annual reports from 1915 to 1919 and the Comptroller of the Currency from 1917 to 1921 had recommended liberalization of branching restrictions. Comptroller of the Currency, Henry M. Dawes, who was concerned about the competitive status of the national banks, urged in his 1924, 1925, and 1926 reports, that legislation be enacted to liberalizae branching and to enable national banks to buy and sell investment securities, but not stocks (Peach 1941, 40).

With the passage of the McFadden Act in 1927, national banks were permitted to branch to the extent that the respective state banks were permitted to do so and were allowed to buy and sell investment securities. Because national banks had always been permitted to invest in securities, the McFadden Act allowed the banks to underwrite security issues, i.e., to buy at one price, and sell at another to customers (Peach 1941, 41). The Comptroller of the Currency was given the duty of defining the types of investment securities which were to be included under this

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[2]The Federal Reserve Bank of Chicago described its examination practices as follows: "Supervision of national banks rests with the Comptroller of the Currency, and of State banks with the State banking departments. Copies of the reports of examination of all national banks are filed with us by the comptroller's representative, and copies of reports of examinations of all member State banks by the respective State banking departments, ... Our field work in actual examinations is confined to a limited number of State banks, principally the smaller institutions" (*Senate Hearings* 1931, 1069).

definition (Peach 1941, 42).

Bank affiliates were organized under state incorporation laws expressly to engage in activities prohibited to national banks (Peach 1941, 62-3). There were various ways of organizing the relationship between banks and their affiliates, but one way that was not open was to have the bank own the stock of the affiliate. However, a holding company structure, whereby the holding company owned the stock of a group or chain of banks, was a means open to national banks. Under this arrangement, a security company owned by the BHC could supply the banks with securities for the bank's own investment, or the banks could distribute the securities to their customers. The BHC subsidiary banks could engage in both commercial banking, as well as the distributing of securities (Peach 1941, 100-1). The growth of the bank holding company structure, though providing many opportunities to investment bankers who were experts in setting up and financing holding companies, alarmed many private bankers who were concerned about the implications for their own survival (Peach 1941, 103).

III. The Regulation of Bank Affiliates and Bank Holding Companies

There has long been popular and Congressional support for limitations on the expansion of bank operations outside a defined geographic area. At the same time, the expansion of banks across city, county, and state borders continued under many forms: group or chain banking and branching. Despite the predominance of unit banking throughout U.S. financial history, there have always been banks which operated branches, especially in the southern states. During the debates over the National Banking Act, the issue of branch banking was not even raised (Fischer 1961, 3). Though the development of a bank holding company form for banks was proposed by a private banker in 1892, it is not until the 1920s, that the impact of the growth of BHCs on the dual banking system became an issue. The ability of state governments to control BHCs was necessarily limited by state boundaries. The Clayton Act of 1914, as originally enacted, prohibited the acquisition of the whole or any part of the stock of one corporation by another where the effect of such acquisition might lessen competition or tend to create a monopoly. The Federal Reserve Board was explicitly given the power to enforce these provisions in the field of banking (James 1961, 13). There were deficiencies in the Clayton Act, as asset acquisition

became more important than stock acquisition.[3]

The growth of BHCs was also stimulated by anticipation of changes in state branching laws and continued after the passage of the McFadden Act. This growth can be attributed to the need for rural bank reform, the consolidation movement in industry, the fear of competing groups and the possible loss of correspondent business, restrictions on branch banks and hope for change, and the bull market speculation which stimulated demand for holding company shares (James 1961, 19). Federal banking officials became concerned and in 1927 Governor Crissinger of the Federal Reserve Board called for federal supervision of BHCs, and in 1929, Comptroller of the Currency John Pole expressed similar concerns (James 1961, 59; Pole 1929).

Beginning in 1930, legislation was introduced to specifically regulate BHCS and Congressional hearings were held. In the legislation introduced during 1930-32 which sought to regulate but not abolish BHCs, the agency designated to regulate BHCs was the OCC. The Beedy bill of January 6, 1930 (H.R. 8005) stated that "every corporation which may own or control the majority of the stock of more than one national and/or State member-banks of the Federal Reserve System shall be subject to the visitorial powers of the Comptroller of the Currency." The McFadden bill, introduced the same day, stated: "The Comptroller of the Currency ... shall examine each Federal Reserve Bank and every member bank affiliated corporation of such member bank." The bill went so far as to abolish all examination authority of the Federal Reserve:

> In addition to the authority to make examinations conferred upon the Comptroller of the Currency by section 1 of this Act or to other provisions of law, all authority conferred by existing law upon the Federal Reserve Board or any Federal Reserve bank to make or approve examinations of any member bank or bank applying for membership in the Federal Reserve System or any other banking corporation organized under law of the United States shall, after the date of the approval of this Act, be exercised by the Comptroller of the Currency. After such date the Federal Reserve Board and Federal

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[3]In the only test of the Clayton Act, some three decades after its enactment, the courts decided for the BHC (Transamerica) and against the claim of restraint of trade through merger and acquisition.

> Reserve Banks shall have no authority to make such examinations and shall not employ any person for such purpose.

Other House bills, introduced by Alan Goldsborough (H.R. 8363) and Benjamin Strong (H.R. 8367), would have abolished bank holding companies (Fischer 1961, 60). The Goldsborough bill would take away the voitng power from all shares of stock in national bank held by a BHC and impose a tax of 2 cents per $100 upon any bank check drawn upon a bank owned by a BHC. The Strong bill required forfeiture of a national bank's charter upon membership in a bank group, as well as denial of the use of the mails or telegraph in interstate or foreign commerce (Cartinhour 1931, 190-1). Clearly, the McFadden and Beedy bills represented a much more moderate position regarding BHCs.

In a review of the proposed legislation written at the time, Gaines Cartinhour argued that the Beedy bill represented the most reasonable approach because it proposed to examine the BHC directly, but it did not go far enough. Cartinhour thought that in order to give the Federal authorities sufficient power to meet present and future exigencies, that a bill should be drafted which should include in its scope every corporation, whatever its nature, which owns or controls twenty-tive per cent of the voting stock of one or more members of the Federal Reserve System or of two or more banks in two or more states (Cartinhour 1931, 192-3). Corporations which are not bank holding companies would be exempt, but the burden of proof would be with the corporation, and not the OCC. All authority for the regulation and supervision of BHCs would rest with the OCC:

> The Comptroller should be authorized, on the basis of his investigations, to make any order or impose any regulation which in his opinion (in which he shall consider any suggestions of the Federal Reserve Board, subject to judicial approval) should be necessary, proper, or advisable to protect the interests of the public as a whole and prevent exploitation of American banks for private gain (Cartinhour 1931, 193-4).

Because the OCC was the primary federal bank regulatory authority, it is not surprising that it was the designated regulatory authority for BHCs. This was also a time when the Federal

Reserve system was under criticism for policies which had contributed to the stock market collapse. It is important to recognize that the legislation also treated the BHCs as an integrated unit, and not separate enterprises. It was recognized that in order to get a proper picture of the financial condition of the banks, it was necessary to have complete disclosure of information on all holding company affiliates, thus the consolidated balance sheet of the bank holding company would be the relevant information.

The House Hearings on *Branch, Chain and Group Banking*, held from February to June 1930, compiled a wealth of statistical data, which revealed, as an example, that at the end of 1929, group banking (holding company structure) represented only one-fourth of the banks, but approximately one-half of bank loans and investments. Two percent of the banks controlled 10% of the loans and investments of all banks in the U.S. (James 1961, 30-31; *House Hearings* 1930).

Near the end of the House hearings, in the Senate Carter Glass introduced the Banking Act of 1930 (S. 4723). In Section 7, the Glass bill provided for the amendment of Section 5211 of the Revised Statutes so that each affiliate of a national banking association would be examined by the Comptroller of the Currency. An affiliate was defined to include finance companies, securities companies, investment trusts, or any other corporation, "of which control is held, directly or indirectly, through stock ownership or in any other manner, by a national bank or by the shareholders thereof who own or control a majority of the stock of such bank." A bank holding company which owned national banks would be considered an affiliate. Any affiliate of a bank which was a member of the Federal Reserve would also be required to file reports with the Federal Reserve Board. The Glass bill was not enacted, though it became the starting point for subsequent legislation introduced by Glass.

After the inquiry on group and chain banking, Congress broadened its investigation into bank affiliates. This was in large part the result of abuses of the affiliate system which had generated a public outcry and raised the moral indignation of members of Congress. Hearings began in late 1930 and continued into 1931 and 1932 (*Senate Hearings* 1931, 1932). Witnesses before the Senate Committee were unanimously in favor of examination of affiliates, and that these examinations should be made by the Comptroller of the Currency. Further, it was recommended that the affiliates should periodically publish balance sheets and a statement of

income. Examination of affiliates and their parent banks would make clear the true condition of both institutions (Peach 1941, 172).

Glass also queried Comptroller Pole on the duplication of bank regulatory authority. He asked,

> *Chairman Glass*: Mr. Comptroller, to begin at the beginning, it has been periodically suggested that the office of the Comptroller of the Currency be abolished and its functions transferred to the Federal Reserve Board, and the reason given for such a suggestion is that there is a large duplication of functions. Do you concur in that belief that there is a large duplication of functions?
>
> *Mr. Pole*: I do not see, Mr. Chairman, that there is any duplication of functions. If the comptroller's office were attached to the Federal Reserve Board, they would necessarily have to designate somebody to take charge of the comptroller's duties, and while the Federal Reserve Board has the right, and does make examinations of banks from time to time, I think that the Board is generally perfectly willing to rely upon the reports of the comptroller's office and indeed of the State superintendents of banks, and where they are not they have the right to make their own examinations. More over, the Federal Reserve Board is a deliberative body, whereas the functions of the comptroller are primarily executive.
>
> *Chairman Glass*: Right upon that point ... (*Senate Hearings 1931*, 4).

Glass, the Father of the Federal Reserve Act, clearly believed that the OCC was the primary bank examination agency, and that the Federal Reserve's examination authority was a secondary responsibility. If bank affiliates were to be permitted, then they would be regularly examined by the OCC. However, though Glass initially favored regulation of affiliates, he quickly came to favor the complete separation of banks and their securities affiliates. Despite the fact that testimony at the hearings had in general favored regulation and not abolition of affiliates, when Glass introduced his revised bill on January 21, 1932, it called for the abolition of affiliates. This bill met with the immmediate opposition of the White House, the Federal Reserve Board, the Treasury Department, the Comptroller of the Currency, and the banking community

(Peach 1941, 154).

The bill had been drafted by H. Parker Willis, Professor of Money and Banking at Columbia University, a long time friend of Glass, and an economic advisor to the Senate Banking Committee at this time. Willis stated that though the original draft of the bill favored regulation rather than abolition of bank affiliates, the public outcry convinced Glass that abolition was necessary. It may have indeed been a public outcry, but Willis's view was well known, and he favored complete separation of banks and affiliates, and the legislation re-introduced in 1932 reflected his view (Peach 1941, 154).

Ironically, the cases of fraud which aroused the moral indignation of members of Congress, would not be eliminated by the separation of commercial and investment banking. As Peach noted, legislative attempts to protect the public were implemented in the Federal Securities Act of 1933 and the Securities Exchange Act of 1934 (Peach 1941, 140). Other cases of abuse, such as pool operations in the stock of parent banks by affiliates could be prevented by making it illegal for affiliates to deal in or own the stock of parent banks. Those cases where officers of the banks and affiliates made a personal profit could also be remedied by legislation (Peach 1941, 141).

What could not be remedied by legislation would be the prevention of the shifting of undesirable bank assets to security affiliates in order to hide the mistakes of parent banks. In this case, compulsory periodic examinations of security affiliates by the Comptroller of the Currency would have revealed this shifting of assets. Also, you cannot legislate that banks should make no bad loans or investments. However, because banks and their affiliates were so closely connected, in order to maintain their competitive position, they had to aid affiliates in trouble, or else the public would perceive that there were problems with the bank as well (Peach 1941, 142). This then, as Peach observed, is the major problem with the affiliate and should have been the deciding factor in whether to regulate or abolish the affiliate system (Peach 1941, 142).

Eugene Meyer, Governor of the Federal Reserve Board, testified that though he favored separation of securities affiliates from banks, he thought that the Board did not have great confidence in the recommendations of anyone with respect to affiliates because of the lack of information. He suggested that reports and examinations over a three year period would throw new light on the subject (Peach 1941, 155).

IV. The Banking Acts of 1933 and 1935

The banking crisis of March 1933 propelled the Glass bill toward passage as part of the Banking Act of 1933, which also included a federal guarantee for checking accounts. The Glass restrictions on bank holding companies were included in the Banking Act of 1933, but as James points out, there were three fundamental weaknesses in the Banking Act of 1933 provisions on BHCs: (1) registration was not mandatory and it was possible for some groups to obtain control with voting permits; (2) the restrictions upon expansion were of questionable value, except in extreme cases, and (3) holding companies were allowed to continue investing in nonbanking enterprises. The Securities Acts of 1933 and 1934 required that BHCs whose securities were registered on a stock exchange or which wished to offer sizable new issues in interstate commerce, had to file periodic reports with the Securities and Exchange Commission (Fischer 1961, 63).

The Banking Act of 1933 proposed to do for bank deposit accounts what the National Banking Act had done for banknotes. Deposit insurance was purely a creation of Congress where its adoption in 1933 was, according to Carter Golembe, due to a uniting of two groups: those that wished to end the destruction of circulating medium due to bank failures and those who sought to preserve the existing bank structure [Golembe 1960: 182].

The Act created a new independent government agency to regulate the banks, the Federal Deposit Insurance Corporation. The FDIC's function was to assure an adequate fund to protect the par-value of bank deposits, but without putting a strain on the federal budget. As Mark Flood (1992) documents, Congress understood the problems with deposit insurance and took measures to protect the depositors and the Treasury.

There were now three bank regulatory agencies: the OCC, the Federal Reserve, and the FDIC. The rationale for the bank examination authority of the OCC and the FDIC were quite similar. The OCC was originally charged with guaranteeing the par-value of banknotes, and thus required information about banks, and similarly, the FDIC not guaranteed the par-value of bank deposits. Logically, the OCC and FDIC could have been consolidated, and as will be discussed below, there were attempts to do so. But what about the bank examination powers of the Federal Reserve? Its original rationale for bank examination authority, the use of the discount window, had virtually disappeared. The Banking Act of 1935 gave the Federal Reserve Board new powers

to take an active role in supplying the proper money supply through the use of operation market operations and reserve requirements. The use of the discount window turned out to be impotent in preventing the collapse of the banking system during the Great Depression, and its role, which diminished in the 1920s and early 1930s, was further reduced by the Act. The Banking Act of 1935 did not not expand the examination authority of the Federal Reserve Board, and there was only a minor revision of the provisions of the Banking Act of 1933 with respect to bank holding companies.

V. Bank Holding Company Regulation Bills after 1935

There was dissatisfaction with the holding company provisions of the Banking Act of 1933, and President Roosevelt, who was a strong opponent of group banking, in a 1938 address to Congress, called for the abolition of holding companies, specifically mentioning the evils of bank holding companies (Fisher 1961, 65). Less than two weeks before Roosevelt's address, Senators Glass and McAdoo introduced a bill to regulate BHCs (S. 3575). The bill was introduced in the House by Congressman Steagall (H.R. 9702). Secretary Morgenthau went on record in support of the Glass/McAdoo bill (*New York Times*, 1 February 1938, 11:2). The bills replaced the OCC as the regulatory authority with regulation and supervision by the FDIC. However, because it was felt that there was insufficient time to consider the bills in the current session, they were withdrawn at the request of Treasury Secretary Morgenthau.

At the same time, responsibilities of the OCC and the FDIC overlapped and consolidation into one agency was an alternative. The OCC had a long history and large staff engaged in bank examinations, and the FDIC had the responsibility for guaranteeing bank deposits. In 1937, a study by the Brookings Institution prepared for the Senate banking committee recommended that the FDIC be the sole examination agency (Benston et al 1986, 284).

On April 3, 1939, Senator Prentiss Brown of Michigan introduced a bill to transfer to the FDIC all bank examining functions (*Congressional Record 1939, 3704-5*). In designating the authority to the FDIC, Brown stated that the FDIC was "the only all-inclusive banking agency of the Federal Government" and because the FDIC's "principal function is to guarantee the deposits ... This, necessarily, requires examination by the Corporation and supervision of all banks." It is for this reason, Brown concluded that the FDIC was "deemed to be the logical

organization in which to vest the examining power."

However, Brown added that the staff of the FDIC would be comprised largely of OCC staff since that agency "has had the longest experience, it has the largest personnel, and probably is the best equipped agency to handle examinations." The bill proposed to transfer that OCC personnel to the FDIC in order to make that agency "the foundation upon which will be built, it is hoped, a unified examining agency which will at once eliminate duplication of organization and in time result in reduction of personnel and should result immediately inconsiderable reduction of expenses." The bank examination function of the Federal Reserve Board and Banks would also be transferred to the revamped FDIC. In 1941, Senator Glass again introduced a bill to regulate BHCs (S. 310), and again specified the FDIC as the regulatory agency. Though Morgenthau again publicly supported the bill, no action was taken (*New York Times*, 17 January 1941, 30:6).

Because of Roosevelt's opposition to BHCs, there was little chance legislation would be passed. However, it is important to note that the general thrust of Congress's actions with respect to banking regulation was to consolidate the bank examination functions, and therefore the regulation of BHCs would be under this single agency. If legislation had passed, then the regulatory agency would have been the OCC and/or FDIC, or most likely, a consolidated agency. As World War Two approached, there was no rationale for nor sentiment in Congress, or in the Executive branch, to expand the bank examination powers of the Federal Reserve, though consolidation of the bank regulatory agencies was on the agenda. The anomaly that occurs then is that beginning in 1943, the Federal Reserve pushes for expanded regulatory power with respect to bank holding companies.

VI. The Federal Reserve Board and Bank Holding Company Regulation

During the war years, the initiative for control of BHCs moved from Congress to the Federal Reserve Board where Marriner Eccles was still Chairman. The Federal Reserve Board's *Annual Report* for 1943 contained a strong attack on BHCs. The document stated that the provisions of the Banking Act of 1933 were inadequate to regulate BHCs, and immediate legislation to prevent the expansion of existing companies and the creation of new ones was necessary (Fischer 1961, 65). Also prominent Congressman such as Senator Glass and

Congressman Steagall exited from the scene. Brent Spence of Michigan replaced Steagall as the Chair of the House Banking Committee in 1943.

The Board prepared a set of regulations which became the basis for legislation introduced in 1945 by Congressman Spence (H.R. 2776). Spence introduced his bill again in 1946 (S. 6225), 1949 (S. 5744), 1952 (S. 6504), 1955 (S. 2674), and 1956 (S. 6227). The latter was passed by Congress and became the Bank Holding Company Act of 1956. Whether Board Chairman Marriner Eccles's concerns were with "turf grabbing" or implicitly authorized by the granting of some regulatory power over the BHCs by the Banking Act of 1933, this was the decisive point in the shift of regulatory power from the OCC to the Federal Reserve.

In the late 1940s, concern about the expansion of the Transamerica Corporation generated legislation to control its growth. Senator Tobey introduced a bill in 1947, and hearings were held, but the legislation never came to a vote (Fischer 1961, 66; *Senate Hearings* 1947). The Board invoked the Clayton Act against Transamerica in 1948, claiming restraint of trade, but ultimately lost the court case in 1951 (Fischer 1961, 67).

Marriner Eccles was not reappointed to the Federal Reserve Board in 1948 in part because of his opposition to the continuation of the policy of supporting government security prices after the war (Timberlake 1993, 313). This policy ended with the Treasury-Fed accord of 1951, and the Federal Reserve was free to pursue an independent monetary policy, and in the same year, William McChesney Martin was appointed Chairman of the Federal Reserve Board. With Eccles out of the way, there was again an opportunity to reevaluate the issue of BHC regulation.

At his nomination hearings in 1951, Senator Fulbright asked Martin to state for the record his views on the regulation of BHCs. Senator Robertson asked specifically to know whether Martin favored extension on restrictions of BHCs. Martin replied: "I just would have to study it a little bit because I haven't been in close touch with that sort of thing, and I am certainly no encyclopedia." Senator Douglas stated that Martin's views would be important because it was widely believed that the Federal Reserve Board wanted to restrict BHCs, while the Secretary of the Treasury Snyder did not agree with that view. Douglas told Martin that it was very important for the committee to know where he stood on the BHC issue, but Martin stated that he had little knowledge and did not want to make any offhand remarks without further information. Though Martin was previously an Assistant Secretary of the Treasury, he stated that he had never

discussed the BHC issue with the Secretary. Senator Schoeppfl asked of Martin: "Then I take it, Mr. Chairman, you are in this present position: You have no preconceived idea one way or the other on that [issue of BHCs] at this moment?" Martin replied "That is correct, sir" (*Senate Hearings* 1951, 8-9). Martin was confirmed as Chairman of the Board of Governors of the Federal Reserve System in April 1951. Though there is no reason to question Martin's veracity on this issue, he did not give the Senators a definite view on whether he would be strongly for or against the continued expansion of BHCs.

Ray Gidney was confirmed as Comptroller of the Currency in early 1953. He was questioned about his commitment to the dual banking system. Gidney replied: "I think I can speak with vigor on that. I have been a dual banking system man for 50 years, since I first went in a State bank. I have been in three State commercial banks and one national in my experience and I have had enough opportunity to see the reasons for a dual banking system and why some people want to be in one and some the other" (*Senate Hearings* 1953, __) Gidney had spent most of his life in the Federal Reserve System, first with the Federal Reserve Bank of New York, and immediately prior to his appointment as the Comptroller of the Currency, as President of the Federal Reserve Bank of Cleveland.

Congress held hearings on BHC legislation in 1953. In his annual *Report,* Gidney stressed that "all supervisory functions over bank holding companies should be vested in a single supervisory agency rather than being divided up among two or more agencies" (*OCC Annual Report* 1953, 17). In the 1955 hearings, Gidney expressed a preference for having the Federal Reserve Board be the supervisory agency, while Martin stated they he would not insist on Federal Reserve Board supervision. Martin was asked specifically about regulatory authority:

> *Mr. Betts*: Mr. Martin, in your statement you refer to approval of certain matters by a Federal Agency. I am not sure what you have in mind. For instance, on page 3 you speak of a Federal agency.
>
> *Mr. Martin*: The present bill, Mr. Betts, provides that the approval shall be given by the Board of Governors of the Federal Reserve System. The reason I used the phrase "Federal agency" is that we don't want to insist that it has to be the Federal Reserve Board."
>
> *Mr. Betts*: I thought you had something else in mind when you said "a Federal agency."

Mr. Martin: Nothing other than I didn't want to appear to be insisting that it be the Federal Reserve Board (*House Hearings* 1955, 92-3).

Gidney testified:

Mr. Multer: Mr. Gidney, Chairman Martin seemed to think that he had no objection to giving you control over the situation and you think his Board would do all right?

Mr. Gidney: Well, we are all modest, maybe. But we are more modest than he is. We think that the Board is the better place for it to be.

Mr. Kilburn: But you agree with him that it ought to be in one hand?

Mr. Gidney: We emphatically do, because this is going to be difficult enough anyway, and if there is going to be pulling and hauling, and a controversy, and a competition, that is not good. We have full confidence that the Board would handle it well, and I expect the people affected would have that confidence.

Mr. Multer: If the Board has jurisdiction over the matter would there be any need to call upon your office for recommendations?

Mr. Gidney: I think so. When we get into dealing with these things we find that it is very important to know the whole story, to get different points of view, and we would like, in our office, to have a chance to have a say, and I know that if that is true for us, that would be even more true for the bank supervisors, who may feel they are more distant from the Board than we are (*House Hearings* 1955, 148-9).

Strong arguments were not put forward for having the Federal Reserve Board be the regulatory agency, rather Martin and Gidney agreed that the most important point was to have one federal agency. In the testimoney, Gidney seemed more sure than Martin that the Federal Reserve would be the approriate agency. The BHCA Act passed and gave regulatory authority to the Federal Reserve, despite the fact that the Federal Reserve's bank examination expertise was virtually nil (Stiller 1993, 6).

Questions were raised about the motivations of Gidney because in 1962, Raymond Gidney became chairman of the board of the Florida National Bank of Jacksonville, the largest bank in

the Florida national group of banks, controlled by the estate of Alfred I. du Pont. The 1956 Act exempted estates controlled holding companies. In his testimony before the Senate Banking Committee in 1966 on amending the Bank Holding Company Act of 1956, Gidney testified that bank holding companies had in the past and continued to be "well operated and have served their territories admirably" (*Senate Hearings* 1966, 457). His praise of bank holding companies was unreserved: "They live up to the best traditions of American banking and are of inestimable value to our national economy" and that they Act "needlessly restricts the operations of these companies" (*Senate Hearings* 1956, 458). Gidney went so far as to state that he believed that "our banking system would not be injured or impaired if most of the provisions of the present bank holding company law were to be repealed" (*Senate Hearings* 1966, 459).

It is not difficult to explain why the Federal Reserve was selected as the regulatory agency in 1956, but the implications of that are significant. The legislation that passed in 1956 had been drafted at the Federal Reserve Board in 1943 under Marriner Eccles, who was a proponent of branch banking, but believed that BHCs growth should be controlled. In 1956, those in Congress were presented with a dilemma. If you favored unit banking, as many did, then you would want to abolish BHCs. This was not politically feasible, and there was some recognition that BHCs could be beneficial. Given that Gidney clearly would not be willing to constrain BHCs, Martin and the Fed appeared to be the most reasonable choice, though Martin by 1955 had generally a favorable view of BHCs, and was certainly not inclined to halt their expansion.

VII. Conclusion

The reason typically given for why the Federal Reserve was chosen as the regulator of BHCs has been that an historical precedent was set in the Clayton Act and the Banking Act of 1933, thus the argument goes, in 1956 the issue was no longer controversial and the Fed was given the authority. This explanation is not satisfactory because the historical precedent argument is in doubt since the record indicates that the OCC was always, and remains today, the primary regulator of banks because of its chartering powers. Why then was the OCC not given regulatory power over BHCs? There are three reasons: the abolition of universal banking, legislative

initiatives by the Federal Reserve in 1943, and concerns about Raymond Gidney's willingness to control BHCs.

The delegation of regulatory authority over BHCs to the Federal Reserve had important implications for the growth of the Federal Reserve. Historically, the Federal Reserve had relied upon examination reports from the OCC. However, it was several years after the passage of the BHCA of 1956, that the Federal Reserve began to expand its own examination department. We have now reached a point which is the exact opposite of the New Deal trend toward a separation of monetary and regulatory authority, to a situation where now the Federal Reserve argues that it must have examination authority in order to be able to conduct monetary policy and handle problems of systemic risk. If the Federal Reserve's primary function is monetary policy and a stable price level, there is little need for it to examine banks itself. In addition, if the both monetary and regulatory authority were concentrated solely in the Fed, there would be an incentive for the Federal Reserve to overconstrain banks which it believed endangered the financial health of the nation (Benston et al 1986, 293).

The possibility of some form of universal banking in the U.S. raises the question of the appropriate means for regulating such institutions, and makes the debates surrounding the Banking Act of 1933 once again relevant. BHCs can be viewed as a financial innovation adopted to avoid bank regulations which placed constraints on multioffice or multiunit bank activities (Eisenbeis 1983, 42). BHCs operate as integrated firms, and should be regulated as such by a single federal regulatory agency. Though there are arguments pro and con on this issue, the simplification, cost savings, and improved regulation, especially of bank holding companies, provide ample rationale for consolidation of the bank regulatory agencies.

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