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SAVINGS AND LOAN HOLDING COMPANIES

GOVERNMENT
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HEARINGS BEFORE THE COMMITTEE ON BANKING AND CURRENCY UNITED STATES SENATE NINETIETH CONGRESS

FIRST SESSION
ON
S. 1542
A BILL TO AMEND SECTION 408 OF THE NATIONAL HOUSING
ACT, AS AMENDED, TO PROVIDE FOR THE REGULATION OF
SAVINGS AND LOAN HOLDING COMPANIES AND SUBSIDIARY
COMPANIES

JUNE 5, 6, AND 7, 1967

Printed for the use of the Committee on Banking and Currency

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SAVINGS AND LOAN HOLDING COMPANIES

MONDAY, JUNE 5, 1967

U.S. SENATE,
COMMITTEE ON BANKING AND CURRENCY,
Washington, D.C.

The committee met at 10:16 a.m. in room 5302, New Senate Office Building, Senator William Proxmire presiding.

Present: Senators Sparkman, Proxmire, McGee, and Bennett.

Senator PROXMIRE. The committee will come to order.

Today we begin hearings on S. 1542, a bill to provide for regulation of savings and loan holding companies.

(The copy of the bill follows:)

90TH CONGRESS
1ST SESSION

S. 1542

IN THE SENATE OF THE UNITED STATES

APRIL 14, 1967

Mr. SPARKMAN (by request) introduced the following bill; which was read twice and referred to the Committee on Banking and Currency

A BILL

To amend section 408 of the National Housing Act, as amended, to provide for the regulation of savings and loan holding companies and subsidiary companies.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That this Act may be cited as the "Savings and Loan Hold-
4 ing Company Amendments of 1967".

5 SEC. 2. Section 408 of the National Housing Act, as
6 amended (12 U.S.C. 1730a), is hereby amended to read as
7 follows:

8 "SEC. 408. (a) DEFINITIONS.—(1) As used in this
9 section, unless the context otherwise requires—

10 “(A) ‘insured institution’ means a Federal savings

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1 and loan association, a building and loan, savings and
2 loan, or homestead association or a cooperative bank, the
3 accounts of which are insured by the Federal Savings
4 and Loan Insurance Corporation;

5 “(B) ‘uninsured institution’ means any association
6 or bank referred to in subparagraph (A) hereof, the
7 accounts of which are not insured by the Federal Sav-
8 ings and Loan Insurance Corporation:

9 “(C) ‘company’ means any corporation, limited
10 partnership, trust, joint-stock company, or similar orga-
11 nization, but does not include the Federal Savings and
12 Loan Insurance Corporation, any Federal Home Loan
13 Bank, or any company the majority of the shares of
14 which is owned by the United States or any State, or by
15 an officer of the United States or any State in his official
16 capacity, or by an instrumentality of the United States
17 or any State;

18 “(D) ‘savings and loan holding company’ means
19 any company which directly or indirectly controls an
20 insured institution or controls any other company which
21 is a savings and loan holding company by virtue of this
22 subsection;

23 “(E) ‘person’ means an individual or company;

24 “(F) ‘subsidiary’ of a person means any company
25 which is controlled by such person, or by a company

1 which is a subsidiary of such person by virtue of this
2 subsection;

3 “(G) ‘affiliate’ of a specified insured institution
4 means any person or company which controls, is con-
5 trolled by, or is under common control with, such insured
6 institution.

7 “(2) For purposes of this section, a person shall be
8 deemed to have control of—

9 “(A) an insured institution if the person directly
10 or indirectly or acting in concert with one or more other
11 persons, or through one or more subsidiaries, owns,
12 controls, or holds with power to vote, or holds proxies
13 representing, more than 10 per centum of the voting
14 shares of such insured institution, or controls in any
15 manner the election of a majority of the directors of
16 such institution; or

17 “(B) any other company if the person directly or
18 indirectly or acting in concert with one or more other
19 persons, or through one or more subsidiaries, owns, con-
20 trols, or holds with power to vote, or holds proxies rep-
21 resenting, more than 25 per centum of the voting shares
22 or rights of such other company, or controls in any
23 manner the election or appointment of a majority of
24 the directors or trustees of such other company, or is

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1 a general partner in or has contributed more than 25
2 per centum of the capital of such other company.

3 “(b) REGISTRATION AND EXAMINATION.—(1) With-
4 in one hundred and eighty days after the enactment of the
5 Savings and Loan Holding Company Amendments of 1967,
6 or within ninety days after becoming a savings and loan
7 holding company, whichever is later, each savings and loan
8 holding company shall register with the Corporation on
9 forms prescribed by the Corporation, which shall include
10 such information, under oath or otherwise, with respect to
11 the financial condition, ownership, operations, management
12 and intercompany relationships of such holding company and
13 its subsidiaries, and related matters, as the Corporation may
14 deem necessary or appropriate to carry out the purposes of
15 this section. Upon application, the Corporation may extend
16 the time within which a savings and loan holding company
17 shall register and file the requisite information.

18 “(2) Each savings and loan holding company and each
19 subsidiary thereof, other than an insured institution, shall
20 file with the Corporation, and the Federal home loan bank
21 of the district in which its principal office is located, not
22 less than two reports during each year, and such additional
23 reports as may be required by the Corporation. Such re-
24 ports shall be made under oath or otherwise, and shall be
25 in such form and for such periods, as the Corporation may

1 prescribe. Each report shall contain such information con-
2 cerning the operations of such savings and loan holding com-
3 pany and its subsidiaries as the Corporation may require.

4 “(3) Each savings and loan holding company shall
5 maintain such books and records as may be prescribed by
6 the Corporation.

7 “(4) Each savings and loan holding company and each
8 subsidiary thereof shall be subject to such examinations as
9 the Corporation may prescribe. The cost of such exami-
10 nations shall be assessed against and paid by such holding
11 company. Examination and other reports may be furnished
12 by the Corporation to the appropriate State supervisory
13 authority.

14 “(5) The Corporation shall have power to require any
15 savings and loan holding company, or persons connected
16 therewith if it is not a corporation, to execute and file a pre-
17 scribed form of irrevocable appointment of agent for service
18 of process.

19 “(6) The Corporation may at any time, upon its own
20 motion or upon application, release a registered savings and
21 loan holding company from any registration theretofore made
22 by such company, if the Corporation shall determine that
23 such company no longer has control of any insured insti-
24 tution.

25 “(c) HOLDING COMPANY ACTIVITIES.—Except as

6

1 otherwise provided in this subsection, no savings and loan
2 holding company or subsidiary thereof which is not an in-
3 sured institution shall—

4 “(1) engage in any activity or render any services
5 for or on behalf of an insured institution which, if per-
6 formed by the institution, would constitute a violation of
7 law or regulation; or

8 “(2) commence, or continue for more than two
9 years after the enactment of this amendment or for more
10 than one hundred and eighty days after becoming a sav-
11 ings and loan holding company or subsidiary thereof
12 (whichever is later), any business activity other than
13 (A) furnishing or performing management services for
14 a subsidiary insured institution, (B) conducting an in-
15 surance agency or an escrow business, (C) holding or
16 managing or liquidating assets owned by or acquired from
17 a subsidiary insured institution, (D) holding or man-
18 aging properties used or occupied by a subsidiary in-
19 sured institution, or (E) furnishing or performing such
20 other services or engaging in such other activities as the
21 Corporation may prescribe by regulation as being a
22 proper incident to the operations of insured institutions
23 and not detrimental to the interests of savings account
24 holders therein. The Corporation may, upon a showing
25 of good cause, extend such time from year to year, for a

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1 period not exceeding five years, if the Corporation finds
2 such extension would not be detrimental to the public
3 interest.

4 The provisions of this subsection shall not apply to any com-
5 pany which is an insured bank of the Federal Deposit Insur-
6 ance Corporation and which has become a savings and loan
7 holding company by virtue of its acquisition of the control of
8 an insured institution or of a savings and loan holding com-
9 pany pursuant to a pledge or hypothecation to secure a loan,
10 or in connection with the liquidation of a loan.

11 “(d) PROHIBITED TRANSACTIONS.—No savings and
12 loan holding company’s subsidiary insured institution shall—

13 “(1) invest any of its funds in the stock, bonds,
14 debentures, notes, or other obligations of any affiliate;

15 “(2) accept the stock, bonds, debentures, notes, or
16 other obligations of any affiliate as collateral security for
17 any loan or extension of credit made by such institution;

18 “(3) purchase securities or other assets or obliga-
19 tions under repurchase agreement from any affiliate;

20 “(4) make any loan, discount, or extension of credit
21 to (A) any affiliate, except in a transaction authorized
22 by subparagraph (A) of paragraph (6) of this subsec-
23 tion, or (B) any third party on the security of any
24 property acquired from any affiliate, or with knowledge

1 that the proceeds of any such loan, discount, or extension
2 of credit, or any part thereof, are to be paid over to or
3 utilized for the benefit of any affiliate;

4 “(5) guarantee the repayment of or maintain any
5 compensating balance for any loan or extension of credit
6 granted to any affiliate by any third party;

7 “(6) except with the prior written approval of the
8 Corporation—

9 “(A) engage in any transaction with any af-
10 filiate involving the purchase, sale, or lease of prop-
11 erty or assets (other than participating interests in
12 mortgage loans to the extent authorized by regula-
13 tions of the Corporation) in any case where the
14 amount of the consideration involved when added to
15 the aggregate amount of the consideration given or
16 received by such institution for all such transactions
17 during the preceding twelve month period exceeds
18 the lesser of \$100,000 or 0.1 per centum of the in-
19 stitution's total assets at the end of the preceding
20 fiscal year; or

21 “(B) enter into any agreement or understand-
22 ing, either in writing or orally, with any affiliate
23 under which such affiliate is to (i) render manage-
24 ment or advertising services for the institution, (ii)
25 serve as a consultant, adviser, or agent for any

9

1 phase of the operations of the institution, or (iii)
2 render services of any other nature for the institu-
3 tion, other than those which may be exempted by
4 regulation or order of the Corporation, unless the
5 aggregate amount of the consideration required to be
6 paid by such institution in the future under all such
7 existing agreements or understandings cannot ex-
8 ceed the lesser of \$100,000 or 0.1 per centum of the
9 institution's total assets at the end of the preceding
10 fiscal year; or

11 “(C) make any payment to any affiliate under
12 any agreement or understanding hereinabove re-
13 ferred to in subparagraph (B) where the institution
14 has previously paid to affiliates during the preceding
15 twelve-month period, pursuant to any such agree-
16 ments or understandings, an amount aggregating
17 in excess of the lesser of \$100,000 or 0.1 per centum
18 of the institution's total assets at the end of the pre-
19 ceding fiscal year.

20 The Corporation shall grant approval under this para-
21 graph (6) if, in the opinion of the Corporation, the
22 terms of any such transaction, agreement, or under-
23 standing, or any such payment by such institution,
24 would not be detrimental to the interests of its savings

10

1 account holders or to the insurance risk of the Corpora-
2 tion with respect to such institution.

3 “(e) ACQUISITION.—(1) It shall be unlawful for—

4 “(A) any savings and loan holding company di-
5 rectly or indirectly, or through one or more subsidiaries
6 or through one or more transactions—

7 “(i) to acquire the control of an insured or
8 uninsured institution or to retain the control of such
9 an institution acquired or retained in violation of
10 this section as heretofore or hereafter in effect;

11 “(ii) to acquire, by the process of merger, con-
12 solidation, or purchase of assets, another insured or
13 uninsured institution or a savings and loan holding
14 company, or all or substantially all of the assets of
15 any such institution or holding company;

16 “(iii) to acquire by purchase or otherwise, or
17 to retain for more than one year after the enactment
18 of this amendment, any of the voting shares of an
19 insured institution not a subsidiary, or of a savings
20 and loan holding company not a subsidiary, or more
21 than 5 per centum of the voting shares of any com-
22 pany not a subsidiary which is engaged in any busi-
23 ness activity other than those specified in paragraph

24 (2) of subsection (c) of this section; or

25 “(iv) to retain, for more than three years

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1 after the enactment of this amendment, control of
2 an insured institution the principal office of which
3 is located in a State other than the State which such
4 savings and loan holding company shall designate,
5 by writing filed with the Corporation within sixty
6 days after its registration hereunder, as the State in
7 which the principal savings and loan business of
8 such holding company is conducted;

9 “(B) any other company, directly or indirectly, or
10 through one or more subsidiaries or through one or more
11 transactions, to acquire or retain the control of more
12 than one insured institution.

13 “(2) The prohibitions of subparagraphs (A) (i), (A)
14 (ii), and (B) of paragraph (1) of this subsection shall
15 not apply to any acquisition which has been approved by
16 the Corporation upon a determination by it that such acqui-
17 sition is advisable to assist in preventing the commencement
18 or continuance of involuntary liquidation of an insured insti-
19 tution.

20 “(3) Any savings and loan holding company, which
21 is an insured bank of the Federal Deposit Insurance Corpo-
22 ration, may, without regard to the provisions of this sub-
23 section, acquire the control of an insured institution or of a
24 savings and loan holding company, pursuant to a pledge or
25 hypothecation to secure a loan, or in connection with the

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1 liquidation of a loan, but it shall be unlawful for any such
2 company to retain such control for more than one year after
3 the enactment of this amendment or from the date on which
4 such control was acquired, whichever is later, except that
5 the Corporation may upon application by such company
6 extend such one year period from year to year, for a period
7 not exceeding five years, if the Corporation finds such extension
8 is warranted and would not be detrimental to the public
9 interest.

10 “(f) DECLARATION OF DIVIDEND.—Every subsidiary
11 insured institution shall give the Corporation not less than
12 thirty days advance notice of the proposed declaration by
13 its directors of any cash dividend on its guarantee, permanent
14 or other nonwithdrawable stock. Such notice period
15 shall commence to run from the date of receipt of such notice
16 by the Corporation. Any such dividend declared within
17 such period, or without the giving of such notice to the
18 Corporation, shall be invalid and shall confer no rights or
19 benefits upon the holder of any such stock.

20 “(g) HOLDING COMPANY INDEBTEDNESS.—(1) No
21 savings and loan holding company or any subsidiary thereof
22 shall issue, sell, renew, or guarantee any debt security of
23 such company or subsidiary, or assume any debt, without
24 the prior written approval of the Corporation.

25 “(2) The provisions of paragraph (1) of this subsec-

tion shall not apply to the issuance, sale, renewal, or guaranty of any debt security, or the assumption of any debt, if such security or debt (A) is payable on demand, or matures within nine months (exclusive of days of grace), after the date of issuance, sale, renewal, guaranty, or assumption thereof, and (B) aggregates (together with all such other securities or debt then outstanding of a maturity of nine months or less (exclusive of days of grace), as to which such holding company or subsidiary is primarily or contingently liable) not more than 5 per centum of the consolidated net worth of such holding company or subsidiary at the end of the preceding fiscal year.

“(3) The Corporation shall, upon application, approve any act or transaction not exempted from the application of paragraph (1) of this subsection if the Corporation finds that—

“(A) the proceeds of any such act or transaction will be used for (i) the purchase of permanent, guarantee, or other nonwithdrawable stock to be issued by a subsidiary insured institution, or (ii) the purpose of making a capital contribution to a subsidiary insured institution; or

“(B) such act or transaction is required for the purpose of refunding, extending, exchanging, or dis-

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1 charging an outstanding debt security, or for other
2 necessary or urgent corporate needs, and would not
3 impose an unreasonable or imprudent financial burden
4 on the applicant.

5 Applications filed with the Corporation pursuant to this sub-
6 section shall be in such form and contain such information
7 as the Corporation may prescribe.

8 “(4) If a State authority or any other agency of the
9 United States, having jurisdiction of any act or transaction
10 within the scope of paragraph (1) of this subsection, shall
11 inform the Corporation, upon request by the Corporation
12 for an opinion or otherwise, that State or Federal laws
13 applicable thereto have not been complied with, the Corpora-
14 tion shall not approve such act or transaction until and
15 unless the Corporation is satisfied that such compliance has
16 been effected.

17 “(5) As used in this subsection, the term ‘debt security’
18 includes any note, draft, bond, debenture, certificate of in-
19 debtedness, or any other instrument commonly used as evi-
20 dence of indebtedness, or any contract or agreement under
21 the terms of which any party becomes, or may become,
22 primarily or contingently liable for the payment of money,
23 either in the present or at a future date.

24 “(h) ADMINISTRATION AND ENFORCEMENT.—(1)
25 The Corporation is authorized to issue such rules, regula-

1 tions, and orders as it deems necessary or appropriate to
2 enable it to administer and carry out the purposes of this
3 section, and to require compliance therewith and prevent
4 evasions thereof.

5 “(2) The Corporation may make such investigations
6 as it deems necessary or appropriate to determine whether
7 the provisions of this section and rules, regulations, and or-
8 ders thereunder, are being and have been complied with by
9 savings and loan holding companies and subsidiaries and
10 affiliates thereof. For the purpose of any hearing, investiga-
11 tion, or any other proceeding under this section, the Corpo-
12 ration or its designated representatives shall have power to
13 administer oaths and affirmations, to issue subpoenas and
14 subpoenas duces tecum, to take evidence, and to require the
15 production of any books, papers, correspondence, memo-
16 randums, or other records which may be relevant or material
17 to the hearing, inquiry, or proceeding. The attendance of
18 witnesses and the production of any such records may be re-
19 quired from any place in any State or in any territory or
20 other place subject to the jurisdiction of the United States
21 at any designated place of hearing. The Corporation may
22 apply for the enforcement of such subpoenas and subpoenas
23 duces tecum to the United States district court, or any other
24 court of the United States, within the jurisdiction of which
25 such hearing, investigation, or proceeding is being carried

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1 on, or where any witness or company subpoenaed resides or
2 carries on business, and such courts shall have jurisdiction
3 and power to order and require compliance therewith.

4 “(3) Whenever it shall appear to the Corporation that
5 any person is engaged or has engaged or is about to engage
6 in any acts or practices which constitute or will constitute
7 a violation of the provisions of this section or of any rule,
8 regulation, or order thereunder, the Corporation may in its
9 discretion apply to the proper United States district court,
10 or the United States court of any territory or other place
11 subject to the jurisdiction of the United States, for an order
12 enjoining such acts or practices, or for an order enforcing
13 compliance with this section or any rule, regulation, or order
14 thereunder, and such courts shall have jurisdiction of such
15 actions, and upon a proper showing an injunction, decree,
16 restraining order, order of divestiture or other appropriate
17 order shall be granted without bond.

18 “(4) All expenses of the Federal Home Loan Bank
19 Board or of the Corporation under this section shall be con-
20 sidered as nonadministrative expenses.

21 “(i) PROHIBITED ACTS.—It shall be unlawful for—

22 “(1) any savings and loan holding company or
23 subsidiary thereof, or any director, officer, employee, or
24 person owning, controlling, or holding with power to
25 vote, or holding proxies representing, more than 10 per

1 centum of the voting shares, of such holding company
2 or subsidiary, to hold, solicit, or exercise any proxies in
3 respect of any voting rights in an insured institution
4 which is a mutual institution;

5 “(2) any director or officer of a savings and loan
6 holding company, or any person owning, controlling, or
7 holding with power to vote, or holding proxies repre-
8 senting, more than 10 per centum of the voting shares
9 of such holding company (A) to serve at the same time
10 as a director, officer, or employee of an insured institu-
11 tion or another savings and loan holding company, not
12 a subsidiary of such holding company, or (B) to acquire
13 control, or to retain control for more than two years
14 after the enactment of this subsection, of any insured
15 institution, not a subsidiary of such holding company; or

16 “(3) any individual, except with the prior approval
17 of the Corporation, to serve or act as a director, officer,
18 or trustee of, or become a partner in, any savings and
19 loan holding company after having been convicted of
20 any criminal offense involving dishonesty or breach of
21 trust.

22 “(j) PENALTIES.—(1) Any company which willfully
23 violates any provision of this section, or any rule, regulation,
24 or order thereunder, shall upon conviction be fined not more

18

1 than \$1,000 for each day during which the violation
2 continues.

3 “(2) Any individual who willfully violates or partici-
4 pates in a violation of any provision of this section, or any
5 rule, regulation, or order thereunder, shall upon conviction
6 be fined not more than \$10,000 or imprisoned not more
7 than one year, or both.

8 “(3) Every director, officer, partner, trustee, agent,
9 or employee of a savings and loan holding company shall
10 be subject to the same penalties for false entries in any
11 book, report, or statement of such savings and loan holding
12 company as are applicable to officers, agents, and employees
13 of an institution the accounts of which are insured by the
14 Corporation for false entries in any books, reports, or state-
15 ments of such institution under section 1006 of title 18 of
16 the United States Code.

17 “(k) SAVING CLAUSE.—Nothing contained in this sec-
18 tion shall be interpreted or construed as approving any act,
19 action, or conduct which is or has been or may be in viola-
20 tion of existing law, nor shall anything herein contained
21 constitute a defense to any action, suit, or proceeding pend-
22 ing or hereafter instituted on account of any act, action, or
23 conduct in violation of the antitrust laws.”

Senator PROXMIRE. We have as our first witness Mr. John Horne, who we have just considered for another term as member of the Federal Home Loan Bank Board.

On Tuesday and Wednesday we will hear from representatives of savings and loan holding companies, from the savings and loan commissioner of California, from the two national trade associations in the savings and loan field, and from various State savings and loan organizations.

The bill before us today would amend section 408 of the National Housing Act which was passed in 1959 and is sometimes referred to as the Spence Act. The Spence Act was regarded at the time as an essentially temporary measure until Congress could evolve a permanent policy on savings and loan holding companies.

The Spence Act froze existing holding companies at their current level and prohibited the acquisition of new savings and loan associations. The act did, however, permit new holding companies to be formed provided they controlled no more than one association.

In addition, the Spence Act prohibited certain forms of financial self-dealing between the controlled association and the parent holding company and its subsidiaries.

The basic purpose of the Spence Act was to preserve the traditional pattern of independent, locally managed savings and loan associations and to protect associations from holding company control which was inimical to the interests of the associations' depositors.

Today I understand Chairman Horne will report to us on how successfully these objectives have been met. The bill before us, which has been recommended by the Board and is part of the President's legislative program, would continue the same prohibition against holding company growth. It also tightens up potential loopholes on the restrictions of self-dealing.

Finally, the bill contains three important new restrictions on holding company activities, about which I am sure we will hear considerable discussion. The new restrictions are:

(1) Holding companies cannot carry on activities unrelated to the savings and loan business;

(2) Holding companies must obtain approval when floating long-term debt which aggregates more than 5 percent of consolidated net worth; and

(3) Holding companies cannot control savings and loan associations across State lines.

I am hopeful we can have a constructive discussion of these points during the course of the hearings. Without objection I would like to insert at this point in the record, statements received by the committee from Senators Kuchel and Murphy of California. The committee looks forward to the testimony of Mr. Horne and to the additional witnesses we have scheduled.

U.S. SENATE,
COMMITTEE ON APPROPRIATIONS,
June 9, 1967.

HON. JOHN SPARKMAN,
Chairman, Senate Committee on Banking and Currency,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: I write this letter in opposition to S. 1542, the Savings and Loan Holding Company Amendments of 1967. There are a number of provi-

sions contained in this proposal which, if enacted, would seriously affect the economy of the State of California.

The savings and loan industry in my State represents assets totaling close to \$30 billion. Family earnings are deposited in over 7 million savings accounts in these associations. A large majority of the families in California own their homes through the availability of funds from savings and loan associations. The key position of the industry in the area of savings and home financing represents a vital element in the economy of my State.

In recent months, however, the industry has had to face the serious challenge of inflation, primarily brought on by inconsistent and ill-timed fiscal policies dealing with interest rates. These economic gyrations resulted in a serious slump in the California housing industry, the real estate market, and ultimately in the savings and loan industry. There are indications today that this industry is slowly emerging from its recent economic crisis.

As recently as 1966, the Banking and Currency Committee has dealt with holding company legislation. In the 89th Congress, we adopted amendments to the Bank Holding Company Act of 1956. I believe that the guidelines that control banking ought to be generally the same guidelines followed by similar financial institutions. There is no justification for the kind of discrimination in the various provisions of S. 1542.

This bill generally would prohibit a savings and loan association owned by a holding company from merging with or acquiring another association. A bank owned by a bank holding company, however, can merge with or acquire another bank subject to agency approval. Why should a different rule apply to a savings and loan agency? I cannot agree with the philosophy of regulation which would deny outright the power of approving a possible merger or acquisition to the Federal Home Loan Bank Board.

More importantly, S. 1542's limited holding company definition, along with the other provisions, will force a number of companies to divest themselves of ownership in savings and loan associations. This bill defines a savings and loan holding company in terms of ownership of more than 10 percent of a single association. The Bank Holding Company Act, on the other hand, defines a bank holding company in much broader terms of control—25 percent of the voting shares of each of two banks. Under the restrictive and discriminatory formula and provisions of S. 1542, divestiture will flood the market with and severely curtail the marketability of savings and loan shares. Such consequences, at the expense of the public interest, would strike clearly at the very stability of the economy of my State and the nation.

These are but a few of the highly prohibitive regulations provided by S. 1542. I oppose this legislation in its present form. I would support legislation providing for reasonable and equitable regulations in this area, generally along the lines of Federal legislation affecting banking institutions. That, it seems to me, is the path along which the public interest lies.

I respectfully urge you and your Committee to weigh carefully S. 1542 in light of the views which I have presented in this letter. It is my hope, as I am sure it is yours, that fair and equitable regulatory legislation for all financial institutions can be enacted by the Congress.

Sincerely yours,

THOMAS H. KUCHEL.

STATEMENT OF GEORGE MURPHY, U.S. SENATOR FROM THE STATE OF CALIFORNIA

Mr. Chairman and Members of the Committee.

I appreciate the opportunity to submit to you my views on S. 1542, the Savings and Loan Holding Company Amendments Act of 1967.

All savings and loan associations throughout the country currently hold combined assets of approximately 130 billion dollars. Sixteen billion of these assets are in savings and loan associations whose stock is owned by holding companies, of which thirteen billion are located in California. Thus, the focus of this legislation falls very peculiarly and substantially on the state I represent.

The savings and loan industry, like our banking industry, is characterized by a dual system of regulation resulting from the fact both the Federal and state governments can grant charters. Those state chartered associations which are insured by the Federal Savings and Loan Insurance Corporation are subject to regulation by both the Federal Home Loan Bank Board and the state of charter. The sole statutory basis for regulation of state chartered associations by the Federal government depends on the exercise of the FSLIC's authority to insure

deposits in state associations. Thus, any regulatory powers given the Board should result from a demonstrable need for such powers to protect the Federally insured deposits.

Your committee has heard testimony from various persons representing savings and loan associations in California affected by S. 1542 including Mr. Gar-eth Sadler, the former California Savings and Loan Commissioner under Governor Brown and the incumbent Commissioner serving under Governor Reagan, Dr. Preston Martin. These witnesses have thoroughly analyzed the provisions of S. 1542 and I am sure their testimony will be most helpful to you in your consideration of the bill. In view of their extensive testimony, there is no need for me to comment in detail on the proposal.

The recent tremendous growth of the population and economy of California would not have been possible without the assistance of the savings and loan industry. The industry attracted capital from within and without the state which financed in large part the construction of residential property needed to meet the demands of the increased families in our state and the acquisition of existing homes and apartments which make up the total housing supply. This contribution to California's growth by the savings and loan industry should be acknowledged in approaching the effect S. 1542 would have on the future growth of California as well as all other states.

In Chairman Horne's testimony some emphasis was placed on the fact supervisory problems existed in the savings and loan industry in recent years a majority of which involve associations owned by holding companies in California. Mr. Horne inferred these supervisory problems resulted from an over-extension of real estate credit. Industry leaders in California agree there was an over-extension of credit in the early 1960's resulting in an over-supply of residential units in the market. What has not been brought out in testimony, however, is the policy followed by the Federal Home Loan Bank Board during this period of liberalizing the availability of credit from the Federal Home Loan system to offset the capital shortage in both Federal and state chartered California associations. The Federal Home Loan Bank Board must assume some responsibility for this over-extension of credit. The Board's recognition of this may be inferred from the policy followed during the past year of curtailing credit available from the Federal Home Loan Bank system.

It is my sincere hope that the Federal Home Loan Bank Board will acknowledge the powers that it received as the result of the Supervisory Act of 1966 and eliminate from S. 1542 requests for supervisory powers which the Board already has or which it does not need to presently protect the insured savings and loan associations which are owned by holding companies. I would also hope that the Board would have behind it some experience in using these broadened powers granted it through the Supervisory Act of 1966 before requesting broad additional powers to this end. We respectfully request the Committee to consider the points of view of responsible industry leaders who have testified before the Committee and have been completely supported by the recent and incumbent Savings and Loan Commissioners and make such amendments to S. 1542 as have been suggested.

The witnesses you heard from California and other states were in substantial agreement in the views expressed on S. 1542. They all agree the Federal Home Loan Bank Board should have the power to require registration, reporting and examination of holding companies and their subsidiary associations and affiliates. There was also substantial agreement in support of controls and prohibitions over certain types of transactions between insured associations and their parent companies and affiliates. In fact there was agreement that a protective wall should be built around the insured institution so that it cannot be damaged as the result of any action on the part of affiliates or the parent holding companies. Thus there was a consensus in support of several important provisions of S. 1542 in which I share.

There are other provisions of S. 1542 that in my opinion serve no public interest and concern which I must express my strong opposition.

The bill requires savings and loan holding companies to divest their ownership of all business interests unrelated to the savings and loan business. No reason has been advanced why such drastic action is required to protect depositors, or the Federal Savings and Loan Insurance Corporation as an insurer of deposits, or in any other way promote the public interest. And I submit there has been a total failure to prove the case in justification of the divestiture provisions in the bill.

As already observed, the sole interest of the Federal government in regulating state-chartered associations relates to the insurance of accounts in these institutions. The divestment provisions of S. 1542 would require such companies as Sear Roebuck, the Paul Revere Insurance Co., All State Enterprises and American National Life Insurance Co. to dispose of their assets in California-chartered savings and loan associations. How would this in any way reduce the insured risks of the FSLIC in these institutions? The answer is it would have just the opposite effect. There is no evidence in the record before this Committee, and I am sure none exists, that the ownership by these companies of California associations has in any way been detrimental to the public interest.

I am aware the Bank Holding Company Act prohibits bank holding companies from engaging in non-banking activities. However, there are reasons why such a prohibition is necessary in the banking industry which are inapplicable and bear no relation to the savings and loan industry. This difference in effect was recognized by this very committee only last year in the report submitted to accompany H.R. 7371, The Bank Holding Company Act Amendments of 1966. That Act redefined "bank" as an institution that accepted deposits payable on demand and excluded those which did not. In the report it was stated that "[t]he purpose of the Act was to restrain undue concentration of control of commercial bank credit, and to prevent abuses by a holding company of its control over this type of credit for the benefit of its non-banking subsidiaries. This objective can be achieved without applying the Act to savings banks . . ." The principal credit activity of savings banks is mortgage lending.

The lending authority of savings and loan associations is narrowly restricted to mortgage lending on real estate, and it is apparent that, unlike the commercial banking industry, there is only minimal danger this lending authority can be used to make intra-holding company loans. Whatever potential danger exists from intra-holding company loans in the savings and loan industry is either prohibited by state law or can easily be reached by the Bank Board under existing authority, particularly that given it by the Supervisory Act of 1966.

Moreover, an anomalous and unfair situation would result from the divestiture provisions of S. 1542 because of the difference in definition of a bank holding company (one which owns two or more banks) and the definition of a savings and loan holding company (one which owns a *single* association). A savings and loan holding company owning one association would be required to sell either the association or all non-savings and loan association interests, whereas a corporation owning one bank remains free to engage in non-banking activities. No reason has been offered for requesting this difference in treatment which results in very serious economic consequences in terms of the marketability of stock savings and loan associations, whether or not owned by a holding company. For example, if an existing savings and loan holding company is forced to elect by reason of the divestiture requirements of S. 1542, to sell its savings and loan association assets and retain those devoted to other purposes, it cannot sell to any other corporation without the latter becoming a holding company and thus required to sell all its other business interests. In the event the owners of a stock association, who are not part of a holding company operation, or their estates find need to sell 10% or more of the stock in the association, for all practical purposes corporations are unavailable as purchasers. The adverse financial consequences resulting from these limitations on marketability are obvious.

We in California are proud of the record of our savings and loan industry. In 1964 our state became the first to pass a law regulating savings and loan holding companies which the industry supported. I am aware that some regulatory problems exist in the industry because a few associations have not been operated in the public interest or mismanaged. The answer, however, is not to sound the death knoll for the vast majority of holding companies operated in the public interest and severely restrict the marketability of stock of the non-holding company associations. To the extent a solution for problem associations is required at the Federal level it can be found by encouraging the Bank Board to use the broad regulatory powers it received from the Congress in the Supervisory Act of 1966 and the enactment into law of those provisions of S. 1542 requiring registration and reporting by holding companies and examination of their operations. In my opinion for the Congress to go beyond this is both unnecessary and unwise.

STATEMENT OF JOHN E. HORNE, CHAIRMAN, FEDERAL HOME LOAN BANK BOARD; ACCOMPANIED BY KENNETH SCOTT, GENERAL COUNSEL; HARRY SCHWARTZ, ECONOMIC ADVISER; ROBERT L. RAND, MEMBER; WALTER L. BROWN, DEPUTY DIRECTOR, OFFICE OF EXAMINATIONS AND SUPERVISION; AND JACK ELIAS, OFFICE OF EXAMINATIONS AND SUPERVISION

Mr. HORNE. Thank you, Senator.

May I identify those at the table with me?

Senator PROXMIRE. Yes, I wish you would.

Mr. HORNE. To my far left is Board member Bob Rand. Mr. Rand was one of the top executives of one of the very well-run savings and loan associations in the State of California. He has had a great deal of experience both in the banking field and in the savings and loan field. He is the newest member of the Board.

To my immediate left is Ken Scott, the general counsel of the Federal Home Loan Bank Board.

To my immediate right is Harry Schwartz, who is in charge of research, and he is the chief economic adviser to the Board.

To his right is Jerry Brown, who is deputy director of the Office of Examinations and Supervision. The director of that office is out because of illness.

To Mr. Brown's right is Jack Elias, who is a staff member of the Board, who has worked a long time on holding companies and who knows quite well the structure of holding companies and the problems that we will testify about today.

Now, Senators Proxmire and Bennett, I of course am very pleased to be with you to testify in behalf of S. 1542. As has been pointed out, the President in his Economic Report of January 26, 1967, to the Congress, renewed the recommendation made in his 1966 Economic Report for stronger regulation for savings and loan holding companies.

It is a privilege for me to appear before you today to testify, on behalf of the Federal Home Loan Bank Board, in support of the pending bill, S. 1542, which would carry out the President's recommendation.

S. 1542 would amend section 408 of the National Housing Act to provide more comprehensive and effective safeguards for the operations of savings and loan holding companies and their subsidiary insured savings and loan institutions.

This is really the second round of consideration by the Board and the Congress of the problems posed by the operations of holding companies in the savings and loan field. The first round led to the enactment on September 23, 1959, of Public Law 86-374, sometimes referred to as the Spence Act, which added to the statute books the provisions now to be found in section 408 of the National Housing Act (12 U.S.C. 1730a).

The Spence Act was intended, according to the report of the House Committee on Banking and Currency on the bill (H.R. 7244) which was enacted into law, "to protect against the encroachment of holding companies in the savings and loan field."

Several reasons were cited for congressional concern and action of this nature. There was a desire "to preserve the traditional pattern of independent, locally managed savings and loan associations." There

was a feeling that action should be taken "to prevent undue concentration of economic control through the holding company device" and to prevent possible attempts "to circumvent State and Federal restrictions on branches." And finally, it was noted that:

* * * the holding company method of operation is susceptible to abuse by unscrupulous promoters. . . . One of the fundamental rules of sound lending is that the parties concerned deal at arm's length. The bill would preserve this sound and tested lending requirement with respect to institutions whose loanable funds are derived almost entirely from the general public.

It is fair to say, based upon our experience with the Spence Act since it was enacted in 1959, that it effectively achieved some of its objectives but obtained others only partially or not at all. In addition, our experience has focused our attention on certain problems that the 1959 law did not undertake to deal with at all.

Although the 1959 enactment placed some restraints upon the growth of a holding company once formed, it can hardly be said to have prevented further encroachment by holding companies in the savings and loan field.

At the end of 1959 there were 44 holding companies controlling 93 associations, which possessed 7.2 percent of the assets of all insured associations.

By the end of 1966 every one of those figures had increased very substantially; there were 98 holding companies controlling 134 associations representing 12.5 percent of the whole industry.

In dollar terms, the assets of holding company associations climbed from \$4.25 billion to over \$16 billion. Of this \$16 billion, some 83 percent is located in the one State of California, but holding company operations are to be found to some extent in 10 other States as well, as shown in table 1.

In table 2, existing holding companies are broken down by type. I should note that since the present law does not require holding companies to register or furnish any information to the Board, our knowledge about holding company operations, or even their existence, is necessarily limited.

The Spence Act has been largely effective in keeping new holding company formation predominantly local in orientation, except in those instances where a large national corporation buys up a savings and loan in some area.

The act has also been generally effective in preventing any individual holding company from increasing at an alarming rate that degree of concentration of economic control which had already come into being by 1959.

Similarly, the restriction of newly formed holding companies to control of a single insured institution seems to have prevented circumvention of branching restrictions.

Senator BENNETT. Going back to the previous paragraph, Mr. Horne, in 1959 there were 44 holding companies, with 93 associations, slightly more than two associations per holding company. In 1966 there were 98 holding companies but only 134 associations, which is slightly less than one and a half associations per holding company. So wouldn't that indicate that statistically, at least, the concentration is lessening rather than increasing, though I realize that there must be exceptions?

Mr. HORNE. To some extent your observation is correct, Senator Bennett. But what has happened is frequently that they have simply merged their subsidiaries. Many of the holding companies from time to time do request and do obtain approval to merge their existing subsidiaries, and this is one of the reasons why the figures are as you have stated.

Senator BENNETT. You have no figures to show what that might have been if the merging process had not taken place?

Mr. HORNE. Mr. Scott?

Mr. SCOTT. The concentration figure, Senator Bennett, would not be affected. All you are affecting here is the number of associations held by the holding company. If a holding company begins with six or seven associations, and merges them into two or four, you have not affected the share of the market it controls in any way.

Senator BENNETT. I understand. This, of course, is only possible in States that permit branching.

Mr. SCOTT. That is correct.

Senator BENNETT. Does your testimony indicate how many States there are that permit branching?

Mr. HORNE. No, sir, it does not. We can supply that information for you if you want us to.

Senator BENNETT. I think it would be helpful.

Mr. HORNE. All right, sir.

In the 23 States in which permanent stock savings and loan associations are permitted to operate, only Illinois prohibits all branching. Two other States (Florida and West Virginia) also have statutory prohibitions against branching, and in two additional States (New Hampshire and Vermont) no branch offices are presently maintained by savings and loan associations, although the State statutes do not expressly prohibit branching.

Mr. HORNE. I think the important figure here is that in 1959 they held 7.2 percent of the assets. Now they hold 12.5 percent. And, also, since 1959, Senator, new holding companies can have only one association.

Senator PROXMIER. The holding companies what?

Mr. HORNE. Since 1959, holding companies that come into being can have only one association. There is only one slight exception to that, Senator, that was made in last year's legislation, but it relates to merging with sick associations.

However, our experience shows that the statutory provisions have not been as effective as desired in safeguarding against possible abuses in holding company operations.

First, in undertaking to enforce those provisions of section 408 which deal with transactions between subsidiary associations and their affiliates, we have been greatly impeded by lack of access to holding company books and records, resulting at times in sheer inability to know what is happening.

Our examination of association records frequently reveals little about the other parties to a complicated transaction and their possible relationships to the parent company.

Second, we have encountered numerous instances where the lack of any regulation over the holding company has enabled it to be used to evade the law governing the operations of its savings and loan subsidiary. It seems clear that the holding company device lends itself to

circumvention of the safeguards designed to protect the operations of the controlled association.

Third, and perhaps most fundamentally of all, it is evident that there are a great many ways in which the subsidiary savings and loan association may be bent to serve the needs of the holding company and the other activities in which the holding company may be engaged.

The transactions between the insured association and its affiliates are not at arm's length and the operating decisions of the association are not independently arrived at.

In the general run of business enterprises and wholly owned subsidiaries, this may occasion little concern, for there may be no real reason to care how the parent company chooses to use its subsidiary or to distribute income and expense and profit or loss among its various activities.

But when one of these subsidiaries has the bulk of its liabilities in the form of savings entrusted to it by the public and when those liabilities are insured by a public agency, then there is a very strong reason for public concern over the purposes which that particular subsidiary is made to serve and over dealings of any sort that are not conducted at arm's length.

Savings and loan associations have been specifically created for expressly favored public purposes, to foster thrift and economical home financing. To insure that they adhere to and successfully serve those purposes, they receive special forms of public support—a public system of insurance for their accounts, a public system for obtaining credit at lower costs, and favorable tax treatment.

There is special assurance provided for public confidence in their financial integrity, based upon a program of regular examinations and supervision. Whether holding companies should be allowed to operate at all in such a field, and how the interests of their insured subsidiaries may be sufficiently protected if they do so operate, are legitimate questions for public concern.

We believe, based on the information available to us, that the imperfection of the present statutory protection of savings and loan subsidiaries of holding companies has been clearly demonstrated.

There are a number of ways to describe our dissatisfaction with the operations of savings and loan holding companies as compared to the rest of the industry.

The figures I am about to refer to give an accurate overall picture of the kind of problem holding company operations have presented to us, but of course they do not describe or necessarily apply to each and every individual holding company.

There are holding companies whose associations are sound, prudently run and ably managed. But, unfortunately, there are quite a number—a disproportionately high number—of holding companies about which that cannot be said.

As one way of getting at the reasons for our particular concern with holding companies, let me analyze for you the so-called problem book.

As I informed this committee last year, the Board keeps a record of those institutions which are of some degree of supervisory concern. There were, at the end of 1966, 28 institutions with \$2.3 billion in assets that were ranked in the category of the more serious problem cases; holding company associations, although possessing only 12.5

percent of the assets of the entire industry, accounted in asset terms for 63 percent of the serious problem group.

In the next category in the problem book were 29 associations with \$700 million in assets. If both categories are combined, the holding company associations account for 54 percent of the assets of institutions whose financial condition and operations are presently troubling us.

In short, we find this one-eighth of the industry producing over half of our supervisory difficulties and almost two-thirds of our most serious problems. Such a situation, in our view, cannot go unremedied if we are to discharge our responsibilities to protect the public's savings and the standing of the rest of the savings and loan business.

The fact that there is greater reason for concern and greater need for protective safeguards with respect to holding company associations than for the rest of the industry is confirmed by nearly every measure we can apply.

In table 3, holding company associations are compared to the other sectors of the industry in terms of a number of ratios, and their performance indicates a more risky mode of operation in almost every respect.

Holding company associations have a level of assets of substantial quality ("scheduled items") that is almost three times as high as the rest of the industry, and that represents a percentage of their net worth that has been rapidly mounting, as shown in the related chart.

Holding company associations are much heavier borrowers and have significantly lower levels of liquidity, than the rest of the industry. Their foreclosure rate has been about three times as high as the rest of the savings and loan business.

We do not find these figures reassuring as to the character of holding company operation.

I might add that we have compared the performance of holding company associations with other stock associations, and the California holding company associations with other California associations, as a means of testing whether these characteristics corresponded to the holding company style of operation or were instead shared by all stock associations or all associations located in a particular market area. However, the pattern remained the same; the holding company statistics and ratios were markedly inferior to other groups.

If I may summarize the conclusion of our investigations, we found the problems associated with holding company control to be too consistent a phenomenon to be approached on a case basis with individual cease-and-desist orders to each individual association.

It does not appear that we have to deal with a matter of random or scattered overreaching or lapses of judgment, but instead with weaknesses that inhere in the situation of a closely regulated and protected business impressed with a public trust being controlled by completely unregulated holding companies.

I must admit that I cannot claim for our findings the status of any startling discovery. A similar problem was experienced in the field of public utility regulation, and led to the Public Utility Holding Company Act of 1935.

In the field of banking regulation and supervision, the potential of these problems led to the Bank Holding Company Act of 1956.

And, in the judgment of the Board, the time has clearly come to follow the first step taken in 1959, with a comprehensive and effective Savings and Loan Holding Company Act as well.

With this background in mind, let me undertake to outline for you in broad terms the structure of the pending bill, S. 1542. There are some technical amendments to this statement, which we would recommend to the committee.

To begin with the scope of the bill, the definition of savings and loan holding company in section 408(a) includes any company which controls an insured savings and loan institution either directly or through one or more subsidiaries.

An individual cannot himself be a savings and loan company, as the definition of company makes it quite clear. Control is defined to include ownership of more than 10 percent of an association's stock, as in the present law, or more than 25 percent of the stock of other companies and subsidiaries.

Basically, the proposed bill builds on the same definition of what constitutes a savings and loan holding company as was enacted by the Congress in 1959, with some clarification as to tracing control through several corporate layers.

The next provision, section 408(b), provides for registration and examination of holding companies and the filing of reports. The intent here is to provide for knowledge of the existence of holding companies and what they are doing.

The need for information is so obviously elementary and essential that I do not believe there is much controversy over this portion of the bill.

The only State law directed toward savings and loan holding companies, one that was enacted in California in 1964, is of this nature; it provides the State commissioner with information on holding company activities, but in no way regulates or restrains those activities.

The section of the bill dealing with further acquisitions by savings and loan holding companies—section 408(e)—likewise is in principle a continuation of the rule prescribed by the Spence Act in 1959 and slightly modified in 1966. That modification I referred to briefly earlier in my statement. A holding company would be forbidden to acquire additional savings and loan associations, except in connection with the disposition of an institution on the verge of involuntary liquidation.

The corresponding portion of the Spence Act appears, as I mentioned earlier, to have served fairly well its intended purpose of preventing substantial further concentration of economic power and market dominance in the hands of individual holding companies.

In section 408(c)(1) we are dealing with the outright misuse of the holding company as a means to evade statutes and regulations that govern the conduct of its subsidiary savings and loan association.

This appears, to our regret, to be not at all uncommon, and hence we have included a provision specifically aimed at it. This subject, as you will note, is closely related to the question of what are or are not permissible related activities, which is dealt with in section 408(c)(2).

The remaining substantive provisions of the bill are all intended to counteract, at least in part, the fact that the publicly insured savings and loan association subsidiary is not free to make independent deci-

sions or to protect itself in dealings with the parent or the parent company's other enterprises.

Thus section 408(d) contains an outright prohibition of various forms of loans and investments by a holding company association in its affiliates. It places very little restriction on the normal lending business of an association to exclude from those with whom it may do business the parent company and its other subsidiaries.

At the same time, the risks of such transactions can be substantial, as very large sums of money can move rapidly out of the association and into the parent's other operations.

Similar prohibitions are part of the present law, and we recommend that they be continued as set forth in the bill.

Section 408(d) of the bill goes on, however, to cover some loopholes in the present law, such as purchases or sales of property or services between the association and its affiliates.

Obviously, these transactions, too, are not free from the risk that advantage may be taken of the savings and loan association when the terms of the transaction are not freely arrived at by arm's-length bargaining.

At the same time, we recognize that they do involve an area where dealings with the parent company may be not only legitimate but helpful to the association, and indeed may form part of the discharge by the parent of the responsibilities that go with its control.

In this area, therefore, the bill proposes, as a general approach, not an outright prohibition, but a requirement of approval by the Federal Savings and Loan Insurance Corporation when the volume of such transactions exceeds certain stated amounts.

Another group of new provisions—sections 408 (f), (g), and (c) (2)—is concerned primarily with the relation between the pressure on the insured savings and loan association to produce high short-run reported earnings and pay out substantial dividends, and the holding company's debt structure and other activities.

Again, our problem is that investment and dividend decisions are not taken independently by the savings and loan association's management on the basis of its own condition and earnings, but are determined by the parent company in order to meet its needs and debts.

Hence, these provisions of the bill look to the parent's debt structure and other activities, restricting both in the interest of limiting or relieving pressures placed on the subsidiary savings and loan association.

The premise of this portion of the bill is that if a savings and loan holding company is that and that alone, then the interests of its savings and loan subsidiary will be predominant in the holding company's decisions.

As a precaution, furthermore, lest reliance on that premise be not entirely warranted, the bill provides for advance notification to the Insurance Corporation of the payment of dividends by the subsidiary association to its parent.

If the association's condition should be impaired or the payment of such a dividend unsound in the light of its condition, this notice would enable the Insurance Corporation to take steps to prevent the payment and to protect the insured association at the cost, if need be, of the demands on the parent.

The authority to take such action by the commencement of a cease-and-desist proceeding was provided to the Insurance Corporation last year by the Financial Institutions Supervisory Act. The purpose of the notice provision is merely to enable that authority to be used, where grounds exist, in time to do some good.

I might note at this point that the foregoing discussion does not sound very much like the testimony presented to this committee in 1959 by some holding company advocates, to the effect that the great advantage of the holding company type of organization was that it could and would come to the aid of its subsidiary associations with capital infusions. But I am afraid that the record of the last 8 years does not sound much like that testimony either.

We have analyzed, for the period 1959-66, the capital contributions that holding companies made to strengthen their controlled associations as compared to the amount of money that they withdrew from their associations as dividends and also in the form of management fees.

In summary, over this period the holding companies have put \$35.4 million into their controlled associations but have taken out \$55.1 million in the form of dividends and \$10.5 million in the form of service fees, for a net drain of \$30.2 million. The details are set forth in table 4.

The record suggests, in general, that holding companies will supply capital as required by State law to support association growth when operations are profitable but are not to be counted on for much, if any, assistance in a period of adversity.

The acid test of the proposition that we should expect the holding company to serve as a support in time of need for its subsidiary association, and not exactly the other way around, was surely in 1966.

Last year saw foreclosures and substandard assets, and losses on both, rise to their highest level yet. These, together with rapidly rising interest costs on savings accounts, very tight monetary conditions and periods of heavy withdrawals from savings and loan associations, left little or no money to put into new mortgage lending and increase current earnings in order to offset rising costs of operations.

The result was a severe squeeze on the earnings of the savings and loan business, with more associations than at any time in recent history unable to meet their reserve requirements or actually reporting operations at a loss.

What was the record of the holding companies at this hour of need? As a group, they put only \$1.8 million into their controlled associations, the lowest amount in 5 years, and took out \$15.6 million in dividends and \$2.1 million in fees, the greatest amount ever.

As some indication of how little this capital flow had to do with the financial position and earnings of the controlled associations, as opposed to the requirements of the holding company to service a heavy burden of debt or support its other activities, we looked at the operating statements of the controlled associations which last year paid cash dividends on stock to their parent companies.

The 43 holding company associations involved had available after taxes, interest on savings accounts, and transfers to loss and other reserves, net income of \$13.5 million. The payment of total cash dividends in the amount of \$15.7 million, therefore, exceeded current net income

and resulted in a reduction of \$2.2 million in accumulated undivided profits.

It does not take much insight to see for whose benefit these decisions are being made or to become aware of the lack of any adequate safeguards from the standpoint of the controlled association in the present law.

It is clear that nearly always the association is used to benefit non-association activities, not the other way around, and the Board does not have adequate authority to prevent such a bias.

To emphasize what I stated before, this might not be a matter of much concern in the usual business enterprise, but must be an object of serious concern when the subsidiaries are entrusted with the savings of millions of American citizens and have their savings liabilities insured by an instrumentality of the Government of the United States.

This question of permitting the holding company to both control a savings and loan association and engage at the same time in a variety of unrelated activities is so significant that I would like to discuss it with you a few minutes longer.

We are told sometimes of the advantages that diversification holds for a parent company, in terms of stabilizing its earnings and economic risks. At the same time, we have noted that on occasion diversification means an expansion by management into fields with which it is unfamiliar and in which the costs of self-education can be rather high.

But the point I wish to make today does not involve just a weighing of the pro and con arguments about conglomerate operations. Whatever the involvement in other fields may hold for the parent company in the way of profits or losses, there is no assurance of any benefit whatever for the savings and loan subsidiary.

The essential point to remember about a holding company structure, is that the holding company calls the tune, and the subsidiary dances—it is fundamentally a one-way street, so the savings and loan may reap the drawbacks but not the advantages of diversification elsewhere.

That conclusion can be illustrated in a number of ways. First, there is the matter of propriety of association. Perhaps as a supervisory agency we tend to be somewhat old fashioned or conservative, but I confess to a distinct lack of enthusiasm over the prospect of a financial institution being controlled by, for example, a racetrack or gambling casino.

Second, we have had occasion quite recently to test the theory that if the savings and loan association is in need of assistance, the other segments of a diversified operation that are doing relatively better, will serve as a source of strength and support to the savings and loan operation.

At the end of 1965, the holding company I have in mind owned a bank holding company controlling one bank, a title insurance company, and a small life insurance company, as well as a substantial savings and loan association.

It became quite apparent by 1965 that the savings and loan association was getting into very serious difficulty; its reported net income fell from \$4.1 million in 1964 to \$0.5 million in 1965. Its ratio of sub-

standard assets to net assets rose to 27.8 percent, and there were rather depressing appraisal reports on some of the rest of its loan portfolio.

The bank, on the other hand, was doing reasonably well.

Did the holding company use the earnings from its bank operation to meet the problems of its saving and loan operation?

Hardly. In fact, it took precautions to avoid even being called upon to do so.

In March 1965, it transferred control of its bank to a newly created subsidiary, and early in 1966 spun off the bank holding company subsidiary by distributing its stock to the holding company's stockholders.

This deprived the holding company at one stroke of 36 percent of its consolidated net worth; its 1965 earnings deficit of \$730,000 would have been twice as large without the inclusion of its equity in the bank and bank holding company earnings.

Thus the profitable bank operations were put safely out of reach while the association's financial condition deteriorated rapidly, so that it is now one of our most serious problem cases.

In short, the holding company and its owners acted to maximize their economic well-being, and that simply does not mean putting money into the savings and loan subsidiary if they think it is likely to be lost or have other and better uses for it.

The theory that the holding company would act otherwise, and pump money if needed into its controlled savings and loan association despite unpromising prospects of return, is comforting. But the practical results, as contracted with theory, are quite discomfoting.

As to what happens when the other operations of a diversified holding company experiencing difficulty, we have also had some experience.

I have already referred to what occurred in 1966, when holding companies took out from their controlled associations almost 10 times as much money as they put in. A more dramatic example was recently supplied by a savings and loan holding company which also owned a controlling interest in a bank, two title insurance companies, a real estate holding company and an insurance consulting firm.

One title insurance firm was placed in receivership by the State because of irregularities which threatened its solvency; its real estate holding company, which constructed a commercial building complex, was the subject of a mechanic's lien suit for \$381,000. The parent company suffered severe financial reverses in 1964, and in 1965 defaulted on two bank loans totaling about \$4.3 million, secured by pledge of the stocks of the bank and savings and loan subsidiaries. The bank stock was sold by the pledgee bank.

The adverse publicity concerning the financial difficulties of the holding company and its nonsavings and loan subsidiaries precipitated a massive withdrawal of savings from the association subsidiary.

During the period from December 31, 1964, through April 6, 1965, the net outflow of savings aggregated approximately \$9 million, reducing savings during that period from \$40.7 million to \$31.7 million.

In order to accommodate these withdrawals and to provide liquidity, the Federal home loan bank advanced \$12.2 million of additional funds

to the association, to the point where its total advances ultimately totaled 52.8 percent of savings.

These conditions, added to some earnings problems the association was itself experiencing, resulted in its opening of negotiations for merger with other associations in order to protect its savers from loss and avoid being placed in receivership and liquidation by the State authorities. The merger was effected within a few months, and the association went out of existence.

To sum it up, we believe firmly that this committee was completely correct when it stated in its 1959 report on the Spence Act bill:

The problems of financial manipulation and intercorporate dealings is one which has occurred in holding company operations in other fields, notably the public utility field. Savings and loan associations, created for the purposes of encouraging thrift and promoting home ownership, must not be permitted to become entangled in a corporate web designed to promote some other and unrelated interest.

I might add, Mr. Chairman, this committee took an identical position regarding bank holding companies. If I may, I would like to read into the record a statement about that.

On page 1 of Senate Report No. 1095 of the 84th Congress, first session (1955), the committee said:

In general, the philosophy of this bill is that bank holding companies ought to confine their activities to the management and control of banks and that such activities should be conducted in a manner consistent with the public interest. Your Committee believes the bank holding companies ought not to manage or control nonbanking assets having no close relationship to banking.

Then, on pages 13 and 14 of the report it says:

Your Committee holds the opinion that bank holding companies should confine their activities to the control and management of banks and activities closely related to banking. They should not combine management and control of banking activities with the management and control of nonbanking activities. The divestment requirements in this bill are designed to remove the danger that a bank holding company might misuse or abuse the resources of the bank it controls in order to gain an advantage in the operation of the nonbanking activities it controls.

The bill before you, S. 1542, reflects our conviction that the wisdom of that statement in 1959, on the Spence Act, has been amply demonstrated by the events of the years since then, and is intended to translate that statement into effective statutory form.

A limited restriction on those to whom large blocs of association stock may be sold seems a small price for the adequate protection of a major public—and industry—interest.

In conclusion, let me try to put this whole subject in its proper setting.

There is no need for me to remind the members of this committee about how major a role the \$130 billion savings and loan industry now plays in our financial structure. It is far and away the largest source of financing for this country's huge residential construction industry.

It is true that the holding company sector amounts to only one-eighth of the savings and loan business, but in terms of the order of magnitude of which we are speaking, that amounts to over \$16 billion in assets and \$13 billion of the public's savings.

I think it is incumbent upon us at the Board to recommend to the Congress those measures that we think essential to insure the integrity of holding company operations.

The problem that I have tried to describe for you this morning is both large in scale and pervasive in its effects.

As the facts and figures show, I believe we have what is really an institutional problem, and not a matter of a few miscreants or a random handful of poor managers.

The legislative response to that problem which we are supporting before you today, and which the Bureau of the Budget has advised is in accord with the program of the President, is contained in S. 1542. It is grounded on the foundation of the existing savings and loan holding company law, expanded to meet the lessons of our experience under that law since 1959.

I realize that it is sometimes difficult for the legislative process to come to bear fully and effectively on a business as powerful and determined as this one can be, but I submit that the reasons for doing so are imperative.

Admittedly, what I have told this committee is deeply disturbing to the Board. Admittedly many of those who own and manage savings and loan holding companies will not be pleased with either what I have said or the proposed legislation. Unquestionably they will endeavor either to prevent passage of the bill or to strip from it many provisions that the Board thinks it needs if it is to give maximum protection to the public interest.

As one, though, who worked as a staff member in the Senate for several years, and who respects and appreciates the legislative process, I concluded that in fairness to this committee and its staff, and to the Board and its staff, I should be straightforward in sharing with you this information that causes our concern, in order that we may join together in meeting our responsibilities.

My fellow members of the Federal Home Loan Bank Board unanimously join me in urging the prompt enactment of S. 1542.

(The charts which accompanied Mr. Horne's prepared statement follow:)

TABLE NO. 1.—*Savings and loan holding company controlled associations portion of total assets of all insured associations in State at Dec. 31, 1966*

State of operation	Total number of holding companies	Controlled associations		Percent of total assets of all insured associations in State
		Total number	Total assets (millions)	
California.....	48	72	\$13,349	50.4
Ohio.....	14	14	809	8.8
Texas.....	7	13	689	12.1
Illinois.....	11	11	293	2.5
Colorado.....	5	9	409	25.6
Arizona.....	2	2	66	8.2
Nevada.....	3	2	331	53.2
Utah.....	2	2	64	9.9
Kansas.....	1	4	89	5.7
Idaho.....	2	2	28	10.5
New Mexico.....	2	2	43	10.5
Guam.....	1	1	3	100.0
Total.....	98	134	16,173	27.4

TABLE NO. 2.—*Analysis of holding companies and controlled associations at Dec. 31, 1966*

[Dollars in millions]

Kind of holding company	Number of holding companies	Number of associations	Total assets	
			Dollars	Percent
Multiple—more than 1 association.....	12	50	10,031	62.0
Unitary—single association.....	86	84	6,142	38.0
Total.....	98	134	16,173	100.0
Pre-Spence Act.....	33	71	12,782	79.0
Post-Spence Act.....	65	63	3,391	21.0
Total.....	98	134	16,173	100.0
Publicly owned ¹	45	82	12,071	74.6
Privately owned.....	53	52	4,102	25.4
Total.....	98	134	16,173	100.0
Diversified—mainly other lines ²	28	30	1,670	10.3
Diversified—mainly S. & L. business ³	30	39	6,762	41.8
Straight S. & L. business.....	40	65	7,741	47.9
Total.....	98	134	16,173	100.0

¹ Holding companies whose securities are traded either on a national or regional securities exchange or in the over-the-counter market.

² Holding companies whose other lines of business are greater than the savings and loan portion of their business.

³ Holding companies primarily engaged in savings and loan business but having other unrelated activities.

TABLE NO. 3.—Savings and loan holding company controlled associations selected financial data and ratios 1959-66

Classification	Associations		Total assets		Scheduled items divided by special assets (percent)	Scheduled items divided by net worth (percent)	Net worth divided by savings (percent)	Mortgage yield (percent)	Expenses divided by average assets (percent)	Borrowing divided by total assets (percent)	Liquidity ratio (percent)	Foreclosure rate per 1,000 loans
	Number	Percent	Amount (millions)	Percent								
1966												
Holding company associations.....	134	3.0	\$16,173	12.5	6.3	82.4	8.3	6.6	1.0	10.8	8.3	16.0
Insured excluding holding company.....	4,372	97.0	112,840	87.5	12.3	126.9	8.1	16.0	1.1	5.0	9.8	4.9
All insured.....	4,506	100.0	129,013	100.0	12.9	134.3	8.1	16.0	1.1	5.7	9.6	5.8
1965												
Holding company associations.....	137	3.0	15,831	12.7	5.6	68.9	8.6	6.5	1.1	9.1	8.9	14.3
Insured excluding holding company.....	4,371	97.0	108,745	87.3	2.5	28.7	7.9	5.7	1.1	4.5	10.3	4.7
All insured.....	4,508	100.0	124,576	100.0	2.9	33.9	8.0	5.8	1.1	5.1	10.1	5.5
1964												
Holding company associations.....	141	3.2	14,538	12.7	5.0	59.2	8.6	6.7	1.1	9.0	9.2	13.4
Insured excluding holding company.....	4,322	96.8	100,115	87.3	2.8	32.8	7.8	6.0	1.1	4.2	10.8	4.6
All insured.....	4,463	100.0	114,653	100.0	3.1	36.3	7.9	6.1	1.1	4.8	10.7	5.4
1963												
Holding company associations.....	135	3.1	12,161	11.8	(²)	(²)	8.4	6.9	1.4	7.4	10.3	11.6
Insured excluding holding company.....	4,284	96.9	90,824	88.2	-----	-----	7.8	6.0	1.2	4.4	11.5	4.5
All insured.....	4,419	100.0	102,985	100.0	-----	-----	7.9	6.1	1.2	4.8	11.3	5.1
1962												
Holding company associations.....	123	2.8	9,249	10.4	-----	-----	9.4	7.4	1.3	6.6	10.3	-----
Insured excluding holding company.....	4,209	97.2	80,081	89.6	-----	-----	8.0	6.1	1.2	3.7	12.0	-----
All insured.....	4,332	100.0	89,330	100.0	-----	-----	8.1	6.2	1.2	4.0	11.8	-----
1961												
Holding company associations.....	105	2.5	6,906	8.9	-----	-----	9.5	7.0	1.3	7.5	10.1	-----
Insured excluding holding company.....	4,116	97.5	70,832	91.1	-----	-----	7.9	5.9	1.2	3.2	12.2	-----
All insured.....	4,221	100.0	77,738	100.0	-----	-----	8.0	6.0	1.2	3.6	12.0	-----
1960												
Holding company associations.....	94	2.3	5,188	7.7	-----	-----	-----	-----	-----	-----	-----	-----
Insured excluding holding company.....	4,004	97.7	62,080	92.3	-----	-----	-----	-----	-----	-----	-----	-----
All insured.....	4,098	100.0	67,268	100.0	-----	-----	-----	-----	-----	-----	-----	-----
1959												
Holding company associations.....	93	2.3	4,276	7.2	-----	-----	-----	-----	-----	-----	-----	-----
Insured excluding holding company.....	3,886	97.7	55,145	92.8	-----	-----	-----	-----	-----	-----	-----	-----
All insured.....	3,979	100.0	59,421	100.0	-----	-----	-----	-----	-----	-----	-----	-----

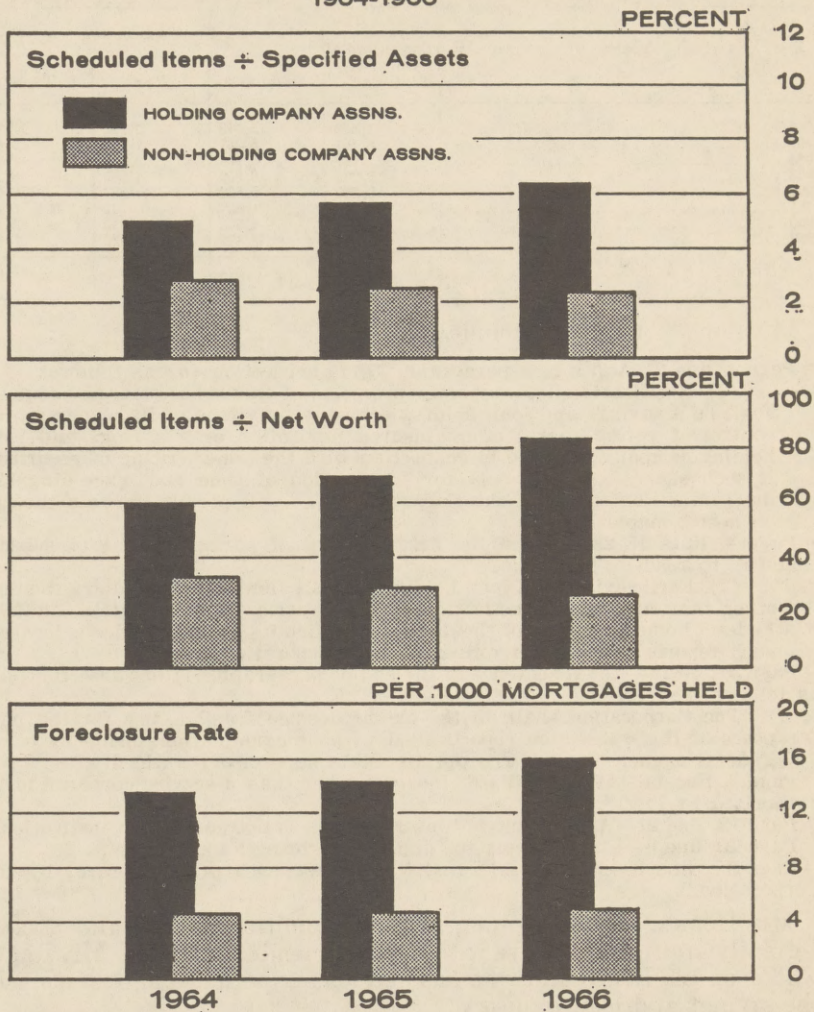
² Classification of scheduled items was not made prior to 1964.¹ Preliminary.

Explanatory notes to table 3

Scheduled items divided by specified assets.	Total scheduled items at year end as a percent of total specified assets at year end.
Scheduled items divided by net worth.	Total scheduled items at year end as a percent of net worth at year end.
Net worth divided by savings.	Net worth at year end as a percent of savings capital at year end.
Mortgage yield.	Total interest income from mortgage loans and contracts, plus fees and discounts earned on loans for the year, as a percent of average amount of mortgage loans and contracts held during year.
Operating expenses divided by average assets.	Total operating expenses for the year as a percent of average total assets.
Borrowings divided by total assets.	Total borrowings (FHLB advances, mortgages on institutions' premises and other borrowed money) at year end as a percent of total assets at year end.
Liquidity ratio.	Total cash and U.S. Government obligations held at year end as a percent of total savings capital at year end.
Foreclosure rate (per 1,000 mortgage loans).	Total number of foreclosures during year divided by monthly average of number of mortgage loans held during year, multiplied by 1,000.

All ratios, except the foreclosure rate, have been computed from data reported by associations as of the end of their fiscal period nearest the end of the calendar year. They may therefore differ slightly from ratios computed from the less complete monthly reports submitted by associations. The foreclosure rate shown is more precise than, and therefore may differ slightly from, the rate regularly published by the Board, which is the sum of four quarterly rates. Scheduled items, specified assets, and net worth are defined in the "Rules and Regulations for Insurance of Accounts."

Chart 1
Selected Operating Characteristics of Holding Company and
Non-Holding Company FSLIC-Insured Savings and Loan Associations
1964-1966



SOURCE: TABLE 3

TABLE NO. 4.—*Savings and loan holding companies—Capital contributions to, and cash dividends and fees received from, controlled associations for the years 1959 through 1966*

[In thousands of dollars]

Years	To association—Capital contributions	From association		
		Dividends	Fees	Total
1966.....	1,863	15,643	2,121	17,764
1965.....	5,147	5,081	2,359	7,440
1964.....	12,159	5,100	2,196	7,296
1963.....	2,284	6,859	1,383	8,242
1962.....	9,269	9,809	887	10,696
1961.....	1,215	4,502	736	5,238
1960.....	1,427	4,958	612	5,570
1959.....	2,052	3,122	232	3,854
Total.....	35,416	55,074	10,526	65,600

PROPOSED TECHNICAL AMENDMENTS TO S. 1542

Page 4, line 2—Add a new paragraph (3) to subsection (a) as follows:

“(3) Notwithstanding any other provision of this subsection, no company shall be a savings and loan holding company by virtue of its ownership or control of voting shares of an insured institution or a savings and loan holding company acquired in connection with the underwriting of securities if such shares are held only for such period of time (not exceeding 120 days unless extended by the Corporation) as will permit the sale thereof on a reasonable basis.”

Page 4, lines 18–23—Amend the first sentence of paragraph (2) of subsection (b) to read as follows:

“(2) Each savings and loan holding company and each subsidiary thereof, other than an insured institution, shall file with the Corporation, and the Federal home loan bank of the district in which its principal office is located, such reports as may be required by the Corporation.”

Page 5, line 13—Add a sentence at the end of paragraph (4) of subsection (b) as follows:

“The Corporation shall, to the extent deemed feasible, use for the purposes of this subsection reports filed with or examinations made by other Federal agencies or the appropriate State supervisory authority.”

Page 7, line 14—After “affiliate” insert “(other than a service corporation as authorized by law)”.

Page 12, line 21—After “thereof” insert “which is not an insured institution”.

Page 16, line 9—Strike “apply to” and insert “bring an action in”.

Page 17, line 9—After “(A)” insert “, except with prior approval by the Corporation,”.

Mr. HORNE. Mr. Chairman, as this committee usually allows, and I greatly appreciate, I have with me staff members and also Mr. Rand, who is on the Board and who has had long experience in operating in the savings and loan industry.

I shall try to answer any questions which the committee members may have. And I appreciate the fact that you let the gentlemen at the table with me assist in trying to answer any questions you may have.

The CHAIRMAN (presiding). Thank you very much.

Do any of the other gentlemen have any statements to add or do they hold themselves ready to respond to questions?

Mr. HORNE. No, sir; I think nothing to add now.

Senator PROXMIRE. Mr. Horne, you have given us an interesting indictment. It seemed to me just offhand as a matter of theory it should be very helpful to the housing industry and the construction

industry for—for holding companies to provide the funds, the reliance in times of stress such as we had at the beginning of last year.

I wonder if in going through this chamber of horrors, and I think we have to proceed through it to the extent it does represent abuse, if you really feel you might have overlooked some of the constructive contributions which holding companies have made. I got the impression there was almost nothing positive and a great deal negative.

Is that a fair impression in your judgment, or is that right?

Mr. HORNE. Well, Senator, I stated earlier in my comments that I did not want to leave the impression that there aren't holding companies that are well run. There are. But I also stated that the problems are disproportionate to the size of the holding company operations.

The Board is not here today to ask that holding companies be abolished. They exist and the problem is how do we deal with the problems that they offer now?

Senator PROXMIRE. What I am getting at is I think it is fine that you have highlighted the abuse. I just wondered if there is anything we can do in this bill to provide incentive and encouragements for contributions.

One of the problems we have, as you know, is that there is too little money available in housing and if we are going to take steps that might discourage investment even further, it might be unfortunate, if there was an opportunity for us to consider the possibility maybe in this bill, maybe not, maybe we have to consider other legislation for that, of getting better funding for our housing industry, which has been starved as we all agree in the last 5 or 6 years.

Mr. HORNE. I, frankly, don't know of any essential contribution that has been made by holding companies, per se, in making more money available to the housing industry.

The amount that they have contributed as capital to the association itself would be trivial in this context.

Now, of course, the subsidiaries which they own have, like other savings and loan associations, made money available to the housing industry. But I don't see the holding company operation itself being of much help in solving the problem that you have related.

Senator PROXMIRE. I notice in your table—Table No. 1—about half of the holding companies are in California, and 83 percent, as I figure it, of the total assets of the controlled associations are in California. This really is very largely a California problem it seems to me.

Is that correct or not? Not exclusively, but very largely.

Mr. HORNE. It is concentrated more in California than elsewhere. But the potential is still there. The important thing is that the potential for considerable national expansion is there. But, unquestionably, as the table shows, there is more of the problem in California than elsewhere.

Senator PROXMIRE. I wonder if your tables really measure the effect of the holding companies, or if they measure something peculiar about California.

You assure us they do not, but you don't document that position where you discuss it here. It may be these figures merely measure the effect of stock company ownership with the special California market.

Could you provide the committee with a breakdown for each State that measures the performance of holding companies in that State?

You make the assertion the California thing wouldn't be much different, but I would feel better about it if you gave us documentation for the record State by State.

Mr. HORNE. We will provide that for you.

In connection with the previous point, Senator, that you raised, as to the potential problem, there are 23 States now that permit the stock chartered form of savings and loan association. And others, of course, are considering whether to do so.

I know such a bill has been introduced in one or two other States, in the present session of the State legislature. So this structure can spread over even more than the 23 States in which it presently could exist.

Senator PROXMIRE. I understand 65 new holding companies have been formed since the Spence Act.

How many of these are predominantly in the savings and loan business?

Mr. HORNE. I think about 40, Senator.

Senator PROXMIRE. Why are these new companies formed, Mr. Horne?

Why do they form them?

Mr. HORNE. You mean what motivates them?

Senator PROXMIRE. Yes.

Mr. HORNE. I suppose you might get a better answer there if they would answer your question frankly. We have not been able to get too much information about it because we haven't been able to require them to report to us, or register with us, or to make examinations. But quoting from what one person gave as an advantage to the holding company—this is a direct quote—"Indicative of the way control of capital can be effectively utilized, by the way, is the fact that the availability of funds from the savings and loan association and from other * * * holdings placed on deposit with commercial banks have proven of great value in inducing the banks to join in the [company's] credit line."

In other words, I suppose you could describe that as providing compensating balances. They can make the savings and loan association—this would be one motivation—put money on deposit in a bank for the parent's use as a compensating balance. There are other ways in which savings and loans have been used to be of assistance to the parent company or other subsidiaries of the parent company.

Senator PROXMIRE. On page 2, you say the Spence Act has not been effective in those instances where a large national corporation buys up a savings and loan in some area. Do you have details on this?

Can you give us the large national corporations who have done this?

Mr. HORNE. We will supply the details on that, Senator.

Attached is a list of publicly-owned corporations (whose stocks are either traded on a registered stock exchange or actively traded in the over-the-counter market and whose market prices are quoted daily in The Wall Street Journal) which have acquired a savings and loan association since 1959. Depending on the definition used of what qualifies as a large national corporation, the list could be somewhat shorter.

List of national companies which have acquired control of savings and loan associations since 1959

Name	Association controlled	Date acquired	Where traded ¹
1. Budget Finance Plan.....	State Savings & Loan Association Stockton, Calif.	1965	NYSE
2. Dumont Corp.....	Safety Savings & Loan Association, Blackfoot, Idaho	1964	PCSE
3. First Western Financial Corp.....	First Western Savings & Loan Association Las Vegas, N. Mex.	1961	NYSE
4. Investors Funding Corporation of New York.	Citizens Savings & Loan Co., Akron, Ohio..	1964	ASE
5. Jim Walter Corp.....	Brentwood Savings & Loan Association, Monrovia, Calif.	1966	NYSE
6. Paul Revere Corp.....	Ventura Savings & Loan Association, Ventura, Calif.	1960	OTC
7. MCA, Inc.....	Columbia Savings & Loan Association Denver, Colo.	1962	NYSE
8. National General Corp.....	Columbia Savings & Loan Association, Los Angeles, Calif.	1964	Do.
9. Realty Equities Corporation of New York.	Buckeye Savings Association, Cincinnati, Ohio.	1965	ASE
10. American National Insurance Co...	Southern California Savings & Loan Association, Los Angeles, Calif.	1967	OTC
11. Sterling Precision Corp.....	Peoples Building & Loan Co., Barnesville, Ohio.	1965	ASE
12. Tower Credit Corp.....	Central Savings Association, Concordia, Kans.	1962	Do.
13. Transcontinental Investing Co.....	Evans Savings Association, Akron, Ohio....	1963	Do.
14. Union Financial Corp.....	Union Savings Association, Cleveland, Ohio.	1960	OTC
15. Zions Utah Bancorporation.....	Zions Savings & Loan Association, Salt Lake City, Utah.	1962	Do.

¹ NYSE, New York Stock Exchange; ASE, American Stock Exchange; PCSE, Pacific Coast Stock Exchange; OTC, Over-the-Counter.

Senator PROXMIRE. Is there any evidence that holding companies facilitate the interregional flow of funds to where the demand is greatest?

Mr. HORNE. I have no real evidence that such is the case.

We have regulations which permit the flow of funds, Senator, whether it is a holding company subsidiary or not. We have, for example, our participation loan programs and we have, under authority conveyed by Congress, permitted savings and loans to engage in nationwide lending of up to 5 percent of their savings capital in metropolitan areas. But I see no real or essential advantage offered by a holding company to spread funds from surplus areas to deficit areas that cannot be done just as well outside holding companies.

Senator PROXMIRE. Maybe I misinterpret your statistics. But in table 3 you show that the fairly consistent record of holding company associations getting a higher yield, mortgage yield, than other associations, 6.8 percent compared to 6 percent, for example.

That might be an indication that there is a tendency to loan in the areas where the yield is higher.

Mr. HORNE. Part of this is explained by the fact that particularly in the California area they have generally paid more money, higher rates, for savings than has been paid in other parts of the country.

And, consequently, they have also had to—

Senator PROXMIRE. You say that is the full explanation or not?

Mr. HORNE. I wouldn't say it is the full explanation; no, sir. They have also taken more risks as evidenced by the fact that they have higher foreclosure rates and are in difficulty otherwise.

Mr. SCOTT. I think, Senator Proxmire, that part of the answer to your question involves trying to distinguish between what the holding company is doing and what its subsidiary associations are doing and what the difference in their position would be from a nonholding company association located in the same kind of market conditions and environment.

As you pointed out correctly, the bulk of the existing holding companies are concentrated in California. Their associations, like all California associations, compared to the rest of the country, have grown much more rapidly than the rest of the savings and loan industry, have advertised in the East and elsewhere and have drawn a flow of funds into California, have lent out at higher interest rates than prevail throughout the country as a whole and so on.

So, to some extent, what you are referring to is a characteristic that is shared with the environment in which they are operating.

The problem you are raising is one of trying to distinguish between what in this can be done by a holding company association or is done by a holding company association, but is not and cannot be done by other associations in that same area.

So far as being able, for example, to advertise for out of state money, or draw in a fairly large amount of out of State money and invest it in a mortgage market that is producing higher yields, the holding company associations have done that to a large degree. And so have the nonholding company associations to a large degree in that same area.

We can give you, if you like, as I believe you already requested, a table that makes a comparison of the holding company associations with the nonholding company associations in the one area of California, and that may help give the kind of sharper focus you are looking for.

Senator PROXMIRE. I understand that savings and loan association stocks have declined with the result that creditors who hold the stocks as collateral for loans of the holding company are demanding more collateral.

How many holding companies are in this situation?

Mr. ELIAS. I would say probably about 10 to 12.

Senator PROXMIRE. Are these large holding companies, would you say?

Mr. ELIAS. They are a mixture.

Senator PROXMIRE. It is hard to draw any generalization.

Mr. ELIAS. Yes. It is a cross section.

Mr. HORNE. I might say, Senator, in response to that—

Senator PROXMIRE. Do you think this is a serious problem?

Mr. HORNE. We think it is. So far the lenders have continued to carry most of these loans, though with increasing pressure on their borrowers and increasing criticism from supervisory authorities.

We know of several instances recently where renewal of a loan was refused. Just how serious this particular problem is going to be, somewhat lies in the future.

We don't know today whether some of them, in the conditions you have described, are going to be able much longer to continue to carry the loans that have been made, in which the stock that was granted as collateral, or other collateral given, has depreciated in value.

Senator PROXMIRE. Is that one of the reasons why you want more control over their debt structure?

Mr. HORNE. Yes.

Senator PROXMIRE. Is there any evidence that holding companies have been used to overcome branching policies?

This is also true for savings and loans as well as banks.

Mr. HORNE. Not to our knowledge, because the Spence Act's prohibition on forming multiple holding company operations pretty largely took care of this.

I might say, though, in this regard that the holding company point is somewhat moot, because, contrary to the way the Federal Deposit Insurance Corporation operates, the Federal Savings and Loan Insurance Corporation or the Federal Home Loan Bank Board does not have any control whatsoever as to what branches are granted, number or need or otherwise, by a State authority to a federally insured State chartered association.

So, even if the branching problem is not added to, or not aggravated by, holding companies, the same State authorities may still grant many branches to a savings and loan association that is insured by us, without any say-so whatsoever on our part. And this would be true of an association that is owned by a holding company or one that is not owned by a holding company.

Senator PROXMIRE. Why shouldn't holding companies be permitted to acquire savings and loans through merger?

Won't there be a shakedown in the savings and loan industry in the next few years, where it will be necessary to transfer the managements of many smaller or weaker savings and loans to stronger hands?

Why should holding companies be precluded from this market?

Mr. HORNE. If they are allowed to acquire through mergers, then, of course, this gets back to the allowance of acquisitions in general. The bill's provision, in keeping with what Congress has done in the past in this area, prevents such acquisitions, except in one limited case with approval of the Board.

I don't see that there is any real advantage gained, if we are not going to permit acquisitions generally, in permitting acquisition by merger. But I would say, if Congress should decide at least acquisition would be allowed by merger, then it would be even more essential to give us the other controls we are recommending.

Presently, as I have said before, they may acquire now by merger, if it is a sick case.

Senator PROXMIRE. Well, it has to be pretty sick. It has to be liquidating—

Mr. HORNE. On the verge, yes, sir.

Senator PROXMIRE. And the verge of involuntary liquidation?

Mr. HORNE. Yes. And I would say until we get some control over the problems we are talking about here—and I assume this is what you have in mind—we would be opposed to a spread of this sort.

If we had this control, as I said, it would be less dangerous to us and more palatable to us.

Senator PROXMIRE. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Bennett?

Senator BENNETT. Thank you, Mr. Chairman. Senator Tower sent in a note saying he had another engagement that prevented him from

being here, and he has a brief statement he would like to have appear in the record, and two or three questions that he would like to have the Board answer in writing since he is not here to amplify on them.

So I ask permission that this statement may so appear and the questions might be put in the record.

The CHAIRMAN. Without objection, that will be done.

(The above-mentioned material follows:)

STATEMENT AND QUESTIONS OF JOHN G. TOWER, U.S. SENATOR FROM THE STATE OF TEXAS

In the Committee report on the so-called moratorium bill in 1959, it was pointed out that further study was needed on the operations of savings and loan holding companies.

That report, a copy of which I have here, was filed by the Home Loan Bank Board on May 31, 1960, seven years ago almost to the day.

In my years on this Committee I have not been aware of any widespread operations by the holding companies that could be classified as dangerous to the industry.

During the consideration of the supervisory bill last year, we were given confidential information by the Board with respect to certain savings and loan operations, but it was my opinion, and I believe the opinion of other Committee members, that irregularities in any institutions coming under the authority of the Board could be met with proper controlling authority.

I would like to have some explanation as to what has been happening during the six years since the Board's report to the Committee that prompts the need for this bill—and also what dangers appear to the Board to be imminent unless this bill is approved. Some of this information may be of a nature the Board feels should be given in confidence, which would be all right with me.

Holding Company Indebtedness: I understand the Bank Board's concern to be the possibility that the indebtedness of a holding company may cause the holding company to require an association to improperly transfer some of its cash or other assets to the holding company.

The Supervisory Act gives you the authority to promptly issue a cease and desist order whenever an association is involved in a practice which is "likely to cause insolvency or substantial dissipation of assets or earnings of the institution, or is likely to otherwise seriously prejudice the interests of its insured members (savers) or the Corporation (FSLIC)." (407(f))

Do you not now have the power to prevent dissipation of the association's assets by reason of the indebtedness of the holding company?

Therefore, is control of holding company indebtedness required?

(The Supervisory Act would also permit the Bank Board to require prior notice to it of a dividend in specific cases. Therefore, section (f) is not needed.)

The Bank Holding Company Act does not prohibit mergers among banks into or within a holding company system, nor does it prohibit further acquisitions of banks by holding companies.

These mergers and acquisitions are made subject to appropriate supervisory approval.

This Bill, however, would flatly prohibit such mergers, except in the case of a failing association, by or within a savings and loan holding company.

Why are you not willing to accept authority to approve or disapprove mergers and acquisitions, depending upon their merits?

ANSWERS TO QUESTIONS OF SENATOR TOWER

Question. Explain "what has been happening during the six years since the Board's report to the Committee that prompts the need for the bill—and also what dangers appear to the Board to be imminent unless the bill is approved".

Answer. To summarize the pertinent portions of the Chairman's testimony on S. 1542, holding company associations, which have grown about twice as fast as the savings and loan industry as a whole between 1960 and 1966 to a point where they now hold over \$16 billion in assets, or 12.5% of the entire industry, produce a disproportionate share of our supervisory difficulties. The holding company sector accounts in asset terms for over 1/2 of the Board's problem cases and almost 3/4 of its most serious problems. Some indication of what has been happen-

ing since 1960 that prompts the need for the bill appears from the data shown on Table 3 attached to this statement, which compares the performance of holding company associations with all other insured institutions from 1960 to 1966. Measured by almost any yardstick one can apply, such as the level of substandard assets ("scheduled items"), borrowings, liquidity, and rates of foreclosures, the performance of holding company associations indicates a more risky mode of operation in almost every respect than other sectors of the industry. For example, the substandard assets held by such associations amounted to 82% of their net worth at the end of 1966, a level almost three times as high as the rest of the industry. See Chart 1 attached to the statement. The Board has found the problems associated with holding company control to be not a matter of random or scattered overreaching or lapses of judgment, but an institutional problem resulting from weaknesses inherent in a situation where a closely regulated and protected business impressed with a public trust is controlled by completely unregulated holding companies.

Associations rated as serious problem cases in the holding company sector held assets in an amount equal to 80% of the combined reserves and unallocated income of the Federal Savings and Loan Insurance Corporation at the end of 1966. The obvious danger that appears to be imminent is that, unless controls and restraints such as those provided for in S. 1542 are enacted into law, the condition of these problem institutions will continue to deteriorate, and actual and potential holding company abuses will continue to go unchecked and unregulated. Such a situation would be prejudicial to the interests of our citizens who have entrusted many millions of dollars of their savings to such institutions, and would increase the insurance risk of the Federal Savings and Loan Insurance Corporation.

Question. Do you not now have the power to prevent dissipation of the association's assets by reason of the indebtedness of the holding company? Therefore, is control of holding company indebtedness required?

Answer. To the extent that any transaction between a subsidiary association and its parent company may be illegal or constitute an unsafe or unsound practice, the Board has the authority to intervene by the commencement of a cease-and-desist proceeding against the institution. In cases where the Board also determines that the transaction in question is likely to cause insolvency or substantial dissipation of assets or earnings of the association, an immediately effective temporary cease-and-desist order could be issued against the institution, assuming that the Board had advance notice of the proposed transaction. But the ultimate resolution of whether the transaction should be permanently enjoined would have to await a full hearing, decision by the Board on the hearing record, and opportunity for judicial review of any order issued by the Board.

However, as mentioned in the Chairman's testimony on S. 1542, a Board study reveals the existence of a serious problem stemming from the pressures to which subsidiary associations have been, and undoubtedly will continue to be, subjected to enable parent companies to meet substantial debt and other requirements. Professor Eugene F. Brigham, an expert witness produced by opponents of the bill, conceded that holding company debt is "clearly a potential threat", and that a number of problems in this area that he saw potentially back in 1963 have become real and more acute. In response to Senator Sparkman's question whether it would not be advisable to place some limitation on how far the holding company could go in regard to its debt, Professor Brigham answered, "I think this clear. I think it is true." Uncorrected Transcript of Hearings, June 6, 1967, pp. 221-223. California Savings and Loan Commissioner Preston Martin also testified that 6 or 7 California savings and loan holding companies (or about 1/7 of the total number) are presently in some difficulty due to an over-extended credit structure. Uncorrected Transcript of Hearings, June 7, pp. 269-270.

Where a problem of this nature is ever present because of the relationship of the parties and where dividend decisions are not taken independently by the association's management on the basis of its own conditions and earnings, the sensible way of attempting to deal with the problem would be to try to find a cure. Enforcement powers by way of cease-and-desist authority may be able to keep a problem from spreading or getting worse but they are wholly ineffective in preventing the problem from arising in the first instance. In the opinion of the Board, some limitation of holding company indebtedness would prevent most of the problems from arising in this area of concern, and it would be a much more effective and economical solution than to attempt to deal with the problem on a case basis with individual cease-and-desist orders issued to each individual association.

In this connection, the record should be clarified as to the authority of the Board under the Supervisory Act of 1966 to require advance notification of proposed cash dividends. Uncorrected Transcript of Hearings, June 6, 1967, p. 132. Such notification could be obtained under the Supervisory Act only by bringing a cease-and-desist proceeding *after* payment of one dividend, proving it was improper, and issuing an order to give advance notification of *subsequent* dividends; as a means of merely getting knowledge of pertinent facts, the technique would be extraordinarily cumbersome and slow. The purpose of the advance notification provision of subsection (f) of the bill is to insure that the Board will have ready access to the facts prior to the actual declaration or payment of a dividend so that it may invoke its cease-and-desist authority, where grounds exist, in time to do some good. In sum, the cease-and-desist authority would be ineffective with respect to the prevention of unwarranted "upstream" dividends without the 30 day notice provision of subsection (f).

Question. Why are you not willing to accept authority to approve or disapprove [holding company] mergers and acquisitions depending upon their merits?

Answer. The Spence Act, which added Section 408 to Title IV of the National Housing Act (12 U.S.C. 1730a), was intended, among other things, "to prevent undue concentration of economic control through the holding company device" and to prevent possible attempts "to circumvent State and Federal restrictions on branches". H. Rep. No. 679 to accompany H.R. 7244, 86th Cong., 1st Sess., p. 3. In furtherance of these objectives, the Act prevents any company which controls an insured institution from acquiring any additional insured institutions. In enacting the supervisory bill (P.L. 89-695), the last Congress saw fit to ease this prohibition to the extent of permitting further holding company acquisitions if necessary to prevent the involuntary liquidation of an insured institution.

As stated above, the fact is that holding companies control an ever increasing portion of the savings and loan industry and, at the end of 1966, 134 associations with assets of over \$16 billion, representing 12.5% of the entire industry, were controlled by holding companies. Any legislation which would remove the present ban on additional acquisitions would only result in an acceleration of the pace of holding company encroachment into the savings and loan field, contrary to a primary Congressional objective in enacting the Spence Act. To provide a statutory basis for the further expansion of individual holding company operations predictably will result in an increase in the very problems that caused the Board to request the enactment of S. 1542. If those problems were met by enactment of the safeguards proposed in S. 1542, then the question of further expansion would be put in a different light.

Senator BENNETT. Mr. Chairman, while I was necessarily absent from Washington, I understand the chairman and Mr. Horne invited staff members of the committee, including the representative of the minority, to a briefing luncheon, and I want to express my gratitude for the information provided there.

Mr. HORNE. Having worked as a staff person myself, I know how helpful it sometimes is to a Senator for the staff people to be thoroughly familiar with the ins and outs of a pending bill, and it was for this purpose we met with the staff. But I would be more than pleased on any occasion, if there is the time or the opportunity, to meet with any Senator that is not able to be here today and to talk with him in person and explain our reasons and answer any questions he may have as to why we think this legislation is so important.

Senator BENNETT. Mr. Chairman, I have a number of questions. I would like your permission, to go through them as quickly as I can. I am intrigued by the apparent evidence that these problems seem to be concentrated in California, which has the largest concentration of holding company operations.

Would it be possible for you to take table No. 1 and break it down for us, and the problems you have been discussing in your statement, the problem areas you have been discussing in your testimony, and

break them down by States? In other words, I come from a State which has two savings and loan holding companies. So naturally I am curious to know whether any of these problems have been created by these two holding companies in my State, each of which apparently controls one association. Maybe this public hearing is not the place to try to develop that, and obviously you haven't broken it down, but I think it would be helpful to the committee if you could locate the relative problem areas in the same way you have located the associations themselves.

Mr. HORNE. Senator Bennett, we will be glad to supply you with that information. It will take a little time, of course, to do it. But we will do it as quickly as we can.

In connection therewith I might suggest that you probably will want to treat it with confidence. Also I want to point out if I may that, repeating something I said earlier, the very fact that we do have these holding company problems, whether they are now geographically concentrated or not, is indicative of the fact that under the kind of structure we have, they can happen anywhere. It can happen in the rest of those three States at any time.

Senator BENNETT. Of course, in this table, referring to my own statement, it is easily seen that each of these companies controls one association, because the two figures are the same. I would also be interested in knowing how many of the holding companies in all of the States control only one association by State.

Mr. SCOTT. That would be the figure shown in table 2. There are 86 so-called unitary holding companies, and 12 multiple holding companies that control more than one association.

Senator BENNETT. I would like that broken down by States, if I could.

Mr. HORNE. Yes, sir, we will do it.

(The following table was submitted by the Federal Home Loan Bank Board:)

Multiple and unitary holding companies—State breakdown

State	Number of unitary	Number of multiple
Arizona.....	2	
California.....	38	9
Colorado.....	4	2
Guam.....	1	
Idaho.....	2	
Illinois.....	11	
Kansas.....	1	2
Nevada.....	3	
New Mexico.....	2	
Ohio.....	14	
Texas.....	6	1
Utah.....	2	
Total.....	86	12

¹ Interstate holding company operations account for larger number of entries than actual number of multiple holding companies.

Senator BENNETT. Because it seems to me, Mr. Horne, that one of the fundamental problems this committee will face is as to whether we should break through the pattern that exists for the banks, who are allowed to have one holding company, and follow your suggestion that there be no holding companies in the sense that there are companies that have other assets and also have the savings and loan.

To put it another way, we have a one bank exclusion in the bank holding company legislation, and that would not be provided in your proposed legislation for Savings & Loan Holding Companies.

Mr. HORNE. In that regard, Senator, may I make a comment, sir? I know what you are driving at. I would like to say that the Savings and Loan Holding Company Act is addressed to a particular set of problems, and we believe it should stand on its own feet, just as the Bank Holding Company Act did in 1956.

We are not urging this bill, we are not arguing for this bill, just in order to follow the Bank Holding Company Act—

Senator BENNETT. I know the two financial systems don't like to point out the similarities between their two systems, but we on this committee have to supervise both, so we may be more concerned with the similarities than you are.

Mr. HORNE. I understand that, sir. I might point out if I may, one further point. While this committee has in its own wisdom not yet adopted the recommendation by the Federal Reserve Board that it be extended to cover one bank holding companies, it is also my understanding that one reason the committee did not go forward with the one-bank amendment last year was because by the time the matter was taken up there were so many already in existence, outside of the present law. In the savings and loan field, one-association holding companies have been covered from the very beginning by our law. And we know in this case that we have enough problems that we hope the committee would decide not to make any change in this particular definition of a holding company.

We are pointing out what objectives have not been accomplished and what additional measures we think we need in order to enable the Spence Act to achieve its purposes as stated in 1959.

Senator BENNETT. As I listened to your testimony, and of course I haven't memorized it so I can turn back quickly and easily, I had the impression that you said at one point in effect that while you had cease and desist powers which might have enabled you to face most of the problems you discussed, you thought this was kind of an onerous and difficult way to handle it, and you would like to have legislation written which would make enforcement automatic rather than in some areas leaving it to the Board.

Mr. HORNE. In a way, sir. I also said that so far as application to a holding company is concerned, we can't get at the causes so quickly or directly. The reason we cannot get at it so quickly with a holding company as we can outside of the holding company is because there is an independent parent structure.

Senator BENNETT. But on page 34 of the summary of activities report in the Senate Banking and Currency Committee, I read Subsection M: Ancillary Provisions:

In making examination of insured institutions, Board examiners are granted authority to make such examination of the affairs of affiliates of such institutions as shall be necessary to disclose the relations of such institutions and their affiliates and the effect of such relations upon the institution. For purposes of this subsection, the term "affiliate" has the same meaning as where used in Section 2(b) of the Banking Act.

Under that act, the affiliate would be a holding company. Now, don't you have the authority to go after them, and isn't it just a matter of

convenience or maybe cost? Don't you have the authority to get that information you may need?

Mr. SCOTT. So far as the examination aspect you are referring to is concerned, since October 16 of last year the Board and the Insurance Corporation do have the authority to examine holding companies. So to this extent there is a duplication in this bill of one point in the existing law, which is temporary—it has an expiration date. This bill was drawn as a self-contained unit.

There are also some differences, however. Under last year's enactment, the cost of any such examination of the holding company would have to be assessed against and paid entirely by the subsidiary.

Under the proposed legislation, for example, the cost of examination of the holding company would be paid for by the holding company.

Senator BENNETT. Have you examined any holding company?

Mr. BROWN. Yes, we have; about four to date, sir.

Senator BENNETT. These are among the problem companies, or is this a routine examination?

Mr. BROWN. We have not set up a routine examination schedule yet. These were among the problem holding companies.

Mr. HORNE. Also, Senator, we have recognized all of the way through that the legislation that was passed last year would not cover what we are trying to get at with the holding company bill. The bank authorities obtained the same legislation last year we did, and they nonetheless have a separate Holding Company Act.

We have always, at the times we have sent up a supervisory bill, sent up a holding company bill also. It happened last year Congress took up and enacted the supervisory bill, but didn't get to the holding company bill.

Senator BENNETT. Of course this will be a separate act, because we have already handled the bank holding company problem for the time being. But there was an old theory about separate but equal. And there isn't any reason, as I can see, why these acts can't be separate and similar.

Mr. HORNE. Then, of course, Senator, examination is only one aspect we cover in this legislation. As you know, there are other things here.

Senator BENNETT. I know. But you make the point in your testimony that things have gone on that you were not able to find out about. And I submit that you probably have the authority to find out about the relationship between the holding company and the savings and loan subsidiary.

Mr. SCOTT. I think we now have much more authority in this regard than existed prior to the action Congress took last year. Examination, in some ways, though, is sort of the hard way to get information. If you are trying to keep your finger on the pulse of a business, reports submitted by the business are both a more rapid and a less expensive method for all concerned of getting a picture of what is going on.

Senator BENNETT. On page 4 you are talking about the problem holding companies and you relate them to the entire industry. Isn't it axiomatic that all holding companies hold stock savings and loan associations?

Mr. SCOTT. Yes; all the ones we are referring to.

Senator BENNETT. So shouldn't this information be related also to the stock holding companies rather than to all holding companies?

Mr. SCOTT. That could be done.

Mr. HORNE. That could be done, and we have a table already, Senator, which shows that as you break down in this regard the institutions with which we are greatly concerned between the associations that are independent stock and those held by holding companies, we have reason for much greater concern as regards the associations that are held by holding companies. We can supply that information for you.

Senator BENNETT. I think that would be interesting, Mr. Chairman. Then you state that holding companies are much heavier borrowers, and have lower levels of liquidity than the rest of the industry, holding company associations. Have these borrowings exceeded your limits? Don't you have limits by which you control borrowings?

Mr. HORNE. We have maximum limits by which we control borrowing, if it is a matter of an association borrowing from the regional home loan bank. We do not control borrowings as far as the other subsidiaries or the parent company are concerned.

Senator BENNETT. Does your reference then include the borrowings from the parents, when you say they are very heavy borrowings, or are you referring to the borrowers from the regional bank?

Mr. SCOTT. If you are referring to table 3, that includes all borrowings from either the regional Federal home loan bank or any other source, by the association only, not by the holding company.

Senator BENNETT. Now my attention was distracted a little. These borrowings, you are referring to borrowings of the associations from the banks?

Mr. SCOTT. Strictly of the associations, but the source of the loan may be, as most of them would be, from the regional Federal home loan bank. It will also include any outside borrowings from commercial banks or other sources the association may have. It would be total borrowings.

Mr. HORNE. To answer your question directly, yes; it relates to association borrowing and we do have some degree of control over that, sir. But up until very recent times the Board controlled aggregate levels of credit and did not undertake to determine whether or not an individual association should actually borrow money. We have, since we have noticed more difficulty in this area, and a worsening portfolio, established schedules which we make applicable to everybody, whether holding company or nonholding company, stock or mutual. Once you get beyond a certain level with scheduled items, you either reduce or cut out entirely your regional bank borrowing.

But this is something that you learn after borrowing has taken place, and with the experience of how well the borrower has used his proceeds.

Senator BENNETT. Are you able to, or would it be helpful if you were to supply us with either some samples or with an analysis of the relationship of the borrowing done by holding companies controlled by associations with those, with the levels done by the stock companies?

Mr. HORNE. We can supply that information; yes, sir.

Senator BENNETT. On page 5 you say you have tested holding company figures with comparable stock company figures. Could you sup-

ply some of this information to the committee? I realize it would be confidential.

Mr. HORNE. Yes, we can do that.

Attached is a table which presents a comparison of performance of holding company associations with other stock associations based on certain key indicators, including borrowing ratios.

Even when the comparison is confined to stock associations, the risk-sensitive indicators (items 3, 4 and 10) show there is more reason for concern with holding company controlled associations than independent associations. The year-by-year comparison shows the position of the independent stock associations to be stable or even improving, while that of associations under holding company control has deteriorated.

Comparison of performance of holding company associations with other stock associations

Classification	(1) Number of associa- tions	(2) Total assets (millions)	(3) Scheduled items, divided by special assets (percent)	(4) Scheduled items, divided by net worth (percent)	(5) Net worth, divided by savings (percent)	(6) Mortgage yield (percent)	(7) Expenses, divided by average assets (percent)	(8) Borrowing, divided by total assets (percent)	(9) Liquidity ratio (percent)	(10) Foreclosure rate per 1,000 loans
1966: Holding company associations.....	134	\$16,173	6.3	82.4	8.3	6.6	1.0	10.8	8.3	16.0
Nonholding company stock.....	546	11,967	4.8	63.0	8.0	6.1	1.2	8.1	9.4	12.7
1965: Holding company associations.....	137	15,831	5.6	68.9	8.6	6.5	1.1	9.1	8.9	14.3
Nonholding company stock.....	554	11,381	4.7	60.0	7.9	6.2	1.3	6.4	10.0	10.7
1964: Holding company associations.....	141	14,538	5.0	59.2	8.6	6.7	1.1	9.0	9.2	13.4
Nonholding company stock.....	535	10,124	5.7	70.8	7.9	6.5	1.4	6.0	10.3	10.1

1 Preliminary.

Senator BENNETT. And page 6 in the first paragraph, you state that in California, where most of your problems are located there is a law requiring the State commissioner to be informed of holding company activities. Do you have access to this information?

Mr. HORNE. Yes, sir; the California officials have cooperated with us in this regard. But I would like to point out two things in this respect, sir. We believe we ought to have our own right to obtain information, of course cooperating with the California authorities, as we do now, to avoid unnecessary duplication or expense. But there may be, and there is, from time to time certain information that we would like to get, which the California commissioner might not himself require.

Then also we feel that since we are insuring those associations, we should not have to depend completely upon whether or not any State authority will choose to give us the information. Most of the time they do. Sometimes we don't always have complete cooperation.

But we have a major responsibility here, because we insure. The California authorities do not insure; the Federal Government does that. So while we would continue to cooperate with the California authorities, as long as they are willing to do as they have done in recent times, we think we are in a safer position and a more appropriate position to have our own Federal authority.

Senator BENNETT. On page 8 you make a strong point of the fact that holding companies have taken more from their savings and loan associations than they have put into them for the period of 1959 to 1966. Isn't that natural?

Mr. HORNE. Well—

Senator BENNETT. In other words, the holding companies invested money in this operation for the purpose, or in the hope of making a profit and receiving dividends.

Mr. HORNE. But it shouldn't make it at the expense of harm to the association itself, just for the benefit of the parent company or the benefit of other subsidiaries.

Mr. Scott?

Mr. SCOTT. I think it is what you would expect. This statistic was offered partly to set in its proper context the kind of fairyland picture sometimes painted of holding company operations, to the effect that they were sort of an unending cornucopia of capital strength, and that is the only way the operation would go. In point of fact, it doesn't look that way. It looks just as you would expect, and just as you referred to it, like an investor who is out to obtain a good return on his investment.

It is not our point there is anything wrong with a stock association paying dividends to stockholders when its condition warrants it. When it is not the wholly owned subsidiary of a parent company, but is in a position where its management can reach independent conclusions about what course is prudent for the association to follow on paying dividends, then while our concern may not disappear completely, it is much reduced.

But when an association, as a holding company subsidiary must, has to do without hesitation whatever the interests of its parent demand,

then dividend policies bear little necessary relation to what is best for the association.

Senator BENNETT. Have you made any study to see whether the rate of dividends paid to holding companies has been substantially higher than those paid by stock companies to individual stockholders?

Mr. SCOTT. Our analysis has been limited to the group of 134 holding company associations, primarily because of technical limitations. When we make this kind of calculation, because of the state of the data base, we have had to make hand tabulations of associations one at a time.

To do this for a very large group becomes laborious indeed. We have not at this point carried it beyond the 134 holding company associations themselves.

Senator BENNETT. And you have not attempted to relate their rate of dividends to the rates paid by nonholding companies, even on a spot check basis?

Mr. SCOTT. That could probably be done, at least on a sampling basis, and might be worth doing.

Senator BENNETT. I think it is important here, because if we leave this without any comparison, the inference is that many of the holding companies are milking their savings and loans with exorbitantly high rates of dividends in order to compensate for losses in other subsidiaries or something of that kind.

But, I would think if the record might show that the rates are fairly comparable, then you would have a different picture.

Mr. SCOTT. There are two things we were concerned with. One, as I say, was simply to counteract the sort of exaggeration in the opposite direction that this is on balance a net flow into the controlled association. That, it clearly is not.

Senator BENNETT. Well, this doesn't impress me, because I realize that the savings and loan subsidiary must attract its loanable funds from its public. It cannot depend on the parent to supply the capital, except in cases of temporary emergency.

So, that doesn't impress me.

Mr. SCOTT. No, I am speaking only within the context of capital inputs or capital takeout. Not deposits, not the loanable funds obtained through savings accounts.

Strictly within the confines of permanent capital or net worth flows, we had heard at one point, in the early consideration of this legislation in 1959, a number of quite glowing statements, more or less, I think, designed to leave the impression that this would be a one-way capital flow into subsidiary associations.

That is not the case, of course.

Senator BENNETT. That is obviously not true, naturally.

Mr. SCOTT. The other issue you are raising is whether the rates of payment by holding company associations and other stock associations are comparable or out of line.

To analyze that fully, we would have to look at several things, and to some extent we can probably undertake to do it. One is to look at the simple rate of flow, the amounts involved. Another is the condition of the association, relating those dividend payments to the earning position of the association.

Senator BENNETT. That is part of the picture, there is no question about it.

Mr. SCOTT. The theoretical concern we have is that, while a stock association owned by some or many stockholders will normally have a management that makes decisions as to what to pay to the stockholders on the basis of their own assessment of the position of the association; in the case of a wholly owned subsidiary, that is not an independent decision any longer.

Senator BENNETT. Well, the wholly owned subsidiary takes the place, in effect, of the board of the company owned by personal stockholders.

And, when you say that the decision is not independent, that is true in one sense, but it is equally true that the power represented by the stock control is involved in the decision in both cases.

Mr. SCOTT. Oh, yes. And I think the situation would be quite comparable in the case of a nonholding company stock association that, say, was 100-percent owned by an individual stockholder. There are a few of these, but very few.

Senator BENNETT. Not necessarily 100 percent, 51 percent is adequate.

Mr. SCOTT. Then you get a different consideration. When you have minority stockholding interests, the actions of the majority stockholder are always, I trust, restrained to some degree by the latent possibility of derivative actions, if he misuses his control position.

In the case of a holding company that owns a subsidiary 100 percent, there are no possibilities of derivative actions serving as a restraint.

Senator BENNETT. On the bottom of page 8, you say 42 holding companies paid cash dividends on stock to their parent companies, which is a little less than half, out of 98.

Can you tell us confidentially, if necessary, something about where these companies were and the circumstances under which dividends were paid?

And, as I have already suggested, how their figures compare with figures of other stock companies?

And, how many paid out more than they earned in the year in which the dividend was supposed to cover?

Mr. SCOTT. We can supply at least some of that information. Since it would involve named associations, you might prefer it to be confidential.

(The following was received by the committee:)

Attached is a table which presents a comparative analysis of those holding company associations and non-holding company stock associations which paid cash dividends in 1966 as related to net earnings and to the impact on undivided profits and net worth.

The question of whether or to what extent an association's ability to operate was impaired as a result of the money that was paid out in dividends involves a judgmental assessment. To take the extreme approach, no association was forced to liquidate or go out of business. However, in one outstanding example, the payment of dividends at a time of operating losses lowered a holding company association's net worth ratio perilously close to the state's limitation below which it would not be able to accept savings, an event which would be likely to jeopardize the association's viability and continued operation.

As can be seen from the table, the two groups were roughly the same as to total net income, but the holding companies had their associations pay out three times as much dividends in the unfavorable circumstances of 1966. The independent stock associations, as a result, increased their undivided profits account in 1966, while the holding company associations reduced theirs.

Comparative analysis of cash dividends paid on permanent stock by holding company controlled associations and associations not under holding company control, year ended Dec. 31, 1966

[Amounts in thousands]

	Number of associations	Net income		Transfers to general reserves	Balance of net income available	Disposition of balance of net income			Balance undivided profits, Dec. 31, 1966	Balance net worth Dec. 31, 1966	Cash dividends as percent of—		
		After taxes	After taxes and interest on savings			Cash dividends on guarantee stock	Transfers to other reserves	Transfers to undivided profits			Net income	Undivided profits Dec. 31, 1966	Net worth Dec. 31, 1966
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
California:													
Holding company associations	23	\$208,953	\$24,267	\$14,173	\$10,094	\$13,440	\$29	(\$3,376)	\$30,063	\$351,020	55.4	44.7	3.8
Nonholding company associations	33	79,616	10,286	6,629	3,657	1,905	1,058	694	9,971	118,598	18.5	19.1	1.6
Texas:													
Holding company associations	6	23,716	4,330	1,952	2,378	1,083	208	1,088	5,024	49,152	25.0	21.6	2.2
Nonholding company associations	46	42,626	5,585	3,950	1,635	1,255	300	80	3,102	64,458	22.5	40.5	1.9
Ohio:													
Holding company associations	9	21,717	3,016	2,143	873	749	-----	124	4,029	34,977	24.8	18.6	2.1
Nonholding company associations	67	85,721	12,458	7,688	4,770	1,895	92	2,783	22,728	154,740	15.2	8.3	1.2
Colorado:													
Holding company associations	2	4,142	561	384	177	330	-----	(153)	103	5,780	58.8	320.4	5.7
Nonholding company associations	6	6,796	893	591	302	227	-----	75	680	11,246	25.4	33.4	2.0
Utah:													
Holding company associations	2	2,754	319	128	191	77	35	79	1,108	5,380	24.1	6.9	1.4
Nonholding company associations	2	8,163	978	680	298	151	112	35	2,732	16,746	15.4	5.5	.9
Kansas:													
Holding company associations	1	970	150	86	64	15	-----	49	57	1,235	10.0	26.3	1.2
Nonholding company associations	28	12,460	1,479	678	801	69	16	716	3,349	19,332	4.7	2.1	.4
Total (6 States):													
Holding company associations	43	262,252	32,643	18,866	13,777	15,694	272	(2,189)	40,404	447,544	48.1	38.8	3.5
Nonholding company associations	182	235,382	31,679	20,216	11,463	5,502	1,578	4,383	42,562	385,120	17.4	12.9	1.4

Senator BENNETT. It should be confidential. And, I would like to know how many of these associations actually impaired their ability to operate as a result of the money that was paid out in dividends?

Page 9, what percent of the assets of the 43 companies were represented by the \$2 million reduction in their accumulated profits?

Mr. SCOTT. Percentage of assets?

Senator BENNETT. What percentage of their—

Mr. SCOTT. Assets or net worth?

Senator BENNETT (continuing). Net worth, yes, was represented by this \$3 million. You intrigued the committee by talking about institutions controlled by racetracks or gambling casinos.

Relationship of reduction in accumulated undivided profits to net worth and undivided profits balances for 43 holding company associations which paid cash dividends during the year 1966¹

[Dollars in thousands]

	Number of associations	Increase or (decrease) in undivided profits account	Net worth		Balance in undivided profits account Dec. 31, 1966	
			Amount	Percent	Amount	Percent
Amounts transferred from undivided profits by associations paying dividends in excess of amounts available from earnings.....	18	(\$10,318)	\$190,771	5.4	\$13,781	74.9
Amounts transferred to undivided profits by associations paying dividends out of available current earnings.....	25	8,129	256,773	3.2	26,636	30.
Combined.....	43	(2,189)	447,544	.5	40,417	5.4

¹ Pages 8 and 9 of Chairman Horne's statement

As I look at the table, it appears in one case that there are three holding companies controlling two associations. How does that work?

Mr. SCOTT. Under the present definition of the Spence Act, a holding company is defined as a company owning more than 10 percent of the stock of an association.

It is conceivable, and there are a few instances, for there to be two companies that are brought by definition under the Spence Act as holding companies for the same association.

The CHAIRMAN. In other words, there are two holding company owners for the same association?

Mr. SCOTT. Yes, sir.

Senator BENNETT. As far as I know, Nevada is the only State where you have a legalized gambling casino, so I suppose you are referring in this case to the three holding companies owning two associations in Nevada.

Mr. SCOTT. We are not endeavoring to imply that one of those companies is now owned by a gambling casino. It is the prospect, not the present reality, that we have to contend with.

There was an instance, several years ago, where a racetrack was involved in merger negotiations with a savings and loan holding company.

Senator BENNETT. Was this a rescue operation?

Mr. SCOTT. No.

Senator BENNETT. Don't you have the authority now—you obviously have the authority to get that information, because you did have it with respect to this case?

Mr. SCOTT. We got it out of the financial page of the Los Angeles Times, but we did get it.

Senator BENNETT. Well, that is probably a fairly good source.

Under last year's act, you have to be notified in advance, do you not, of any change in ownership?

Mr. SCOTT. Not in advance. We have to be notified after a change of control or certain kinds of loans which hold the potential of a change of control.

Senator BENNETT. How long after?

Mr. SCOTT. I don't remember that there is any time period specified in the act. The word in the statute is "promptly."

Senator BENNETT. Well, you are in a position to write a regulation and define "promptly," aren't you?

Mr. SCOTT. It might be advisable for us to do so.

Senator BENNETT. Well, isn't that part of your responsibility?

Mr. HORNE. Yes, sir; it is.

Senator BENNETT. Have you done that?

Mr. SCOTT. At this point, there are no regulations under this section of the statute to carry it out further, no.

Senator BENNETT. Mr. Chairman, you have been very patient with me, the only purpose in my questions is to try and help the committee work out its problems.

Mr. HORNE. We understand that, sir, and we will get you as much of the information you requested as quickly as we can.

Senator BENNETT. I have the impression personally, after your testimony and the discussion that preceded my questioning, that this is a fairly restricted area in which your problems exist and is not, does not extend to all of the States which permit stock savings and loan associations, which therefore represent all of the States in which problems could exist.

Mr. HORNE. Yes, sir.

Keep in mind, in that connection, as I know you will, Senator, that we are concerned about a structure that makes it possible for such things to arise, whether the problems are presently to be found in all or not. There are 23 States potentially involved, and I am reasonably certain that there are going to be others involved later down the road.

As I said earlier, there is already one State in the current session of the legislature that has introduced a law that would give the State authorities the right to charter stock associations.

Then, another thing that bothers us is the fact that while there is only one-eighth of the industry presently involved, it supplies 63 percent of our most serious difficulty. While this might now be concentrated in one geographical area more than in another, as I say, it can spread. And even if it shouldn't spread, we want some way to get at it where it is now.

Senator BENNETT. I have no further questions, Mr. Chairman.

Thank you.

The CHAIRMAN. May I ask this question: Senator Bennett asked you about the similarity between the Bank Holding Company Act and this

act, whereby under the Bank Holding Company Act each holding company may hold one other bank or one bank.

Now, isn't it true that that same term is in the present law with reference to the savings and loan holding companies?

Mr. HORNE. As I understand it, and I will ask Mr. Scott to correct me if I am in error as to the law, Mr. Chairman, when a savings and loan association is sold to a purchaser, under the Spence Act, then the company that has purchased over 10 percent of the savings and loan becomes a holding company and cannot acquire any others.

The CHAIRMAN. That is what I mean. The grandfather clause permits it to retain those it held at the time the law went into effect.

Mr. HORNE. That is correct.

Senator BENNETT. With no divestiture.

The CHAIRMAN. Under the Bank Holding Company Act, a company is not a holding company unless it holds more than one bank, whereas under this, the holding company would just one and that is all it could hold.

Mr. HORNE. Yes, sir.

The CHAIRMAN. Now, the time is here for the Senate to meet.

I have some questions that have been prepared, which I would like to submit to you and ask you to let us have your written answers.

Mr. HORNE. All right, sir.

(The questions and answers follow:)

Question. As the word affiliate is defined on page 3 of the bill, does it include an officer or director of a mutual institution, who controls more than 10% of the voting rights of that institution?

If so, does that provision in conjunction with any other, give the Board power to promulgate regulations regarding practices of mutual savings and loan associations?

Answer. As the terms "affiliate" and "control" are defined in S. 1542, an officer or director who controls more than 10% of the voting rights in any institution would be deemed to have control of the institution and thus he would be an affiliate of the institution. However, the limitations of the bill upon transactions between insured institutions and their "affiliates" relate only to institutions which are holding company subsidiaries.

Nothing in the bill would give the Board power to promulgate regulations regarding the practices of mutual savings and loan associations as such. It is possible that a holding company could gain control of a mutual association, and in that event the bill would become applicable.

Question. Do you intend to regulate the voting or proxy practices of the owners or officers or directors of either stock institutions or mutual institutions?

Answer. The voting or proxy practices of stock institutions or mutual institutions might well, as the question implies, be reviewed and made the subject of regulations designed to assure fair and equitable treatment of all shareholders in accordance with modern standards. The Board will be glad to undertake such a review and act in accordance with its findings. This is, however, a separate subject and one not related to or covered by savings and loan holding company legislation.

Question. Do you intend to control the proxy practices of Federal savings and loan associations through the provisions of this bill?

Answer. S. 1542 does not cover or deal with the proxy practices of Federal savings and loan associations.

Question. What are the kinds of problems the controlled associations have?

Answer. Attached is a table which shows the type of problems experienced by holding company associations in each problem case classification and compared with all problem associations.

PROBLEM ASSOCIATIONS

*Number of associations in each category evidencing particular types of problems,
Dec. 31, 1966*

	Category I (hard core)		Category II (possible hard core)		Total	
	Total (28 associations)	Holding company associations (11 associations)	Total (29 associations)	Holding company associations (2 associations)	Aggregate (57 associations)	Holding company associations (13 associations)
Management ¹	23	10	18	2	41	12
Scheduled items.....	24	11	26	2	50	13
Lending practices ²	25	10	16	2	41	12
Earnings inadequate.....	19	9	5	2	24	11
Failure to meet reserves.....	21	7	12	1	33	8
Violations.....	12	6	7	0	19	6
Borrowing capacity approaching limit.....	8	4	1	1	9	5

¹ Problems with management exist because management failed to pursue sound policies and practices, resulting in high scheduled items and inadequate earnings. In the majority of the cases, the beginning was the desire for growth which was achieved by highly promotional solicitation of savings capital on the basis of a higher-than-competitive dividend rate and the need to invest such funds in loans at higher interest rates than were obtainable on average risks.

² Problems in lending practices manifest themselves in excessive appraisals, in inadequate attention to the credit worthiness of the borrower, and in disbursement on construction loans without adequate controls for the protection of the association. In a large majority of the cases, the lending was concentrated in loans at high fees and interest rates to a few speculative builders for construction in poorly located areas or without regard to the ability of the market to absorb the new amounts.

Question. Section (c) (1) of the bill prohibits a holding company from engaging in activities on behalf of a savings and loan association which would be illegal if the savings and loan association engaged in them directly. Are these the activities referred to in the second paragraph of page 3 of your statement? Give examples.

Answer. Yes. These are the activities referred to on page 3 in the paragraph beginning "Second, we have encountered numerous instances where the lack of regulation over the holding company has enabled it to be used to evade the law governing the operations of its savings and loan subsidiary." Where the purpose is the evasion of a regulation that is technical in content, the transaction and its explanation may be somewhat technical or intricate also, and hard to follow. However, the following examples may illustrate the point:

(1) *Circumvention of Loan Fee Deferral Regulations*—Section 563.23-1 of the *Insurance Regulations*.—In order to avoid the loan fee deferral requirements imposed by the *Insurance Regulations*, a subsidiary insured association appointed a holding company affiliate as its loan agent. Under this agreement, that portion of a loan fee that would be subject to deferral, if collected by the association, was collected by the affiliate from the borrower as a loan brokerage fee. Also under the agreement the affiliate agreed to assume the responsibility for various association operating expenses.

During the years of 1964 and 1965 the fee income so diverted to the affiliate was \$1,464,996 and \$1,173,060, respectively. The extent that association expenses were assumed by the affiliate during these years was such that the affiliate had an operational loss of \$164,928 during 1964 and an operational profit of \$213,755 in 1965.

The net effect of this arrangement was that the association was able to pay current operating expenses from income that both the regulations and sound accounting principles required to be deferred to future years. Had the association followed this practice without the use of the affiliate, it would have constituted a direct violation of the *Insurance Regulations*. Therefore, it becomes apparent that this was a means devised for the sole purpose of circumventing the regulations under which the association is supervised.

(2) *Holding Company Arrangement Entered Into in Order to Circumvent the Broker Capital Regulations*.—Through a series of negotiations, an oral agreement was made among an insured association, its parent holding company, and

a mortgage broker that: (a) the holding company would acquire savings capital from savings brokers and pay the commissions, (b) the mortgage broker would reimburse the holding company for these commissions, (c) the association would have funds available to grant loans to clients of the mortgage broker, subject to appraisals and acceptable credit, and (d) the mortgage broker would receive finders fees from the proceeds of loans granted to its clients.

The savings received under this arrangement exceeded \$3 million. The association did not classify savings received in this manner as broker savings, and did not maintain the records for these accounts required by Insurance Regulation 563.25. Because of the lack of association records, it could not be determined if the association was in violation of that regulation; however, based upon the amount of broker savings capital, for which the association did maintain the required records, it was highly probable that it was in violation of that regulation.

The association granted six loans, totaling \$424,500, to clients of the mortgage broker. The association did not make additional loans because the applications submitted by the broker were unacceptable. As a result of the association's refusal to grant additional loans to his clients, the broker brought suit against the association and the holding company for \$14,158, representing savings broker fees paid to the holding company, and \$81,098 for damages allegedly resulting from the association's refusal to grant loans to his clients.

Had not the mortgage broker brought suit against the association, the examiners would not have become aware of this transaction, for there were no records of its within the association until that time. All of the accounting for this had been recorded in the holding company records.

(3) *Circumvention of Regulations Regarding Classification of Substandard Assets.*—During a 13-month period an insured association refinanced 31 delinquent loans totaling \$371,581 which were brought to a current status with funds advanced by the holding company just prior to the date of refinancing. These advances were made by the parent company to allow the association to refinance these loans and circumvent the restrictions of the Rules and Regulations for Insurance of Accounts. These regulations classify a loan granted by an association to refinance a delinquent loan as a substandard asset [scheduled item]. Therefore, by lending the borrower sufficient funds to cure his delinquency prior to the time his loan is refinanced, the new loan can technically be classified as a standard quality asset.

Question. On page 3 you also indicate the Spence Act has been unable to prevent holding companies from bending the activities of the controlled savings and loan associations to serve the needs of the holding company. Can you give us some specific examples?

Answer. The text of the statement discussed this point at some length. In addition, the following practices might give further examples:

(1) *Compensating Balances.*—One of the most pernicious practices is the arrangement whereby the subsidiary insured associations are caused to maintain deposits with commercial banks to support loans by these banks to the holding company or holding company affiliate. Virtually every holding company which has a bank loan requires its subsidiary association to maintain a deposit with the bank lender as a compensating balance. We have noted that in connection with bank loans to a substantial stockholder of a holding company, the subsidiary association maintained deposits with the lending banks.

To the extent that such compensating balances are in interest-free deposit accounts, the association suffers unnecessary loss of earnings. In one instance over a 2½ year period a compensating balance has cost an association which has a poor earnings record an amount approximately equivalent to its entire 1966 earnings.

In another case, a subsidiary association has a certificate of deposit in a bank in a distant state. The certificate has matured and the bank is attempting to offset the certificate against notes due to the bank by the association's holding company parent which is under Chapter X of the Federal Bankruptcy Act.

(2) *Use of the Association To Purchase Questionable Assets From the Holding Company Affiliates.*—An affiliate of a holding company sold five loans aggregating \$2.8 million to a subsidiary association. All of the loans were secured by land which was to be developed into residential building lots. Within a year of the sale four of the loans were delinquent, foreclosed or in the process of fore-

closure, thereby increasing the association's non-earnings assets by \$2.5 million in property for which there is no resale market.

As to the current status of these loans, four are real estate owned and the security of the fifth is under the jurisdiction of the bankruptcy court. It is estimated that as a basic minimum indicated losses are approximately \$300,000 in addition to the loss of income on such loans since 1964.

This association is classified as a major supervisory case.

(3) *Use of Associations Resources To Finance Activities of Holding Company or Affiliates.*—Holding companies have used their subsidiary associations as a source of funds to finance real estate activities such as the sale of property to builders who obtain their funds from the subsidiary associations. In one notable example a subsidiary association made 51 loans aggregating \$2,500,000 to a builder who had purchased land from an affiliate of its holding company. Part of the proceeds was paid over to the holding company affiliate in payment for the land. Prior to completion of construction the borrower went into bankruptcy. As a result the association had to initiate proceedings to foreclose the 51 loans with unpaid balances of about \$2.3 million. It has been estimated that thus far the net loss on these transactions to the association, including allowance for loss of income, aggregated approximately \$260,000.

Question. Is there any evidence that holding companies have used the loopholes in the Spence Act to circumvent the prohibitions on self-dealing?

Answer. Yes, the examples furnished in response to the question on page 87 evidence several types of self-dealing transactions not covered by the Spence Act.

Question. If Congress provides you with the increased supervisory controls over holding companies, what would be your views on relaxing the prohibitions on their expansion? Do you think you should have the authority to approve a holding company acquiring new savings and loans as does the Federal Reserve Board with respect to bank holding companies?

Answer. In the Board's view, any substantial easing of the present ban on holding company expansion, whether by way of mergers or purchases of stock or assets of another insured institution, would only result in an acceleration of holding company encroachment into and, in some areas, dominance of the savings and loan industry. This would plainly be contrary to one of the major objectives of the Spence Act. If Congress adopts the holding company controls that the Board is seeking in S. 1542, it is true, many of our problems would be reduced to more manageable proportions.

However, if Congress sees fit to enact legislation permitting holding company acquisitions, it would be of utmost importance, so far as the preservation of competitive balance as well as the safety and soundness of the savings and loan industry are concerned, that holding company expansion be made subject to prior Board approval as in the case of bank holding companies under the Bank Holding Company Act.

Question. Why do you feel an outright prohibition on unrelated business activities is necessary? Wouldn't it be possible to provide the same protection through regulation and examination in order to prevent any improper financial transactions between the savings and loan and the holding company structure?

Answer. As indicated in the testimony on the bill, the Board subscribes fully to the view expressed by this Committee in its 1959 report on the Spence Act bill (S. Rep. 810, 86th Cong., 1st Sess., p. 5), as follows: "Savings and loan associations, created for the purpose of encouraging thrift and promoting home-ownership, must not be permitted to become entangled in a corporate web designed to promote some other and unrelated interest".

The Committee expressed the identical point of view in its report on the Bank Holding Company Act, S. Rep. 1095, 84th Cong., 1st Sess., pp. 1, 13-14.

For the same reasons as under the Bank Holding Company Act, a savings and loan holding company should not be permitted to combine savings and loan and non-savings and loan business under common management and control. The Board's experience has been that subsidiary associations have not experienced any measurable net benefits simply because of its parent's engagement in diversified activities. Rather, the controlled institution has been used all too often to benefit other activities of the holding company, and the interests of the association have been subordinated to the needs of the holding company.

Despite the arguments made by opponents of the divestiture provisions of the bill, the Board is firmly convinced that the real and potential evils that are inherent in diversified holding company systems, so far as captive financial institutions are concerned, outweigh by far the purported benefits that are supposed to accrue to the controlled institution. In sum, the Board adheres to its view that outright prohibition on unrelated holding company activities is advisable in the public interest.

The regulatory and examination authority provided in S. 1542 would undoubtedly be useful in preventing improper transactions between an association and its affiliates, but not in preventing the association from being required to embark on a course of high risk lending to develop high current income needed for the parent's other commitments. Moreover, while the power of examination is necessary for effective supervision, all too often the facts are stale by the time they are disclosed by examination, and the regulatory agency is faced with a *fait accompli*.

Question. What is the impact of the requirement for holding companies to divest themselves of unrelated activities? How many holding companies are in this category? How many unrelated companies are involved?

Answer. The major impact of the divestiture provision would fall on the broadly diversified or conglomerate type holding company whose major business or activity is outside the savings and loan business and who would undoubtedly elect to dispose of their savings and loan subsidiaries. There are 28 holding companies of this type and they control 30 associations with \$1,670 million of assets representing about 10% of the holding company controlled segment of the business.

In the table below there is presented, to the best of our current knowledge, a list of the major unrelated activities and businesses engaged in by savings and loan holding companies which would be required to be divested under the proposed bill.

Activity or business:	Number of companies engaged
Title insurance and abstract.....	10
Construction	6
Life and other insurance.....	11
Banking	14
Equipment leasing.....	15
Manufacturing	9
Small business investment companies.....	6
Consumer and other finance.....	8
Real estate.....	20
Uninsured association.....	6
Entertainment	2
Merchandising	5
Securities dealer.....	2
Miscellaneous	9

Virtually every holding company in California is engaged directly or indirectly through a subsidiary in the business of trustee on the deeds of trust with respect to loans granted by subsidiary associations.

Question. What has been the trend to unrelated activities? Have the large, multiple, pre-Spence Act companies moved into new activities since 1959?

Answer. The trend toward unrelated activities has developed principally from the acquisition of savings and loan associations by diversified companies. In this connection please see the list of national companies which have purchased associations since 1959, furnished in response to Senator Proxmire's request on page 48 of the transcript.

The movement by the large multiple holding companies into unrelated activities since 1959 has been to date on a relatively minor scale.

Question. Why do you feel the prohibition on interstate holding companies is needed?

Answer. The prohibition against holding company acquisitions of out-of-State savings and loan associations is consistent with the traditional principle that the operations of such associations should be confined to a single State. It is also in accord with the Congressional view that the tradition of local ownership and

local management of such associations should be maintained. H. Rep. No. 679 to accompany H.R. 7244, 86th Cong., 1st Sess., p. 3. The provisions of subsection (e) (1) (A) (iv) of the bill are also designed to prevent what in effect may be a form of branching not otherwise permitted to nonholding company associations.

However, if the Committee should decide to except from the operation of said subsection (e) (1) (A) (iv) out-of-State insured institutions held by holding companies as of the date of the enactment of the bill, the Board would regard such an amendment as posing no substantial problem.

Question. What would be the impact of Section (g) dealing with holding company debt? How many holding companies are already exceeding the 5% limit, and how many are close to it?

Answer. It should be noted that this provision does not prohibit a holding company from issuing debt. It simply requires that before a holding company can incur any long-term debt, or short-term debt above the 5% limitation, the Corporation must be satisfied, in accordance with the standards prescribed by the provision, that the debt transaction is sound and will not constitute an undue burden on the holding company's subsidiary association.

With respect to 28 holding companies predominantly in the savings and loan industry for which consolidated financial information is available, 10 had short-term debt aggregating less than 5% of consolidated net worth, and 18 had more than 5%. Of the 10 with short-term debt less than 5%, only 2 were close to the 5% limit. Six holding companies for which financial information is available do not furnish consolidated financial statements.

MEMORANDUM SETTING FORTH THE POSITION OF THE FEDERAL HOME LOAN BANK BOARD ON SOME OF THE FUNDAMENTAL ISSUES REGARDING THE PROVISIONS OF S. 1542 AND THE NEED FOR ITS ENACTMENT

1. *The central problem*

Experience shows that there are some inherent weaknesses and pressures in a holding company structure that will continue to plague holding company associations unless and until sufficient statutory safeguards are erected. When the holding companies, a mere $\frac{1}{8}$ of the industry, are responsible, in asset terms, for nearly $\frac{2}{3}$ of the institutions in serious difficulty, as is the present fact, something is fundamentally wrong and needs correction. The performance record of holding company associations is markedly more risky, whether viewed on a state-by-state basis or as a group in comparison to other stock or mutual associations.

2. *Geographical concentration*

While the holding company problems, like the holding company industry, are most concentrated in California, they are also to be found in Arizona and Illinois and Nevada and New Mexico. To a lesser but still disturbing degree, operating problems or tendencies associated with holding companies exist wherever holding companies are located. The holding company system of operation is not yet nationwide, but it is most definitely large enough that its problems must be taken seriously. There is presently over \$13 billion in savings in holding company associations; the reserves of the Federal Savings and Loan Insurance Corporation, by way of comparison, now aggregate about \$1.9 billion. It may easily be seen that the serious problems already existing among holding company associations can pose a real threat to the resources of the Insurance Corporation.

3. *National implications*

Acute problems in one segment of the savings and loan industry, even though concentrated in relatively few areas, are of serious concern to the entire business. The holding company associations have been the most aggressive in advertising for funds and obtaining public attention, so that troubles in this sector will have magnified consequences for the whole business. The public is not likely to make fine distinctions and view their difficulties as unrelated to the position of the savings and loan business in general.

4. *Marketability of stock*

The extent to which the bill would limit the market for selling stockholders in all stock associations has been greatly exaggerated. The bill has little or no

impact on small stockholders in savings and loan associations. The only significant effect would be on owners of more than 10% of an association's stock who wish to dispose of their holding in large blocs; they could not sell more than 10% to a single corporation engaged in some other business, although they could make several such sales of 10% or less or could sell the entire amount through a public offering. Even that limitation does not loom very large in the light of the fact that, of the 680 stock associations in the country as a whole, there are only 30—or about 4%—that are owned by companies primarily engaged in some other business. As applied to the current scene, therefore, the bill would effect about a 4% constriction of the market.

5. Solving problem cases

It has been argued that letting a diversified company buy up a savings and loan association is good because it will help to solve problem cases. This argument is either total fiction or wishful thinking. The Board does not know of a single instance in the period from 1959 to 1966 in which a diversified company purchased a savings and loan association that was in serious difficulty. As a moment's reflection should make clear, companies in other fields that might have an interest in entering the savings and loan business would be looking for sound institutions with good prospects, not feeble or failing institutions that someone wants to get rid of. At times the problem institutions have some elements of value from the standpoint of a company already in the savings and loan business, so that it is possible to work out mergers. But when a large conglomerate corporation goes shopping, it is not deliberately out to buy itself a headache, however nice that might be for the supervisory authorities, and there is no known case in which it has done so.

6. Performance of diversified holding companies

"Diversified" holding companies present a broad range, from large national corporations whose savings and loan interests are but a minor part of their operations to local, predominantly savings and loan holding companies that have embarked on one or two other lines of activity. By picking a selected group out of this whole range, almost any picture can be painted. Taking the range as a whole, however, it shares the distinctive characteristics of holding company associations as compared to all other insured associations that were shown in Table 3 attached to Chairman Horne's testimony. The essential problem remains the same: since control is a one-way street, the subsidiary association will feel the consequences of losses in the holding company operations but is not in a position to reap for itself any benefits that diversification may bring to the parent.

7. Precedent of Bank Holding Company Act

S. 1542 has many similarities with the Bank Holding Company Act and some differences. Any legislation is drawn to meet a particular set of problems, and should be judged accordingly, on its own merits. The savings and loan holding company law, as it happens, has applied to one-institution holding companies since its first enactment, unlike the BHCA.

8. Use of Supervisory Act

The 1966 Supervisory Act is no more of a substitute for a savings and loan holding company law than it is for the bank holding company law; they are aimed at different things: The two holding company laws are aimed at watching over holding company operations directly and restricting those operations in various ways so that problems do not arise. The Supervisory Act is aimed at enabling supervision to cope with an institution's problems before they lead to severe damage or ruin. But if there is a fundamental and continuing source of problems, it should be corrected by preventive legislation. The enforcement powers provided by the Supervisory Act may keep a problem from spreading or getting worse, but they give no answer to the question of why the problem keeps arising in the first place.

9. Control over debt structure

Commissioner Martin and Dr. Brigham testified that there are real debt problems among the holding companies and that they are getting worse. Savings and loan associations are already rather heavily leveraged, with borrowings from Federal Home Loan Banks and from the public in the form of savings accounts that are from 10 to 16 times net worth. To permit without restraint

another substantial layer of debt at the holding company level, that can be repaid only out of earnings from the savings and loan association, is to narrow sharply the margin of survival for the whole structure. This process is now being experienced in fact in a number of holding company systems.

10. Profit System

The Board's support for this legislation lies not in concern over or hostility toward the profit system but in awareness of the particular vulnerability of a subsidiary company toward its parent. On occasion the Board experiences difficulty with the motivation or objectives of those in control of institutions of every sort, but on the whole it can rely on management to put the interests of the association first. In the case of a subsidiary, the assumption has to go the other way—that the interests of the parent come first. And that is where the special problems of the holding company device originate.

The CHAIRMAN. If there is nothing else, the committee stands in recess until 10 o'clock tomorrow morning.

(Whereupon, at 12 m., the Senate subcommittee recessed to reconvene at 10 a.m. the next day, June 6.)

SAVINGS AND LOAN HOLDING COMPANIES

TUESDAY, JUNE 6, 1967

U.S. SENATE,
COMMITTEE ON BANKING AND CURRENCY,
Washington, D.C.

The committee met at 10:05 a.m. in room 5302, New Senate Office Building, Senator John Sparkman (chairman of the committee), presiding.

Present: Senators Sparkman and Spong.

The CHAIRMAN. Let the committee come to order, please.

We expect some other Senators to be here later but we have a very full schedule for today and we are going to have to get moving. We hope to finish.

Our first witness is Mr. Ernest Leff of Savings Associates.

Mr. Leff, we have a copy of your statement. I would like to say this to all of those who are going to make a statement. The entire statement will be printed in the record.

We would be very glad for you to discuss it in such a way, read it if you want to, or maybe you can summarize it, but I do hope that we can hold the time down reasonably in order that we can finish this schedule today.

All right, Mr. Leff, go ahead, sir.

STATEMENT OF ERNEST LEFF, SAVINGS ASSOCIATES

Mr. LEFF. Thank you, sir.

Mr. Chairman and Senator Spong, in accordance with your remarks Mr. Chairman, I think I will summarize rather than read my statement.

The CHAIRMAN. Very well.

Mr. LEFF. Our first point we would like to bring to the attention of the committee is the fact that this bill represents, we hope, a new and fresh look at the savings and loan holding company industry.

We think we deserve such a look because since 1959, our activities have been under a freeze imposed by this Congress as, we say, a temporary expedient. You heard yesterday when the Chairman of the Federal Home Loan Bank Board testified that the bill which is before this committee represented in his opinion the firm intent of the Congress and, therefore, he has imposed further inhibitions and bans upon the activities of holding companies.

We would rather have this committee look at the whole picture and permit us to operate in a fashion which other industries operate, principally in the bank holding company industry, which while it is separate from ours, represents comparably the closest financial industry that we can think of.

We are not here to tell this committee in any sense, Mr. Chairman, and Senator Spong, that the savings and loan holding company industry does not need regulation. To this degree, we do favor substantial portions of the bill which is before the committee.

We favor the registration of savings and loan holding companies with the Bank Board and we agree that subsidiaries of savings and loan holding companies and their affiliates should be required to file reports with the Bank Board.

We support examination of the Bank Board by holding companies and their subsidiaries as needed. However, I would point out at this time, that we have found from testimony yesterday, that the Bank Board concedes that they presently do have examination powers in respect to holding companies.

To the extent that power needs amplification, I am sure that our industry would support it; at least, that portion of our industry for whom I speak.

And that represents approximately \$8 billion in assets, which is approximately one-half of the entire holding company industry in terms of assets.

And we are not here to try and convince the committee that everything is well in the savings and loan holding company industry. We do recognize that there are problems and that there is abuse by a few people without a sense of public responsibility and there is in addition to that, some mismanagement in the savings and loan holding company industry.

However, this is not a peculiarity of our industry. This is typical of certain situations in all facets of the industry. It applies to the mutuals, it applies to the nonholding company stock associations and it applies to the stock associations which are owned by corporate owners.

What I point out here is that corporate ownership is not necessarily or inherently evil and, therefore, that the regulation of savings and loan associations should not entirely depend on the fact of holding company ownership in the form of corporate ownership.

One of the principal provisions of S. 1542 that is neglected, in our opinion, is the fact that the Bank Board has given very little if any attention to the vast and what I contend are awesome powers of investigation and examination and regulation which the Congress gave to the Bank Board in 1966 pursuant to the supervisory bill of 1966.

And we think that in that respect, the Bank Board has obtained all the power which is necessary to protect an institution from any raids or looting by corporate ownership, by individual ownership, by partnership ownership, by mutual ownership, and I think that the Bank Board necessarily should attempt to employ those powers before attempting to ask this Congress to give them vast new and broad authority to regulate savings and loan associations.

There are some provisions of the bill that we do oppose and I would like to illustrate these by several examples, the first of which is the matter of mergers and acquisitions.

At the present time, savings and loan holding companies are precluded from acquiring any other institution except those which are on the brink of supervisory liquidation. I don't believe that there is any other financial industry in the United States which is precluded

or foreclosed from acquiring other institutions or from merging with other institutions.

I do not think that is in the interest of the industry. I do not think it is in the interest of the Bank Board to have this foreclosure.

As my prepared statement says, we do not agree with the philosophy of regulation which prompts the Bank Board to ask the Congress to enact a bill by which the Board is forbidden from approving a merger.

Bank holding companies may merge with other bank holding companies, banks owned by bank holding companies may merge with other banks. All of that would be subject to the regulatory approval of the Federal Reserve Board and we ask for similar approval on behalf of the Federal Home Loan Bank Board to approve mergers by institutions owned by holding companies in the savings and loan industry and also mergers among holding companies in the savings and loan industry.

The second provision of the bill which we do not favor is the one dealing with divestiture. The provisions of the bill require a holding company to divest itself of any activity other than a few limited activities within 180 days after the activity commences except for a 2-year period evolved in respect to the enactment of the bill itself. It is 180 days thereafter.

Divestiture, I think, the courts and administrative agencies have all taken to be an extreme remedy to be applied on a very selective basis.

Now, we do recognize that the bank holding companies are required to divest nonrelated banking activities if they are a bank holding company. But the divestiture requirement of the bank holding company bill, as we find it in Senate Report 1179 accompanying the Bank Holding Company Amendments of 1966 was, and I quote—

To restrain undue concentration of control of commercial bank credit, and to prevent abuse by a holding company of its control over this type of credit for the benefit of its non-banking subsidiaries.

We do not think that this type of situation occurs in our industry at all, since our industry is confined principally to mortgage lending, both by Federal and by State law. So the inherent abuses which are involved in the control of commercial credit simply do not exist in our industry, and, therefore, we do not think there has been any case made in respect to divestiture by the Bank Board.

I don't think they have attempted to make a substantial case for divestiture and we think that divestiture is not needed until the case has been made by the Bank Board. And again we would emphasize that the Supervisory Act of 1966 provides them with the ability to examine holding companies and to make such a case if the case exists.

And another reason that we disfavor the divestiture provision is the fact that it destroys the marketability of savings and loan institutions, principally those which are not related to holding companies at the present time. And that works in this fashion: the bank holding company bill provides that it requires 25 percent control over two or more banks in order to become a bank holding company.

The bill before this committee provides that more than 10 percent of the stock of one single association is sufficient to create a holding company and once a holding company is created under the bill it would be required to divest itself of nonrelated activities.

In practical terms that means if an owner of a savings and loan association or his estate wished to transfer his control over that association and found it necessary to do so and look for a buyer of that institution, because of the fact that heavy capital requirements would be involved, it would be natural to assume that a corporation would want to acquire control over that association.

However, if a corporation did acquire control over that association, under the provisions of the bill, it would immediately have to get out of whatever business it was then doing and confine itself solely to the business of being a savings and loan association holding company.

And I think it can be taken for granted that in such circumstances few corporations would be looking to buy a savings and loan association. And this is particularly true if the indebtedness was also to be reviewed by the Federal Home Loan Bank Board for activities not related to the savings and loan operation, a matter which I will come to now.

Another provision of the bill that we disapprove and find very unnecessary is the portion of the bill dealing with the control of indebtedness by the Federal Home Loan Bank Board.

Now, the indebtedness that the Bank Board wants to control is the debt of the holding company, not of the insured institution. And it is our position that the intrusion of the agency control in this area of regulation should be and necessarily has to be a result of the fact that it insures the savings and loan association and because of that risk, has some interest in what goes on with the ownership of that association.

However, because the Supervisory Act provides that any transfer of cash or other assets to a holding company can be prohibited or the threatened transfer can be prohibited if the result of such transfer is an adverse effect upon the institution of its financial condition, we say that the control of indebtedness at the holding company level is entirely unnecessary.

In addition, there are prohibitions in the present act and in S. 1542 which is before this committee, prohibitions which we agree with, as to transactions between an association and its affiliates. We say that this restriction is unnecessary, since further control of the association's activities is found in the Spence Act and also in this bill, to control the indebtedness of a holding company.

And as I have already indicated, control of indebtedness would very severely affect marketability of savings and loan associations, not only those owned by holding companies, but more particularly those which are not owned by holding companies and which may have to be sold.

And finally, we oppose the provision that savings and loan holding companies cannot have institutions which cross State lines. And since we favor giving the Bank Board the right to approve or disapprove mergers or acquisitions, this necessarily means that the Bank Board would have the ability to approve or disapprove a merger or an acquisition which crossed State lines, so we find no substantial need for this type of legislation and of course we have not heard any substantial request for this type of legislation from any State authorities.

And in conclusion, Mr. Chairman, let me say this: We find that the savings and loan holding company industry is an honorable industry. We have never attempted to conceal anything from any regulatory

agency which the regulatory agency felt was justified in respect to its control over the insured institution or the regulated institution. In point of fact, approximately 83 percent of this industry at the present time is subject to regulation, examination, and investigation by State authority.

The California law requires all holding companies to register, to be examined, and to submit reports to the California savings and loan commissioner.

And for several years we have been registered, all of us, in our savings associates group, with the California commissioner. We have filed reports with him and we have been examined by him.

And we want the Federal Home Loan Bank Board to have comparable authority for the reason that we think that if the Federal Home Loan Bank Board has the same access to our books and records that the California commissioner has, that this will dispel any notion that there is something inherently evil about a savings and loan holding company.

We have found no substantial reason for the prohibitory requests rather than the regulatory requests which the Bank Board has provided in the bill before this committee. These are the prohibitions against mergers and acquisitions, operations across State lines, prohibitions against indebtedness without stringent approval by the Bank Board, and matters of that kind which I have covered earlier.

Finally, we believe that the Supervisory Act, which was enacted in October of 1966, has not been applied by the Bank Board for a variety of reasons. To my knowledge, no final regulations have been issued with respect to that bill until a few days ago.

That bill permits the Bank Board to interdict any activity between a holding company and its association which would create an unsound and unsafe condition in the association by preemptory cease and desist orders.

These orders can be effective immediately upon service by the Federal Home Loan Bank Board. So the Bank Board has vast authority now to regulate and control the relationships between an insurance institution and its holding company and it should be required to make a case before this committee, before it asks for additional prohibitions against savings and loan holding company activities.

It has not made such a case and for this reason, Mr. Chairman and Senator Spong, we would ask that this committee regulate this industry on behalf of the Federal Home Loan Bank Board, provide a bill which would do so, in a fashion roughly comparable to the regulation of bank holding companies, and as mentioned, that this bill be enacted to provide the Federal Home Loan Bank Board with whatever information it requires to administer the associations owned by savings and loan holding companies.

Thank you, sir.

The CHAIRMAN. Thank you very much, Mr. Leff. You have given us a very thoughtful statement and we appreciate it.

I want to ask you this: It seems to me there is some inconsistency in your statements. For instance, in part of your presentation you use the Bank Holding Act as an analogous act and seem to approve it, and then there are other provisions where you don't approve the application of the Bank Holding Act to you. Instead you bring up

the proposition that the savings and loan business is a different business. And I agree with you that it is a different business, but don't you meet yourself coming back on the two different positions that you take?

Mr. LEFF. Mr. Chairman, I recognize the inconsistency in the application of the two bills to each other and I tried to explain that in this fashion, if I may restate my position with respect to that. As I have read the reports of the bank holding company bill, I do not think that the Congress would have required bank holding companies to divest their nonrelated activities unless the Congress had found an inherent abuse or potential abuse of commercial bank credit in respect to nonbanking functions entertained by a bank holding company.

And the distinction I drew between that situation and the savings and loan business is this: The savings and loan holding company operation, insofar as leverage is concerned from the insured institution, relates only to mortgage lending or principally to mortgage lending, and there is not very much chance of abuse of credit opportunities with mortgage lending ability as there is in commercial credit bank ability.

And I think that is a valid distinction. But I do recognize that there is a difference in applying the full impact of the bank holding company provisions to the savings and loan holding company bill; yes, sir.

The CHAIRMAN. You don't see any potential conflicts of interest in a holding company controlling both savings and loan associations and a real estate development corporation, for instance?

Mr. LEFF. I think that there is potential conflict of interest in virtually any financial institution, Senator. I didn't mean to say that I think there is no possibility of abuse in mortgage credit opportunity.

I think that with the supervisory bill, which was not in effect at the time the bank holding company bill was enacted, the Bank Board has the power to interdict that type of abuse of mortgage credit lending if it exists.

But I say the danger of it is not in the same magnitude as the danger of conflict of interest with commercial credit of a bank which has a far and wide ranging application.

The CHAIRMAN. Let me ask you this general question: Why should a nonfinancial institution own a financial institution?

Mr. LEFF. I think the principal reason for that would be, Senator, at least so far as it concerns California, is the fact that when these financial institutions obtain the size of a great many of these holding companies, then the form of ownership, as in most other forms of industry, is corporate ownership. Because individuals, very few individuals have the accumulation of wealth so that they can control an institution of substantial size. And this industry has grown, particularly in California, and particularly in metropolitan areas all over the United States, to such proportions that ownership has to be essentially corporate. There are very few individuals of that type of wealth, so I think that is essentially the reason for corporate ownership of large savings and loan associations or holding companies.

The CHAIRMAN. Can't all of those advantages be accomplished without the necessity of owning a financial institution?

Mr. LEFF. If you are asking me, Senator, whether a savings and loan association can operate without corporate ownership, of course it can, yes, sir. But I am saying the need for corporate ownership arises when it becomes of such magnitude that an individual can't in and of himself control the situation with his own private wealth.

The CHAIRMAN. Do you represent all of the holding companies in California?

Mr. LEFF. I represent seven holding companies. I have them in my statement.

The CHAIRMAN. You have them at the very end of your statement?

Mr. LEFF. Yes, sir, a footnote to page 1.

The CHAIRMAN. How large are they?

Mr. LEFF. I can give you the approximate size.

H. F. Ahmanson & Co., with respect to the savings and loan operations is approximately \$2.3 billion in size.

First Charter Financial Corp. would be approximately \$2.1 billion in size.

Great Western Financial Corp. would be approximately \$1.7 billion in size.

Imperial Corporation of America would be approximately \$1.1 billion.

Wesco Financial Corp. would be approximately \$400 million.

Trans-World Corp. would be approximately \$350 million.

And Southern California Financial Corp. would be approximately \$200 million, sir.

The CHAIRMAN. What would be the nature of the businesses of the unrelated activities that are engaged in by holding companies that you represent?

Mr. LEFF. I don't have a complete list, but from memory, sir, I think it would break down this way: It would involve insurance companies, banks, one finance company in Texas, to my recollection, a title company or perhaps more than one title company. But essentially, they are in the financial field.

That is the best I can do at this time, Senator.

The CHAIRMAN. I wonder if you would be willing to give us a report, to put in the record, breaking it down by different ones?

Mr. LEFF. Yes, sir, I will be very happy to.

The CHAIRMAN. Yesterday, Chairman Horne, of the Home Loan Bank Board, said that maximum profits for holding companies were not necessarily consistent with the welfare of each subsidiary institution.

How do you feel about this argument?

Mr. LEFF. I would agree that maximum profits are not necessary for the welfare or consistent with the welfare of the insured institution, but I don't see much significance to that statement as it stands, Mr. Chairman.

A point I would like to make, that the Chairman did not make yesterday, is that there is abuse inherent, irrespective of the ownership. There is nothing peculiar about abuse by corporate ownership. Individuals have abused savings and loan associations—it was not mentioned yesterday—and individuals have abused mutual savings and loan associations. We know that, Senator. And so long as there is going to be private ownership of these institutions or private con-

trol of these institutions, there is the possibility of abuse and that is the price we pay for such ownership.

I don't condone it or defend it, you understand that, Mr. Chairman, but, I think that it is there.

The CHAIRMAN. In the case of the companies you represent, have there been transactions between the savings and loan associations and other affiliates?

Mr. LEFF. Other affiliates of the institution?

The CHAIRMAN. Yes, sir.

Mr. LEFF. Yes, sir.

May I say this, Mr. Chairman. Transactions between our institutions and our ownership are at the present time regulated to a substantial degree by California law. So that there are certain prohibitions, for example, absolute prohibitions under penalty of felony convictions on transactions between a holding company and its affiliate of a nature not approved by the California savings and loan law. So many abuses of affiliate relationships are already interdicted by California law and, therefore, the nature of our transactions are within the keeping of the California law, such as perhaps the deposit of accounts with a commercial bank or something like that, keeping a commercial checking account.

The CHAIRMAN. Do these affiliates compete for the association's business in any sort of competitive bidding?

Mr. LEFF. I don't see how that question applies to our transactions, Mr. Chairman. For example, I don't know specifically what your question implies. In our own organization, let me say, we maintain a commercial checking account with our own bank. But that is a small commercial checking account. Most of our money is desposited with other banking institutions, such as the Bank of America and Union Bank, United California Bank, and a very small portion is deposited with our own bank.

So we do have transactions in a competitive nature with other people other than our affiliates, that is true.

The CHAIRMAN. Senator Bennett was not able to be here this morning. He had a very urgent meeting of the Finance Committee, but he has submitted a few questions that I might ask on his behalf.

Mr. LEFF. I would be very happy to try and answer them.

The CHAIRMAN. One is, would you comment on Mr. Horne's statement about the problem cases being centered in California among the holding companies? If this is true, why is it?

Mr. LEFF. I think that some of the statistical data that Chairman Horne provided yesterday in respect to holding company operations is true. And I think the explanation in a large part is this, it may not be in the most significant part, but in a large part is this, Mr. Chairman, and that is the fact that the holding company industry would like to solve many of the problems which occur in certain institutions in the savings and loan business by itself and has been precluded from doing so.

If I may explain just a bit more: When a mutual institution in California, a Federal savings and loan association, is a problem case the bank board generally urges and to some degree coerces a merger between that Federal association and a large Federal association.

In our situation, where a subsidiary of a holding company is a problem case and there have been attempts to merge that problem case with a healthy savings and loan subsidiary, the bank board generally takes the position that such a merger will not be approved. And I think you will hear from the California commissioner on that, Mr. Chairman, and from the former commissioner on that. I don't know what they are about to say but I think that if you will ask them that question you will find that they have brought merger partners to Washington, involving subsidiaries of holding companies which are problem cases, and the bank board has indicated that they would not approve such mergers.

Therefore, these problem cases endure as a statistic and go on and on and on because we are not permitted to solve the problem.

In a Federal situation these problems are solved promptly by coerced mergers or encouraged mergers and I think that if the savings and loan holding company industry would be permitted to solve many of these problems, they would be solved.

The CHAIRMAN. Senator Proxmire yesterday asked whether there was likely to be a shakeout in the industry. How would this bill affect that problem?

Mr. LEFF. Mr. Chairman, I think that this is one of the few industries in the United States which has not had the shakeout that Senator Proxmire referred to and I think that many people recognize that such a shakeout is coming.

In such a situation, particularly in California, and perhaps to a lesser degree but to a substantial degree in Texas, when that shakeout comes, where mergers are necessary, in order to enhance the competitive situation, I think that problems will occur if this bill is enacted by reason of the fact that a savings and loan holding company would not be able to acquire any of these institutions unless they were on the brink of supervisory liquidation. And then if the present practice of the Board continues, I doubt very much that the Board would approve those acquisitions even at that point.

But in any event, I think it would make more difficult the ability of the Bank Board to solve the problems in the industry by this absolute refusal to permit acquisitions or mergers by associations which are owned by corporate owners.

The CHAIRMAN. As a lawyer representing holding companies, what is the scope of the present powers of FSLIC to control the problem of holding companies milking their savings and loan subsidiaries?

Mr. LEFF. Mr. Chairman, I think that this again involves the supervisory bill in 1966. I assume by milking, the Senator is relating a circumstance where a cash dividend would be paid upstream to a holding company or assets would be transferred to a holding company in order to discharge indebtedness of the holding company or to provide profits to the holding company which might increase the holding company's stock price.

At the present time, and under the present powers given to the Bank Board, the Bank Board has the ability to absolutely prohibit any transfer of any cash or any transfer of any asset or any other transaction which would place the association in an unsafe and unsound condition as determined by the Bank Board itself. And it may do so almost immediately by serving a cease-and-desist order upon

the insured institution forbidding such a transfer and that order becomes effective immediately.

So I think that the nature of the transaction can be absolutely prohibited under present powers of the Bank Board.

Incidentally, we supported giving the Bank Board such powers.

The CHAIRMAN. Well, in that connection—this is not Senator Bennett's question, this is my own—did you read the paper that Chairman Horne presented?

Mr. LEFF. Yes, sir.

The CHAIRMAN. Do you recall the case that he told about? He didn't say this was in California. He didn't designate the location. He said there was a holding company that had controlled a bank and a savings and loan association. The savings and loan association was in financial difficulty, while the bank was financially healthy. In order to put the profitable bank operations safely out of reach, the holding company spun off the bank and distributed its stock to the holding company stock holders. This left the savings and loan association holding the bag. Do you remember that?

Mr. LEFF. The circumstances that Chairman Horne referred to, which I read, and the only one that comes to mind, is the circumstance where a holding company owned a bank and a savings and loan association. And when the savings and loan association got into trouble, Chairman Horne said that the bank was spun off, and the bank is a healthy bank and the savings and loan is one of their problem cases.

The CHAIRMAN. Of course he was using that to illustrate the fact that the savings and loan association didn't necessarily get the benefit of tying in with another organization.

Mr. LEFF. Yes, sir, not always, but we could document examples where savings and loan did get the benefit of tying in which a holding company.

The CHAIRMAN. What could the FSLIC have done in that case that Chairman Horne talked about?

Mr. LEFF. I am familiar with that case, Mr. Chairman, if we are both speaking about the same one, because I am a so-called public service director of that association. Chairman Horne has asked me to serve in that capacity. So I think I can speak from knowledge with respect to that institution and the problems it had.

The institution was known to be a problem institution by the Federal Home Loan Bank Board for several years, because of the examinations by the Bank Board of that institution. However, it had no cease-and-desist authority in order to interdict any of the transactions which created unsafe and unsound conditions in the institution. And, therefore, it did not have the power to stop it short of terminating the insurance of that institution at that time. But the circumstances are far different today, Mr. Chairman.

Since October of 1966 the Bank Board had the authority to absolutely stop each one of the transactions which created an unsafe and unsound condition in that association.

The CHAIRMAN. What is your idea about advance notice of change of ownership?

Mr. LEFF. I think I would favor that, Mr. Chairman. I have no opposition to that.

The CHAIRMAN. Does the law at the present time permit mergers between a holding company controlled association and a healthy, non-controlled association?

Mr. LEFF. No, sir, a flat prohibition against that.

The CHAIRMAN. Well, I thank you very much, Mr. Leff.

Mr. LEFF. Thank you, Mr. Chairman.

The CHAIRMAN. Wait just a minute. What is your feeling on advance notice of dividend payments?

Mr. LEFF. Well, we favor that provision of S. 1542 as my prepared statement indicates. However, I think that the Bank Board presently under the supervisory act has the power to require advance notice of payment of dividends at the present time and they could do so simply by regulation without requiring a separate bill to be passed including such provision.

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

We appreciate your giving us your testimony.

(The prepared statement of Mr. Leff follows:)

PREPARED STATEMENT OF ERNEST LEFF OF SAVINGS ASSOCIATES¹

Mr. Chairman and Members of the Committee: I speak on behalf of a group of 7 California-based savings and loan holding companies with combined assets in excess of \$8 billion.

We welcome this review of the savings and loan holding company industry by the Senate. Since 1959, when the Spence Act was enacted, this industry has been foreclosed from pursuing ordinary avenues of expansion and growth. No other financial industry has been compelled to operate under the inhibitions imposed upon holding companies by the provisions of the Spence Act. No other financial industry has been precluded from effecting mergers or acquisitions which would enhance a competitive situation. From a reading of Report No. 810 published in 1959 and Report No. 1754 published in 1960, both of which were issued by this Committee, we are convinced that the Spence Act was a temporary expedient designed to give this Committee and the Congress the opportunity to study the need for savings and loan holding company legislation and to maintain the status quo pending such review. The Federal Home Loan Bank Board appears to assume that the Spence Act represents a definitive attitude of this Committee and of the Congress respecting holding companies. S.1452, therefore, builds upon the prohibitions contained in the Spence Act, and adds further restrictions, inhibitions and bans upon activities of savings and loan holding companies.

We appreciate the need to provide the Bank Board with the ability to regulate savings and loan holding companies. In this respect we favor much of what is contained in the provisions of S. 1542. We agree that savings and loan holding companies should be required to register with the Bank Board. We agree that holding companies and their subsidiaries should file reports with the Bank Board. We support examinations by the Bank Board of holding companies and their subsidiaries. We agree that the Bank Board should regulate and control, in a reasonable manner, transactions between an association and its affiliates. We do not oppose any proper measure designed to provide the Bank Board with such information respecting an insured association and its holding company and affiliates as will enable the Bank Board to protect the financial integrity of the association.

We are not here to try to convince this Committee that associations owned by holding companies are not subject to abuse by the few who operate without a sense of public responsibility. All financial institutions, irrespective of the nature of ownership, are susceptible to practices by those who own or control them, which could impair their financial soundness. It was for these reasons that the Congress in 1966 provided the Bank Board with vast new powers to protect the financial condition of insured associations. The supervisory Act allows the Bank

¹ An informal organization consisting of: H. F. Ahmanson & Co., First Charter Financial Corp., Great Western Financial Corp., Imperial Corp. of America, Wesco Financial Corp., Trans-World Corp., Southern California Financial Corp.

Board to prohibit predatory behavior by all who own or control associations, including holding companies. The Supervisory Act also provides the Bank Board with the power to conduct examinations and investigations of all affiliates of associations, including holding company affiliates, "as shall be necessary to disclose fully the relations between such institutions and their affiliates and the effect of such relations upon such institutions."² No substantial consideration is given by the Bank Board in S. 1542 to these broad powers to interdict activities of associations and their ownership. The Bank Board seeks broad new prohibitory powers although it admits that no substantial effort to apply the authority of the Supervisory Act has yet been undertaken. No case has been made by the Bank Board indicating that the powers of the Supervisory Act are inadequate to deal with the problems the Bank Board raises resulting from corporate ownership of associations.

The Bank Board in S. 1542 has given scant attention to the circumference of authority which the Congress has provided to the agencies which regulate and control bank holding companies. The powers which the Bank Board seeks range far beyond the authority which the Federal Reserve Board has in respect to bank holding companies. Since this Committee has dealt with bank holding company legislation as recently as 1966, our critique of S. 1542 relies heavily on such legislation.

There are provisions of S. 1542 that we oppose. These provisions are prohibitory and not regulatory and are illustrated principally by the following:

(a) *Mergers and Acquisitions.* S. 1542 would prohibit an association owned by a holding company from merging with another association other than an institution which is on the brink of supervisory liquidation. This continues the freeze upon expansion established in the Spence Act. All other savings and loan associations are permitted to merge, subject to Bank Board approval. A bank owned by a bank holding company, however, can merge with another bank subject to agency approval. We favor permitting mergers between associations, irrespective of the nature of ownership, subject to Bank Board approval and relevant anti-trust considerations. We do not agree with the philosophy of regulation which prompts the Bank Board to ask the Congress to enact a bill by which the Board is forbidden from approving a merger. Similarly, bank holding companies, without merger, may acquire an additional bank or a bank holding company with agency approval. S. 1542 would prohibit such acquisitions by a savings and loan holding company. We believe that the Bank Board should have the discretion to approve such acquisitions.

(b) *Divestiture.* S. 1542 would prohibit a holding company which is now engaged in business activities unrelated to the operations of savings and loan associations, with very limited exceptions, from continuing such activities. In essence, this requires a holding company to divest itself of any business activity not provided for in S. 1542.

Divestiture is an extreme remedy to be employed on a highly selective basis. The Spence Act has never contained divestiture provisions. We recognize that bank holding companies were required to discontinue activities not related to banking by the Bank Holding Company Act. However, this divestiture requirement was the consequence of a determination of the Congress, as expressed by this Committee, in Senate Report 1179 accompanying the Bank Holding Company Act Amendments of 1966, "to restrain undue concentration of control of commercial bank credit, and to prevent abuse by a holding company of its control over this type of credit for the benefit of its non-banking subsidiaries."

The danger of such control over credit does not exist to any substantial degree in the savings and loan industry. Pursuant to federal and state law, savings and loan associations must confine their activity almost entirely to the business of mortgage lending. There is only limited ability to benefit non-association subsidiaries by the abuse of mortgage lending authority. To the degree that the potential abuse exists, it can be met by the power of the Bank Board to issue a cease and desist order to meet any threat to the financial condition of an association. Moreover, unlike the banking industry, there has been no undue concentration of economic power in mortgage lending. We submit that the penalty of divestiture is inappropriate unless and until the Bank Board has made a convincing case that the Supervisory Act is not adequate to any situation involving the potential abuse of mortgage lending. Until such a case is made, this Committee should not compel the dismemberment of many existing corporations.

² 12 U.S.C. 1730(m) (1).

(c) *Marketability*. Another reason why the divestiture provisions of S. 1542 should be eliminated is the burden they place upon owners of associations other than corporate owners. Such owners would be deprived of a market for their shares in the event that a sale of an association by the owner or by his estate become necessary or desirable.

The Bank Holding Company Act defines a bank holding company in terms of control over 25% of the voting shares of each of two banks.

S. 1542, on the other hand, defines a savings and loan holding company in terms of more than 10% of a *single* association.

Should an owner of an association sell more than 10% of his voting shares to a corporation engaged in an unrelated business, the corporation would have 180 days to do one of two things: (a) divest itself of the unrelated business activities, or (b) dispose of the stock in the association. Faced with such consequences, not many corporations would acquire an association. Not many owners would find a market for their associations if every entity defined as a "company" in S. 1542 were in this manner eliminated. In contrast, a single bank, regardless of its size, may be owned by a corporation engaged in any number of enterprises, without consequences under the Bank Holding Company Act.

(d) *Indebtedness*. S. 1542 would require a holding company and its subsidiaries to obtain the permission of the Bank Board before incurring any indebtedness other than in specified limited amounts, for limited duration and for limited purposes. Control over the amount and other terms of holding company indebtedness represent a radical extension of agency authority. We assume that the Bank Board, in respect to the indebtedness of holding companies, is concerned with the possibility that an association would be required to make improper payments to the holding company in order to discharge the debt of its holding company. To the extent that the possibility exists that a few holding companies may improperly use subsidiary associations to discharge indebtedness, this circumstance is controlled by authority both in S. 1542 and in the Supervisory Act. S. 1542 contains provisions against "upstream" and "cross-stream" transactions between an association and its holding company. The provisions of the Supervisory Act, as we have discussed previously, permit the Bank Board to prevent the transfer or threatened transfer of any cash dividend or other asset to a holding company if such transfer will create an "unsafe and unsound" financial situation. In this connection we favor the proposal, that an association must give 30 days notice to the Bank Board prior to paying a dividend to the parent company.

Control over holding company indebtedness would adversely affect the marketability of associations. Few corporations would be willing to acquire an association if all facets of their unrelated business operations would be subject to the indebtedness control of the Bank Board. The authority is unneeded since the Bank Board presently has the ability to prevent the abuse of associations for the benefit of holding companies.

(e) *Operations across state lines*. A few holding companies which now operate across state lines should not be required to divest all association holdings in every state but one, as S. 1542 would require. Since we favor giving the Bank Board the right to approve or disapprove holding company mergers and acquisitions, the Board can decide whether future mergers and acquisitions across state lines should be permitted.

CONCLUSION

Mr. Chairman and Members of the Committee, we have nothing to hide in respect to our holdings of savings and loan associations. For several years we have been registered with the California Savings and Loan Commissioner; we have reported to him and have been examined by his employees. We would welcome the grant of authority to permit the Bank Board to obtain all the information it must have respecting our ownership and operations of savings and loan associations. We are confident that we will thereby dispel the idea that there must be something evil about a savings and loan holding company. We have found no substantial reason for the prohibitory requests of the Bank Board as contained in S. 1542 which would inhibit and ban many important operations of our holding companies. We remind the Committee that FSLIC does not insure our holding companies. We believe that the Supervisory Act contains all the authority the Bank Board needs in respect to any unsafe and unsound activity of an association on behalf of its owners. We therefore would urge this Committee to amend S. 1542 so that the Bank Board would be enabled to regulate us in a manner comparable to the regulation of bank holding companies by the Federal Reserve Board, and as so amended, be approved.

Our next witness is Paul Porter, accompanied by Gene Brigham and Gary Sadler, Council of Savings & Loan Stock Companies.

Mr. Porter, we are very glad to have all of you. We have your statements and they will be printed in full in the record.

Mr. PORTER. Thank you, sir.

The CHAIRMAN. You may proceed.

STATEMENT OF PAUL A. PORTER; ACCOMPANIED BY EUGENE F. BRIGHAM AND GARETH W. SADLER, COUNCIL OF SAVINGS & LOAN STOCK COMPANIES; CARL H. LINDNER, CHAIRMAN OF THE BOARD AND PRESIDENT OF AMERICAN FINANCIAL CORP.; AND VICTOR H. KRAMER AND JOHN D. HAWKE, JR.

Mr. PORTER. In accordance, Mr. Chairman, with your admonition, we will summarize our statements and try to be brief because I don't think I have ever made any permanent enemies in Congress by being brief and I will undertake to adhere to that policy.

The CHAIRMAN. I have heard those statements before.

Mr. PORTER. Mr. Chairman, we appear here today on behalf of the Council of Savings & Loan Stock Companies. The membership of the council is described, together with a description of their assets and their allied activities of our corporate members, in my complete statement.

My name is Paul Porter. I am accompanied here by Mr. Gareth Sadler, Dr. Eugene F. Brigham and my partners, Mr. Victor Kramer and John D. Hawke, Jr., as well as Mr. Tom Clarke of the Trans-Coast Financial Co.

Mr. Sadler is the former California savings and loan commissioner. Dr. Brigham is an economist from UCLA and is probably the leading authority in the field of savings and loan holding companies. As a matter of fact, I think Dr. Brigham has probably written the only definitive study and analysis of the holding companies.

Now as I said, we each have prepared statements here which will be inserted in the record and with the chairman's permission, we will just present short summaries and then we will sit as a panel here, if it is in accordance with the chairman's wishes, and attempt to respond to any questions you might have.

The CHAIRMAN. Fine.

Mr. PORTER. First of all, our position on S. 1542 may be summarized as follows: We believe that the Federal Home Loan Bank Board is really not very well informed about the holding companies. Chairman Horne reiterated yesterday that the Board had not had the power to get the information it needs to inform itself. You may recall that his distinguished predecessor, Chairman McMurray, once said that as far as holding companies are concerned, the Board was in a "hooded cockpit" and didn't know where they were flying.

Now the Board, we are informed, at present is in the midst of a very important study in depth of the industry which has been funded for about half a million dollars and we also are informed this study will give particular attention to holding companies. Thus, we say that we think the cart is before the horse here, that once they obtain those facts, they should then proceed to make their recommendations. Until

that time they should not attempt the type of radical surgery that may be implicit in some provisions of this bill.

Now we have, as I say, absolutely no objection to the provisions of S. 1542 that would provide the Board with all of the information that it needs. Certainly we support those provisions of S. 1542 to enable the Board to prevent conflicts of interest, self-dealing, that endangers or might endanger the associations.

In California, it will be developed, where most holding companies are located, these transactions have been strictly regulated for many years.

Now, with respect to the advance notice of proposed cash dividends, we think, as Mr. Leff pointed out, that the Board presently has that power and we would have no objection if it were made explicit in the pending legislation.

We are flatly opposed to those provisions in S. 1542 that would limit the ability of a holding company to diversify its activities or would give the Board the power to control holding company indebtedness. I have developed the reasons for that position in my prepared statement.

Finally, we believe it is in the best interest of the savings and loan industry, that holding companies be permitted to expand their savings and loan interest through a merger or a stock acquisition, subject, of course, to the Board's prior approval.

Now, with that brief summary of our position, I would like to reflect just momentarily on some of the larger implications of the Board's proposals as we see them.

We firmly believe that holding companies have performed and continue to perform an extremely important function in this industry. They are the only type of organization in the savings and loan business having access to the capital markets to secure public financing. This ability, which is directly related to their corporate form and their freedom to diversify, we believe, puts them in a position to infuse fresh capital into their subsidiary savings and loan institutions and to support and strengthen these institutions. And by infusing new capital, the holding companies can not only strengthen their subsidiaries and affiliates, but can provide additional protection for the insurance risks of the Federal Government.

Now yesterday Chairman Horne testified that from 1959 to 1966, the holding companies contributed \$35 million to their subsidiary associations. We believe that this is proof of the point I have just made. Where else in the savings and loan industry does the ability to pump \$35 million of permanent capital into the insured institutions exist? It simply would not exist without the holding companies. Capital contributions by individuals simply do not occur.

By Chairman Horne's figures now, the holding companies took out in dividends some \$20 million more than they put in. Bear in mind that the company that contributed this capital are not necessarily the same ones that received dividends. So we think that the statistic does not truly reflect the position of the net contribution. We submit further that unless dividends received by holding companies can be compared with dividends paid by nonholding companies, that this bare statistic has no particular significance.

But in the second place, if that figure were computed as a percentage of return on invested net worth, we submit it would be shown to be extremely low.

The simple fact is that holding companies have been remarkably restrained in realizing a return on their investment and we believe the Board's own figures substantiate that point.

Now, of course, there is no denying that holding companies are operated for a profit, but in the Board's mind, men who are moved by the profit motive in this industry seem to be considered in some respects as unscrupulous promoters. This, of course, is not the case. The profit motive has caused the holding companies to attract to the housing and mortgage market savings dollars that otherwise would have gone into other areas. And it has caused these companies to operate at a level of efficiency that we believe exceeds that of all other segments of the industry. The ability to generate profits has enabled these companies to bring to this industry the vast resources of the public capital market. In short, we submit, Mr. Chairman, that the profit motive well serves this industry.

Chairman Horne expressed the opinion that the problem of the holding companies is "structural." The facts, we submit, do not bear this out. We notice he did not cite a single example of improper transactions between a holding company and a savings and loan subsidiary. He cited statistics relating to the high level of problem cases, but this is not a symptom, we submit, of a structural problem. It is a peculiar symptom of what has occurred in one State, California. Substantially all of the holding companies are located in California and California is where the Board's so-called problem cases, or most of them, are located. It is also the State having the most effective system of regulating loan associations and holding companies. Holding companies have been subject to extensive disclosure requirements for 3 years in California, and for many years there have been laws and regulations governing transactions between holding companies and their affiliates.

The demand for housing in California, as the chairman well knows, and the need for housing capital in that State, was greater during the early 1960's than any place else in the country. The California holding companies were unquestionably the leaders in filling this great demand. When the demand for housing slackened in 1965 and 1966 and money became tighter, the holding companies naturally felt the effect to a commensurately greater degree. Their present problems are simply evidence of the extent to which they were effectively serving a demonstrated public need when the need was most crucial.

California's experience, we submit, is peculiar to that area and is not related to the structure of the industry or to the holding companies' participation. We contend that to restrict holding company operations would be to impair their ability to obtain public financing. If Board approval is required before any long-term borrowings can be made, they may no longer have access to capital markets. In short, we believe that savings and loan holding companies should be encouraged to put another \$35 million or more of permanent capital into their associations. This can be done, we contend, with proper safeguards against improvident outflow of dividends.

Now that concludes, Mr. Chairman, the summary of my statement and at this point I would like to ask Dr. Brigham, whose qualifications are set forth in his prepared statement, to give a summary of his statement.

The CHAIRMAN. Very well.

(Mr. Porter's full statement follows:)

STATEMENT OF PAUL A. PORTER, COUNCIL OF SAVINGS AND LOAN STOCK COMPANIES

Mr. Chairman, my name is Paul A. Porter of the firm of Arnold & Porter, and I appear today on behalf of the Council of Savings and Loan Stock Companies. I am accompanied by Mr. Gareth Sadler, the distinguished former Savings and Loan Commissioner of the State of California, and Dr. Eugene F. Brigham, an outstanding economist from the Graduate School of Business Administration of the University of California at Los Angeles, and Mr. Carl H. Lindner, Chairman of the Board and President of American Financial Corporation.

The Council of Savings and Loan Stock Companies was formed in 1965 by a group of financial corporations that had interests in the savings and loan industry. Membership in the Council is presently open to all corporations owning savings and loans, as well as all stock savings and loan associations, whether or not they are affiliated with a holding company.

At the present time the Council represents 45 savings and loan stock companies, having total assets in excess of \$3.5 billion. Twenty-two of these associations are affiliated with holding companies. Our members are located in California, Ohio, Texas, Washington State, Illinois, New Mexico and Colorado. Ten of our corporate members are publicly-owned companies. The common stock of four of these companies is traded on the New York and Pacific Coast Stock Exchanges, and the rest are traded in the over-the-counter market. For the convenience of the Committee and its staff we are submitting copies of the latest annual reports of each of our corporate members. In addition, we have inserted at this point in our statement a chart describing our 10 holding company members.

Company	Consolidated assets as of end of last fiscal year	Stock traded
American Financial Corp.....	\$174,682,000	Over the counter.
California Financial Corp.....	247,814,000	New York Stock Exchange; Pacific Coast Stock Exchange.
Capital Alliance Corp.....	30,199,000	Over the counter.
Financial Corp. of Santa Barbara.....	166,719,000	Do.
Financial Federation, Inc.....	1,153,484,000	New York Stock Exchange; Pacific Coast Stock Exchange.
First Lincoln Financial Corp.....	424,675,000	Over the counter.
Gibraltar Financial Corp. of California..	423,561,000	New York Stock Exchange; Pacific Coast Stock Exchange.
Hawthorne Financial Corp.....	82,100,000	Over the counter.
National General Corp.....	104,574,000	New York Stock Exchange; Pacific Coast Stock Exchange; Midwest Stock Exchange.
Trans-Coast Investment Co.....	88,024,000	Over the counter.

Non-savings-and-loan activities:

	Number of affiliated associations
Commercial bank, insurance agency, life insurance company, leasing company, construction	2
Mortgage company, insurance agency, title companies, real estate development and brokerage.....	1
Trustee, property management, real estate investments.....	1
Trustee, insurance agency, mortgage company, construction loan disbursement control	1
Trustee, insurance agency, data processing, real estate investments, management services (mortgage, savings, accounting, and appraisal consultation)	11
Commercial bank, data processing, insurance agency, real estate investments, trustee, title company.....	1
Commercial bank, trustee, escrow company, insurance agency.....	1
Trustee, insurance agency.....	1
Motion picture theaters and production, building construction, CATV, fruit packing, music publishing leasing, insurance agency, trustee, real estate investment.....	1
Insurance agency, trustee, real estate investments.....	2

Before discussing the Council's position on S. 1542 I would like to make some general background observations.

The subject of savings and loan holding companies is one about which there is not much information available. There is woefully little published data or analysis relating to the nature, extent and operations of these companies, and the most recent government publication is a report of the Federal Home Loan Bank Board in 1960. In 1959, the Board was directed by Congress to "make a full and complete survey of all aspects of savings and loan holding companies" and to report its findings, together with recommendations for further legislation, to the Committees on Banking and Currency of the Senate and House of Representatives. Pending submission of the Board's report, Congress enacted a "freeze" on holding company expansion. This legislation, known as the Spence Act, was admittedly no more than a stopgap measure, intended to preserve the status quo while the Board and Congress could study the implications of holding company growth. The Spence Act prohibited existing holding companies from acquiring additional savings and loan associations, and it prohibited the creation of new multiple-association holding companies. The Spence Act did not, however, prohibit the creation of single-association holding companies, nor did it limit in any way the activities that holding companies could engage in.

In May 1960 the Board transmitted to the Congress its report pursuant to the direction of the Spence Act. The 86th Congress was at that time drawing to a close and the presidential election was imminent. This Committee recognized that the Congress would have very little time to study the subject prior to the expiration of the then temporary Spence Act, which was scheduled to expire on May 31, 1961. Accordingly, this Committee recommended that the Spence Act "freeze" be made permanent so that "more thorough and careful consideration can be given to the entire problem of the proper regulation of savings and loan holding companies." (S. Rep. 1754, 86th Cong., 2d Sess., p. 6).

Since 1960 there has been no consideration of the general subject of savings and loan holding companies by the Congress, although the Board has on a number of occasions proposed legislation, substantially in the form of S. 1542, to regulate the holding companies. These hearings are the first occasion on which any formal consideration has been given to the subject since the Board's 1960 report.

To our knowledge the Board itself has not conducted any further study of holding companies since 1960. Certainly, it has made nothing public. It recently embarked on such an inquiry as part of a \$500,000 study of the savings and loan industry as a whole, but the results of that study will not be available for another year or two. As a matter of fact, the only study of holding companies that has been conducted since 1960 was performed by Dr. Brigham. It is entitled "Savings and Loan Holding Companies: Their Development and Operations" and it was published last year by the Graduate School of Business Administration of the University of California at Los Angeles.

We have provided the Committee with a copy of Dr. Brigham's study, which hopefully will become part of the record of this Committee's proceedings on this legislation. The Brigham study contains a rich and thorough description of the reasons for the formation of savings and loan holding companies, and rather than attempt to summarize these reasons, I would respectfully refer the Committee to the study itself. Suffice it to say that the reasons for the formation of holding companies are varied.

The Brigham report also puts to rest, I believe, the notion that there is some meaningful comparison between savings and loan holding companies and the nefarious public utility holding companies of the twenties and thirties. In a word, there is absolutely *no* comparison between the two types of business.

The public utility holding company format was employed for the purpose of leveraging earnings and control. Through the pyramiding of relatively small equity interests in heavily debt-capitalized companies, promoters of the public utility holding companies were able to control billion-dollar empires with equity investments of but a few hundred thousand dollars. These structures were unsound from the start, and the legislation that was enacted in 1935 to control them was eminently sound.

Savings and loan holding companies, on the other hand, generally own the entire equity in the underlying savings and loan association. They have not been created for the purpose of leveraging, and their debt structures have been quite conservative. They have been formed primarily to facilitate public ownership and to achieve the benefits of diversification.

In view of the great lack of solid information relating to holding companies, we are dismayed that the Board should be pressing so vigorously for such radical legislation as it has proposed in S. 1542. It is particularly disturbing to us that in the midst of a half-million dollar study of this industry the Board should feel compelled to begin fighting for a bill that it has given no priority at all to in the last two or three Congresses. This is not merely another "stopgap" bill, such as the Spence Act. It pronounces a death sentence on diversification by holding companies, for it would require divestiture of non-savings and loan activities.

Presumably the purpose of the death sentence on diversification is to provide insurance against self-dealing and conflicts of interest within the holding company structure. But we respectfully submit that there is no evidence that conflicts or self-dealing have occurred to any significant extent. The Board itself has frequently bemoaned its lack of information about holding companies and its inability to secure information about the relationships among holding company affiliates. In 1963, for example, former Chairman Joseph P. McMurray stated before a Committee of Congress that the Board operates "in a hooded cockpit without any instruments to determine many of the relationships between holding companies and their subsidiary associations which might be critical for the national interest." In 1964 he again stated that "a veil exists between the controlled association and the parent company which the Board cannot penetrate."

It was only last year, in the Financial Institutions Supervisory Act, that Congress amended section 407(m) of the National Housing Act to give the Board power to examine the affairs of all affiliates of insured associations. The purpose of this provision was to give the Board power to explore fully the relationships between such associations and their affiliates and the effect of such relationship upon the associations. Yet the bill now before this Committee is the same bill the Board has proposed for a number of years. It is clearly not the result of discoveries made under their new supervisory powers.

We sincerely believe that before the Board asks you to destroy what we consider to be an economic form of great usefulness—both to the savings and loan industry and the public generally—it should be required to make the kind of thorough investigation it has heretofore not had the power to make. For this reason we fully support those portions of S. 1542 relating to registration and reporting by and examination of holding companies and their affiliates.

I might add that full disclosure is an accepted way of life for our members. All of our holding company members file extremely detailed registration statements with the Securities and Exchange Commission in connection with public issues of their securities, and each year when they elect directors they publish proxy statements in compliance with the SEC's very demanding regulations on proxy solicitation. Those located in California are subject to full reporting to and examination by the California Savings and Loan Commissioner, whose office is widely recognized as being the most effective state regulatory body in this industry. In addition, our members file a variety of financial reports with the SEC and the various stock exchanges on which their securities are traded.

Having stated that we support the disclosure provisions of S. 1542, I now want to summarize the Council's position on other major aspects of the legislation:

- 1 We are flatly opposed to any restrictions on the otherwise lawful activities that holding companies may engage in.

- 2 We are flatly opposed to the requirement that the holding companies must obtain prior approval of the Federal Home Loan Bank Board before incurring indebtedness.

- 3 We believe that holding companies should be permitted to grow in the savings and loan field by stock acquisition and merger under standards and procedures spelled out in the Act.

In our view, the legislation in its present form would have the result of severely inhibiting the flow of private capital into this industry. The consequence of that inhibition would be that this segment of the industry would be greatly handicapped in fulfilling its responsibilities of providing financing for the nation's housing.

In an appendix to this statement we have set forth, in the form of amendments to S. 1542, those changes which reflect the position I have just stated, as well as certain other changes we would like to propose. Each of these proposed amendments is followed by explanatory comment. At this point, however, I would like to elaborate briefly upon our major points.

HOLDING COMPANY ACTIVITIES

The very strict restrictions in S. 1542 upon holding company activities appear to be modeled upon a similar provision in the Bank Holding Company Act. We believe there are several factors relating to bank holding companies that make the Bank Holding Company Act a particularly inappropriate model for this provision:

1. The Bank Holding Company Act, of course, only applies to companies controlling more than one bank. There is, therefore, no limitation whatsoever upon the activities of companies owning but a single bank, and as this Committee is well aware from its hearings last year on this subject, the range of activities engaged in by the unregulated, single-bank holding companies, is extremely broad.

2. The operation of savings and loan associations is limited almost entirely to the making of mortgage loans and accepting savings deposits. Commercial banks, on the other hand, can not only make a wide variety of types of loans and accept a wide variety of types of deposits, but are permitted as well to engage in other varied activities. They can, for example, engage in equipment leasing, run an insurance agency, operate a travel agency, engage in the trust business, and invest in small business investment companies, to name but a few. Banks, moreover, are not subjected to geographical limitations, while savings and loans must confine their lending to an area within 100 miles of their home offices. In other words, diversification in the bank holding company occurs at the level of the controlled bank, whereas in our case it can only occur at the level of the holding company.

3. The rationale that led to severe restrictions on non-banking activities in the Bank Holding Company Act is not present in our industry. It is amply clear from the legislative history of the Bank Holding Company Act that the intent of Congress in restricting the non-banking activities of holding companies was to prevent conflicts of interest. Specifically, Congress was concerned that the holding company or its non-bank subsidiary might become preferred borrowers from the controlled bank. In other words, the concern was with self dealing. The potential for this type of abuse does not exist, to any significant extent, and can be easily controlled in the savings and loan industry, since savings and loans are only permitted to make secured mortgage loans.

In our view, the ability of the savings and loan holding company to diversify its activities is one of its most important assets. There are three chief reasons for this:

1. Through diversification the holding company is able to reduce the business risks and potentially unstable income flow that result from engaging solely in a business dependent upon the mortgage market. By engaging in a number of diverse activities, or by operating in several localities, the holding company can minimize the effects of a slack in demand in any one product or geographic market.

2. The ability to diversify is important in order to preserve the marketability of the stock of savings and loan associations. What option does the owner of a block of stock in a savings and loan association have when he wishes to diversify his investments, or what options does the executor of an estate consisting of savings and loan stock have when faced with the need to pay death taxes? He can attempt to find a wealthy individual to buy his block of stock, but this may be extremely difficult. He can attempt to sell the stock piecemeal to a number of buyers, but in doing so he would lose the value of having a large block. However, if he is permitted to sell his stock to a corporate purchaser he has a wide market and thus a far more liquid investment. The effect of enacting S. 1542 would be to destroy this market for savings and loan stock. Ultimately, the effect of such destruction would be to inhibit the creation of stock savings and loan associations and inhibit private capital from entering this vital industry.

3. Finally, use of the holding company format enables all of the owners in the underlying savings and loan to realize the benefits of the business opportunities that are generated in connection with the business of making mortgage loans. For example, home buyers will generally need residential insurance coverage, title insurance, and the service of an escrow agent and trustee. It is not an uncommon procedure in the savings and loan industry for the manager of the association or a few insiders to engage in these activities on their own, in connection with loans made by the association. When the holding companies provide these ancillary services, however, the economic benefit is shared by all of the

owners of the association, and not by a few insiders. In addition, the borrower is given the added protection of being able to know with whom he is dealing, since the conduct of these activities by the holding company is fully public and the relationships are fully disclosed.

To sum up, diversification means strength, and Congress should move with great caution before purposely weakening a financial institution. We submit, moreover, that it is wholly unnecessary for Congress to enact a death sentence for diversified holding companies in order to achieve the purposes the Board wishes to achieve. With the very extensive disclosure powers that the Board has and will get under this legislation, together with the provisions requiring Board approval for transactions between affiliates and the Board's existing powers to issue cease-and-desist orders against unsafe and unsound practices, the Board has all the tools it can reasonably ask for to prevent conflicts of interest and self dealing. Certainly, such a drastic step should not be taken while the Board itself is in the midst of conducting its first significant study of this industry in seven years.

The Council supported the Financial Institutions Supervisory Act, and we will support all reasonable restrictions on self dealing and conflicts of interest. As a matter of fact, all of our California members have long been required to secure prior approval from the State Savings and Loan Commissioner before engaging in transactions with affiliates. We are accustomed to this type of regulation. In short, it is our view that it would be senselessly destructive to enact these severe limitations on holding company activities. Indeed, it would deprive the industry of a great source of strength.

HOLDING COMPANY INDEBTEDNESS

Our primary objection to the proposal for requiring prior approval by the Board of holding company indebtedness is that it is simply unnecessary. Presumably, the rationale for this provision is that when the holding company incurs excessive debt, pressure is exerted upon it to extract earnings from the subsidiary association in the form of upstream dividends. Yet with its present power to issue cease-and-desist orders against unsafe and unsound practices, and the requirement in S. 1542 of prior notification to the Board of the issuance of a dividend, the Board is fully able to control the harmful extraction of earnings from the subsidiary savings and loan.

We submit that the Board has no proper function interfering with the otherwise lawful activities of a holding company unless those activities present a clear threat to the interest of the federal government as insurer of the savings accounts of the subsidiary association. Yet the proposed provision relating to holding company indebtedness would require a diversified holding company, such as National General Corporation, a relatively small portion of whose earnings is derived from its savings and loan association, to come to the Board when it wanted approval for the issuance of debt to construct a new movie theatre. As a matter of fact, under this bill the Board could not approve such proposed indebtedness. There is no comparable provision in the Bank Holding Company Act, and we believe that it is unprecedented for an agency whose responsibility is as narrowly defined as the Federal Home Loan Bank Board to expand its jurisdiction into areas of corporate operation that may have little or no relation to the savings and loan industry.

It is common in this industry for the holding companies to inject capital into their subsidiary associations. The Board's own figures show that since 1959 holding companies have contributed over \$35 million to their savings and loan associations. This type of capital infusion can only be performed by the holding companies. Again, the Board is proposing to deprive the savings and loan industry of a source of great strength, namely the ability of the holding companies to go into the capital markets for the benefit of the insured association. We believe this is bad policy.

I wish to emphasize again that the public utility holding company experience cannot be used as a model for this proposal. The public utilities themselves, as well as the holding companies, were heavily debt-capitalized. Indeed, the very purpose of these holding companies was to use debt capital for the purpose of leveraging equity ownership and earnings. As Dr. Brigham's report shows, the savings and loan holding companies have been extremely conservative in their use of debt capital. The average capital structure of the publicly held companies is approximately 20 percent debt and 80 percent equity.

HOLDING COMPANY GROWTH

The Board's bill makes no provision whatsoever for holding companies to acquire additional associations, except in cases where an association is threatened with involuntary liquidation. In other words, the Board proposes to continue the 1959 "freeze" forever.

We believe that this position is unsound as a matter of public policy, and frankly we have difficulty understanding it. We do not understand the Board to argue that holding companies are evil *per se*, for even the Board would continue to permit the free creation of single-association holding companies. This being the case, why should not holding companies be permitted to grow by stock acquisition or merger, subject to the approval of the Board under standards set by Congress? Under existing law and regulations the Board must approve *all* mergers of insured savings and loans, and all savings and loans other than those in holding companies may merge with Board approval. As long as the Board has this power, there can be no rational fear of uncontrolled holding company growth. To continue a flat ban on growth is thus to discriminate without reason against one segment of the industry.

Indeed, there may be many occasions where the public interest would be well served by integrating a small or shaky institution into a strong holding company under circumstances far short of a threat of involuntary liquidation. One would think that the Board, having some broad responsibilities for the health of this industry, would want more flexibility in solving problems than it has asked for under this bill.

In conclusion, we believe that the wisest course for this Committee to follow would be to give the Board additional powers to get the information it needs to understand thoroughly the operations of holding companies, and to require the Board to complete a thorough study of the industry before proposing radical surgery as a cure for the problems it can only theorize about now. In addition, we believe it is reasonable for the Board to have some powers, in addition to its cease-and-desist powers, to control transactions among affiliates of a holding company, and we have raised no objection to the portions of S. 1542 that would grant such powers. However, it would be unwise, we submit, and needlessly destructive, to shear the strength of an important segment of this important industry in the face of an admitted lack of information. In its present form S. 1542 would achieve that result.

PROPOSED AMENDMENTS TO S. 1542

The following are proposed amendments to S. 1542. All page and line references are to the official text of the bill, as introduced by Senator Sparkman on April 14, 1967.

Material that is to be deleted from the bill as introduced will be set forth in brackets and stricken through; new material will be underlined.

PROPOSED AMENDMENT NO. 1

Section 408(c), page 5, line 25 through page 7, line 10:
Delete the entire section as presently drafted.

COMMENT ON PROPOSED AMENDMENT NO. 1

This amendment reflects the Council's opposition to *any* limitations upon the otherwise lawful activities of holding companies. It would eliminate entirely the prohibitions against holding company engagement in activities other than the narrow range permitted by the bill.

This amendment also reflects our dissatisfaction with the prohibition in the bill against a holding company performing activities "for or on behalf of" the association that the association could not perform itself. The bill's language in this respect is very broad and could be interpreted to prohibit almost any activity by the holding company. We believe the Board should be required to clarify its intentions and to propose new and more specific language.

PROPOSED AMENDMENT NO. 2

Section 408(d) (4), page 7, line 20 through page 8, line 3:
"(4) make any loan, discount, or extension of credit [to (A) any affiliated], except in a transaction authorized by subparagraph (A) of paragraph (6) of

this subsection, to (A) any affiliate, or (B) any third party on the security of any property acquired from any affiliate, or with knowledge that the proceeds of any such loan, discount, or extension of credit, or any part thereof, are to be paid over to or utilized for the benefit of any affiliate;

COMMENT ON PROPOSED AMENDMENT NO. 2

The purpose of this amendment is to permit an association to make a loan on the security of property acquired by the borrower from an affiliate of the association, so long as the prior approval of the Board is obtained.

PROPOSED AMENDMENT NO. 3

Section 408(d) (5), page 8, lines 4-6:

"(5) guarantee the repayment of or agree to maintain any compensating balance for any loan or extension of credit granted to any affiliate by any third party;"

COMMENT ON PROPOSED AMENDMENT NO. 3

The bill proposes to prohibit an association from using its funds to maintain compensating balances for loans to its affiliates. Since the holding company may have a well-established banking relationship with a bank that is also the depository for the subsidiary association, this language may be broad enough to interfere with this relationship even though there is no understanding about the maintenance of a compensating balance. Thus, we propose that the restriction be clarified to provide that only an agreement to maintain a compensating balance shall be unlawful.

PROPOSED AMENDMENT NO. 4

Section 408(d) (6) (A), (D) and (C) page 8, line 18, page 9, lines 8 and 17. Change the words "lesser of \$100,000 or 0.1 per centum" to read "greater of \$100,000 or 0.1 per centum."

COMMENT ON PROPOSED AMENDMENT NO. 4

The bill proposes to limit annual asset transactions and management agreements between a controlled association and its affiliates to an aggregate of the lesser of \$100,000 or 0.1 percent of the association's assets during any year, unless prior approval is granted. This would mean that any association having assets in excess of \$100 million would be subject to the \$100,000 limit. We believe that the 0.1 percent ratio should be maintained in the cases of associations whose assets exceed \$100 million. These transactions will naturally bear a relationship to the size of the association and the larger an association is, the larger, the aggregate of such transactions is likely to be. To enact a flat ceiling of \$100,000 unreasonably discriminates against the larger associations.

PROPOSED AMENDMENT NO. 5a

Section 408(e) (1), page 10, line 3:

"(e) ACQUISITION.—It shall be unlawful, except with the prior approval of the Corporation, for —"

PROPOSED AMENDMENT NO. 5b

Section 408(e) (2), page 11, lines 13-19:

Delete present text and substitute the following:

"(2) Upon receiving from a savings and loan holding company any application for approval under this section, the Corporation shall within thirty days thereafter notify the applicant in writing of the date for commencement of a hearing by it on such application. Any such hearing shall be commenced not less than ten nor more than thirty days after the Corporation has given such notice. The length of any such hearing shall be determined by the Corporation, but it shall afford all interested parties a reasonable opportunity to testify at such hearing. Within 120 days after, the Corporation shall by order grant or deny the application on the basis of the record made at such hearing. The Corporation shall not approve—

(i) any proposed transaction under this section which would result in a monopoly, or which would be in furtherance of any combination or con-

spiracy to monopolize or to attempt to monopolize the savings and loan business in any part of the United States, or

(ii) any other proposed transaction under this section whose effect in any section of the country may be substantially to lessen competition, or to tend to create a monopoly, or which in any other manner would be in restraint of trade, unless its finds that the anticompetitive effects of the proposed transactions are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served.

In every case, the Corporation shall take into consideration the financial and managerial resources and the future prospects of the savings and loan holding company and the insured institutions concerned, and the convenience and needs of the community to be served."

COMMENT ON PROPOSED AMENDMENTS NOS. 5a AND 5b

These amendments would permit holding companies to acquire additional insured institutions, by merger, consolidation, or asset or stock acquisition, subject to prior approval by the Corporation. The standards and procedure set forth in the amendment are substantially identical to those found in the Bank Holding Company Act of 1956, as amended in 1966.

PROPOSED AMENDMENT NO. 6

Section 408(e), page 12, following line 9:

Add the following new paragraph:

"(4) Nothing in this section shall be construed to prohibit any company that does not control and is not affiliated with an insured or uninsured institution from acquiring in a single transaction control of the subsidiary insured institution or institutions of a savings and loan holding company."

COMMENT ON PROPOSED AMENDMENT NO. 6

Although the bill would not prohibit the creation of new single-association holding companies, section 408(e)(1)(B) prohibits the creation of new holding companies that would, by reason of simultaneous acquisitions, control more than one association at the time the holding company itself is formed. It seems clear that the primary purpose of this section is to limit the number of uncontrolled associations that might come under holding company control. The effect of the language, however, is to prevent a company that controls *no* associations from assuming control of a group of associations that already belong to a holding company. Since no new associations would be brought under holding company control by such a transaction there seems no reason to forbid it. To prohibit such a transaction, moreover, is to limit substantially the market for the holding company's stock. The purpose of this amendment is to make clear that a company may in a single transaction acquire control of associations that are already owned by a holding company.

PROPOSED AMENDMENT NO. 7

Section 408(g), page 12, line 20 through page 14, line 23:

Delete this section entirely.

COMMENT ON PROPOSED AMENDMENT NO. 7

The purpose of this amendment is to delete the requirement of prior approval for debt insurance by the holding company.

Mr. BRIGHAM. Mr. Chairman, in the limited time available to me, I would like to confine my remarks to the matter of diversification. There are three basic types of diversification that are recognized in economic literature. First, there is geographic diversifications; second, vertical integration; third, there is what might be called conglomerate diversification, which involves moving into product lines that bear little relationship to the firm's primary output.

Each of these three types of diversification can reduce the total risk inherent in savings and loan enterprises, but the scope for risk reduc-

tion by each type of diversification is somewhat different. In vertical integration, for example, the firm engages in activities related to real estate operations and this is unlikely to have much potential for reducing risks, since construction lending, insurance operations and all other related activities, mortgage lending, are likely to fluctuate much in the same manner as does mortgage lending.

However, the other two types do seem to offer significant scope for reducing enterprise risk. Geographic diversification can reduce risk, especially when the S. & L. diversifies outside of a single metropolitan area.

Conglomerate diversification probably provides the greatest scope for risk reduction. It is a well established fact that consumer lending and residential mortgage lending, are not perfectly correlated. Therefore, if an S. & L. were to expand into personal loans, its earnings stream would be somewhat stabilized. If this product line of diversification were extended even further, there would be even more scope for risk reduction. Real estate activity is countercyclical to most other economic activities, so when a savings and loan firm is associated with a firm in some other line of activity, then the total enterprise risk is significantly reduced. This risk reduction occurs when such firms as MCA, Inc., Jim Walter Corp., National General Corp., American National, Sears Roebuck and similar firms, acquire savings and loan associations.

It also seems to me there are some social benefits from diversification. These benefits accrue to all of the participants in the S. & L. activity, to the employees, guarantee stockholders, to the Federal Savings and Loan Insurance Corporation and to depositors. The reasons for the social advantages seem to lie in the fact that the demand for funds shifts from sector to sector during different periods. In one period, mortgage demand may be relatively strong. We had this in California in the early 1960's. In another period, business demand may be strong; while in still others, State and local governments or consumers may be seeking funds most vigorously.

If we have a system of specialized lending institutions, then funds have to shift between lending institutions if they are to flow where they are most needed. This causes dislocations. Some institutions are left with excess capacity in terms of their organizational ability to generate deposits and to make loans, while others, whose specialized loans are in strong demand, are straining at the limits of their capacity.

Now I think one important consideration that would have to go into this is since we do have these shifts that take place, and it is particularly true in real estate—where you have a long leadtime and changing fundamental conditions—that you have to be sure that there is some fair share of the available funds allocated to the mortgage market.

I think that is one of the things that this committee, particularly the Subcommittee on Housing, would want to be aware of. I think it is pretty clear how holding companies would achieve diversification and through diversification the ability to reduce risk.

First, if a holding company controls the stock of two or more associations, and if these associations are operated in different areas, then you get increased geographic diversification. This can be particularly

important in a State like California or any State that has defense-oriented communities. If you have one association that is tied directly to the area and is not diversified geographically, then this can present certain problems.

If the savings and loan associations are affiliated with firms that are in other activities, other businesses than real estate, then you get significantly lower risks and this can take the pressure off savings and loan management to keep itself occupied, keep itself going when the real estate activity is particularly depressed. Again, California illustrates this.

What we have had in California is a buildup and then we had a significant downturn in immigration which significantly affected the demand for housing. The problems that can come up when you have an oversupply of housing could be significantly alleviated by having diversified multiproduct line savings and loan holding companies.

I would like to make one statement on this. There conceivably are certain antitrust considerations that should be considered and these are included in my prepared statement.

Second, it is true that in certain types of holding companies, particularly public utility holding companies, the ability to issue debt securities has been abused. This doesn't seem to have happened in the savings and loan business, but clearly this is something that should be considered and does require further study.

Finally, there is the issue that has been raised by holding companies having conflicts of interest, dealing between firms. Again the counter-prohibitions have been brought up to deal with this and this is a good thing.

Now, all of the potential problems could be solved by severely limiting holding company activity, but this seems to be undesirable, although it is necessary that the regulatory authorities be informed of potentially dangerous situations. This again leads us back to the approach that has been evolving in California where the commissioner gets holding company reports and then combines these with a flexible set of savings and loan regulations.

This would enable us to alleviate the potential abuses of savings and loan holding company systems without at the same time eliminating actual benefits that they seem to be contributing toward improving the performance of the industry.

Thank you.

The CHAIRMAN. Thank you very much.

(Mr. Brigham's full statement follows:)

STATEMENT OF EUGENE F. BRIGHAM,¹ GRADUATE SCHOOL OF BUSINESS ADMINISTRATION, UNIVERSITY OF CALIFORNIA

DIVERSIFICATION AND SAVINGS AND LOAN HOLDING COMPANIES

The two decades since the end of World War II have witnessed some remarkable changes in the savings and loan industry. Entering the postwar period as a

¹ Professor and chairman, Division of Finance, Real Estate, and Business Economics, Graduate School of Business Administration, University of California at Los Angeles. This paper is based largely on the author's books (1) "Savings and Loan Holding Companies: Their Development and Operations" (UCLA, real estate research program, 1967), and (2) chapters 26 and 27, *Mergers and Holding Companies and Financial Aspects of Mergers*, of "Managerial Finance, Second Edition" (New York: Holt, Rinehart and Winston, 1966), coauthored with J. Fred Weston. The opinions contained herein are, of course, the sole responsibility of the author.

collection of small, local firms, many of them housed in second-story offices and staffed by part-time employees, the savings and loan business has emerged as a giant financial industry with many large, modern institutions. Fastest growing, and containing the largest and probably the most modern firms, is that segment of the industry controlled by holding companies.

At the end of 1965 there were 92 companies controlling 12.2 percent of total S&L assets, and these companies operated in 11 states. California was by far the most important holding company state, having 50 companies and 84 percent of total holding company assets. Of the 92 companies, 46 were publicly owned, but they were generally large and had 76 percent of total holding company assets. All of the companies, but especially the public ones, have experienced rapid growth as measured by any standard. From 1959 to 1965, holding company-controlled S&L assets grew from \$4.3 billion to \$15.8 billion, or at an annual rate of 25 percent. This compares with a growth rate of about 12 percent for all U.S. associations during the same time span. Holding company growth would doubtless have been much faster in the absence of Federal restrictions on holding company acquisitions of stock associations and on conversions of mutual S&Ls to capital stock companies.

A number of reasons have been advanced for the growth and development of S&L holding companies.² By far the most important of these reasons, however have to do with aspects of diversification, which is the main topic explored in this paper.

I. THE ENTERPRISE SYSTEM

The business firm is the foundation upon which our productive and distributive system is built, and under this system the United States has become the most prosperous and productive country the world has known. This system, which in economics is called the "Theory of the Firm" and which more generally is known as the "Enterprise System," is based on the theory that firms seek profits, and that in their quest for profits they produce and distribute the assortment of goods most desired by society. Competition forces firms to produce in the most efficient manner and, therefore, at the lowest possible cost.

The theory has never worked perfectly; in certain industries conditions lead to monopoly, and monopoly, in turn, has led to the set of social controls embodied in the anti-trust provisions. Also, some activities, such as stock market manipulation, produce harmful effects and must be curbed in the interest of society. In addition, since some goods—for example highways—cannot be produced effectively in the private sector, they must be produced by governmental units. There are also industries whose fundamental importance to the economy necessitates some governmental controls in the interest of stability—banking is a good example of this. Finally, certain industries are used as instruments of federal policies in the quest to attain specific social goals—the use of the banking system to influence the general economy, or stimulating housebuilding by stimulating S&Ls, are examples. With these modifications, the enterprise system has produced demonstrably superior results than has its alternative—socialism.

Given the good record of the enterprise system, one must be quite sure of himself before condemning one of its new creations. The world is dynamic and subject to frequent change. Technology advances, tastes change, new products are created, and the enterprise system must be sufficiently fluid and flexible to adapt to these new developments. Thus far, the enterprise system, with the enumerated modifications, has met these challenges with distinction.

Our economic system has developed in an evolutionary manner. When technology was such that farming, retailing, and cottage manufacturing constituted the bulk of our economy, the business firm was synonymous with the individual. This was the era of the sole proprietorship. As technology advanced, manufacturing and commerce were carried on by larger firms. This led to the use of the partnership. As mass production and distribution techniques became available, the partnership grew into the corporation. Continued economic progress has led to large, multi-divisional corporations and to the ultimate development in the corporate structure—the holding company.

In general, the name "holding company" has an unfavorable connotation that is undoubtedly related to the infamous practices of some public utility holding companies during the 1920s. This is unfortunate, for most present-day holding companies—be they bank holding companies, manufacturing holding companies,

² For an enumeration, see Brigham, "Savings and Loan Holding Companies," *op. cit.*

or savings and loan holding companies—bear no relationship to the early public utility holding companies, save their name. Therefore, it is most important to judge savings and loan holding companies on their own merits, and not to find them guilty by association with the early public utility companies. A carefully reasoned and objective analysis will show that savings and loan holding companies may well be not only a desirable evolutionary product of our enterprise system but one that has tended to increase the effectiveness of the savings and loan industry as well. This has not been conclusively demonstrated, but preliminary evidence suggests that S&L holding companies, controlled to some extent, can confer a positive benefit on society.

II. ECONOMIES OF SCALE

Why were savings and loan holding companies created? They were begun for the same reasons that partnerships grew from proprietorships, and corporations from partnerships—because these new forms of organization enabled business firms to provide services at lower costs than was possible with the pre-existing forms of organization. This is a fundamental point, but one whose very simplicity often causes it to be overlooked.

Why is it that savings and loan holding companies have advantages over independent savings associations? There are actually several reasons for this, the first of which is the matter of economies of scale.

By comparison with most industries, the savings and loan business consists of relatively small firms. A great deal of evidence suggest that there are certain types of economies of scale in savings and loan operations. Because of these potential economies, the enterprise system is stimulating savings and loan firms to become larger. Holding companies, by facilitating growth in firm size, help the industry to move toward this optimum size structure.

Operating costs

What economies of scale are there in savings and loan operations? First, there seem to be at least some cost advantages to size—larger firms generally can produce at a somewhat lower cost per unit. Really satisfactory cost studies for the savings and loan industry are not yet available, but the studies that have been produced suggest that operating economies of scale in the business are relatively minor.

Capital costs

A second type of scale economy, and one which is clearly present in the savings and loan business, deals with raising capital. It is a well-known fact that larger firms can obtain both debt and equity capital at a lower cost than is available to small firms. Capital—both debt and equity—is a necessary ingredient in any business, and if it can be obtained more cheaply by large firms, then there are clearly advantages to larger size. One may lament this fact and wish that small firms could obtain money at the same cost as larger ones. Fortunately for the economy, policymakers, in their attempts to bring about equality, have deemed it better to aim at decreasing the cost of capital to small firms rather than at preventing the growth of large efficient economic units.

Feasible types of output

A third potential source of economies of scale lies in the fact that larger firms are frequently able to do things that smaller firms cannot do. As manufacturing and retail firms grow, commercial banks find it necessary to grow if they are to provide a full range of services to their customers. The same thing holds true in the savings and loan business. Single family homes are now being produced by large-scale builders, who need large loans. Similarly, our increased trend toward urbanization has led to higher and higher population densities, and this, in turn, has increased the development of large-scale apartment complexes. These big apartment units, like the far-reaching single family tract, require large-scale financing. Larger savings and loan associations are better suited to meet this new need than are smaller associations.

Savings and loan holding companies have several different ways of increasing the size of savings and loan enterprises. For one thing, where geographic lending limits have prevented the individual S&L from expanding by adding branches, the holding company has been able to group together several small S&Ls into one large enterprise. Holding companies have also created larger economic enterprises by combining savings and loan associations with related businesses.

California Financial Corporation, for example, has combined a savings and loan association with a mortgage-banking operation and several other related types of business. The combined enterprise is able to function with one top management, one set of data processing equipment, and so on, and thereby has gained operating economies. In addition, California Financial is large enough to have obtained a listing on the New York Stock Exchange; the individual enterprises, taken separately, would not have been large enough to list their stock and, thus, to obtain the attendant reduction in the cost of equity capital.

The trend in scale economies

Developments in the economy are increasing the limits of economies of scale. The 1950s and 1960s witnessed a rapid and wide-scale development of management control techniques and devices. These include operations research and accounting developments, as well as the increased use of electronic computers. The primary results of these developments are that (1) closer coordination and control has led to a decline in the cost of services, (2) the build-up of corporate staffs and the use of computers has increased overhead cost, making it necessary to spread these costs over a larger operation, and (3) closer control and better coordination made possible by these developments have enabled management to effectively control large, diverse organizations.

Every indication is that these trends will continue into the future. This suggests that the optimum size for savings and loan enterprises will be larger and larger as time goes by. To the extent that holding companies enlarge the S&L enterprise, they should become increasingly important in the future if regulations permit.

III. REDUCTION IN RISK THROUGH DIVERSIFICATION³

Three basic types of diversification are generally recognized in economic literature. First, there is geographic diversification, which refers to extending the geographic scope of market coverage. Second, there is vertical integration, which means that the diversified firm expands backwards, to produce materials used in its own operation, or forward, to use its own primary output in a higher process. When savings and loan associations engage in construction lending and, even more, when they engage in land development, they are practicing vertical integration. Conglomerate diversification is the third type. It involves moving into product lines that bear little relationship to the firm's primary output.

Income stabilization

Why is it that diversification is thought to lower the total risk of an enterprise? The reason is that a diversified firm generally has a relatively stable earnings stream. This principle is demonstrated in Figure 1. The vertical axis of the graph measures the firm's gross income, and the horizontal axis shows the time period. The cash flows necessary to meet fixed charges are shown as a horizontal line, while cash flows generated from Product A (or Market A) and Product B (or Market B) fluctuate. If the firm produced only one product, or if it operated in only one market, then cash flows would periodically fall below cash requirements. However, by engaging in product line or geographic diversification, the firm is able to stabilize cash flows well above the minimum requirement. Clearly, risk has been reduced.

The illustration in Figure 1 implies a perfect negative correlation between the products or geographic markets. This ideal is seldom, if ever, realized in practice—generally, the two curves tend to cycle together. However, unless the two curves cycle perfectly together—something which, again, seldom happens in practice—diversification still reduces risk. In general, the closer the correlation between the cycles of the two products or markets, the less the reduction in risk by diversification.

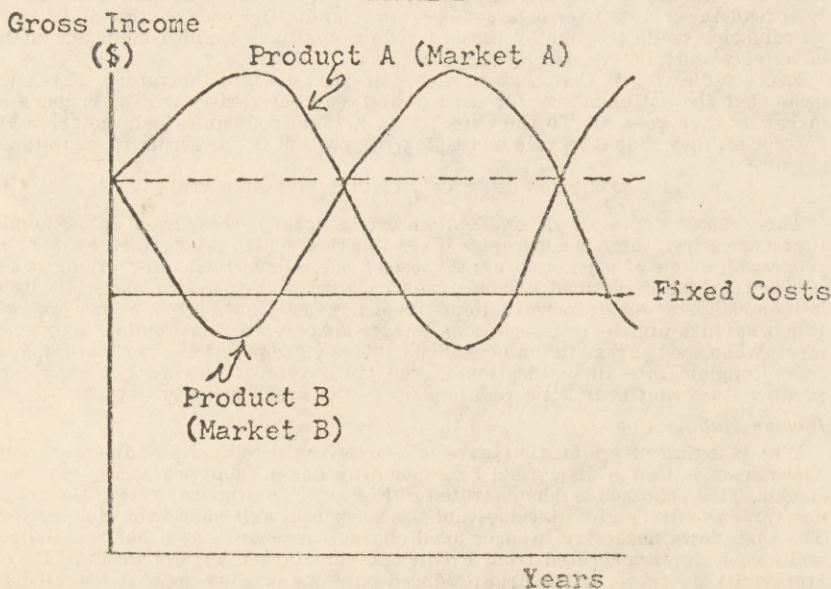
Scope for Risk Reduction by S&Ls

Just how much scope is there for savings and loan enterprises to reduce their risk by greater diversification? The answer to this question depends largely on the individual situation and the type of diversification that is practiced. Although vertical integration appears unlikely to have much potential for reduc-

³ Portfolio theory, the formal treatment of the relationship between risk, return, and diversification, had its beginning in 1952 when the article "Portfolio Selection," by Harry Markowitz, appeared in the "Journal of Finance." Markowitz's work has had a profound impact on the fields of corporation finance, investments, and industrial organization, and it is the primary basis for this section.

ing risk since construction lending, insurance operations, and so on fluctuate in much the same manner as does lending on completed homes and apartments, it might provide other benefits. For example, it might create a larger enterprise with economies of scale. But this type of diversification would not seem to do much in the way of reducing risk. Geographic diversification, on the other hand, does have some scope for risk reduction. This occurs if an S&L in a particular geographic area expands its lending and savings operations throughout a broad metropolitan area. Then if, for whatever reason, one part of the metropolitan area suffers a decline, other parts may take up the slack. Even more scope for risk reduction is provided by geographic diversification outside a single metropolitan area. When this broader geographic diversification is practiced, recession in a local area does not necessarily jeopardize the entire operation. Some good examples of this have been provided in the Southern California region, where large defense contracts have tended to shift somewhat from area to area.

FIGURE 1



Conglomerate diversification probably provides the greatest scope for risk reduction in the savings and loan business. It is a well-established fact that consumer lending and residential mortgage lending are not perfectly correlated. Therefore, if an S&L expanded into personal loans, its earnings stream would probably be stabilized somewhat. If this product line diversification is extended even further, there is even greater scope for risk reduction.

It is a well-established fact that real estate activity is countercyclical to most other forms of activities. Therefore, if a firm that is closely tied to the real estate market—and an S&L certainly is—merges with a firm in some other line of activity, then the total corporate risk doubtless is reduced for the combined enterprise. This risk reduction occurs when such firms as MCA and Sears Roebuck acquire savings associations.

Beneficiaries of Lower Risk

Who benefits if diversification lowers risk? All participants in the savings and loan activity do—employees, guarantee stockholders, the FSLIC, and depositors. First, employees clearly benefit by being a part of a more stable enterprise. It is nerve racking from management's point of view to manage an unstable enterprise, and non-management employees are certainly better off if they can avoid the periodic lay-offs that occur in fluctuating businesses. Second, guarantee stockholders benefit because earnings and stock prices will be relatively stable.

Finally, the FSLIC benefits for obvious reasons, as do the S&L depositors, to the extent that their positions are not already covered by the FSLIC.

IV. SOCIAL ADVANTAGES OF DIVERSIFICATION

Economists, regulators, and other interested parties question the rationale for the existing financial structure: Could the total cost of financial intermediation be reduced by permitting greater diversification? Also, could allocational efficiency be increased if our financial institutions were more diversified in both the lending and the borrowing markets?

During the years preceding 1963, the savings and loan industry expanded rapidly to meet the growing demand for mortgage funds. The industry, especially in the more rapidly growing sections of the country, was geared for growth. Firms were opening new branches at a rapid rate, were advertising heavily, and were buying savings through brokers. At the same time, the Federal Home Loan Bank System was following expansionary practices. Among other things, it was encouraging the use of FHLB advances and participating loans. The industry had momentum, and funds were pouring in at a rapid rate.

Loan demand in 1963 was reasonably strong, but not strong enough to absorb the funds at the rate that they were flowing into the industry. Rather than cutting back on their inflows and thereby reducing their rate of growth, significant segments of the industry put the new deposits to work by encouraging builders to construct new houses and apartments, by lending to marginal borrowers, and by reducing downpayment requirements. This obviously could not continue—and it did not. Housing starts greatly exceeded the demand for new housing in 1963, while the heavy flow of funds into the S&Ls caused overbuilding to continue into 1964. By the end of that year, the excess supply of housing was acute.⁴

Most observers argue that such a pattern of events is not desirable since sharp expansions and contractions in particular sectors of the economy are not conducive to efficiency. Many also attribute these particular developments to the degree of specialization practiced by financial institutions. If our intermediary system had consisted of diversified lenders, the flow of funds channeled into residential mortgages probably would have been reduced as early as 1962 or 1963. This would have prevented the flow of funds into the housing markets that induced the sharp construction cutback in 1965 and 1966.

Some would also argue that the disruptive construction decline was made overly severe by the reduced flow of funds into the savings and loan industry during 1966. S&L portfolios turn over relatively slowly and carry fixed interest payments. Commercial banks portfolios, on the other hand, turn over rapidly and can be adjusted to reflect higher yields when interest rates in the economy increase. When rates rise rapidly, as they did during 1966, the S&Ls are at a relative disadvantage vis-a-vis commercial banks. Banks are most profitable and are best able to compete for savings during periods of tight money—provided that they are not unduly hampered by Regulation Q.

Not being mortgage specialists, and in many cases not being particularly interested in mortgage lending, the banks have tended to channel their inflows of funds into non-residential markets. This has led to a drought in the residential mortgage market.

The argument continues that if the banks had not been restricted in their mortgage market operations for so long by Regulation Q and by the rather severe limits on their ability to compete for conventional loans in terms of maturities and down payment requirements, banks would probably have channeled a larger part of their 1966 inflows into the mortgage market. This would have benefited construction and kept it from declining as far as it did.

This theory can be generalized: The demand for funds shifts from sector to sector during different periods. In one period, mortgage demand may be relatively strong; in another, business loan demand may be strong; while in still others, state and local governments or consumers may be seeking funds most vigorously. In a system of specialized lending institutions, funds must shift between lending institutions if they are to flow where they are most needed. This causes dislocations—some institutions are left with excess capacity in terms of their organiza-

⁴ See my paper "California Housing and Mortgage Markets: 1950-1966," submitted to the Subcommittee on Housing and Urban Affairs of the U.S. Senate Committee on Banking and Currency, May 1966, for details on this point.

tional ability to generate deposits and to make loans, while others, whose specialized loans are in strong demand, are straining at the limits of their capacity. The logical conclusion to this argument is that it would be much more efficient for funds to flow internally within diversified institutions. The argument has not been proven in any sense of the word, but it does have a certain amount of logical appeal.

There is, of course, a counter to this argument. Stimulating home construction is one of our National goals, and one way to stimulate home building is to encourage the growth of financial institutions that specialize in home mortgage lending. There is a valid point to this argument, but it seems to most observers that the social cost of transferring funds between specialized lenders rather than within diversified lenders exceeds the social gains.

It might be observed that practically every careful inquiry into this question has concluded that diversification is preferable to specialization in financial intermediation. For example, the report of the Commission on Money and Credit, which was based on eighteen separate research volumes by some of the foremost economists in the U.S., came out with a strong recommendation in favor of both geographic and product line diversification. This recommendation, especially if it is combined with the obvious attempt of a major segment of the savings and loan industry to diversify and with the good record that our enterprise system has had in producing and distributing goods and services, strongly suggests that diversification should be encouraged, not discouraged.

V. HOLDING COMPANY OPERATIONS

How do holding companies enable the S&L industry to obtain the advantages of large size and of diversification described above? First, if a holding company controls the stock of two or more associations, it effectively combines them into a larger economic unit. If the separate associations operate in different areas, then geographic diversification is also increased. Further, the holding company can engage in such related activities as mortgage banking, operating an insurance agency, and so on. This further increases the size of the economic unit and, also, brings about whatever risk reduction advantages can be obtained from vertical integration. Finally, if the savings and loan holding company is widely diversified and has activities in product lines unrelated to the real estate business, then the risks to the enterprise may be significantly lowered.

Distribution of ancillary income

Some of these advantages, particularly those associated with vertical integration, may be obtained without the holding company structure. Both the owners of most stock S&Ls that are not affiliated with holding companies and the managers of most mutual S&Ls have insurance brokerage businesses, escrow companies, and so on. However, if the unaffiliated stock companies' guarantee stock is widely held, then the income from the ancillary activities accrues only to those stockholders who control the association. And in the case of mutuals, which are supposedly owned by the depositors, ancillary income goes to management, not to depositors. If one questions the equity of this distribution of ancillary activities' income, which can be quite significant, then a good case can be made for holding company operations. The holding company can own the stock of the S&L and can also own the related businesses. All of the income from all of the activities accrues to the holding company. In this way, stockholders all share equitably in the total income of the enterprise. This virtue of holding company operations is important when stock companies are widely held, particularly if they are publicly owned.

Cost of Capital

Another advantage of the holding company organization is the fact that it facilitates the acquisition of capital. For one thing, there is clear evidence that savings associations should have more long-term debt capital. The industry makes long-term loans, but it obtains most of its capital in the form of withdrawable deposit accounts. Its assets are illiquid, but its liabilities may be withdrawn on very short notice. The capital and reserve accounts provide long-term capital, but it is not feasible for these sources of funds to provide as much permanent capital as a growing S&L needs. One solution is for the S&L to borrow on long-term debentures. Long-term debentures have been used to strengthen the commercial banks' capital position, but prohibitions against long-term debt have prevented their wide-spread use in the S&L industry. However, the prohibitions

apply to the S&Ls themselves, not to the holding companies, so it is possible for the latter to sell bonds and to use the proceeds to buy stock in their affiliated savings associations. Since long-term debt capital is cheaper than equity capital, the net result is that holding company affiliates are able to obtain funds at a relatively low cost.

It should be mentioned that holding companies' ability to use debt is not an unmixed blessing. For one thing, there are cases of the holding company, at its formation, selling bonds and using the proceeds to buy the guarantee stock of the acquired associations. In such cases the proceeds from the holding companies' debt are not put into the S&Ls; rather, they are used to buy the S&Ls' stock. In such cases debt is being used to replace equity in the consolidated S&L enterprise.

If debt at the holding company level is excessive, then this can create potential dangers. The holding company must service its debt, and in order to do so it may withdraw funds from its affiliated S&Ls at a time when the S&Ls themselves need the money. This potential danger must be recognized, and attempts should be made to deal with it.

This is an extraordinary complex area. If S&L holding companies are permitted to obtain the significant advantages of vertical and conglomerate diversification, then they will end up with very different types of asset structures. For example, some S&L holding companies will be engaged in retailing, insurance, manufacturing, and so on. What might constitute relatively little debt, given one type of asset structure, might well be excessive for a holding company with other types of assets. The simplest solution to the problem would undoubtedly be to restrict holding company operations and to make all holding companies fit into the same mold. Since this, of course, would eliminate most of the advantages to the holding companies' operations, it is to be hoped that a better solution can, and will, be reached.

VI. MONOPOLY CONSIDERATIONS

Holding companies clearly lead to larger economic enterprises, and larger economic units necessarily involve a higher degree of concentration than smaller units. Therefore, the question must be raised whether concentration resulting from savings and loan holding companies has been or is likely to substantially reduce competition in savings and mortgage markets.

Since holding company operations are largely concentrated in California, and since California associations are, on the average, far larger than those in any other part of the country, it is appropriate to examine the California experience. Two major studies have been conducted on savings and loans in California—one in 1962 by Professor Shaw of Stanford University and another in 1963 by Professors Grebler and Brigham of UCLA. The studies reached different conclusions on the state of competition, Shaw concluding that elements of oligopoly were present, Grebler and Brigham finding competition to be relatively keen. These two works were examined and compared by Professor Murray Polakoff, Chairman of the Department of Economics at New York University, and his conclusions were published in *The Journal of Finance*. After asking how one would evaluate the merits of the Shaw case in comparison to that of Grebler and Brigham, Polakoff states (italics supplied):⁵

"One basis, of course, is to look at the scope and consistency of the data from which Shaw and G&B derive their conclusions: On this basis, it appears to the reviewer that G&N's chapters 5 and 6 (which deal, in part, with some of the critical questions posed by Shaw) take into account many more adjustments factors than Shaw does in his enumeration. G&B also arrive, through the aid of additional data, at an allowance for exceptional risk which is far more sophisticated than Shaw's, and which tends to decrease pure profits. Further, their analysis of gross income, operating expense, net income, dividend and net profit ratios, and the components of each, all obtained from uniformly good data for California associations and those throughout the country, is much to be preferred to Shaw's conclusions based as they are on relatively inadequate and nonhomogeneous data. The data certainly lend weight to G&B's assertion that "a strong presumption if no definite proof [exists] that the higher income,

⁵ Murray E. Polakoff, comparative review of "Savings and Loan Market Performance" (Shaw), and "Savings and Mortgage Markets in California" (Grebler and Brigham), "Journal of Finance," December 1964, pp. 732-736.

expense, and dividend ratios of California savings and loan associations as a group, compared to their counterparts elsewhere, are functionally related to their asset composition, savings account behavior, and mode of operations" (p. 129); and, therefore, are the resultant of the relatively higher growth rates to be found in California as compared with the rest of the nation.

"Another factor which helps explain Shaw's conclusions is his omission of potential competitors of S/L's in both the share and mortgage markets and, consequently, his deduction that the market structures within California are highly oligopolistic and sheltered. Such an omission is incomprehensible, coming as it does from the co-author of *Money in a Theory of Finance*. On the other hand G&B, in an excellent chapter on the structure of California mortgage markets, indicate a sufficient market overlap on all mortgage and loan characteristics with the exception of interest rates so as to suggest the presence of interindustry competition. Even with regard to rigidity in mortgage rates, they make a case for interindustry competition inasmuch as there are sufficient borrowers who can trade off lower rates at non-S/L lenders with more liberal loan terms at associations. As for the post-war savings markets in California, while G&B's data are organized in such a manner as to preclude a definitive test of the interest elasticity of liquid savings, they do suggest that the higher returns offered by California associations relative to banks and associations in other parts of the country have been instrumental in channeling relatively large sums into the industry.

"Given the existence of interindustry competition in both the share and saving markets, the relatively low concentration ratios derived by G&B on a state and county basis for all competing intermediaries suggest sufficient alternatives open to lenders and borrowers to warrant their conclusion that the California industry is less oligopolistic than suggested by Shaw, and that the major obstacle to even greater intra- and inter-industry competition lies primarily in the restrictive actions of the regulatory authorities.

"Finally, hazardous as such imputations may be, the reviewer would like to put forth the notion that Shaw is led astray in his analysis of the California associations by a strong value commitment to the purely competitive model, so that rather than have it serve as a mere analytic construct it actually represents for him a state of pristine bliss. This becomes apparent from one of his concluding statements, to wit: 'Intermediation in its present design has compromised the chance for pure and perfect competition' (p. 147). Such an emotional attachment can lead to subtle though critical differences in evaluation when weighting such marginal choices as whether growth or price leadership is primarily responsible for differential returns between the California associations and those in the rest of the nation. Further, an understanding of the reasons why nonprice competition is more or less inevitable focuses attention, in part, on differential services provided by the same and different types of financial institutions, and suggests possible trade-offs between them and price variables when evaluating appropriate public policy."

The evidence is by no means overwhelming, but it does support the thesis that in California, where holding company operations are most highly concentrated, savings and mortgage markets are competitive by comparison with most other segments of the economy. In the absence of strong evidence to the contrary, it would seem undesirable to use the argument of potentially undesirable concentration as a basis for not permitting the S&L industry to gain the very real benefits to be derived from increased diversification.

This is not to say that one should be unmindful of the erosion of competition, and it is not to say that unlimited concentration should be permitted. Clearly, unrestricted mergers between S&Ls in the same market area could lead to concentration that might unduly restrict competition. The same thing would hold true if a limited number of S&Ls controlled an unduly large segment of a related industry. While recognizing these factors, it is the author's position that at this time certain types of diversification that would be prohibited by Senate Bill 1542 would improve the efficiency and viability of the S&L industry, and would enable the industry to do a better job of financial intermediation.

VII. SUMMARY AND CONCLUSIONS

The purpose of this paper is to provide some insights into the growth and development of savings and loan holding companies. In particular, the paper

explores certain aspects of the general theory of diversification and applies these principles to the savings and loan industry.

The enterprise system

The first section deals with the enterprise system and shows how and why business organizations have evolved over time. It is shown that the enterprise system does not always function perfectly and that externally imposed modifications are occasionally necessary. However, the point is made that the enterprise system has functioned better than any known alternative and that extreme caution should be exercised before condemning one of the system's evolutionary developments.

Economies of scale

The second section deals with the matter of economies of scale. Three different aspects of scale economies are discussed—operating costs, capital costs, and feasible types of output. The term "feasible types of output" means that larger savings associations can do certain things that are impossible for smaller associations. Operating economies of scale seem to be relatively limited, but there do appear to be significant economies of scale in raising capital and in producing different types of output. Further, it seems clear that the limits of the three types of economies of scale are increasing as time goes by. The development of new management control techniques, as well as the increased use of electronic computers, is causing this trend.

Diversification

Three basic types of diversification are generally recognized in economic literature. First, there is geographic diversification, which refers to extending the geographic scope of market coverage. Second, there is vertical integration, which means that the diversified firm expands backward to produce materials used in its own operation, or forward, to use its own primary output in a higher process. Conglomerate diversification is the third type; it involves moving into product lines that bear little relationship to the firm's primary output.

Each of these three types of diversification can reduce the total risk inherent in an S&L enterprise. The reason for this is that, as the S&L diversifies, each of the new markets that it enters will be less than perfectly correlated with its primary market. This fact tends to level out the income stream of the entire enterprise. The scope for risk reduction by each type of diversification is somewhat different. Vertical integration appears unlikely to have much potential for reducing risk since construction lending, insurance operations, and other activities related to mortgage lending are likely to fluctuate in much the same manner as does mortgage lending. However, the other two types do seem to offer significant scope for reducing enterprise risk. Geographic diversification can reduce risk even within a metropolitan area, but it becomes increasingly important when the S&L diversifies outside a single metropolitan area.

Conglomerate diversification probably provides the greatest scope for risk reduction in the savings and loan business. It is a well-established fact that consumer lending and residential mortgage lending are not perfectly correlated; therefore, if an S&L were to expand into personal loans, its earnings stream would probably be somewhat stabilized. If this product line diversification were extended even further, there would be even greater scope for risk reduction. Real estate activity is counter-cyclical to most other economic activities. Therefore, if a firm that is as closely tied to the real estate market as an S&L merges with a firm in some other line of activity, then the total corporate risk is reduced for the combined enterprise. This risk reduction occurs when such firms as MCA, Inc. and Sears Roebuck acquire savings associations.

Social benefits from diversification

All participants in the S&L activity—employees, guarantee stockholders, the FSLIC, and depositors—benefit directly from lower risk. There also seem to be certain social advantages from S&L diversification. The reason for this is that the demand for funds shifts from sector to sector during different periods. In one period, mortgage demand may be relatively strong; in another, business loan demand may be strong; while in still others, state and local governments or consumers may be seeking funds most vigorously. In a system of specialized lending institutions, funds must shift between lending institutions if they are to flow where they are most needed. This causes dislocations—some institutions

are left with excess capacity in terms of their organizational ability to generate deposits and to make loans, while others, whose specialized loans are in strong demand, are straining at the limits of their capacity. The logical conclusion to this argument is that it would be much more efficient for funds to flow internally within diversified institutions. To the extent that diversified lenders failed to allocate a "fair" share of the available funds to the mortgage market during periods of extremely heavy business loan demand, it might be necessary to require them to allocate some minimum to this market.

The argument in favor of greater diversification has not been proven in any sense of the word, but it does have a certain amount of logical appeal. There is, of course, a counter to this argument—stimulating home construction is one of our national goals, and one way to stimulate home building is to encourage the growth of financial institutions that specialize in home mortgage lending. It might be observed, however, that practically every inquiry into this question has concluded that diversification, qualified perhaps, is preferable to specialization in financial intermediation.

Holding company operations

Section V describes how holding companies can enable S&L firms to obtain the benefits of diversification and scale economies in the preceding sections. First, if a holding company controls the stock of two or more associations, it can effectively combine them into a larger economic unit. If the separate associations operate in different areas, then geographic diversification is also increased. Further, the holding company can engage in such related activities as mortgage banking, operating and insurance agency, and so on. This further increases the size of the economic unit, bringing with it benefits of scale economies plus whatever risk reduction advantages can be obtained from vertical integration. Finally, if a savings and loan holding company is widely diversified and has activities in product lines unrelated to the real estate business, then the risks to the enterprise may be significantly lowered.

Monopoly considerations

Even if one agrees with the preceding statements, it is still necessary to give consideration to the question of whether or not holding companies adversely affect the competitive posture of the savings and loan industry. Holding companies clearly lead to larger economic units, and larger units necessarily increase concentration. However, the best available evidence suggests that the savings and loan business is highly competitive relative to most other industries in the country. Therefore, it seems undesirable to use the argument of potentially undesirable concentration as a basis for not permitting the S&L industry to gain the very real benefits to be derived from increased diversification.

This is not to say that one should be unmindful of the possible erosion of competition, and it is not to say that unlimited concentration should be permitted. Clearly, unrestricted mergers between S&L in the same market area could lead to concentration that might unduly restrict competition. The same thing would hold true if a limited number of S&L controlled an unduly large segment of a related industry. While recognizing these factors, it is the author's position that at this time certain types of diversification that would be prohibited by Senate Bill 1542 would improve the efficiency and viability of the S&L industry, and would enable the industry to do a better job of financial intermediation.

The preceding material is all favorable toward S&L holding companies. Before concluding, it seems appropriate to make it clear that they are not perfect and that they probably should be regulated to some extent. First, the anti-trust considerations raised above clearly warrant further study. Second, it is true that different types of holding companies, such as the public utility ones, in the past used debt to an excessive degree. This does not seem to have happened in the savings and loan industry—at least to any great extent—but it is a matter that requires further study. Another point that has been raised against the holding companies deals with conflicts of interest that might arise when a single management operates a number of related firms.

All of these potential problems might be solved by severely limiting holding company activities. This seems undesirable, but it is, of course, necessary that regulatory agencies be informed of potentially dangerous situations as they develop, and this suggests an alternative approach similar to the one that seems to be evolving in California. The California policy involves a combination of holding company disclosure and examination, together with a flexible set of S&L regulations. The holding company examinations are designed to uncover what

appear to be questionable practices, and when such activities are discovered, the affiliated S&Ls are scrutinized with exceptional care under appropriate regulations. Such a system curbs the potential abuses of savings and loan holding companies without at the same time eliminating the actual benefits that they may contribute toward improving the performance of the industry.

Mr. PORTER. Mr. Chairman, our next spokesman is a very distinguished lawyer, Mr. Gary Sadler, who was former commissioner in California. He is now a private citizen, but we felt that it might be useful to the committee if we had Mr. Sadler give you a summary of his experience in regulating holding companies as commissioner.

The CHAIRMAN. Fine.

Mr. SADLER. Mr. Chairman, I would like to summarize only three points in my prepared statement. First, I support the provisions of S. 1542 which would give to the Federal Home Loan Bank Board and the Insurance Corporation authority to require registration, reporting, and examination of holding companies and their subsidiaries and affiliates. I think that is entirely appropriate and most desirable. The bill provisions parallel closely the law that was enacted in California in 1964. In my view, that is possibly the most important and most useful provision of the present Federal statute. I don't think this point needs to be belabored.

The second point is that I support a restoration of the full discretion of the Insurance Corporation and the Bank Board to act with respect to mergers in particular, and acquisitions, where a corporate holding company as defined under this Federal bill, is involved. At the present time, as has been pointed out, the discretion of the Bank Board is severely limited to mergers, involving corporate holding companies in cases where there is a showing of failure or imminent failure—I think somebody used the words, “brink of failure”—on the part of an insured association.

I think that sound discretion of the Bank Board should be employed and should be available at a fairly early stage. I think that it is clearly in the interest of the Insurance Corporation to be able to take timely preventive action. I think to that extent, the Insurance Corporation's range of discretion should properly be strengthened. This does not say that any merger will be approved. The Bank Board will still be free to say “Yes” or “No.” At the present time, its hands are tied. I think their hands should be untied.

The third point has to do with diversification, subsection (c) of section 408. I have been reviewing the experience of the past several years in California with respect to corporate holding companies. I do not find that there is a case for forcing out of California industry diversified holding companies. I do not find that there is a case for forbidding diversified holding companies from entering into the savings and loan industry in California.

The Bank Board's bill does not propose to eliminate holding companies. The chairman made that quite clear in his remarks yesterday. But what it does propose to do in subsection (c) is to force every holding company, which has other interests which are not permitted by the statute or the regulations, to elect between staying in the industry and getting out.

I think clearly the large corporate holding companies which have other interests of the kind that Dr. Brigham has described, will

almost certainly have to elect to leave the industry. Also, it means that major corporations which have other interests which are not immediately connected with the savings and loan industry, would not be able to come into the industry.

I do not find that this is in the interest of the industry or of the Insurance Corporation. If I could refer specifically to one provision of my prepared statement, there are certain major supervisory problems, known or anticipated, which may well require the kind of strength, both as to management and capital, which can best be provided by a diversified holding company. There may well be supervisory problems to come, which are beyond the resources of any nondiversified holding company. Recourse to the assistance of the Federal Savings and Loan Insurance Corporation or the U.S. Treasury may be the only alternatives if the industry is deprived of diversified holding companies in particular problem cases of the first magnitude.

A further point is that the inability of the stock companies to attract capital in the future, I think, will inevitably limit the role which this important industry can play in housing in the years to come and I do not think that is in accordance with the public policies which this committee has supported in the past.

In conclusion, I think that the disclosure provisions of S. 1542 should be enacted on the lines of the California statute. I think that the discretion of the Bank Board to permit mergers involving holding companies at an earlier stage should be restored, and I feel that the attempt to distinguish between diversified holding companies and nondiversified holding companies should go back for the study that the Bank Board is presently engaged in to see if there is in fact an overwhelming or persuasive case for taking such action. But I do not believe that there is any basis for taking it as proposed in this bill.

Thank you very much.

(Mr. Sadler's full statement follows:)

STATEMENT OF GARETH W. SADLER, FORMER SAVINGS AND LOAN COMMISSIONER
OF THE STATE OF CALIFORNIA

GENTLEMEN: I wish to thank the Committee for this opportunity to present my views on certain provisions of Senate Bill 1542, the "Savings and Loan Holding Company Amendments of 1967."

From 1963 until February 1965, I served as Chief Deputy Savings and Loan Commissioner of the State of California, and assisted Commissioner F. E. Balderston in securing the enactment in 1964 of the amendments to the California Financial Code which require registration, reporting and examination of Savings and Loan Holding companies which control California State-licensed Savings and Loan Associations. This California Statute is in effect limited to requiring disclosure of holding companies. The 1964 California statute enacted by the Legislature and signed into law by Governor Edmund G. Brown is paralleled closely by the registration, reporting and examination provisions of Senate Bill 1542.

I was appointed as Savings and Loan Commissioner of the State of California by Governor Brown on February 1, 1965 and served in that position until January 2, 1967. One responsibility as Commissioner was the enforcement of the California Savings and Loan Holding Company Act, and the regulations adopted thereunder.

As of December 31, 1966, there were 62 corporate and 155 non-corporate savings and loan holding companies registered under the California statute. In 1966, 85 examinations of registered holding companies were conducted, and 139 reports were filed with the California Commissioner's office.

In the period of over two years during which the California Savings and Loan holding Company Act has been in effect, sufficient experience has been accumulated to permit certain conclusions.

It appears that certain of this experience may be germane to the work of this Committee in considering Senate Bill 1542.

The great majority of all California State licensed associations with assets of \$100 million or more are subsidiaries of Corporate Holding Companies within the definition of S.B. 1542. The overwhelming majority of all assets of the California State licensed associations are held by associations which are subsidiaries of such holding companies.

First, it appears to be most desirable that disclosure requirements similar to those enacted in 1964 in California should be enacted into Federal law. The California requirements for registration, reporting, and examination for holding companies and their subsidiaries have proven their value in both preventing trouble and also helping in timely correction of difficulties. The records of the California Savings and Loan Commissioner respecting registered Savings and Loan Holding Companies and their subsidiaries have been made available to the Federal Home Loan Bank Board on a regular basis over the past two years. Extension of such disclosure requirements to the rest of the industry should prove to be of positive assistance to the industry and to the public.

Second, experience as Savings and Loan Commissioner in 1965 and 1966 impells me to oppose enactment of Subsection (C) of Section 408 of Senate Bill 1542. That Subsection, entitled, "Holding Company Activities," is described in the Section-by-Section analysis presented with the bill as one which would restrict the nature of the activities or business which could be conducted by a savings and loan holding company. Further, that analysis states that subsection (C):

"would make it unlawful for a holding company or any of its subsidiaries to commence or continue for more than 2 years after the enactment of the bill any business or service other than those set out in subsection (c) or those permitted by regulation of the corporation."

What would the probable effect of subsection (C) be upon the corporate saving and loan holding companies now registered under the California Financial Code, and upon their subsidiary California State-licensed savings and loan associations?

Subsection (C) would force every holding company and its subsidiaries (other than associations) to discontinue all activities or services except the very limited number specifically authorized by subsection (c) and such other activities or services as the corporation by regulation may deem "a proper incident" to the operations of an association.

In effect, each registered holding company which now controls one or more California State-licensed savings and loan associations would be compelled to consider divesting itself of its savings and loan association or associations, if the holding company or its subsidiaries now engaged in a significant level of activities or services not within the narrow sphere permitted by the statute and the regulations.

While such divestiture might not be elected in every case, it appears to be probable that such divestiture would be undertaken by a large number of holding companies. Such divestiture would be a virtual certainty in any case where the savings and loan association represented a minority of the consolidated assets of the holding company and all of its subsidiaries.

For convenience, such holding companies may be described as "diversified" holding companies.

What is the evidence which would support a judgment that "diversified" holding companies should be forced out of the savings and loan industry and that none may enter the industry?

The undersigned is not aware that any compelling evidence has been adduced which would support any conclusion that "diversified" holding companies as such are detrimental to the savings and loan industry or the public.

On the contrary, there is a large body of evidence that the management, capital strength, and performance of savings and loan associations controlled by such "diversified" holding companies, judged by objective criteria, is equal to and in certain instances actually superior, to the management, capital strength and performance of savings and loan associations controlled by holding companies which are of the "non-diversified" type.

To my knowledge there is nothing in the regulatory history of the California State-licensed associations over the preceding four years which would demonstrate any systematic advantage which will follow by replacing "diversified" holding companies with "non-diversified" holding companies, and barring the industry to such "diversified" holding companies in the future.

Certain major supervisory problems, known or anticipated, may well require the kind of strength, both as to management and capital, which can best be provided by a diversified holding company. There may well be supervisory problems to come, which are beyond the resources of any "non-diversified" holding company. Recourse to the assistance of the Federal Savings and Loan Insurance Corporation or the United States Treasury may be the only alternatives if the industry is deprived of "diversified" holding companies in particular problem cases of the first magnitude.

It appears that it would cause a major dislocation of the savings and loan industry to attempt to force the wide-scale series of divestitures contemplated by subsection (C), even if this were tried over a longer period than the basic two year period proposed in the bill.

Further, I question whether the ability of *all* California stock associations to attract additional equity capital would not be adversely affected by the enactment of Subsection (C). If that section were to become law it would not only force existing diversified holding companies out of the savings and loan industry, but also prohibit their entry into it. I believe this could only serve to circumscribe and depress the equity value of all stock associations.

The interests of the Federal Savings and Loan Insurance Corporation are in my view best served by an association with a strong capital base with which it can absorb losses. Any legislation which weakens the ability of stock associations to raise equity capital would appear to be contrary to this interest of the Insurance Corporation.

Orderly growth of the stock associations in California and elsewhere in the nation will be an important factor in the health of the housing industry in years to come. Again, legislation which cripples the ability of stock associations to attract equity capital will work against this public policy objective.

Third, I urge that the Corporation be given discretion to allow any transactions otherwise prohibited flatly by Section 408(d), so as to permit it to take extraordinary actions in exceptional cases. To this same end, I would urge the restoration of the discretion of the Corporation to permit a merger or other acquisition of more than one insured association by a holding company, where such merger or acquisition is in the public interest. The provisions of Section 408(e)(2) are, I believe, unduly and unnecessarily restrictive upon the Corporation. Its sound discretion should be utilized to cope with problem cases at a far earlier stage than is now possible under the statute.

John A. Lundquist, President of United Smaller Associations, has requested me to state to your committee that the foregoing statement respecting Subsection (C) of Section 408 of S.B. 1542 is in accordance with the views of that group. United Smaller Associations is a California membership corporation, comprised of more than 40 savings and loan associations located in California. The assets of the member associations average \$15 million, approximately. Both State-licensed and Federally chartered associations are members of United Smaller Associations.

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

Mr. PORTER. Mr. Chairman, that concludes our presentation. If you have questions, I have some experts here that are qualified to respond.

The CHAIRMAN. I have questions to submit to all of you one at a time; I will submit them separately.

To you, Mr. Porter: Do you see any potential conflict of interest between a savings and loan association and a real estate development corporation owned by same holding company? I asked Mr. Leff that same question.

Mr. PORTER. Yes, I think I would associate myself with Mr. Leff's answer on that, Mr. Chairman. And that is that you would have no more conflict-of-interest problem if the corporate form exists than you do when the officers of a mutual association engage in collateral activities. I think it all comes down to effective supervision, and that is something that I think everybody agrees is essential.

The CHAIRMAN. Thank you.

Why do you assume that holding companies would be destroyed under this legislation when the legislation merely requires holding companies to divest themselves of unrelated business activities?

Mr. PORTER. Well, an example has been given here this morning, that one of the holding companies is Sears, Roebuck. And if this bill is enacted, and Sears, Roebuck has to make an option as to whether they stay in the merchandising business or adhere to their savings and loan institution, I don't think they would have much difficulty making that choice.

The CHAIRMAN. Do you agree with what I understood Mr. Sadler to say that the big holding companies would certainly get out of the savings and loan business rather than the other business they are in. Wasn't that your statement?

Mr. SADLER. Where the association represents a small portion of their total assets, I think that is clearly indicated.

The CHAIRMAN. Do you recommend that holding companies be permitted to grow through acquisition and merger in accordance with procedures outlined in the act and would you also require approval of the Federal Home Loan Bank Board as a condition for acquisition or merger?

Mr. PORTER. Yes, we take that position in our statement, Mr. Chairman. And I might add, we also recognize that if there is any anticompetitive effect or any undue concentration that the antitrust laws are fully applicable; section 7 of the Clayton Act would interdict any undue concentration.

The CHAIRMAN. You indicate we should not follow the procedure in the Bank Holding Company Act of requiring divestment of unrelated activities for savings and loan holding companies. Your argument seems to be based on the assumption that investment powers of savings and loans are quite limited, therefore, the potential for conflicts of interest are equally limited.

Many people, however, have argued that the investment powers of savings and loan associations should be expanded in order to avoid the severe strain placed on them during 1966. Would your recommendation therefore be contrary to the long-term trends of savings and loan associations?

Mr. PORTER. It is my understanding, Mr. Chairman, that if the savings and loan industry had the flexibility of commercial banking they might be very happy, and I understand that the extent to which their functions would be expanded under the request that has been made, would be very limited in scope. So I don't think there is any inherent contradiction in that.

The CHAIRMAN. You referred to Mr. Brigham's study which shows that holding companies are capitalized at approximately 20 percent debt and 80 percent equity. Isn't it true, however, that there are substantial variances in these figures? For example, some companies have a debt to equity ratio of greater than 50 percent?

Mr. Brigham, I will let you answer that.

Mr. BRIGHAM. Yes, sir, that is quite true. The example that I cited in my study was California Financial Corp., which has a mortgage banking subsidiary. And it is quite true that if you get diversified

hold companies, you are going to find some whose asset structures will support more debt, others that will support less debt. This relates, I think, primarily to the asset structure. Although there are some savings and loan holding companies that, it seemed to me in making the study, had a little bit too much debt. I am not quite sure how to measure too much debt. I think it is something that is a very nebulous sort of thing, but potentially I would say that you could have too much debt in holding companies.

I would like to see something done, but I am not sure what.

The CHAIRMAN. Do you believe an adequate solution is included in the several recommendations that you made with reference to additional powers being given to the Board? I think Mr. Porter recommended, and in fact I think all three of you did to some extent, that the Bank Board should have additional powers.

Mr. PORTER. Mr. Chairman, they have control of the dividend policies of insured institutions. They have control of the reserve requirements, and liquidity. I would suggest that it is the function of supervision to guard against many of these problems. It seems to me, if you put in limitations on the debt structure of a holding company, to that extent, you might block their complete access to the capital markets, which is a source of strength to these companies. And there I think you have to rely upon the prudent management of the holding companies not to acquire such debt. They would get this debt in order to strengthen their association or some other meaningful collateral activity which would also strengthen the association.

The CHAIRMAN. I have some questions that have been requested of me to propound to Mr. Brigham.

Is it correct that your views about the advantages of conglomerate operations of holding companies are highly tentative because of the limited nature of the data available for your earlier study?

Mr. BRIGHAM. I think that is correct. I think most of the statements that I would want to make, as an academician, would have to be hedged pretty much.

The CHAIRMAN. I gather that from your own writings. In fact, perhaps I might quote just a little bit.

"The reader is therefore cautioned to reserve final judgments and opinions until additional research has been completed and until the income gap has been filled." On page 5.

And again: "While this section of the report does deal with the question of operating efficiency, it must be made crystal clear that the author does not feel that the results generated here are anything more than suggestive. The available data was too limited to produce firm conclusions." That is page 59.

That is still your opinion?

Mr. BRIGHAM. Yes, sir, it certainly is.

Mr. PORTER. Mr. Chairman, may I suggest that perhaps the Board itself should follow the same caveat, and wait until the facts are in. I understand that is what the present study is for.

The CHAIRMAN. In order to gather information.

Mr. PORTER. Right.

The CHAIRMAN. Does your suggestion that holding companies provide geographic diversification amount to a recommendation that the operator cross State lines or in contravention of some State laws?

Mr. BRIGHAM. I am not sure how far I want to push this. I think that I personally like branching, I like the idea of as broad a geographic diversification as you can get. I think from a practical point of view, intrastate, within State diversification, is as far as I would want to go at this point. I am not sure that I would want to see cross State line diversification, but I have in theory no objection to it. In theory, I like it.

The CHAIRMAN. To what extent can savings and loan associations themselves, without any holding company around, obtain geographical diversification in their lending? The present rules don't allow very much extension, do they?

Mr. BRIGHAM. No, sir, I think that is one of the reasons for the development of holding companies, in order to get the benefits of diversification that I think exists, that theoretically exists. I believe the holding companies have tended to come into existence partly in order to obtain the benefits.

The CHAIRMAN. I believe your report states that holding company debt is "clearly a potential threat." On page 97.

In terms of what has happened since the date of the statistics you studied, do you feel those potential threats are beginning to be realized? Wouldn't it be advisable to place some limitation on how far the holding company for an insured institution could go in this regard?

Mr. BRIGHAM. I think this is clear. I think it is true. It is true the Board has controls over the associations themselves—but it seems to me also true that if the holding company has debt, and attempts to service this debt, if you get into periods where the loan profits are low, this could cause the holding company to put pressure on the association to give them funds in order for the holding company to service its own debt.

The difficulty comes up here, if you follow what I think is reasonable and have diversified, widely diversified holding companies, then you are going to have very different assets.

Jim Walter Corp., which is a strong company, half-million-dollar company, is in a different position than Sears, Roebuck. Sears, Roebuck has Sears, Roebuck Acceptance, which is a finance company. Finance companies typically are going to have more debt than certain other types of industries. So if you had widely diversified savings and loan holding companies, I would think that it would be logical to have differential treatment of them, and it seems difficult to reconcile the imposition of a flat debt limit and still permit wide diversification of assets. It is kind of a discretionary thing that would have to come out of it.

The CHAIRMAN. Did you read the statement that Chairman Horne presented yesterday?

Mr. BRIGHAM. Yes, I did.

The CHAIRMAN. Do not the statistics that he gave in there suggest that a number of the problems which you potentially saw were present in 1963, are becoming more acute and to that extent alter your earlier conclusions?

Mr. BRIGHAM. I am sorry, I didn't hear the question because of the bell.

The CHAIRMAN. I am sorry, we have these bells that bother us sometimes. First, I am referring to the data that Chairman Horne gave in

his statement. You said you had read his statement. Would you not agree that the statistics that he gave, the data that he gave, suggests that a number of the problems which you saw potentially back in 1963 are becoming real and more acute?

Mr. BRIGHAM. I think this is probably true.

The CHAIRMAN. Would that change in any way the conclusions which you drew?

Mr. BRIGHAM. I thought at that point, potentially and in certain instances, debt could be a problem. If in a declining real estate market, that has happened. I think these problems wouldn't have happened had savings and loan holding companies been more widely diversified and been in lines and activities which are now quite profitable in the economy.

The CHAIRMAN. Did you conclude in your paper that despite certain holding company advantages that it was clear that they should be regulated further?

Mr. BRIGHAM. I think that the disclosure provisions definitely, absolutely, in the interest of anything I could think of. I would think also that at some point we would probably want to have some control over holding company debt. That is my personal opinion. As I say, I think it is a very complicated thing. If you put the premise that diversification would alleviate some of the problems that the holding companies had, then this diversification itself is going to mean that you have a complicated problem in supervising the holding companies, because they will be quite different.

The CHAIRMAN. I quote from your paper, page 101: "It is equally clear, however, that potential abuses do exist and that some reasonable additions to the laws governing holding companies may be in the public interest."

I was going to ask you what might be those additional laws. If I gather though, from the testimony from all three of you, it is perhaps a broader and tighter use of existing authority, and perhaps some expansion in some of the authority. Is that correct?

Mr. BRIGHAM. I really have not given much thought to the nature of the supervisory process. I am not prepared to say whether or not the existing provisions are adequate. I just simply haven't studied that. I couldn't say.

The CHAIRMAN. You did relate in your direct statement, you had something to say about some of the abuses that could have been cured through supervisory powers?

Mr. BRIGHAM. Right. If there is so-called milking taking place, it would seem to me, about what I heard about the laws particularly, after the cease and desist laws last year, this probably could have been cured. It has happened in California. I have had extensive discussions both with Mr. Sadler and members of the California savings and loan commissioner's permanent staff, and they have given me illustrations of how they have gone in and talked to holding companies and had these things stopped before they became a problem.

The CHAIRMAN. Thank you very much.

Now let me ask some questions that have been prepared for Mr. Sadler.

I gather that your term as commissioner was all subsequent to the enactment of the California holding company reporting law, is that clear?

Mr. SADLER. I was chief deputy commissioner to Dr. Balderston at the time the law was enacted, Mr. Chairman.

The CHAIRMAN. You had a number of associations in California which had to be merged. Did you have any holding company associations among those that you were most worried about?

Mr. SADLER. The number of associations that were merged over the period of the past 2 years did include subsidiaries of holding companies.

The CHAIRMAN. Did not include?

Mr. SADLER. Did include.

The CHAIRMAN. Do you know how many?

Mr. SADLER. I would be very glad to get that statistic for you.

The CHAIRMAN. I think it would be helpful if you could give us the total number that had to be merged, and break that down in holding company associations.

Mr. SADLER. Would you also like that broken down between diversified and nondiversified?

The CHAIRMAN. Yes, that would be very helpful.

Did you find that controlled associations that were in difficulty had participated in transactions with holding companies or other affiliates which were not to its advantage or added to its problems?

Mr. SADLER. I think there is no question about the fact that the difficulties of the associations which were supervisory problem cases, and in which merger was one of the solutions, that was either considered or adopted, did include instances in which there were transactions direct, or indirect, which were not in the best interests of the controlled association; yes, sir.

The CHAIRMAN. Then those transactions were not covered by the Spence Act, nor were they prevented by the existing California law, isn't that correct?

Mr. SADLER. As I say, some of these actions that were taken were indirect. Whether they were violations of existing statutes, State or Federal, is extremely difficult to ascertain.

I would like to point out that the disclosure provisions with respect to California holding companies were enacted in 1964, and the first active administration of that law took place essentially in 1965, registration, reporting, and the examination. And I think that the disclosure provisions of the 1964 act turned up matters which had not previously been known or not fully known to State or Federal supervision.

I think that this had an extremely therapeutic effect. Some of the problems that we are referring to, Senator, were matters that had gone on over a period of years. I think that we are talking also about a limited number of instances of this nature. I hope that it is not understood or assumed that we are characterizing the savings and loan industry or the holding company portion of it as having been engaged in wide-scale violations or evasions of State or Federal law. I don't think the record will support that.

The CHAIRMAN. Did you experience any cases where the holding company had engaged in other activities such as real estate develop-

ment, or construction or something of that kind that got it into financial difficulty and added to the problems of its subsidiary savings and loan association?

Mr. SADLER. Could I inquire, are we referring to holding companies as an entire class or are we distinguishing diversified from nondiversified?

The CHAIRMAN. I didn't catch the first part.

Mr. SADLER. Are we talking about holding companies in general or are we talking about diversified as opposed to the nondiversified?

The CHAIRMAN. The diversified.

Mr. SADLER. I would believe, Senator, that the examples of the nature that are referred to in that question, where there have been instances of that nature, have occurred to a much greater extent with respect to the nondiversified companies, which have been under greater pressure by reason of the fact that their assets are almost entirely those of the savings and loan associations themselves. And the assistance which we were able to obtain in many cases came from the diversified companies, which had alternative sources of finance, and had greater capacity to cope with problems.

The CHAIRMAN. Do you feel that this committee should strengthen their regulation of holding company activities beyond what is provided for in the Spence Act?

Mr. SADLER. I certainly do, Senator. As I stated in my prepared statement, and in my summary, I think that the most important provisions of S. 1542 are the disclosure provisions paralleling the California law. And I heartily support the enactment of those provisions.

The CHAIRMAN. Thank you very much, gentlemen. I appreciate very much your help.

The next witness is Mr. Edwin G. Alexander, vice president, Midwestern Financial Corp.

Mr. Alexander come around. We are very glad to have you. We have your statement, and you have heard me say, it will be printed in full in the record and you proceed as you see fit.

STATEMENT OF EDWIN G. ALEXANDER, VICE PRESIDENT, MIDWESTERN FINANCIAL CORP.

Mr. ALEXANDER. Mr. Chairman, I think my written statement is brief enough so that if I may, I will simply read it, and then answer any questions if you have any.

My name is Edwin G. Alexander and I reside in Denver, Colo., I am vice president of Midwestern Financial Corp., a Colorado corporation, with its principal office located in Denver. My primary responsibilities concern the conduct of our savings and loan operations, which consist of four associations located in Colorado and Kansas. On behalf of the officers and directors of Midwestern, I want to express our appreciation for this opportunity to appear before you and explain the effect that S. 1542 will have on our company, should it be enacted in its present form.

In preface to this explanation, we would like to make very clear our attitude and opinion about the need for supervisory powers and prohibitions as provided for in S. 1542, as well as those existing laws governing financial institutions. We recognize and support the estab-

lished proposition that institutions granted the corporate authority to act as intermediaries and custodians of private trust funds subject themselves to a great degree of public scrutiny compared with the private individual or business firm dealing with its personal wealth. We support in general, indeed, we compliment the members of the Federal Home Loan Bank Board in dealing with the circumstances of the past several years. Given the experience of the real estate market during the last 3 years, and the critical circumstances in the money market last year, it is our judgment that the Board is to be commended for its conduct of the Federal Home Loan Bank System and the Insurance Corporation.

In the hope that I have established a complete lack of hostility on our part toward the Board and its request for this legislation, I invite you to examine its potential effect on Midwestern Financial Corp.

As shown on page 1 of the memorandum supplied to you, our company is made up of six operating divisions: savings and loan associations, mortgage banking, banking and finance, real estate, administrative services, and a legal division.

Midwestern was formed as a financial holding company in 1957, and as indicated by the founding date of each subsidiary, the company is made up of several old and established financial institutions, along with several subsidiaries formed in recent years in accord with our objective of developing an integrated financial organization. Because we own more than one savings and loan association, we have been subject to the present Savings and Loan Holding Company Act since its adoption in 1959.

If you will turn to page 2 of our memorandum, you will see a red crosshatch indicating the subsidiary corporations and divisions that Midwestern Financial would be forced to divest under the provisions of S. 1542. All of the non-savings and loan subsidiaries subject to divestment were formed or acquired after the enactment of the present saving and loan holding company law in 1959. Commerce Savings, located in Kansas, was acquired prior to the present law, but would be divested under S. 1542 since it is not located in our principal State, Colorado.

The forced divestiture of these holdings would amount to a reduction in our working assets in an amount in excess of \$7 million, or a sum equal to about 40 percent of our present total working assets at present.

These critical problems face a company like Midwestern when forced into this position:

1. Divestiture forced by law would necessarily create a forced sale market condition. No one could reasonably expect that the marketplace would not take advantage of this situation, causing an unwarranted loss on the sale of assets.

2. This problem would be particularly acute because of the debt control provision of the bill. Midwestern on behalf of its mortgage banking and finance subsidiaries would be required to be in constant consultation with the Board to obtain approval of their debt transactions during the period prior to divestment. Mortgage banking and finance companies typically carry a debt structure several times their net worth which at all times is in excess of that allowed by S. 1542. As a part of their normal operations, these

companies continually retire and acquire bank debts. In our opinion, the apparent approval procedure would be so unworkable as to endanger the operation of these subsidiaries and would force immediate divestment.

The prohibitions of S. 1542 as to holding company activities and acquisitions, produces investment in additional savings and loan assets by merger or otherwise.

3. Regardless of the amount of loss incurred by a forced sale, therefore, Midwestern would have no way of reinvesting the proceeds received from divestment in appropriate working assets.

The event of divestment, therefore would subject the stockholders of Midwestern Financial to the risk of capital loss on their investment and a serious loss of income from the reduction in working assets. While Midwestern Financial is a small company compared with the many large financial institutions in the country, we believe the members of the committee will give due consideration to the impact of this legislation regardless of the size of the organization affected. In this regard, we believe it is important to recognize that our stockholders have a place in the public interest as well as our savings customers.

For your information, Midwestern Financial is a publicly held corporation with approximately 4,000 stockholders. Our stock is listed on the American Stock Exchange and the largest single stockholder owns less than 14 percent of the shares outstanding.

Recognizing the good intentions of the authors of S. 1542, we ask in all candor, what is to be gained, what is to be corrected, how is the public interest served, how are the stockholders of Midwestern Financial and the customers of our subsidiaries protected if we are forced to divest over 40 percent of our working assets with the attendant risks and hazards of loss that would be incurred?

We respectfully suggest that it is inconceivable that anyone could benefit from such an event. Let me again state that we have no quarrel with the Federal Home Loan Bank Board and its need for whatever legitimate supervisory powers are necessary in order that it may protect the public interest. We cannot subscribe, however, to the thought that the solution to these problems is the elimination of a legitimate business organization operating as an integrated financial holding company.

We have no detailed knowledge of the specific problems which the Board faces in its role of supervisor of insured savings and loan associations. We can only assume that each of the provisions of S. 1542 is designed to correct or eliminate certain problems faced by the supervisory authorities. It would seem to us that the only practical need answered in S. 1542 is the right of examination by the Board of the transactions between a holding company and a subsidiary savings and loan association. While the Financial Institutions Supervisory Act of 1966 apparently provides the Board with powers of examination over the savings and loan holding companies, if this language is inappropriate, S. 1542 may well be appropriate in this regard. In our own instance, we have always informed the Board's examiners, as well as our State examiners, that they were welcome at any time to review the records and transactions of Midwestern Financial and its subsidiaries, S. 1532 may well be appropriate in this regard.

Given the broad and penetrating powers of supervisory control which the Board now has over savings and loan associations, it seems

unnecessary to subject a company like Midwestern Financial to a partial liquidation in order to solve particular, if not isolated, problems within the savings and loan business. It was in fact just a year ago that the Congress in response to the Board's request, enacted the Financial Institutions Supervisory Act of 1966. The acknowledged merit of the supervisory powers contained in that act was that it gave the Board the needed authority to deal with supervisory problems on a case-by-case basis rather than through the imposition of nationwide restrictions to solve individual case problems.

In summary, therefore, we believe that forced divestiture by Midwestern and compliance with other provisions of S. 1542 would be extremely costly to our stockholders and would needlessly disrupt the organization and activities of our subsidiaries. We believe that such an event will adversely affect both our savings and loan subsidiaries, as well as those we will be forced to divest. We do not believe that the public interest will be served under the provisions of this bill.

The CHAIRMAN. Thank you very much, Mr. Alexander. I have just a couple of questions. One of them is very much in line with what I have been proceeding with.

Do you see any possible conflict of interest with your organization owning both savings and loan associations and real estate and construction corporations?

Mr. ALEXANDER. Mr. Chairman, I note that you have asked that question of each of the witnesses. In our institution, as you see, we have a real estate company.

The CHAIRMAN. I notice that from your chart.

Mr. ALEXANDER. This company primarily owns and develops a subdivision in the Denver metropolitan area. Our savings and loan subsidiaries any funds to that corporation. And I would see no need to do that so that I frankly cannot conceive of a conflict of interest there.

The CHAIRMAN. But how about the people who purchase property from that company?

Mr. ALEXANDER. I am sure that we have never made loans to the initial purchasers of new homes in that subdivision. It is possible that on resale—we never have attempted to trace this, but it is possible on resales—that we have financed some of those homes, but I see no possibility of conflict of interest that would be to the detriment of the association.

The CHAIRMAN. How would you insure that the management of your subsidiaries are responsive to the needs of their communities?

Mr. ALEXANDER. It would seem to me that the entire concept of the savings and loan association, its ability to serve a financial need in a community, is the basic fact from which it derives its profitability and makes it a prosperous and viable institution to own.

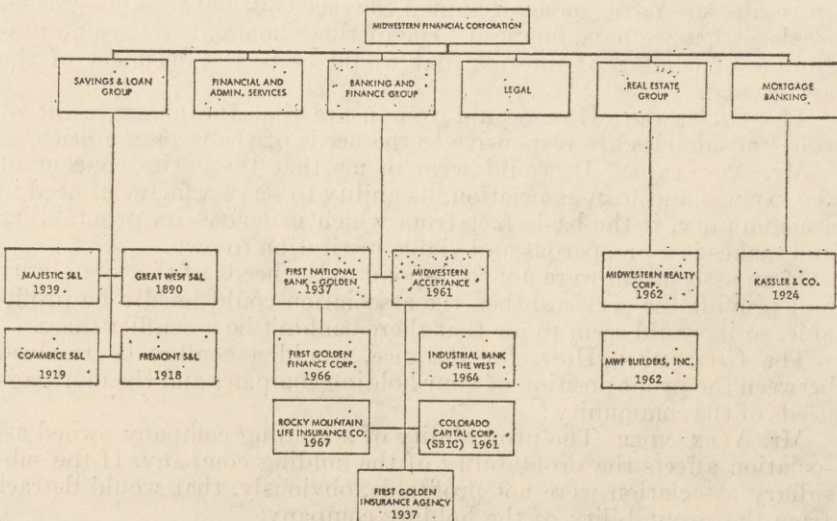
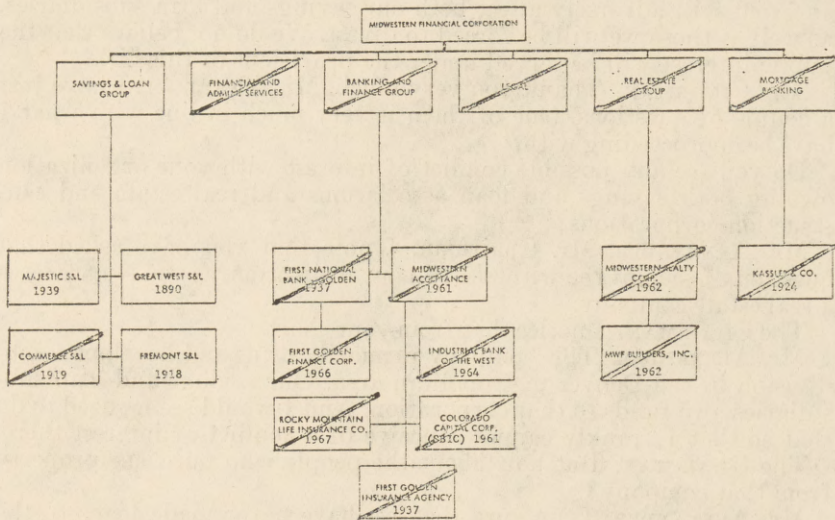
If an association were not to respond to the needs of the community and provide the services, then the association could hardly be profitable, so it would seem to me that there couldn't be a conflict there.

The CHAIRMAN. How, for instance, would a conflict be resolved between the profit position of your holding company and the mortgage needs of the community?

Mr. ALEXANDER. The profitability of a holding company owned association affects the profitability of the holding company. If the subsidiary association were not profitable, obviously, that would detract from the profitability of the holding company.

The way in which a savings and loan association is profitable, is through its ability to attract the savings capital of the people in the community and to reinvest those funds in mortgage loans, and the other investments permitted savings and loan associations the more effectively that is done, from the standpoint of prudent investment, and the economy of operation, then the more profitable the association will be, so I can see no reason why a holding company would attempt to run the association in an unprofitable manner because that would detract from the earnings of the holding company.

The CHAIRMAN. Thank you very much, Mr. Alexander. We appreciate your coming and giving us this testimony.



The next witness is Mr. C. E. Bentley, Abilene Savings Association. We are glad to have you.

**STATEMENT OF C. E. BENTLEY, ABILENE SAVINGS ASSOCIATION,
ACCOMPANIED BY JAMES O. GERST, SAVINGS AND LOAN COM-
MISSIONER OF TEXAS**

Mr. BENTLEY. Mr. Chairman, I believe you have a copy of a statement that I have given to the committee. I would, in the interest of conserving time, simply like to say that my concern, my presence here, is related to the definition under this proposed bill as it would affect the marketability of the stock of mutual savings institutions.

There are some 150 associations in Texas in the same dilemma. I think most of them are equally as concerned. With your permission, I would like to now speak as a member of the Savings and Loan Section of the Finance Commission of Texas, and ask if you would consider hearing Mr. Jim Gerst, the commissioner of our savings and loan department, who has a 2-minute statement prepared, that I believe you do not have a copy of, and it relates to the same thing that I have covered in my written statement.

The CHAIRMAN. What is his title?

Mr. BENTLEY. Commissioner of Savings and Loan Department of Texas.

The CHAIRMAN. Very well.

(Mr. Bentley's prepared statement follows:)

STATEMENT OF C. E. BENTLEY, ABILENE SAVINGS ASSOCIATION

My name is C. E. Bentley of Abilene, Texas. I am president of Abilene Savings Association with which I have been associated since 1943. The assets of this association are \$60 million, and there are 88 individuals and corporations who own the guarantee stock of this association. My family and I own 51% of the total.

I appear before you because S.B. 1542, called the Holding Company bill, affects our relatively small association. I didn't realize it until last week because I thought the bill only affected the large holding companies. There are hundreds of other small savings and loan associations with guarantee stock that are owned by local businessmen who are going to be mighty surprised and pretty mad when they find out what this bill does to them.

I have built the Abilene Savings Association during the last 24 years. I'm not going to live forever. If I set up a trust for my children with 10% or more of the stock, I have created a holding company as I read S.B. 1542. Does this make any sense? Just because I do some tax planning for the years ahead, the trust I set up becomes a holding company, subject to the cost of registering and sending in reports—two or more a year. The examination we now get from the State of Texas and the FHLBB should tell them how we operate.

Finally, suppose I or my estate need to or want to sell my stock. Suppose any of my 88 stockholders who own the stock have to sell their stock. If S.B. 1542 passes, no existing and active corporation could be a buyer of more than 10% of my association's stock, without thereby becoming a holding company, and prohibited from engaging in any business which a savings and loan association could not engage in. What would this do to the value of the stock of my association and many others? It would depreciate the value because for all practical purposes we could only sell to individuals—and not to corporations which are permitted to buy the stock of any other corporation—bank or otherwise.

I understand the various witnesses are urging the Committee to amend the bill to permit a corporation to buy a single association without becoming a holding company. This is good, but if the Committee does this, it must go further and change the provision that permits the Bank Board to control the debt structure of a corporation owning a savings and loan association. There are many

corporations engaged in many businesses which would not want to come to Washington to get approval every time it wants to raise money for its own operation. As I understand it, if a company owns the stock, and all the stock of one bank—or 24% or less of several banks, no banking agency has control over its indebtedness. Why shouldn't a comparable situation apply in the savings and loan industry.

Thus bill S.B. 1542 will have some affect on the big savings and loan holding companies, but I want the members of the Senate Banking and Currency Committee to know that it will affect hundreds of stockholders of small savings and loan associations much more adversely. I ask you to please don't pass the bill in its present form.

STATEMENT OF JAMES O. GERST, SAVINGS AND LOAN COMMISSIONER OF TEXAS

Mr. GERST. Thank you, Mr. Chairman, for allowing me time to testify before this committee. My name is James O. Gerst, I am the savings and loan commissioner for the State of Texas and I appear in behalf of the Saving and Loan Department of the State of Texas. I will read from a prepared statement and to conserve your time I have kept my statement brief.

I would like to address myself to subsection (c) (2) of the act, Holding Company Activities. We have 189 operating State chartered associations in Texas. Twenty-four of these are mutual type associations and the balance of 165 are permanent stock associations. No mutual charter has been granted since 1947. A very small number of the permanent stock associations within the last 2 or 3 years, at my request, have had to sell additional permanent stock to establish specific reserves. Other associations have sold stock to meet insurance reserve requirements. In most instances this has happened to the newer association. If we had been granting mutual type charter and from our examination of such associations we determined that a specific reserve needed to be established, I don't know where they would have acquired the additional paid-in capital. The directors or shareholders of a mutual institution would have no incentive to pay in funds to establish the reserve.

To raise funds, associations need free access to the money market. Subsection (c) (2) seems to remove a large segment of the financial community and this adversely affects the marketability of permanent stock. To meet the financial needs of our expanding role of thrift and home financing, we must be prepared to undergird increased savings with increased risk capital. The language of this subsection (c) (2) and (g) would make even limited minority investment in savings and loan institutions by corporations, trusts (including pension trusts, testamentary trusts and inter vivos trusts), partnerships and joint ventures very unattractive. In fact the limited scope of their outside activities permitted under this subsection would eliminate most responsible prospective corporate investors.

In conclusion I want to offer my support of those portions of S. 1542 designed to give the Federal Savings and Loan Insurance Corporation the right to examine and receive reports from savings and loan holding companies and their affiliates, but I firmly believe subsections (c) (2) and (g) should be omitted from the bill.

The CHAIRMAN. Thank you very much.

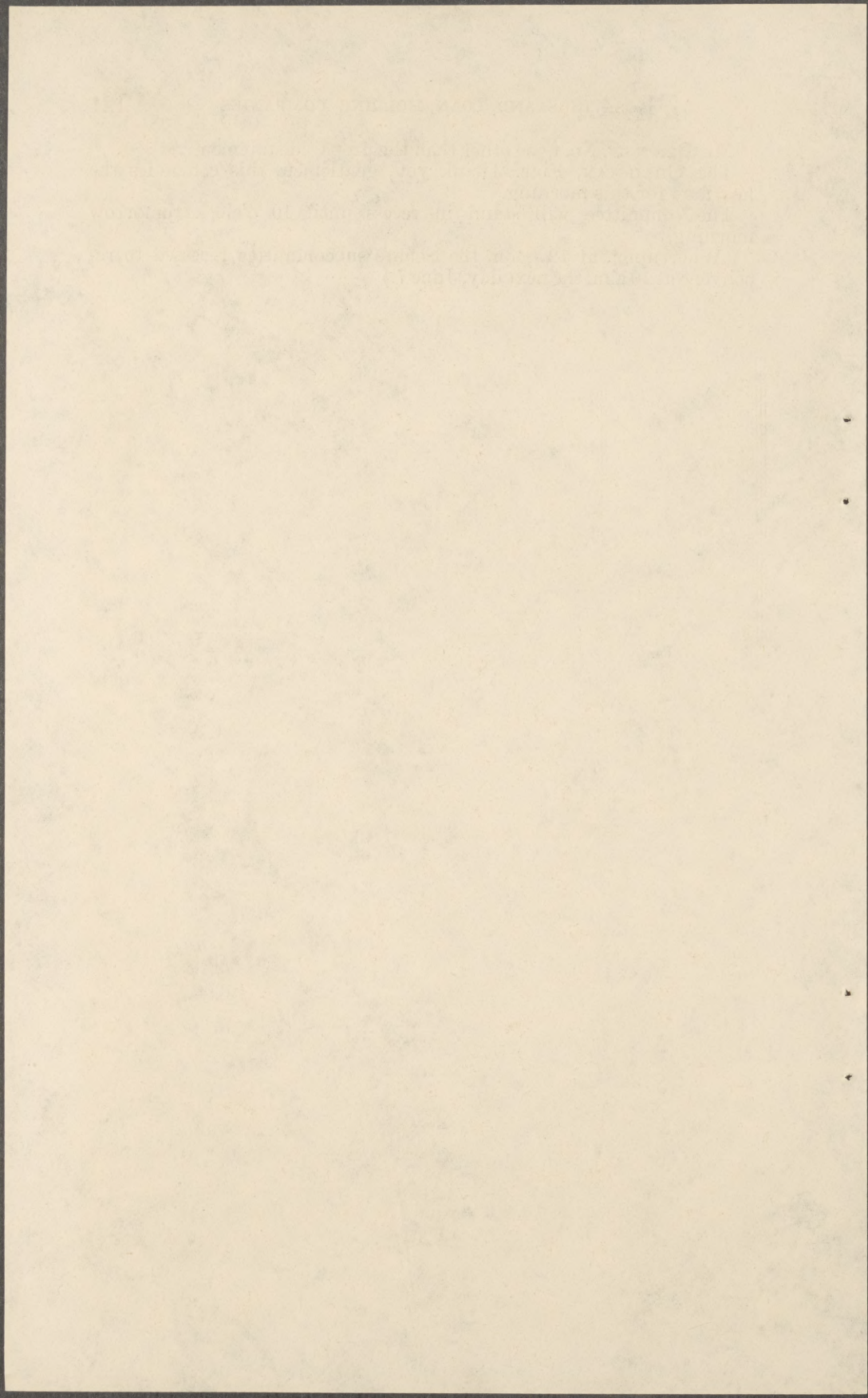
You are not going to make a statement yourself?

Mr. BENTLEY. No, none other than the prepared statement.

The CHAIRMAN. Fine. Thank you, gentlemen, this concludes the hearings for this morning.

The committee will stand in recess until 10 o'clock tomorrow morning.

(Whereupon, at 12 noon, the Senate subcommittee recessed to reconvene at 10 a.m. the next day, June 7.)



SAVINGS AND LOAN HOLDING COMPANIES

WEDNESDAY, JUNE 7, 1967

U.S. SENATE,
COMMITTEE ON BANKING AND CURRENCY,
Washington, D.C.

The committee met at 10 a.m., in room 5302, New Senate Office Building, Senator John Sparkman (chairman of the committee) presiding.

Present: Senators Sparkman, Proxmire, and Bennett.

The CHAIRMAN. Let the committee come to order, please.

I hope that additional Senators will come in, but I think we had better get started. We all have committee meetings today and the Senate is already in session. We have a very long schedule and I would like to finish it if we possibly can this morning.

Our first witness is Mr. Preston Martin, savings and loan commissioner of the State of California.

Mr. Martin, we are very glad to have you.

May I say to all of those who are going to appear this morning all of your statements will be printed in full in the record, so you may handle them as you see fit. You may read them or summarize them and comment on them, just as you wish.

We are glad to have you, sir.

STATEMENT OF PRESTON MARTIN, SAVINGS AND LOAN COMMISSIONER, STATE OF CALIFORNIA

Mr. MARTIN. Thank you, Mr. Chairman.

It is an honor to appear before you, sir, and to present a summary of my written statement on Senate bill 1542.

I would like to begin by stating that at the present time the cooperation between the Division of Savings and Loan of the State of California and the regional home loan bank and that of the Federal Home Loan Board and its staff is excellent and that cooperation and sharing of information is a very vital part of the functioning of our division, in the supervision of State-chartered savings and loans within the State of California.

The division supervises savings and loans with total assets at the moment in excess of \$18 billion and it is certainly a dual supervisory function which is exercised within the State of California.

We currently examine, require reports from, conduct hearings with savings and loan holding companies. Approximately 40 to 50 meetings of boards of directors of savings and loans and of savings and loan holding companies are held at the division's instigation and within the division's premises each year. And the representatives of the su-

pervisory agent and at times a representative of the Insurance Corporation are present at all of these hearings within the division.

So we bring to you a certain amount of experience with a savings and loan holding company supervisory law.

Let me start by saying that there are certain areas within Senate bill 1542 which the division supports. These go to the sections which generally parallel the California law as was testified by my distinguished predecessor, former Commissioner Sadler, yesterday. So in the reporting, the examination, registration, the disclosure features, in other words, we have had a salutary experience with these provisos. We can understand and we support the need of the Federal authorities for this kind of information and these powers.

We would respectfully ask that the language of the appropriate sections be considered in the light of the need of State authorities for a continued flow of information; that the word "may" in the section indicates that it might be possible that the State authorities would not receive information at some future time—I stress the current cooperation among the agencies, but it might be the word "shall" would relieve this anxiety on the part of many State supervisors.

With regard to the notification of dividends and with regard to prior notice of debt financing, it is our position that prior notification of dividends is a salutary thing. We recognize that there can be in some instances a problem with regard to the operating savings and loan if excessive dividends are paid. We also support the prior notification for debt financing. We have had problems in the debt financing area which we recognize and which the Federal authorities recognize.

We would take exception, however, to any fixed ratio which would restrict the amount of debt that a holding company could incur relative to its net worth or relative to its assets. We take this position in the awareness that the extensive study which has been authorized by Congress on the savings and loan industry and upon holding companies, as a part of that study, will provide us with data on which we can make judgments as to the appropriate percentage of the capitalization of a savings and loan holding company, which should come from debt.

We do not feel we have sufficient data to set any kind of ratios and restrictions related to ratios at this time. We would also suggest that our experience with debt financing and with dividends in California indicates that a feasible approach to this subject might be to regulate those savings and loans most closely which appear upon the problem list, or as I believe the distinguished Chairman Horn referred to it, the problem book of savings and loan associations is on the first day of these hearings. The savings and loan industry needs capital. The savings and loan industry across the country will continue to need capital.

The various projections of the housing stock into the 1970's indicate a need in several areas to double the housing stock in order to provide housing for Americans and better housing for Americans.

Rigid restrictions of debt on holding companies across the board rather than specific limits imposed on holding companies with problem savings and loans would, we feel, impede the flow of capital into this industry and into housing.

Now as to the question of divestment of nonsavings and loan holdings by diversified holding companies, we would respectfully call your attention to the data contained in table 1, Mr. Chairman, and members of the committee, in table 1 of my prepared statement, which we put together—it is on the last page—which we put together in an effort to summarize the California experience with six diversified holding companies.

The holding companies are listed in the footnote to the table, sir. The seventh diversified holding company has not owned a savings and loan for a long enough time for us to have any valid experience. But here is 5 years experience. I am sorry it does not match Chairman Horne's data, but I didn't know what years he was going to use, and I used the past 5 years. So the years don't match.

The chairman and the members of the committee can see that the capital contribution of these diversified companies with which we have had experience has been one of capital inflow into the savings and loans which they own.

The total inflow over this period of time has been slightly in excess of \$7 million. The total outflow via cash dividends, management and other fees has been approximately \$2.4 million.

The dividends when aggregated are a relatively small percentage of after-tax earnings during this period of time. So we would submit that our experience, of which this is only just a part, a corner, is that the diversified holding company is one of capital contributions and is one having a salutary effect upon the operations of the savings and loans which they own.

Let me fill in this picture a little more. Six of the seven diversified companies, if we add in the currently acquired one, have not drawn any cash dividends nor management fees since 1963. Risk spreading in these diversified companies has maintained their per-share earnings which have not dropped so much as the per-share earnings of holding companies solely in the savings and loan and savings and loan infrastructure business. Each of these companies owns only one savings and loan and this argues for permitting further acquisition by conglomerate companies of one savings and loan as permitted in the bank Holding Companies Act.

The CHAIRMAN. Let me ask you a question there. You say each of these holding companies. Are you referring to the seven companies, or to all of the companies?

Mr. MARTIN. No, sir; I am referring to the six companies listed here.

The CHAIRMAN. Six out of the seven?

Mr. MARTIN. Yes, sir.

The CHAIRMAN. All right.

Mr. MARTIN. These are one-company holding companies, all of them, and six out of the seven have refrained from drawing in this 3-year difficult period.

The CHAIRMAN. Yes.

Mr. MARTIN. Forced divestment by these existing diversified holding companies, Mr. Chairman, we feel would complicate the supervisory problems. It would complicate the supervisory problem in that we are currently dealing with a number of problem savings and loans. Some of these are far advanced in their difficulties.

The management of these associations is looking for a buyer and the forced divestment in this industry we feel would greatly limit the market for these associations, many of which are small, many of which would appeal only to a company with experience in the field or only to a company with experience in the financial field.

The bill would limit the business of savings and loans, savings and loan holding companies and their subsidiaries to lines of activity closely related to savings and loan operation. It seems to us that these limitations which go against diversification and toward specialization would tend to complicate the adjustment of the savings and loan industry to the basically changing consumer needs in this country.

I am in favor of diversification. I am in favor of diversification within holding companies. My reason for that is our good experience with the diversified companies, and our contact with the consumer markets in our State, where the consumer's needs are basically changing, and in many cases they are changing away from the single-family residence. They are changing away from a passbook savings account. If the Congress in its wisdom severely limits the activities which the holding companies can engage in, we feel it will limit the flow of innovation into this industry at the very time when the industry is in the throes of an agonizing adjustment to basic changes in their markets.

Furthermore, the diversified company and the holding company, as a form, tends to provide additional managements into this industry. This is an industry whose growth has greatly outstripped the ability of any managements group to grow their own middle managements and to know management people.

We need ways of bringing in capable managers, managers with experience in the financial field, but managers who can innovate, who can adjust, who can plan and who can engage in good financial planning.

We really raise the question if this bill is passed in its present form, to whom would the supervisory authorities, Federal and State, be able to sell a problem association?

Let me qualify this statement by saying that it has been the stated policy in the operation of the division since I have been commissioner, to do everything in our power to encourage the small savings and loan association, to permit it to survive. However, there are market situations in which the small association has no choice but to seek a parent or to seek a merger.

On the subject of merger, it has been our experience and the experience alluded to by former Commissioner Sadler yesterday that the current provisions of Federal law which hold off acquisition of a savings and loan until it has indeed reached the point of involuntary liquidation, prevents timely and preventive action in many cases by both the Federal and State authorities, where both authorities have exhausted the possibility of merger of the problem association with a non-holding-company acquirer. There are cases in which there is no small association nearby, which can handle the problem association, lest its own financial soundness be impaired. These market situations extend to the point at which there is no medium-sized or large as-

sociation which is not a member of a holding company, which likewise could acquire this problem association.

We have cases on the books, in our little problem book which we also keep, in which the holding company is the only feasible acquirer. So we are here to testify as to the complication of the supervisory problem which the present limit point for acquisition poses to both supervisory authorities.

On page 4 we have summarized some additional points of objection. We have already mentioned the upstream dividend problem. We think that requirements of notice here might be modified to include only those associations on one or another of the problem lists, either of the Federal or State authorities.

The bill prevents a holding company from doing anything for the association which would be a violation of law or regulation for the association. We feel this is unnecessarily restrictive, since it subjects a holding company to savings and loan rulings, and therefore prevents a holding company, for example, from making a second mortgage loan to a purchaser where the first mortgage loan is being made by the savings and loan. It may be that this is a way to move the problem assets to a buyer, and it may be this is the only way to move the problem assets to a buyer.

The table on the last page which I have alluded to shows some of the secondary financing which has been done by holding companies to favor the working out of problems by the savings and loan.

In summary, Mr. Chairman, the division's objections to this proposed bill are to certain sections. These are the sections which would inhibit the flow of capital into the industry; these are the sections which would make it difficult for both Federal and State supervisory authorities to work out the problems of savings and loans in difficulty. This goes both to the injection of capital by the parent into the operating savings and loan; it goes to the acquisition of problem associations by so-called outsider or conglomerate buyers; it goes to the too late cutoff point for merger with holding companies, with which we have had to deal.

We appreciate the thrust of this legislation. We appreciate the continued cooperation of the home loan bank board, the Board, the distinguished staff.

We submit these suggestions and these objections with care and with the knowledge of the underlying problems of the industry.

That concludes my summary, Mr. Chairman.

(The complete text of Mr. Martin's statement follows:)

STATEMENT OF PRESTON MARTIN, SAVINGS AND LOAN COMMISSIONER, STATE OF CALIFORNIA

Mr. Chairman and Members of the Committee, this is to summarize the position of the Division of Savings and Loan, State of California, as to the probable effects of the passage of the above bill upon its supervision of state-licensed savings and loan associations and their holding companies.

CALIFORNIA STATE SUPERVISION

The Division supervises 195 savings and loan associations with total assets of approximately \$17.9 billion on December 31, 1966. In addition, the Division examines and requires reports from "holding companies" which in 1966 consisted of

155 individuals plus 62 corporations. In 1966, 85 holding companies and 249 non association subsidiaries were examined. Also, 110 corporate and 29 non-corporate holding company reports on financial and operating transactions with association subsidiaries were analyzed. These data, reports and examinations are made available to the Federal Home Loan Bank Board and the San Francisco F.H.L.B. Between 40 and 50 meetings of holding company and savings and loan boards of directors are held at the Division's instigation each year. Federal Home Loan Bank Board system representatives are always present at these meetings.

In 1966, merger and acquisition were used to rescue 11 problem association cases, and each was accomplished through close working cooperation between the Division, the insurance corporation and the F.H.L.B. system.

The Division has enjoyed the fullest cooperation and support of the Board and the San Francisco bank, without which its functioning would be severely limited. For example, 91% of our examination activity in 1966 was jointly activity with F.H.L.B. system examiners.

California officials are grateful for the courtesy and cooperation of Chairman Horne, his associate members and his staff in their attention to our views of negotiation and other matters affecting state savings and loans. The comments which follow reflect our concern as to S. 1542's probable impact upon the exercise of state supervisory powers in California.

The Division generally supports the section of S. 1542 dealing with disclosure, divided notification, and notification of debt flotation, as defined. It opposes the sections dealing with merger and acquisitions, with divestment by diversified holding companies, and with limitations upon debt funding in the manner proposed.

MERGER AND ACQUISITION

Acquisition of state associations and holding companies, particularly those with problems of non-earning assets, low capital ratios, and worsening operating results, has been used to protect the public from losses and the insurance corporation from financial burdens. These supervisory tools will be vital to this large segment of the national savings and loan industry in coming years.

S. 1542 would effectively close the avenue of savings and loan acquisition by firms outside this industry. It would compel divestment by existing diversified "outsiders."

The California experience has been that the diversified holding company has performed in a manner superior to holding companies with only savings and loan, escrow, and insurance operations.

California's diversified or "conglomerate" holding companies have contributed significantly more capital into their savings and loans (\$4.67 million) than they have drawn in the form of cash dividends, plus management fees during the last five years, 1962-1966. Table I shows the data, with the individual companies aggregated to protect their identities.

Only one of these seven companies has failed to provide net capital inflows. The table shows that dividends plus management fees have amounted to a reasonable percentage, about 9%, of net earnings. Six out of the seven companies have not drawn any cash dividends nor management fees since 1963, thus removing upstream cash drains during these last three most difficult years. Risk spreading has maintained per share earnings compared to specialized holding companies.

Each of these holding companies owns only one savings and loan. This argues for permitting further acquisition by conglomerate companies of one savings and loan, as the Bank Holding Companies Act (12 USC 1841-1848) does.

Forced divestment by existing diversified holding companies would place a further burden of sale upon the industry at a time when investor interest is minimal and earnings aggravate the present over-specialization of savings and loan associations to which Vice Chairman Robertson of the Federal Reserve has alluded to as comparable to the specialization of the Brontosaurus Rex.

The bill limits the business of savings and loan holding companies and subsidiaries only to lines of activity related to savings and loan operation. It would prevent risk spreading of diversified asset portfolios. The industry's very specialization, which S. 1542 would promote, has led it to the difficulties of the mid-1960s. Housing markets are extremely cyclical. Overbuilding produces scheduled items. Underbuilding produces operating losses.

Specialization is the antithesis of risk spreading. This is particularly true of rapid growth areas like Texas and California, where capital must be imported in magnitudes in the billions.

The Division's "problem" list of 45 savings and loans June 1, 1967, included 16 holding company subsidiaries of 10 holding companies. No subsidiaries of diversified holding companies were on that list.

The Division's current problems with holding company subsidiaries are concentrated in 10 out of 52 corporate holding companies which operate solely within the savings and loan industry and with the industry's intra-structure (insurance, escrow and related activities). Only one of the seven diversified holding companies on June 1, 1967 had a savings and loan on the monthly reporting list of problem associations maintained by the Division.

MERGERS

Senate bill 1542 would prevent holding companies from acquiring additional associations or holding companies by purchase or merger unless the association is *in extremis*. Present legislation and S. 1542 prohibits timely and preventive board action where holding companies are the only possible acquirer. This greatly impedes the work of supervision in a number of problem cases before the Division currently. In several cases an association is operating at a deficit, has inadequate management, and a deteriorating portfolio value, yet it is not at the very stage of involuntary liquidation. These savings and loans cannot be merged with holding company subsidiaries. Washington Savings and Loan Association, acquired by Lincoln Savings and Loan Association in 1966, would not qualify for example. It is not in the public interest to waste assets and to imperil the business reputation of the sound financial institutions in the same savings markets with the problem operators by precluding timely and preventive action prior to the point of involuntary liquidation.

ADDITIONAL POINTS OBJECTED TO

The requirements of a notice period prior to the "upstream" dividends and fees should be modified to include only those cooperative relationships where such payments appear to have the possibility of impairing the financial soundness of the operating savings and loan associations. Perhaps a suitable test would be whether the savings and loan affected were on the "problem list" of the Board or the state supervisory authority.

The bill prevents a holding company or subsidiary from doing anything for the association which would be a violation of law or regulation for the association. This may be unnecessarily restrictive since it subjects a holding company to savings and loan rules. For example, it would prevent a holding company making a second mortgage loan to a purchaser buying real estate from an association. This has been a means of helping get rid of excess real estate. I do not believe a holding company should be restricted to savings and loan association rules.

The close restriction on holding company borrowing and upon transactions with "affiliates" will inhibit capital inflow to the industry in the future from the capital market. This in turn will reduce the flow of funds from the savings and loan associations into the housing market across the country. The savings and loan industry needs added capital and additional management to pursue its long-run function of financing housing growth.

A final point of objection comes to the wording of the bill related to the sharing of information on holding companies by federal examiners with state officials. The language indicates that such reports *may* be furnished to state supervisors. I would respectfully urge that the language be modified so that federal agencies could accept a joint examination process in states where holding companies are now examined, in accordance with present joint examinations of operating companies. In California, both the federal and state supervisory agencies have found joint examinations to be quite satisfactory. In 1966, 193 such examinations were held.

In summary, my opposition to certain sections of S. 1542 is based upon careful consideration of both its positive and its potentially negative impact upon state supervision, now and in the future. Holding company supervision and examination by federal and state officials is vital. Likewise, diversification within the industry and acquisition from without the industry is patently necessary to solve supervisory problems and to improve the level of public service rendered by this major component of the housing industry.

TABLE I.—California "diversified" holding companies,¹ capital flows and earnings in their savings and loans

Year	After tax earnings	Cash dividends	Management and other fees	Purchases: real estate owned and loans	Secondary financing supplied	Capital contribution and loans	1962-66	
							Total outflow	Total inflow
	(1)	(2)	(3)	(4)	(5)	(6)		
1966-----	\$1,663,269	\$133,020	-----	\$3,098,542	\$558,972	\$500,000	\$133,002	\$4,157,514
1965-----	6,527,899	199,503	-----	949,281	612,618	-----	199,503	1,561,899
1964-----	6,591,655	256,501	-----	817,160	103,856	400,000	256,501	1,321,016
1963-----	6,116,320	234,337	-----	-----	-----	-----	234,337	-----
1962-----	7,420,132	1,543,260	-----	-----	-----	-----	1,543,260	-----
Total-----	28,319,275	2,366,603	-----	4,864,983	1,275,446	900,000	2,366,603	7,040,429

¹ Jim Walter Corp., National General Corp., Sears, Roebuck, Allstate Enterprises, Tower Financial Corp., Coastline Financial, and Budget Holding Co.

The CHAIRMAN. Mr. Martin, you said that perhaps this legislation would make it impossible for a holding company to take over a weak or failing savings and loan association. Do they, as a rule, take them over, at the present time? Do you know of any holding companies that have taken over failing savings and loan associations?

Mr. MARTIN. Well, yes, in 1966 there were a number of acquisitions, mergers really, of problem associations by holding companies in California.

We have alluded to one in the prepared statement. My argument was that the current legislation, currently on the books, is more restrictive than prior legislation in that it requires these associations to be on their death bed, whereas prior legislation gave the Board the power to, after study and looking at the recommendations of the State people, to say yes or no for an acquisition. The Board doesn't have that power now until the association is at the point of involuntary liquidation.

Now this is different from the acquisition, the mergers by holding companies in the past. And we believe it is unduly restrictive.

And there have been denials by the Board of acquisitions in which the bank, in San Francisco and ourselves, have carefully canvassed the market to find a buyer and the only buyer was a holding company, yet the savings and loan was in bad shape, but was not on its death bed. We are simply asking for restoration of powers to the Board.

The CHAIRMAN. There is another thing I want to ask you about in your statement on the inflow and outflow of money.

Mr. MARTIN. Yes, sir.

The CHAIRMAN. It seems to me there is quite a difference between your figures and those of Chairman Horne. Now I believe you said something about being based on different years. Is that right?

Mr. MARTIN. Yes. There are two points of difference, Mr. Chairman. One is I didn't know what years Mr. Horne was going to use, so I only used 1962-66. We thought these were the critical years.

The CHAIRMAN. You used 1962-66?

Mr. MARTIN. And the Chairman went back to 1959.

The CHAIRMAN. What figures did you get on 1962-66? What was the inflow? The inflow and outflow?

Oh, I remember. Seven million dollars was the inflow and \$2.6 million was the outflow.

Mr. MARTIN. Excuse me—\$2.4 million; yes, sir. We simply took the operating statements of these companies and added up these categories for them. The second difference, Mr. Chairman, is that—

The CHAIRMAN. Now isn't it true though in giving your figures you have selected only these seven companies, whereas Chairman Horne took all of them in California and if we use his figures—not in California, I mean nationwide.

You took seven in California.

Mr. MARTIN. The figures I saw on the first day I think were all holding companies. We just have the diversified holding companies.

The CHAIRMAN. In other words, you are narrowing your statement in that respect to the diversified?

Mr. MARTIN. Yes, sir. Diversified holding companies, right.

The CHAIRMAN. I noticed the figure in Chairman Horne's table 4 that if you take the same 6 years, the same 5 years that you used, 1962-66, and apply it to the holding companies, all of them in all of the States, the inflow would be \$30 million and the outflow \$51 million?

Mr. MARTIN. Yes, sir, that is all holding companies?

The CHAIRMAN. Yes. I mean in all of the States, not just in California.

Mr. MARTIN. Yes, sir; right.

The CHAIRMAN. One thing I think we have to keep in mind is that whereas the situation might show up well in one area, we have got to consider the whole area?

Mr. MARTIN. Yes, sir; I quite agree with that.

The CHAIRMAN. Don't you think these are a little discouraging?

Mr. MARTIN. Yes, I think they are discouraging.

The CHAIRMAN. Apparently they were part of the argument that Chairman Horne was making in behalf of the legislation. How do you explain the fact, as Chairman Horne testified on Monday, that there is a disproportionation number of problem savings and loan associations which are controlled by holding companies?

Mr. MARTIN. Well, again going to our California experience, I went through the list of associations on our list, our monthly reporting schedule list, and I found that of the 32 corporate holding companies, 10 of them had one or more associations on that list.

I would say that the problem, therefore, and looking at a further breakdown of the list, the problems are concentrated in those 10 holding companies in California and they are further concentrated within the 10. So that is the reason I tried to supply some breakdown in my analysis here to show that the problem is pretty concentrated, that it is not characteristic of each holding company. And the Chairman so testified here.

The CHAIRMAN. Do you feel that any of the California holding companies are in some difficulty due to an overextended credit structure?

Mr. MARTIN. Yes, sir; I do believe that.

The CHAIRMAN. Could you say how many?

Mr. MARTIN. I wouldn't be able to say offhand. Just as an off-the-cuff thing, Senator, six or seven.

The CHAIRMAN. Six or seven?

Mr. MARTIN. Yes, sir.

The CHAIRMAN. That is all right that you show reluctance to give the figure because you don't have it. But if, when you think it over, you want to correct the figure, you may do it. The record will be open for some time.

Mr. MARTIN. All right. I will get the data.

The CHAIRMAN. Fine.

Do you believe that the Board should be given authority or additional authority to deal with this problem, over extended debt structure?

Mr. MARTIN. Yes, sir; I believe the Board should be given the power to require prior notice before the debt, as defined in the proposed bill, as incurred. I think given that power it might be that the Board would operate particularly with cease and desist powers upon those associations related to holding companies on their problem list.

The CHAIRMAN. Now I notice in your statement there is a good deal in the bill you approve of?

Mr. MARTIN. Yes, sir.

The CHAIRMAN. And you have pointed out specifically those things which you do not approve of?

Mr. MARTIN. Yes, sir; I have. The transactions among affiliates, to the extent to which those sections parallel the California law, we have found this to be a good supervisory tool. We have used it and we certainly support that approach on the part of the Board.

The CHAIRMAN. Someone has suggested that there might be a provision whereby, a parallel course to the Bank Holding Company Act might be followed?

Mr. MARTIN. I think it can be paralleled, Mr. Chairman, at times, where the two kinds of institutions are the same. I think it has to be modified in other areas where the operations are not the same. I think it depends on what aspect of the savings and loan business it deals with.

The CHAIRMAN. Some of your holding companies hold two or more?

Mr. MARTIN. Yes, sir.

The CHAIRMAN. You do not believe there ought to be any required divestment?

Mr. MARTIN. I don't believe at this time, Mr. Chairman, we have enough knowledge of the operation of the multicompany, holding company, versus the single.

The CHAIRMAN. I want to make it clear, I was not referring to the associations, but to the unrelated businesses. You do not believe they ought—

Mr. MARTIN. No, I don't have a basis to draw a line at this time. Some of the multicompany holding companies, as Chairman Horne testified, are good guys.

The CHAIRMAN. Of course you know the Bank Holding Act does require divestiture?

Mr. MARTIN. Yes, sir. But you see—I think I can refer to that a little more directly, Mr. Chairman. Savings and loans operate within limited submarkets, little parts of a State. Commercial banks operate over a much larger area and particularly in California they operate in a much larger area, as the chairman knows. So there is not the overlapping of markets you see of the savings and loan in town A and in town B. They are serving separate submarkets.

The CHAIRMAN. Well, thank you very much, Mr. Martin. I wish we had time to discuss this at length, but we appreciate your statement.

Mr. MARTIN. I appreciate the privilege of appearing, sir.

The CHAIRMAN. Mr. C. Elwood Knapp, chairman, U.S. Savings & Loan League.

STATEMENT OF C. ELWOOD KNAPP, CHAIRMAN, U.S. SAVINGS & LOAN LEAGUE, ACCOMPANIED BY T. BERT KING, WASHINGTON COUNSEL; AND STEPHEN SLIPHER, STAFF VICE PRESIDENT AND LEGISLATIVE DIRECTOR

The CHAIRMAN. For the benefit of the record, will you identify your companions?

Mr. KNAPP. This is Stephen Slipher, vice president, U.S. Savings & Loan League and manager of the Washington office; and T. Bert King, Washington counsel for the U.S. Savings & Loan League.

The CHAIRMAN. We are glad to have you all here. You may proceed as you see fit.

Mr. KNAPP. I am C. Elwood Knapp, past president of the U.S. Savings & Loan League and chairman of the league's special committee to study holding company legislation. I am also president of the Friendship Federal Savings & Loan Association, of Pittsburgh, Pa. My association, like all federals and most State chartered associations, is a mutual institution. Mutual institutions, of course, are owned by their savers and are not subject to ownership or control by a holding company.

The U.S. Savings & Loan League sponsored legislation to deal with holding companies in the savings and loan field promptly after the first one was organized in 1955. It endorsed the original savings and loan holding company law now known as the Spence Act. This was initially a temporary ban on the expansion of savings and loan holding companies and gave the Federal Home Loan Bank Board minimum powers over transactions between holding companies and their savings and loan affiliates. This temporary legislation was made permanent in 1960.

For a number of years the U.S. Savings & Loan League's official legislative program has included endorsement of a strong holding company law. We agree with the administration and Federal Home Loan Bank Board that the time has come to replace what admittedly was a stopgap measure, which is now on the books, with permanent, carefully conceived legislation based upon experience in the savings and loan field with the operations of holding companies—a law that appropriately will regulate and control the activities between holding companies and savings and loan affiliates in the public interest. There now has been sufficient experience in this field to permit Congress to write an adequate law, and we hope such a law will be written this year. There should be no further delay.

The heart of this legislation is the requirement that savings and loan holding companies register with the Federal Home Loan Bank Board and be subject to examination by the Board. This is essential if the Board is to be able to spot potential problems, uncover any abuses that may exist, prevent any activities which would weaken savings and loan associations and increase the risks to potential losses of the Fed-

eral Savings and Loan Insurance Corporation. Such examination also would be necessary to develop any future legislation which may be needed.

California, the home of the majority of savings and loan holding companies, enacted a law requiring registration and examination several years ago. This law, of course, does not give the Federal Home Loan Bank Board the picture with respect to the operations of holding companies that operate in other States. The Federal Home Loan Bank Board through the Federal Savings and Loan Insurance Corporation, of course, has a major interest in the operation of California savings and loan associations and California holding companies.

Another key feature of S. 1542 is the prohibition against certain dealings between holding companies and subsidiaries or transactions between holding companies and affiliates. These provisions are essential to enable the Federal Home Loan Bank Board to prevent any improper dealings or arrangements between the holding company and affiliate.

The concern of the U.S. Savings & Loan League is with the welfare of the individual savings and loan association, not holding company activities per se. The league's responsibility is in preserving the strength and service of savings and loan associations everywhere, including those owned by holding companies.

Included in the Board's purview of transactions between holding companies and subsidiary associations is the proposed authority in this legislation to require associations owned by holding companies to give the Federal Home Loan Bank Board 30 days notice of any dividends being paid on guarantee stock—so-called upstream dividends. This law itself would not give the Board authority to prevent the payment of any dividend, but it would permit the Board to proceed under other basic savings and loan statutes to prevent the payment of dividends if it could prove that it would improperly add to the risks of the FSLIC. This type of supervision over transactions between holding companies and affiliates we feel is necessary and appropriate to prevent the possible weakening of insured institutions owned by holding companies.

The CHAIRMAN. Mr. Knapp, I am sorry, I have a very important meeting I need to be in right now. Senator Proxmire has come and kindly agreed to preside. I apologize for leaving.

I will read your statement in full with great interest. I will be back as soon as I can, but I don't know how long that will be.

Mr. KNAPP. All right.

Senator PROXMIRE (presiding). You might proceed, sir.

Mr. KNAPP. Thank you.

Unlike the bank holding company law, we believe that the registration, examination, and control of transactions between holding companies and affiliates should be applied to all savings and loan holding companies and all corporations which control the stock of an association whether the holding company or corporation owns one or several associations. The bank holding company law applies only to corporations or holding companies which control two or more banks. We believe that the savings and loan holding company law should depart from the bank law in this major respect and apply to every savings and loan holding company and corporate owner.

The fact is that most savings and loan holding companies own but one association and some of the units held by the holding companies are very large. Data indicate that 84 holding companies own only one association and 12 have more than one. Thus the possibilities of abuse and added risks to the FSLIC are just as great in the case of a holding company which owns one large association as in the case of holding companies which may own several small ones.

We believe that these requirements as to registration, examination, and control of transactions should apply to all corporations which own an association and not be limited to corporations whose sole or principal business is the owning of savings and loan associations. There are a number of instances of so-called general purpose corporations which have a significant or 100-percent interest in a savings and loan association as an investment just as some corporations own a commercial bank or insurance company as an investment.

There is one feature of this bill that gives the officers and legislative leaders of the U.S. Savings and Loan League concern and that is the potential effect of one of the provisions of the bill upon the approximately 600 so-called independent or family owned stock-type associations. Section (c), beginning at the bottom of page 5 of the bill, discussing "holding company activities," would limit the activities of any corporation which owns more than 10 percent of the savings and loan stock almost exclusively to the business of owning savings and loan associations. This is somewhat similar to the provisions of the bank holding company law, but the bank holding company law applies only to corporations which own more than one association.

Our concern is not so much with the activities of present-day so-called holding companies but the effect of this provision in the bill upon the marketability of the guarantee stock of the nonholding company associations. These associations operate in some 20 States. They are family owned or owned by a scattering of people in the community. The effect of this provision in the bill would be to severely limit the market for the stock of these associations.

The stock of these associations, of course, must be sold from time to time, particularly in the settlement of estates. If this law were passed in this form, corporations in effect would be prohibited from buying the stock of any one of the existing nonholding company owned associations. Ofttimes the market price to a corporate purchaser would be higher than would be the case if the stock could be sold only to individuals.

Some of these associations are of considerable size. It might, in fact, be impossible for a family to sell its stock upon liquidation of an estate if corporations were, in effect, prohibited from buying more than 10 percent of the stock of an association. We do not think there are any particular potential abuses necessarily inherent in corporate ownership. Corporate ownership exists in commercial banking and exists in the insurance field. With adequate power of the Board to examine the records of a corporate owner insofar as their records relate to their savings and loan holdings, and with the Board having adequate power to control transactions and prevent abuses, we see no good reason to deny the corporate market to the owners of the stock of savings and loan associations who may at some future date want to sell their stock.

A practical way to solve this problem is to amend the bill to provide that the prohibitions in section (c) relating to holding company activities shall apply only to those holding companies which own more than one association. The bill in this instance would be similar to the bank holding company law.

Again, with the registration, examination, and supervision of transaction sections apply to all corporate owners, whether they own one or more than one, the possibility of abuse through such an amendment to this section relating to holding company activities we think would be eliminated.

There is another feature of the bill that should be amended in this same connection. Section (g) on page 12 entitled "Holding Company Indebtedness" would require that any holding company or corporate owner of a savings and loan association would have to have Federal Home Loan Bank Board approval prior to the issuance of any debt of a longer maturity than 9 months or in excess of 5 percent of the net worth of such corporation. Obviously, if general purpose corporations are to be permitted to own savings and loan associations, and permitted to buy more than 10 percent of the stock of an association, it would be impractical for the Board to be approving the debt issuance of a wide variety of corporations whose ownership in a savings and loan association might be just one of many investments. Some associations are owned by finance companies or insurance companies. These are owned as investments. If this kind of ownership is to be permitted to continue and similar general purpose corporation investments are permitted in savings and loan guarantee stock, then obviously the Federal Home Loan Bank Board could not and should not be put in the position of having to approve the debt structure of such corporations.

This particular section was not in previous holding company bills before this committee and we suggest that it should be eliminated entirely both as its applicability to corporations owning one or several savings and loan associations.

In connection with the activities of savings and loan associations, we believe that the Board in drafting section (c) has left itself too little flexibility. We suggest a number of technical amendments, not changing the thrust or purpose of this section in the slightest but merely giving the Board a little more flexibility in approving activities other than those specifically enumerated in this section. The precise changes we suggest in subsection (2) of section (c) are shown in the attached addendum to this statement.

The United States Savings & Loan League believes that savings and loan holding companies should be prohibited from owning associations in more than one State. We do feel, however, that the few holding companies that presently operate in more than one State should not be required to divest themselves of ownership of associations outside the principal State in which they do business. Thus a grandfather clause permitting operations in their several States should be permitted.

The bill should provide that if any expansion is permitted under law, this should be limited to the State such holding companies would declare to be the principal State in which they do business. There should be no further holding company activities across State lines either by merger or by purchase.

Finally, we believe that the provisions prohibiting individuals from doing certain things prohibited to their holding companies should be eliminated. This legislation should confine itself to corporate activity and not get into the field of personal action. We do not believe there has been sufficient abuses nor do we see potential abuses as a result of personal ownerships. Furthermore, we are quite uncertain as to the long-range effect of these provisions in the bill. If problems arise through the personal investments of individuals and personal activities of individuals associated with holding companies, then the Board will be able to document these rather easily as a result of the new power of examination it will receive as a result of this legislation and it can come to Congress and document its case for this type of control.

Let me say that aside from these proposed amendments designed chiefly to protect the marketability of the stock of existing privately owned or family owned associations, together with some other minor technical amendments we will discuss with the staff, we believe the bill, as proposed, is a good bill.

Again, we hope that Congress will pass this legislation this year. We believe with these amendments that S. 1542 will be in the public interest and will protect the long-run health and service of the savings and loan business.

NOTE.—The United States Savings & Loan League has a membership of 5,100 savings and loan associations, representing over 95 percent of the assets of the savings and loan business. League membership includes all types of associations—Federal and State chartered, insured and uninsured, stock and mutual. The principal officers are Otto Priesler, president, Chicago, Ill.; Hans Gehrke, Jr., vice president, Detroit, Mich.; C. R. Mitchell, legislative chairman, Kansas City, Mo.; Norman Strunk, executive vice president, Chicago, Ill.; and Steve Slipher, legislative director, Washington, D.C. League headquarters is at 221 North LaSalle Street, Chicago, Ill.; and the Washington office is maintained at 425 13th Street, NW., Washington, D.C.; Telephone 638-6334.

(The addendum follows:)

ADDENDUM

"(2) commence, or continue for more than two years after the enactment of this amendment or for more than one hundred and eighty days after becoming a savings and loan holding company or subsidiary thereof (whichever is later), any business activity other than (A) furnishing or performing management services for a subsidiary, (B) conducting an insurance agency or an escrow business, (C) holding or managing or liquidating assets owned by or acquired from a subsidiary, (D) holding or managing properties used or occupied by a subsidiary, or (E) furnishing or performing such other services or engaging in such other activities as the Corporation may approve as being a proper incident to the operations of savings and loan holding companies or their subsidiaries and not detrimental to the interests of savings account holders in any such subsidiary insured institution. The Corporation may, upon a showing of good cause, extend such time from year to year, for a period not exceeding five years, if the Corporation finds such extension would not be detrimental to the public interest."

Senator PROXMIRE. Thank you, Mr. Knapp. On page 4 you discuss in more detail the marketability problem. Couldn't that be solved by permitting holding companies to acquire more than one savings and loan subject to Board approval? In this way the holding companies would become a potential market, rather than corporations.

I wonder if you considered this as an alternative to the marketability problem?

Mr. KNAPP. Could I ask Mr. Slipher to speak to that?

Senator PROXMIRE. Yes.

Mr. SLIPHER. Senator, that would help solve the marketability problem, but our league is not ready yet to open up the whole acquisition field.

Senator PROXMIRE. It would open it up of course subject to Board approval. The Board would have to consider it, and I presume, knowing the Board, and you know it well, they are men who understand the industry and men of integrity, that they would be very careful on this.

Mr. SLIPHER. It would be difficult for the Board to turn down an acquisition unless there was some statutory inhibition.

Now, if you are talking about problem cases, I think we would agree with that, but if you are talking about pure acquisitions, that opens up the whole field.

Senator PROXMIRE. What was your first comment?

Mr. SLIPHER. If you are talking about problem associations, acquisition of a problem savings and loan, we might agree with that.

Senator PROXMIRE. How about acquisition by merger, not just problem companies.

Mr. SLIPHER. Acquisition by merger would be all right.

Senator PROXMIRE. I don't see any difference between acquisition by merger and just acquisition. You say the acquisitions should be confined to problem savings and loans, is that right?

Mr. SLIPHER. Yes. We don't think it should just be an open field for acquisitions.

Senator PROXMIRE. Thank you very much, Mr. Knapp, we very much appreciate your testimony. It is mighty comforting that your fine association supports the bill as you do and I think your amendments are very interesting.

Thank you.

The next witness is Mr. Edmond F. Dagnino, Legislative Chairman, National League of Insured Savings Associations.

**STATEMENT OF EDMOND F. DAGNINO, LEGISLATIVE CHAIRMAN,
NATIONAL LEAGUE OF INSURED SAVINGS ASSOCIATIONS, AC-
COMPANIED BY KENNETH G. HEISLER, EXECUTIVE DIRECTOR,
AND WILLIAM J. KERWIN, EXECUTIVE VICE PRESIDENT**

Senator PROXMIRE. Mr. Dagnino, you may handle this in any way you wish, you may read the statement or place it in the record, how ever you wish.

Mr. DAGNINO. I will read the statement, sir.

On my right is Mr. Kerwin, executive vice president of the national league, and Mr. Heisler, executive director.

Mr. Chairman, I appreciate the opportunity to outline the views of the National League of Insured Savings Associations on S. 1542, which would amend Section 408 of the National Housing Act to provide for the regulation of savings and loan holding companies.

I am Edmond F. Dagnino, legislative chairman of the national league and president of the Boston Federal Savings & Loan Association of Boston, Mass. As you may know, there are no savings and loan holding company operations in the State of Massachusetts. In accordance with your request, Mr. Chairman, I shall be brief in my presentation.

At the outset I should like to emphasize that the national league supported enactment of the present Savings and Loan Holding Company Act. Generally speaking, the membership of the national league has favored maximum flexibility for savings and loan management and minimum restriction on association operations in the belief that such policies would facilitate homeownership. To this end, we have favored for more than 10 years the vesting of regulator authority within the Bank Board on the operations of savings and loan holding companies rather than statutory prohibition of the type embodied in S. 1542. Accordingly, we support the regulation by the Federal Home Loan Bank Board of savings and loan holding companies in the same manner by which it now regulates savings and loan associations and in which the Federal Reserve Board regulates holding companies.

On February 21, 1957, the national league made the following statement to the House Banking Committee in support of the present savings and loan holding company law: "We see the practical difficulty involved in prohibiting any type of operation unless it results in monopoly or restraint of trade but do not see any difficulty in regulating holding companies and believe it is fair and proper to do so."

The present holding company law was enacted in 1959 as stopgap legislation pending a study by the Federal Home Loan Bank Board. The Board subsequently recommended that the law, which in effect bans additional savings and loan acquisitions by holding companies, be made permanent. The Federal Home Loan Bank Board now has come forward with a refinement of the present law to require registration, regular reporting and examination of holding companies, and new prohibitions of certain types of business activities in addition to the present ban on acquisitions.

As a league, we favor those provisions of S. 1542 which would require savings and loan holding companies to register and report regularly to the Federal Home Loan Bank Board and submit to Federal Home Loan Bank Board examination. We note, in passing, similar requirements under the Securities and Exchange Act and the laws of California. Basically, S. 1542 is a bill which does not regulate in the same manner as the Bank Holding Company Act, but rather is prohibitory in nature, banning by statute certain activities which we believe might better be left to the regulatory discretion of the Board.

Moreover, S. 1542 is more restrictive than the Bank Holding Company Act in several important respects. For example, a bank holding company comes under the act when it controls 25 percent or more of the voting shares of two or more banks. Under the pending bill, any company having control over more than 10 percent of the stock of a savings and loan association automatically becomes a holding company.

The Federal Reserve Board has the regulatory authority to approve or disapprove mergers in the bank holding company area, but savings and loan holding companies are now and would be prohibited from merging except with institutions not in the best of financial health. Presently the Board permits mergers of Federal and State chartered associations, and we believe savings and loan subsidiaries of holding companies should have the same right of merger as Federals and other State chartered associations. We think the question of mergers and

acquisitions would be better left to the Federal Home Loan Bank Board, as opposed to outright prohibitions on mergers and acquisitions.

Another provision of the bill would require existing holding companies to dispose of all subsidiary savings and loan associations not located in the home State of the holding company. Inasmuch as some mutual associations are presently authorized to maintain and do maintain branch offices across State lines, we believe enactment of a ban on interstate operations by holding companies may set a precedent which could be applied to mutual institutions and again would represent a form of discrimination difficult to understand.

With respect to other features of the bill, we believe that provisions which would restrict the operations of holding companies and require divestment deserve close scrutiny by the committee. Under provisions of the bill—to cite an example—stock-type association could not sell more than 10 percent of its stock to another corporation unless the corporation agreed to divest itself of business activities unrelated to the savings and loan association. This would restrict marketability of hundreds of independent non-holding-company stock associations on a basis that would be far more severe than any similar restriction applied in the sale of commercial bank stock, and we would urge that this be deleted from the bill.

Similarly, we do not believe the Congress should enact the provision which would require holding companies to secure Board approval of any debt security except in certain limited circumstances. Equipped with ample disclosure and reporting requirements and “cease and desist” authority, we believe that the Board has the power necessary to insure the safety and soundness of individual associations in connection with the purchase of debt instruments of a parent company. We note that the Federal Reserve does not have similar restrictions on the debt structure and investments of corporations owning bank stock.

With respect to the issue of diversification of investments, we urge the committee to take note of the fact that many objective observers—including the Commission on Money and Credit and the so-called Heller Committee—have recommended broader investment powers for savings and loan associations to enable them to perform more efficiently as home mortgage lending institutions. Had this been the case in the last several years, we believe that some of the problems which developed in the savings and loan industry might have been averted because our institutions would have had greater investment flexibility to earn profits necessary to meet the high cost of money. In this connection, we would point out that in 1964 the Congress passed legislation to authorize Federal associations to invest 1 percent of their assets in equity ownership of business corporations in an effort to help these institutions to diversify their operations.

As a league, we are committed to the proposition that savings institutions must have broader investment powers in order to survive intensified competition for savings funds and provide the public with economical home financing. Corporations generally are engaging in an intensified campaign of diversification. This legislation would reverse this trend for the savings and loan business by relegating the industry to a secondary position in the quest for investment capital.

During the last several years, the savings and loan business has been

sharply oriented toward concepts which govern commercial banking. For example, we have quite similar capitalization requirements. By virtue of the Financial Institutions Supervisory Act of 1966, we have the same type of Federal supervision. Regulatory changes soon to be adopted will give us identical Federal insurance coverage. The new Federal rate control law promises in time to remove any remaining rate distinctions in the competition for savings.

In the face of tremendous demands for funds to house the American people, we believe that the savings and loan industry needs the help and assistance of the Congress to be in a position to acquire the savings to meet these home financing requirements. Greater diversification of investments by the savings and loan industry would help to meet this objective.

Thank you for this opportunity to present the views of the national league on this matter.

Senator PROXMIRE. Thank you. You indicate, Mr. Dagnino, that this bill would restrict the marketability of savings and loan associations. Have you thought at all of savings and loan associations going public and selling their shares to the public in the secondary market. I am talking about including—

Mr. DAGNINO. Are you talking about mutuals going public?

Senator PROXMIRE. Stock going public.

Mr. DAGNINO. Stock going public. There are some now, aren't there, through the holding companies?

Senator PROXMIRE. Through the holding companies. Why can't they do it through investment bankers?

Mr. DAGNINO. I don't see why they couldn't, Mr. Chairman. I don't see why they couldn't.

Senator PROXMIRE. Wouldn't this be an alternative worth exploring?

Mr. DAGNINO. It could be.

Senator PROXMIRE. It may be it would be confined to the larger ones. Obviously a small savings and loan going public, the experience I have had in investment banking is pretty limited, but it would suggest to me you have to have a reasonably substantial corporation before there is any feasibility in selling to the public, because of the necessity of investigation and so forth.

But I think this is something we might look into and explore.

Mr. DAGNINO. Well, Mr. Chairman, at the present time the national league is working on a Federal stock capital bill which would include such a provision. This is something we are working on.

Senator PROXMIRE. Yes. There is one other question. You indicated this bill would reverse the trend for savings and loans to diversify their investments. You say that on page 5. I wonder how this would happen? What restrictions are there in the bill which limit the investment powers of the savings and loan, other than in investing in an affiliate of the holding company?

Mr. DAGNINO. I didn't get your question, Senator.

Senator PROXMIRE. You indicate that this bill would restrict the opportunity for savings and loans to diversify their investments. That is on page 5. You say, "This legislation would reverse this trend for the savings and loan business by relegating the industry to a secondary position in the quest for investment capital." I am wondering how this

would happen, what restrictions there are in the bill which limit the powers of the savings and loan in this respect.

Mr. DAGNINO. May I ask Mr. Heisler to answer that?

Senator PROXMIRE. Yes.

Mr. HEISLER. Our position there, Senator, is that at a time when corporations generally are engaging in diversification, this bill represents an opposite trend in the savings and loan business, when it would restrict us more to specialization in the savings and loan holding company and this does not address itself—

Senator PROXMIRE. How does it restrict again?

Mr. HEISLER. To the holding company that has a savings and loan subsidiary, but there is nothing in the bill that would be addressed to the savings and loan affiliate itself.

Senator PROXMIRE. What you are saying is that you would concede the bill does not restrict the opportunity for the savings and loan association to diversify, but you say it does prevent the holding company from diversifying?

Mr. HEISLER. Yes, it represents a trend contrary to what is occurring generally.

Senator PROXMIRE. All right. Thank you very much, gentlemen, we appreciate your testimony, it is very constructive.

Our next witness is Mr. Donahoe, chairman of the legislative committee of the California Savings & Loan League.

STATEMENT OF F. MARION DONAHOE, CHAIRMAN, LEGISLATIVE COMMITTEE, CALIFORNIA SAVINGS & LOAN LEAGUE; ACCOMPANIED BY LOUIS R. VINCENTI, VICE CHAIRMAN, LEGISLATIVE COMMITTEE; AND FRANKLIN HARDINGE, JR., EXECUTIVE VICE PRESIDENT

Senator PROXMIRE. Mr. Donahoe, would you please identify the gentlemen who are accompanying you for the record?

Mr. DONAHOE. Senator Proxmire, I am accompanied by Louis R. Vincenti, president of the Mutual Savings & Loan Association, Pasadena, and vice chairman of our committee on legislation, incidentally, Mr. Vincenti is also a lawyer.

I am also accompanied by Franklin Haringe, Jr., who is the executive vice president of the California Savings & Loan League.

Senator PROXMIRE. Fine. Mr. Donahoe, I notice you have a detailed statement, an excellent statement, but it is detailed. I wonder if you might be able to abbreviate it, or if you want to skip any part of it, the entire statement will be printed in the record. We have already read your statement carefully. So if you wish to do that, as I say, the entire statement will be printed and available to all of the committee and the Senate.

Mr. DONAHOE. What I proposed to do this morning, Senator, is to outline the position of the league relative to the bill.

Senator PROXMIRE. Fine.

Mr. DONAHOE. May I say I am Marion Donahoe, president of the Citizens Federal Savings & Loan Association, San Francisco, and I am chairman of the Committee on Legislation for the California Savings & Loan League.

Because California is the seat of most and many of the largest savings and loan holding companies in the Nation, the league feels it has a responsibility to convey its position to assist your committee in its consideration of S. 1542.

Basically the league supports the additional restrictive savings and loan company legislation, but urges that the legislation generally be along the lines of the bank holding company law as amended in 1966.

Our specific positions are as follows:

(1) The definitions in S. 1542 should be amended to parallel the definitions under the bank law, except that for registration, examination, and reporting purposes we concur with the provisions of S. 1542 that a savings and loan holding company shall be any company controlling one insured institution.

This contrasts with the more liberal provision that a bank holding company exists when two or more banks are controlled.

(2) Similar to the bank holding company law, control of 25 percent instead of 10 percent of an insured association should define a holding company.

(3) Similar to the bank holding company law, provision should be made in S. 1542 that no company shall be a holding company because of temporary ownership or control of shares acquired in connection with underwriting of securities.

(4) Because of our competitive position with banks, we believe provision should be made in S. 1542 that in addition to banks no other company shall be a holding company because of temporary ownership or control of shares acquired in connection with a loan made and secured by such shares.

(5) We concur with the provisions of S. 1542 regarding registration, examination, and reporting, but similar to the bank holding company law we recommend that adequate examinations by, and reports to, other Federal or State authorities may be wholly or partially accepted by the FSLIC.

(6) S. 1542 should be amended to provide that, similar to the provisions under the bank holding company law, only savings and loan holding companies controlling two or more insured associations be restricted from controlling additional other companies, or from engaging directly in additional other businesses.

(7) We concur with the provisions of S. 1542 which in general restrict upstream and cross-stream transactions between the insured association and its holding company, its affiliates, or any of its holding companies' controlled companies which in general is similar to the bank law provisions.

(8) By a 1964 amendment to the Home Owners Loan Act of 1933, Federal associations were authorized to invest up to 1 percent of assets in so-called service corporations organized under the laws of the association's home office State. There have been differences of opinion regarding the latitude of authority under this amendment. In its regulatory implementation the Federal Home Loan Bank Board rather narrowly restricted such authority; at both the State and national levels we urge clarification and explanation of this authority.

S. 1542 would restrict an insured institution from a downstream investment in a subsidiary corporation. The league urges modification of this restriction and urges authority for all savings and loan asso-

ciations to invest downstream up to 1 or 2 percent in subsidiary corporations which have limited powers, but powers additional to sheer service-type authority.

(9) We believe that a new holding company should not control more than one insured association and that an existing holding company should control no more additional insured associations in State or out of State; but we oppose the requirement to divest present out-of-State associations. However, we believe a controlled association subject to approval of the FSLIC should be permitted full merger and purchase of assets opportunities, but only within the association's operating territory.

These would be more restrictive provisions than for the bank holding companies.

(10) We concur with the provision of S. 1542 to require subsidiary insured institutions to give the FSLIC 30 days' notice of any proposed declaration of cash dividends on its capital stock, a restrictive provision not contained in the bank holding company law.

(11) Considering the restrictions we hereby favor and considering the enacted Financial Institutions Supervisory Act of 1966, we feel that much stronger protective walls will have been constructed around all insured savings institutions including holding company controlled institutions.

Therefore we oppose the provision in S. 1542 which would require prior written approval of the insurance corporation of a holding company's debt engagements resulting in parity in this respect with the bank holding companies.

(12) We believe that similar to bank law holding company restrictions should relate solely to corporations and not include individuals.

(13) We observe what appear to be technical flaws in the drafting of S. 1542 which, when taken literally, cause certain restrictions we are sure were not intended. These are pointed out in our written report.

Senator, we appreciate this opportunity to make this expression and this concludes our statement.

(The prepared statement of Mr. Donahoe follows:)

STATEMENT OF MR. F. MARION DONAHOE, CALIFORNIA SAVINGS AND LOAN LEAGUE

This statement represents the position of the California Savings and Loan League regarding S. 1542. The League favors the enactment of additional federal legislation regulating holding companies in this session of Congress. However, the bill before this committee has serious defects and requires substantial amendment. Unless so amended, this bill would unduly harm independent permanent stock associations and small holding companies. This position has been arrived at through the League's Legislation and Taxation Committee and approved by its board of directors. All members of the League have been made acquainted with this position through mailings.

The membership of the California Savings and Loan League includes 264 (out of a total of 268) savings and loan associations with assets of approximately \$26 billion. These comprise 182 state-chartered guarantee stock institutions and 74 federally chartered and 12 state-chartered associations which are mutual. Among the state-chartered stock associations are those independently owned as well as those owned by holding companies.

An estimated 6,500,000 savings accounts are held in member institutions of the California League. Taking into consideration that to a large degree these accounts represent family savings, an estimated total of 60 percent of the family units in California have savings which have been entrusted to our membership. Our institutions have 1,338,000 loans secured by first liens on 1,150,000 Cali-

fornia residential properties. We are proud to say that, by a considerable margin, an actual majority of the families of California which own their own homes are able to do so because our members loaned them the money. This position of primacy in savings and home financing could not have been achieved if our membership did not recognize that public interest considerations are dominant.

Our membership has had to accommodate itself in recent years to rapid changes in the money market with dramatic effects on California real estate conditions and in continuously changing patterns of supervisory objectives and regulatory impositions which have whittled away at the variety and scope of proper management operational alternatives at a time that flexibility has been particularly important.

Many recent regulatory enactments restricting operational flexibility of savings and loans have been purportedly justified by the fact that some tiny minority of institutions has operated in a manner such as to earn supervisory criticism. In order to control the operations of a small minority, the entire industry has been subjected to restrictions which have reduced its effectiveness in promoting thrift and home ownership. The great preponderance of savings and loan associations pays full respect to supervisory pronouncements and to the principles of safe and sound operation. Following the pattern of recent supervisory innovations, the present bill would have uniform applicability, both to the small minority that gives rise to some need for it and to the uninvolved and unaccused majority of the guarantee stock associations of the industry which are thus unnecessarily deprived of critically important flexibility.

The most serious effect of the enactment of the proposed legislation in its present form would be its adverse impact on the marketability and value of savings and loan stock of nonholding company savings and loan associations held by thousands of individuals.

The California Savings and Loan League has long recognized the need for special statutory provisions relating to corporate entities controlling insured savings and loan associations. In 1964 the League aggressively sponsored in the California State Legislature a bill to impose registration and reporting provisions on all holding companies operating in California and subjecting these companies to examination by the State of California.

The League favors in principle additional federal legislation to impose registration, reporting and examining provisions on such holding companies. Because the vast majority in assets of savings and loan holding companies are now subject to California law, registration, reporting and examination provisions of state statutes should be recognized by the federal authorities in the new federal legislation of this general nature. It is not advisable that a whole new set of reporting and examination procedures be superimposed upon those existing in the State of California. The legislative objectives of S. 1542 should include minimizing the additional burden on such companies which are already subject to state control and examination. At the minimum the federal authorities should cooperate with the State Savings and Loan Commissioner in developing common reporting forms and in the conduct of examinations.

The California Savings and Loan League believes that the provisions of this bill should pertain only to corporate holding companies and not pertain to individuals who happen to own guarantee stock of savings and loan associations. Existing state and federal statutes, including the Financial Institutions Supervisory Act of 1966, adequately protect the public interest so far as individual stockholders are concerned. California Savings and Loan Law strictly regulates and controls relationships between majority stockholders or directors of state-chartered associations and the association. We believe that the Federal Home Loan Bank Board is competent to administer these matters under existing law.

In 1956 the Federal Congress passed the Bank Holding Company Act. This provides generally that the ownership of one bank does not qualify such owners as a bank holding company nor does the ownership of one bank and less than 25 percent of the stock of other banks. So long as a company does not own more than one bank and no more than a minority interest in other banks, such company is permitted to engage in outside activities. Only when a company owns two banks does it qualify as a bank holding company, and then it is precluded from engaging in activities other than the ownership of the banks so owned.

In general, when the bank holding company act and the savings and loan holding company act have otherwise comparable provisions, the tests for the application of those provisions should be similar and generally no more onerous.

There is no reason, for example, that control in the case of the bank holding company act should be 25 percent of the stock and in the case of the savings and loan holding company be 10 percent of the stock. The 25 percent provision of the bank holding company act should be incorporated into the savings and loan holding company act. If, at some future date, the bank holding company act test is changed, the savings and loan holding company act could be simultaneously amended.

The same principle would hold with respect to whether or not holding company legislative provisions have applicability to a corporate entity controlling only one financial subsidiary. At the present time, the provisions of the bank holding company act have applicability only when the holding company has two or more banking subsidiaries. The California Savings and Loan League believes that in this respect, too, the savings and loan holding company bill should be the same as the bank holding company bill, with the exception of the registration, reporting and examination provisions. If, at some future time, the bank holding company law is changed, then at the same time the savings and loan holding company law can be amended.

The League therefore suggests that the registration, reporting and examination provisions of this bill, unlike the provisions of the bank holding company act, apply to holding companies owning one or more associations. Intercorporate transactions which could conceivably weaken the savings and loan should also be prohibited even if the parent does not own another savings and loan subsidiary. However, paralleling the bank holding company act, a holding company which owned no more than one savings and loan association should be permitted to carry on diversified activities. Such a change in S. 1542 would go far toward preserving the marketability of savings and loan stock, thus protecting such stockholders against harsh and unnecessary loss of value which would inevitably result from the enactment of the bill in its present form.

A corporation which had diversified interests would not be permitted, after the effective date of S. 1542, to acquire a savings and loan association regardless of whether it already held one or more. The provisions of S. 1542, which would require divestment on the part of a diversified holding company already controlling more than one association, are not justified. The League suggests that, not only should the bill be amended to permit a diversified company to acquire its first savings and loan subsidiary, but existing holding companies should be permitting to hold their existing subsidiaries.

We are advised by various counsel that the bill, as presently written, would prevent a savings and loan association, which happens to be owned by a holding company, from making any investment pursuant to Section 6702.1 of the California Financial Code in its own corporate subsidiary. The Congress stated its policy of encouraging similar corporate subsidiaries by its amendment in 1964 to the Home Owners Loan Act applicable to federal associations. In the light of this Congressional enactment, which permits federal associations to invest up to 1 percent of their assets in corporations that are subsidiaries of such federal associations, the same principle should be adhered to in the bill before us by permitting state-chartered associations to have comparable powers of investment in the stock of subsidiary corporations. The League believes that the Federal Home Loan Bank Board should be instructed in this bill to encourage the maximum utilization of the 1 percent subsidiary investment authority granted by Congress to federals in order to offset any competitive disadvantages which federal associations and other independent associations may have and to promote the viability of the industry. The League further believes that the present regulations of the Board, which require specific approval on a case-by-case basis of such subsidiary corporations to engage in other than very restrictive activities, are a thwarting of the basic intent of Congress in enacting this provision.

In the Financial Institutions Supervisory Act of 1966, the Congress gave the Federal Home Loan Bank Board power to examine affiliates of insured institutions. The California Savings and Loan League respectfully suggests that various sections of the bill before us are unnecessary, in view of this new grant of supervisory power.

The Federal Home Loan Bank Board now has authority to prohibit, by regulation, payment of dividends to guarantee stockholders (and therefore to a holding company) if the net worth of the savings and loan association does not equal any reasonable regulatory minimum after the dividend payment. The Board already has full control over any transactions or activities which would imperil the safety and soundness of the savings and loan association. There is no

objection to a provision that the Board be given 30 days' notice before the payment of a dividend on guarantee stock, which requirement could now be imposed by regulation in any event under existing statutes without further amendment.

The Federal Home Loan Bank Board responsibility is to protect the insured institution, its members and those who might do business with it. This responsibility does not extend to control over the activities of the stockholders, whether individual or corporate, of such an institution, except as those activities relate to the insured institutions.

Other related provisions of the bill are equally objectionable for this same reason. By permitting only a commercial bank to purchase guarantee stock which is collateral for advances and to hold such stock for a reasonable period of time without becoming itself a holding company, the bill in its present form would effectively preclude the use of savings and loan stock as collateral for borrowings except from commercial banks and raises the question of constitutionality in its applicability to existing loans made by creditors other than commercial banks on the security of such equities. It would appear that nonbank lenders could not realize on savings and loan stock held as collateral if they were engaged in any other activity, except those within the narrow range permitted to savings and loan holding companies.

The California League firmly represents that the commercial banks should not be the only eligible creditors as to loans procured by stockholders of savings and loan associations, particularly in view of the competitive position of commercial banks and savings and loan associations.

Further, there should be an amendment to exclude, for a reasonable period, underwriting firms which handle the issuance and sale of stock for holding companies.

This decision of the League is taken in the light of the provisions of this and other legislation which give the Bank Board the means of acquiring information as to relationships between the association and its stockholders and of effectively policing those relationships.

The provisions relating to mergers involving associations owned by holding companies point to a special problem which exists among savings and loans. In the commercial banking field there are no mutuals, nor are there comparable restrictions upon the geographic area of a bank's operations. In contrast, savings and loans are mutuals as well as guarantee stock institutions. Geographic boundaries are fixed by law and regulation within which both insured state and federally chartered associations must operate.

The California Savings and Loan League believes that consideration should be given to offsetting the competitive advantage existing multiple subsidiary holding companies may have to operate beyond normal savings and loan lending areas by giving some related advantages to associations in competition with them without requiring any divestment of holding companies or otherwise restricting their present proper areas of operation.

The California League also believes that the right of merger should be the same for all savings and loan associations whether state or federal, stock or mutual. Permission of the Federal Home Loan Bank Board is required in connection with any merger. The present statute makes it possible under special circumstances for a corporate holding company to acquire a savings and loan entity operating in a different lending area than that in which its existing savings and loan subsidiaries are permitted to operate. The League believes that, if this opportunity is available to holding companies, it should be made available also to federal associations and nonholding company associations through mergers. If the opportunity is not to be granted to federal associations and other nonholding company savings and loans to expand their areas of operations by such mergers, then holding companies should not have the right of acquisition of associations in corporate form, but only the subsidiary insured institution should be permitted to be involved in a merger or purchase of assets of another association and only within its normal lending area as permitted federal associations.

Present Section 408 (f) of the National Housing Act was taken from the bank holding company act. These provisions were stricken from the bank holding company act by Congress last year. At the same time, the powers granted to both banking and savings and loan supervisors by the Financial Institutions Supervisory Act of 1966 assured control over such arrangements by the supervisors. Nevertheless, the League favors the retention of the provisions of existing Section 408 (f) and any warranted strengthening.

Subsection (i), as proposed, would severely restrict the ability of officers, directors, and employees of savings and loan holding companies to serve as officers, directors, employees of other insured institutions or other savings and loan holding companies that are not subsidiaries of such holding company, regardless of whether there is any situation comparable to that proscribed in the case of banks in Section 8 of the Clayton Act (15 USC Sec. 19[5]). The bank holding company law has no similar restrictions on such service. No purpose is served by generalized, unqualified prohibitions, as set forth in S. 1542, against existing relationships without objective reason as set forth in S. 1542. We suggest that, in lieu of the present provisions of the bill, the principles of Section 8 of the Clayton Act (15 USC Sec. 19) be applied to savings and loan associations by prohibiting any director, officer or employee of a savings and loan association from serving at the same time as a director, officer or employee of another savings and loan association except one that is not located and has no branch in the same city, town or village as that in which the first association, or any branch thereof, is located, or in any city, town or village contiguous or adjacent thereto. In any event, it seems that a person currently a stockholder of a savings and loan association or serving as an officer or director thereof, and who is causing no problems to the Federal Home Loan Bank Board, should not be required to divest his interests.

Section 408(e)(1)(A)(iv), as amended by S. 1542, would require that a holding company owning associations located in more than one state divest its holdings outside its state of principal operation within three years after enactment of this bill. The California Savings and Loan League does not believe that the ownership of associations across state lines by a holding company is causing unusual problems. To require the divestment of such out-of-state associations would cause undue hardship to such holding companies, and to their thousands of stockholders, and would affect the market for savings and loan stock adversely for many years, all for no apparent practical purpose. Thus, the California League suggests that the status quo be preserved by permitting the continuing ownership of state associations beyond state lines only where already owned. The further acquisition of any such interest by merger or otherwise, except in the state or principal operation of the savings and loan subsidiaries, should be precluded.

Present Section 408(a)(1)(C) of the bill includes within the definition of "company" any "trust". This means that a family trust set up by a savings and loan association stockholder for the benefit of his children could become a savings and loan holding company and subject to the provisions of the bill. The bank holding company act, on the other hand, includes only business trusts or other trusts which need not terminate within twenty-five years or not later than twenty-one years and ten months after the death of individuals living on the effective date of the trust. Again, this is a section of the bill which should be amended to prevent inequities which are not related to the purpose of the bill.

An example of an obvious error in draftmanship, which will produce unwanted results, is Section 408(g)(1). As drawn, in most instances, an insured association owned by a holding company could not utilize its line of credit with the Federal Home Loan Bank without prior written approval of the Federal Savings and Loan Insurance Corporation. We cannot believe that this restriction was intended by the Bank Board.

However, the California Savings and Loan League believes that it is not necessary that the Federal Home Loan Bank Board have any control over the debt structure of savings and loan holding companies. The bank holding company act has no such provision. The Bank Board now has ample powers over insured savings and loan associations to enable it to protect the integrity of the assets of such associations owned by any form of ownership—corporate or otherwise. Furthermore, control over the debt structure of corporate holding companies will act as a deterrent to corporations which now own or in the future might purchase savings and loan stock, thus having an adverse effect on the marketability of such stock. For these reasons, the California League recommends the deletion of Section 408(g). Such deletion will also solve the problem mentioned in the paragraph above.

In conclusion, the League requests that the Congress review the proposals of S. 1542 to determine which are objectively needed and do not duplicate existing authority of the Federal Home Loan Bank Board. It is no excuse for additional legislation that existing authority, adequate for the purpose, is unused. If supervisory cases exist, the first question to be asked is whether existing authority

has been utilized to solve them. Another, and important, question is whether generalized impediments to proper operation must be imposed on the overwhelming majority because of the operations of a tiny minority. Further, Congress should not adopt restrictions on the marketability or otherwise adversely affect the value of stock held by many thousands of uninvolved citizens, unless required by a clear public purpose.

Senator PROXMIRE. Thank you very much, Mr. Donahoe. I believe you are a member of the Federal Home Loan Bank Board's National Advisory Group, are you not?

Mr. DONAHOE. Yes; I am.

Senator PROXMIRE. That is the Federal Savings and Loan Advisory Council.

I have a letter here from the Chairman of the Advisory Council to Senator Sparkman, the chairman of the committee, indicating their unanimous endorsement of the holding company legislation.

Without objection, I would like to place this letter in the record at this point.

Senator BENNETT. No objection.

(The letter referred to follows:)

FEDERAL HOME LOAN BANK BOARD,
Washington, D.C., June 6, 1967.

HON. JOHN SPARKMAN,
*Chairman, Committee on Banking and Currency,
U.S. Senate,
Washington, D.C.*

DEAR MR. CHAIRMAN: As Chairman of the Federal Savings and Loan Advisory Council, a Congressionally created advisory group, this is to advise you that the Council for many years has favored the enactment of legislation which would improve the control of the Federal Home Loan Bank Board over holding companies. This legislation is one of a series of steps needed by the Board to improve the quality of supervision. It is part of an over-all plan to provide a greater degree of protection to savings in thrift institutions.

In the discharge of its obligations, the Council has become privy to the supervisory problems of the Board and its frustrations because of lack of legislation to deal with them. Some of these problems could be cured by regulation, and the Council encouraged the Board as it improved its regulations regarding the earnings of fees, strengthened its reserve regulation, adopted a limitation on loans to one borrower and other measures designed to eliminate weaknesses. Other problems required legislation, and the Council supported the Board and testified in favor of the Financial Institutions Supervisory Act of 1966.

This act, though, is inadequate as regards the ability of the Board to get at the peculiar problems that exist in holding companies. Since the problem became acute in the late 1950's, the Advisory Council has consistently supported the enactment of strong holding company legislation. That support is recorded in the Council minutes and advice given to the Bank Board.

In his testimony before your committee the other day, Board Chairman John E. Horne stated that the preponderance of problems in associations held by holding companies greatly exceed the problems that exist in other associations. His figures showed that about 12½% of the assets of the industry are in associations owned by holding companies. Yet, far more than one-half of the problems of the total industry come from this 12½% segment which demonstrates the need for remedial legislation.

You probably are aware of the fact that the Council is the only organization statutorily charged with the responsibility of advising the Bank Board. It consists mostly of leading Federal and state savings and loan managers whose institutions represent over \$2.7 Billion in assets. They frequently are described as bringing a management point of view before the Board. A list of current Council Members is attached.

At its latest meeting (April 10-11, 1967) with the Board, the Council unanimously passed the following resolution:

"RESOLVED, That the Advisory Council favors in principle the proposed holding company legislation as outlined by General Counsel Scott at the April 10 meeting of the Council."

Unquestionably, it is imperative that the Federal Home Loan Bank Board have the necessary supervisory authority over holding company operations to prevent any abuses now being committed.

Sincerely yours,

LLOYD BOWLES,
Chairman, Advisory Council.

FEDERAL SAVINGS AND LOAN ADVISORY COUNCIL—FOR CALENDAR YEAR 1967

APPOINTED BY FEDERAL HOME LOAN BANK BOARD

C. A. Duncan, Jr., President (Immediate Past President—United States Savings and Loan League), Farm and Home Savings Association, 221 West Cherry Street, Box 248, Nevada, Missouri 64772.

Rex G. Baker, Jr., President (President—National League of Insured Savings Associations) Southwestern Savings Association of Houston, Texas, 3401 Main Street Houston, Texas 77002.

Allan D. Housley, Director (President—National Association of State Savings and Loan Supervisors) Department of Building, Savings and Loan Associations, State Office Building, 301 West Preston Street, Baltimore, Maryland 21201.

Frederick P. Smith, President (President—National Association of Mutual Savings Banks), Burlington Savings Bank, 148 College Street, Burlington, Vermont 05401.

Emil A. Gallman, Chairman—Executive Committee, New Jersey Savings and Loan League, 10 Commerce Court, Newark, New Jersey 07102.

Leon N. Weiner, President, National Association of Home Builders, 4 Denny Road, Wilmington, Delaware 19809.

FEDERAL SAVINGS AND LOAN ADVISORY COUNCIL—FOR CALENDAR YEAR 1967

ELECTED BY FEDERAL HOME LOAN BANKS

Boston

Charles C. Horton, Vice President, Old Colony Co-Operative Bank, 58 Weybosset Street, Box 788, Providence, Rhode Island 12901.

New York

Dr. Gordon W. McKinley, Vice President—Economics, McGraw-Hill Inc., 330 West 42nd Street, New York, New York 10036

Pittsburgh

William J. McKeever, President, Public Federal Savings and Loan Association, 7th and Chestnut Street, Philadelphia, Pennsylvania 19106.

Greensboro

John H. Randolph, Jr., President, First Federal Savings and Loan Association, Broad and Third Streets, Richmond, Virginia 23219.

Cincinnati

William S. Guthrie, President, Buckeye Federal Savings and Loan Association, 36 East Gay Street, Columbus, Ohio 43215.

Indianapolis

A. G. Shireman, President, Tower Federal Savings and Loan Association, 216-218 W. Washington Avenue, South Bend, Indiana 46601.

Chicago

Al C. Steinhauer, President, Anchor Savings and Loan Association, 25 West Main Street, Madison, Wisconsin 53701.

Des Moines

Frederick Bjorklund, President, Minnesota Federal Savings and Loan Association, 355 Minnesota Street, St. Paul, Minnesota 55101.

Little Rock

Lloyd Bowles, President, Dallas Federal Savings and Loan Association, 1505 Elm Street, Dallas, Texas 75201.

Topeka

Junius F. Baxter, President, Western Federal Savings and Loan Association, 700 17th Street, Denver, Colorado 80202.

San Francisco

F. Marion Donahoe, President, Citizens Federal Savings and Loan Association, 706 Market Street, San Francisco, California 94102.

Spokane

Harold H. Cake, President, Equitable Savings and Loan Association, 411 S.W. Sixth Avenue, Portland, Oregon 97204.

Senator PROXMIRE. On page 3 of your statement you recommend existing holding companies should not be required to divest themselves of unrelated activities, but at the same time you say you favor having the principles in the Bank Holding Company Act apply here. But this is not comparable to the Bank Holding Company Act, this proposal of yours, as far as not being required to divest themselves of unrelated activities.

What is your rationale for selecting certain provisions of the Bank Holding Company Act as a guide and not selecting others?

I don't blame you for wanting them, but I would like to get your rationale for it.

Mr. DONAHOE. In the first place we do agree that from here on holding companies holding two or more associations should not be conglomerate, should not have diversified holdings.

Senator PROXMIRE. Except the ones who already have them?

Mr. DONAHOE. Yes. Now our position on this is, it is my personal impression that the holdings, the outside holdings of present-day holding companies is rather nominal and therefore we did not think that their holdings were important enough to request them to divest.

Senator PROXMIRE. I understand that. But here you have a situation where you might have on one hand a holding company that has a billion dollar association, and on the other hand you have a holding company that has two \$50 million associations.

In other words, you say the billion dollar association can diversify, but the two \$50 million holding company can not.

Mr. DONAHOE. You are talking about the case of the one versus the two?

Senator PROXMIRE. That is right.

Mr. DONAHOE. Well, our main argument in the case of exempting the one is marketability. In other words, this circumstance, I think would affect the noncontrolled associations today in that it would lessen the market for their shares in the case that, for personal reasons or otherwise, the shareholders of a noncontrolled association wanted to sell their shares. This causes a limited market for the sale of those shares.

And, incidentally, thousands of shareholders throughout the country are involved in the ownership of these noncontrolled associations.

Senator PROXMIRE. Did you consider alternatives in this marketability, merger, acquisitions, the secondary offerings, the kind of things we suggested to the other witnesses?

Mr. DONAHOE. Pardon me, I didn't understand you, Senator.

Senator PROXMIRE. Have you considered alternatives to this marketability problem, mergers being one, acquisitions, secondary offerings to the public?

Mr. DONAHOE. Yes; we have. As a matter of fact, in our paper we are recommending mergers of the held institution, not mergers involving the holding company itself.

Now, relative to the market, I think small associations would be handicapped in using the secondary market. Perhaps my associate, Mr. Vincenti, would like to comment on this.

Mr. VINCENTI. When you limit yourself to marketability to your competitors, the market is very narrow. When you limit yourself to secondary offerings in small associations, you run into an almost impossible situation. If you have as marketability going to general-purpose corporations, it is much broader. It is a matter of how broad you are willing to allow the people to go.

Senator PROXMIRE. Senator Bennett?

Senator BENNETT. I didn't have time to read your whole statement and didn't hear all of it, but when you talk of marketability, are you concerned about the opportunity of a single stockholder to find a market for shares he may have to sell as a result of a death in the family or something of that kind? Or are you just concerned about the opportunity of the majority stockholder to dispose of the control of the business?

Mr. VINCENTI. Well, there is of course a great difference. When anyone has a minority interest in any kind of business, he always has a marketability problem that you can't solve in general legislation. It is peculiar to one particular business.

Senator BENNETT. I am trying to get clear in my own mind whether you are concerned only with the effects on the marketability of the majority or controlling interest, or whether you are concerned with the general problem of marketability that might affect the minority stockholder or the small stockholder.

Mr. VINCENTI. We have to be concerned here with the marketability of the savings and loan association which in general is the majority control of the association; within the majority control those people have to cooperate among themselves.

Senator BENNETT. Yes. But in your testimony, Mr. Donahoe talked about the fact that there are thousands of shareholders over the country. I thought he was concerned about that problem.

Mr. VINCENTI. Well, within a particular association, the group in there has to come to an agreement among themselves. But until you find a vehicle where, when they agree among themselves, they can find a market, there is no use in finding agreement among themselves.

But the Congress has never attempted to legislate to force agreement among a small group within one association.

Senator BENNETT. Then you are saying to me there is no normal market for a minority share in a stock savings and loan association, that these are not traded and that the only trade you are concerned

with are the trades of the majority, the trades involving the control?

Mr. VINCENTI. There is a normal market that often happens for minority stocks in many businesses, savings and loans and otherwise. And that is not our concern. We are saying that when the group decides that they want to sell out, that if you say no corporation that is engaged in any other business can buy, you have then denied the group a very wide market.

Senator BENNETT. I think I have a clearer picture of what you are talking about now. Thank you.

Senator PROXMIRE. Thank you very much, Mr. Donahoe and gentlemen, for your testimony. It was very helpful.

Senator PROXMIRE. The next witness is Mr. Frederick J. Gassert, Jr., assistant general counsel, Allstate Enterprises, Inc.

SUPPLEMENTAL STATEMENT OF THE CALIFORNIA SAVINGS AND LOAN LEAGUE

In the testimony presented to the committee by John E. Horne, chairman of the Federal Home Loan Bank Board, certain tables were included on which the California League would like to comment.

In Table No. 3, certain statistics regarding associations owned by holding companies were presented and compared with the same figures for insured associations not owned by holding companies. We would like to point out that the associations owned by holding companies were able to reduce their operating expenditures from 1.4% of average assets in 1960 to 1.0% in 1966. In this same period, all other insured institutions did not improve their expense ratios from the 1.1% which existed in 1960.

We would also like to point out that the associations owned by holding companies consistently had a better ratio of net worth to savings than did insured institutions not owned by holding companies, although the spread has narrowed over the years, principally because of the different growth patterns of these two segments of the business.

Table No. 4 presented by Chairman Horne demonstrated that the capital contributions of savings and loan holding companies amounted to \$35 million in the eight-year period from 1959 through 1966, whereas these companies withdrew \$65 million in fees and cash dividends from associations. Enclosed is a table which places these same figures into better perspective. We have taken from Table No. 3, presented by the Bank Board, the percentage of net worth to savings and calculated the dollar amount of net worth. We have also calculated the total dollar amount of operating expenses from the ratio of expenses to average assets shown in Table No. 3. Therefore, our figures are based upon those presented by the Federal Home Loan Bank Board.

Our first observation is that, while the percentage of net worth to savings dropped from 9.5% to 8.3% between 1961 and 1966, the net worth in dollars more than doubled in this same period, up from \$526 million to \$1.78 billion. The cash dividends paid from the association to the holding company, as you can see, never resulted in a rate of more than 1½% of that net worth. Thus, we do not believe that, in the aggregate, the amount of money withdrawn from associations for cash dividends has been excessive.

In addition, we point out that, to the best of our knowledge, those associations which were paying the cash dividend to their parent holding companies were well able to do so. We are aware of the fact, however, that there is at least one example where the cash dividend paid by the association to the holding company was certainly subject to criticism, and it is with this knowledge that the California League has agreed in principle with the right of the Federal Home Loan Bank Board to have notice of the intended payment of cash dividends.

We further point out that, if no cash dividends had been paid in the year 1966, it would have increased the ratio of net worth to savings from 8.3% to 8.42%, which is not a significant change.

We have also related the fees paid, as listed in Table No. 4 of the Bank Board's statement, to the dollar amount of operating expenses in those same years. Here, again, it demonstrates that the fees which are a part of the total operating expenses never exceed 1½% of the total expenses and therefore could hardly be

construed to be a significant drain on such associations. In other words, while it might have appeared significant that \$65 million was paid by associations to holding companies, put in perspective, these amounts are insignificant in relation to the overall operations of associations owned by holding companies.

Savings and loan holding companies, 1961-66—Capital contributions to controlled associations, cash dividends related to net worth, and fees received related to expenses

[Dollar amounts in thousands]

Years	To association— Capital contributions	Net worth, percent of savings	Net worth	From association			Total operating expenses	Fees, percent of expenses
				Dividends	Dividends, percent of net worth	Fees		
1966-----	\$1,863	8.3	\$1,078,000	\$15,643	1.5	\$2,121	\$160,020	1.3
1965-----	5,147	8.6	1,106,000	5,081	.5	2,359	167,035	1.4
1964-----	12,159	8.6	1,005,000	5,100	.5	2,196	146,850	1.5
1963-----	2,284	8.4	813,000	6,859	.8	1,383	149,870	.9
1962-----	9,269	9.4	696,000	9,809	1.4	887	105,014	.8
1961-----	1,215	9.5	526,000	4,502	.9	736	78,611	.9

NOTE.—Prepared by the California Savings & Loan League.

Sources: Federal Home Loan Bank Board and the Federal Reserve Bulletin.

STATEMENT OF FREDERICK J. GASSERT, JR., ASSISTANT GENERAL COUNSEL, ALLSTATE ENTERPRISES, INC.

Mr. GASSERT. Senator Proxmire, Senator Bennett, I propose, if you agree, to summarize my statement.

Senator PROXMIRE. We would appreciate that.

Mr. GASSERT. I will try to do it as briefly as I can.

Senator PROXMIRE. Your full statement will be printed in the record.

Mr. GASSERT. Thank you. Allstate Enterprises is a wholly owned subsidiary of Sears, Roebuck & Co. Allstate Enterprises owns the Allstate Savings & Loan Association of North Hollywood, Calif. Sears, Roebuck & Co. owns a controlling interest in Metropolitan Savings & Loan Association of Los Angeles, Calif.

I appear before you on behalf of both Allstate Enterprises and Sears Roebuck.

We favor reasonable and proper regulation of the savings and loan holdings companies. We oppose certain of the provisions of S. 1542 for the simple reason that they would force us to sell our savings and loan association.

There is an option in the bill as presently written: we could get out of the merchandising business and insurance business, but we do not consider that much of an option.

That line was stolen from me yesterday by Paul Porter, and I objected very strenuously to it, but I couldn't do much about it. Fortunately, Senator, you weren't here.

I would respectfully suggest to you that legislation should not only be in the public interest, but should serve a public interest.

We see no public interest that is served by forcing us to dispose of our property. There is no inherent evil in the ownership of a savings and loan association by a company engaged in other business activities.

If there are potential evils foreseen by the able personnel of the Home Loan Bank Board and the Federal Savings and Loan Insurance Corporation, surely they can be controlled and regulated by far less drastic legislative surgery.

Should this committee agree with our position in this respect, we must then point out that the provisions of the proposed section 408(g), holding company indebtedness, would be unnecessarily burdensome and expensive to both the savings and loan holding company and to the regulator.

This section provides, as you know, for prior approval of the regulator of all debt incurrences by the savings and loan holding company or any of its subsidiaries. We do not believe such sweeping powers are necessary to effectively regulate the relationship between savings and loan holding companies and their associations. The primary purpose of regulation of these companies must and can only be the protection of the depositors in the savings and loan associations which they control. Many of the tools of regulation are being given to the Home Loan Bank Board and to the FSLIC in this bill. Those of registration and examination would bring the knowledge that the regulator requires to control those transactions which might hurt the depositor.

We suggest, gentlemen, that this is all that the regulator needs. I think I would conclude the summary at this point, Senator.

(The prepared statement of Mr. Gassert follows:)

STATEMENT OF FREDERICK J. GASSERT, JR., ASSISTANT GENERAL COUNSEL,
ALLSTATE ENTERPRISES, INC.

Allstate Enterprises is a wholly-owned subsidiary of Sears, Roebuck and Co. Allstate Enterprises owns the Allstate Savings and Loan Association of North Hollywood, California.

Sears, Roebuck and Co. owns a controlling interest in Metropolitan Savings and Loan Association of Los Angeles, California.

I appear before you on behalf of both Allstate Enterprises and Sears, Roebuck and Co.

We favor reasonable and proper regulation of savings and loan holding companies.

We oppose certain of the provisions of Senate 1542.

Most important, we oppose the proposed Section 408(c), "Holding Company Activities." And the reason for our opposition is rather basic—it would force us to sell our savings and loan associations.

To be more explicit: under the definition of savings and loan holding company in the proposed Section 408(a)(1)(D) and 408(a)(2), both Allstate Enterprises and Sears, Roebuck and Co. are savings and loan holding companies. The proposed Section 408(c) would prohibit Allstate Enterprises or Sears, Roebuck and Co. from engaging in any activity prohibited to a savings and loan association. I would concede that the bill would permit us to retain those associations if we chose to abandon our merchandise business, our insurance business and the other activities in which we are engaged, but we do not consider that much of an option.

I would respectfully suggest that legislation should not only be in the public interest, but should serve a public interest; and we see no public interest that is served by forcing us to dispose of our property.

There is no inherent evil in the ownership of a savings and loan association by a company engaged in other business activities. If there are potential evils foreseen by the able personnel of the Home Loan Bank Board and the Federal Savings and Loan Insurance Corporation, surely they can be controlled and regulated by far less drastic legislative surgery.

Should this committee agree with our position, then we must point out that the provisions of the proposed section 408(g), "Holding Company Indebtedness" would be unnecessarily burdensome and expensive to both the savings and loan

holding company and to the regulator. This section would provide for the prior approval of the regulator of all debt incurrences by the savings and loan holding company or any of its subsidiaries. We do not believe such sweeping powers are necessary to effective regulation of the relationship between the savings and loan holding company and its associations.

The primary purpose of regulation of savings and loan holding companies must, and can only be the protection of the depositors in the savings and loan associations which they control. To effectively regulate these companies for that purpose, the regulator requires several tools. He needs in the first instance information; and this would be provided by the registration section of S 1542, Section 408(b). Continuing knowledge is his next requirement, particularly information as to solvency, and this would be provided by the examination provisions of the proposed 408(b). For some of the possible improper actions that might arise out of the relationship between a savings and loan association and a holding company, the regulator needs the tool of statutory prohibition; and this is provided in the proposed section 408(d). For others, he needs the tool of prior approval of transactions, also provided in that section.

As your committee required this statement is written in advance of the testimony of the proponents of this legislation. Even so, the key question in the consideration of the merits of S 1542 is what tools the regulator needs immediately, at the onset of regulation of a hitherto unregulated business. The tools of statutory prohibitions and prior approval of the regulator are restrictions on the management of private business. If they serve the public interest and that of the depositors, they are needed; if they have no demonstrated relationship to these concerns, they are not needed. The State of California, as I am sure you know, has equipped its regulator primarily with the informational tools, and has not yet seen fit to include the others; nor has the regulator, to my knowledge, requested them.

Often, in the course of discussions on predecessors of this proposed legislation, the Bank Holding Company Act has been cited as precedent. I respectfully suggest that it is not a precedent. A savings and loan association does not have the power of a commercial bank. It is severely restricted in its lending powers, both as to the purposes of its loans and as to geography. The evils at which the Bank Holding Company Act strike have been described as recently as in 1965, in the debate in the House of Representatives, by Congressman Hanna of California.

"The question here is on the public policy as expressed in the Bank Holding Company Act itself. That public policy, simply stated, is that it is not good for people in business activity to own banks and to own *competitive* businesses within the same community. The feeling is that if they have a competitive business and they have a bank they have a financial advantage that is not fair. That is the public policy." (Italic supplied.) *Congressional Record, September 23, 1965, page 24029.*

On this basis, the Holding Company Act required the divestiture of controlled banks by holding companies engaged in other business activities. It permitted them, however, to own one bank. Senate 1542 does not even permit this exemption for savings and loan holding companies engaged in other businesses.

As I have said, this statement is written in advance of the testimony of proponents of the legislation. One can only conjecture, therefore, what examples of savings and loan holding company activities will be cited as justification for this legislation. When you are considering those examples which concern holding companies which are not engaged in other business activities, please bear in mind the paradox inherent in this bill: it would permit those companies to stay in business under regulation, but it would force my companies, and others similarly situated, out of the business.

Again we observe that we do not consider this in the public interest. We value our corporate good name and reputation. This is an asset our depositors have over and above Federal insurance.

We urge, and knowing this committee we know it will receive, careful and thoughtful consideration to Senate 1542 and to our objections to it.

Senator PROXMIRE. Mr. Gassert, if the Spence Act limitations were removed, would it not be possible for Sears, Roebuck to get set out to acquire one or more savings and loan associations in every State of the country?

Mr. GASSERT. Yes, sir.

Senator PROXMIRE. Do you recommend such an amendment to this committee?

Mr. GASSERT. No, sir.

Senator PROXMIRE. You do not?

Mr. GASSERT. No, sir.

Senator PROXMIRE. What are the different interrelationships between the various Sears enterprises and the savings and loan association which you control?

For example, how high a percentage of your association's loans does Allstate write the insurance coverage on?

Mr. GASSERT. I do not have a figure on that. I can tell you this, from our experience in the insurance business—

Senator PROXMIRE. Can you furnish that for a recent year?

Mr. GASSERT. I would be happy to.

I can tell you this, though, for many years our company, in the insurance business, has had great problems with savings and loan associations refusing to accept our policies. As a consequence of this we have bent over backward in the management of the savings and loan association to see that this doesn't happen there.

I can assure you that there is not a single insurance policy written by the Allstate Insurance Co. on a home loan of either association which is not done voluntarily by the policyholder, and not at the suggestion of the association.

Senator PROXMIRE. Thank you very much. Senator Bennett?

Senator BENNETT. I just want to get the picture of your corporate structure in my mind.

Does Allstate Enterprises own the Allstate Insurance?

Mr. GASSERT. No, sir; Sears, Roebuck does.

Senator BENNETT. Sears, Roebuck does?

Mr. GASSERT. Yes, sir.

Senator BENNETT. What does Allstate Enterprises own then?

Mr. GASSERT. Allstate Enterprises, as I indicated, owns the one savings and loan. It is also engaged in the automobile finance business. It owns in California, for example, Allstate Credit Corp., which is the only vehicle we were able to utilize to go into the automobile finance business in California. It owns and operates the Allstate Motor Club; Service Review, which is an inspection company, and Schirmer Engineering, which is a fire insurance inspection company. I think that is the whole list.

Senator BENNETT. But it does not own the life and casualty insurance?

Mr. GASSERT. No, sir. Allstate Insurance Co. is owned 100 percent by Sears, Roebuck. It is in the fire and casualty business. It owns the Allstate Life Insurance Co. But, as I think the Senator knows, the insurance company by law may not own nonrelated, noninsurance businesses.

Senator BENNETT. Fine. Then Sears, Roebuck directly controls the Metropolitan Savings & Loan Association?

Mr. GASSERT. Yes, Senator.

Senator BENNETT. So you have a grandparent, a parent, and two children?

Mr. GASSERT. That is correct.

Senator BENNETT. Thank you. I think that clears it up for me.

I would be interested to know under the provisions of this bill if this bill were so written that holding companies would be allowed to hold one savings and loan association, would Sears, Roebuck expect to hang onto Metropolitan Savings, while Allstate Enterprises hung onto Allstate Savings?

Mr. GASSERT. If that were the only amendment, I do not believe under the remaining provisions of the law we would be permitted to do so, unless there were language which permitted a merger within a specific period of time.

Senator BENNETT. Thank you. I have no further questions.

The CHAIRMAN (presiding). Thank you very much, Mr. Gassert.

Our next witness is Mr. Raymond C. Brumbach, president, Security Savings & Loan Association, Seattle, Wash.

STATEMENT OF RAYMOND C. BRUMBACH, REPRESENTATIVE, COMMITTEE OF STATE-CHARTERED GUARANTEE STOCK SAVINGS AND LOAN ASSOCIATIONS OF THE STATE OF WASHINGTON

Mr. BRUMBACH. Thank you, Mr. Chairman. I am happy to be here to testify before your committee. I speak on behalf of a group of State-chartered guarantee stock savings and loan associations, all doing business within the State of Washington. None of these associations, at least at the present, are owned or controlled by a savings and loan holding company.

I appear here today to oppose certain provisions contained in S. 1542 which, if enacted, will amend section 408 of the National Housing Act.

Specifically, we are deeply concerned about the effect this bill will have on all stock associations and not just the present savings and loan holding companies.

Our objections are directed to the definition of a holding company, contained in subsection (a), the limitation of activities contained in subsection (c), the restrictions on acquisitions contained in subsection (e), the control over the declaration of cash dividends contained in subsection (f), and the debt restrictions contained in subsection (g).

SECTION 408 (a)—DEFINITIONS

As contained in the bill, a savings and loan holding company is defined as follows:

"Savings and Loan Holding Company" means any company which directly or indirectly controls an insured institution or controls any other company which is a savings and loan holding company by virtue of this subsection;

We should like to point out the Bank Holding Companies Act defines a bank holding company as any company that directly or indirectly owns, controls, or holds, with power to vote, 25 percent or more of the voting shares of each of two or more banks.

We cannot understand why the law applicable to banks at least in this regard should not equally apply to savings and loan associations. Both are financial institutions dealing with the public's money and both must equally have the public's confidence.

Therefore, we feel the definition is too limited and would like to see it amended to include the ownership and control of each of two or more insured savings and loan institutions.

Senator BENNETT. Would you include in your reference here the 25-percent voting conditions?

Mr. BRUMBACH. Yes, I would.

Senator BENNETT. Thank you.

Mr. BRUMBACH. We further feel the definition of a savings and loan holding company should expressly exclude an individual.

SECTION 408 (c)—HOLDING COMPANY ACTIVITIES

An analysis of this subsection makes it quite clear that a holding company, as defined in the bill, or a subsidiary, which is not an insured institution, can engage in only four permitted activities. These are—

(a) Furnish or perform management activities for an insured institution;

(b) Conduct an insurance agency or escrow business;

(c) Hold, manage, or liquidate assets owned by, or acquired from a subsidiary insured institution; and

(d) Hold or manage properties used or occupied by a subsidiary insured institution.

The above are the specific enumerated activities permitted under S. 1542. In addition, the bill provides that a holding company can—

(e) Furnish or perform such other services or engage in such other activities as the Corporation may prescribe by regulation as being a proper incident to the operations of insured institutions and not detrimental to the interests of savings account holders.

A careful check of the above activities leads us to conclude that the aim of the Federal Savings and Loan Insurance Corporation is to limit the activities of a holding company to those commonly associated with a service company. Conceivably, one of the activities may be performed for the public at large, and that is conducting an insurance agency or escrow business. Any other activity by a holding company is prohibited.

We find these restrictive provisions so unjust we are convinced if enacted they will virtually destroy the marketability of the guarantee stock of all capital stock associations as well as the stock of the present holding companies.

A savings and loan association, unlike a bank or other business, cannot diversify. Its primary function is to loan on first mortgage real estate loans. Therefore, the only possible way a savings and loan association can diversify is through a holding company. Economists maintain that diversification is the soundest approach for the stability of any business. One only has to read any issue of *Forbes* or any other business magazine to learn that the great number of mergers taking place today are for the purpose of diversification. It is the American way of successful and progressive business enterprise. The ultimate effect of this subsection is to preclude any company which controls a savings and loan association from engaging in unrelated business activities. We strongly urge the committee to amend this subsection by deleting these restrictions.

SECTION 408(e)—ACQUISITIONS

We oppose the restrictive language of this subsection on acquisitions and particularly oppose the limitation placed upon a holding company's ownership of an insured institution whose principal office or place of business is not located in the same State as its parent company. What possible good can come from such a restriction?

If enacted, the marketability of the guarantee stock of every capital stock association would again be adversely affected. We in the State of Washington could sell only 9.99 percent of our stock of a company whose principal office is located outside the State. The Federal Home Loan Bank System is set up to regulate across State lines, and, as a matter of fact, most Federal legislation is designed for that purpose. Such a restriction would only penalize the many thousands of guarantee capital stockholders rather than aid the Board in its duties to regulate.

The prohibitions on mergers, as spelled out in this subsection, are such that only "sick" associations will be permitted to merge. Although the language is restricted to mergers involving associations controlled by holding companies, we submit such language establishes a standard that will be used against all stock associations.

Where mergers are involved, Federal legislation has established certain standards to protect the public. Stated in its simplest form, these include two inquiries:

- (1) Will the merger of A and B create a monopoly?
- (2) Will such a merger result in a restraint of trade?

It is true that many mergers in the business world have taken place to prevent a company from going into either voluntary or involuntary liquidation, but where Congress has legislated on the subject, we believe it has more generally been in the areas of preventing a monopoly or restraint of trade. We feel more liberal rules should be established for permitting associations to merge. If such legislation is adopted, there will be little need for the FSLIC to concern itself with the added supervisory responsibility of "arranging" for a merger or acquisitions of a "sick" association to prevent an involuntary liquidation.

SECTION 408(f)—DECLARATION OF DIVIDENDS

We support some notification prior to the issuance of any cash dividends. We do, however, seek the unabridged right to issue such dividends provided the subsidiary insured institution has met all its reserve requirements and after the issuance thereof, continues to meet such requirements as established by the FSLIC and State regulations.

SECTION 408(g)—HOLDING COMPANY INDEBTEDNESS

The restrictions imposed upon the issuance of debt security by a holding company or any subsidiary thereof is, in effect, an attempt by the FSLIC to assume one of management's most important functions. Such restrictions would be all but unworkable. Favorable interest rates could be completely lost through delays if the authority contained in this subsection is enacted.

The FSLIC has ample authority to regulate insured institutions for the protection of the public. The authority contained in this subsection is so restrictive that it is further evidence of an attempt by the FSLIC

to legislate holding companies out of existence, for the implication is that only indebtedness, the proceeds of which will be used for "(i) the purchase of permanent, guaranty or other nonwithdrawable stock to be issued by a subsidiary insured institution, or (ii) the purpose of making a capital contribution to a subsidiary insured institution," will be approved by the FSLIC.

We submit such legislation is not necessary for the FSLIC to properly carry out its supervisory functions.

In concluding, let us say many people are under the mistaken belief S. 1542 affects only the savings and loan holding companies, when in fact it affects all guaranty stock associations, and we believe a good many mutual associations.

The bill, as proposed, would give the FSLIC vast new powers to control the management activities of all stock associations. The essence of this bill is contrary to the free enterprise system and could adversely affect a large segment of the homebuilding industry.

(The attachment to Mr. Brumbach's statement follows:)

STOCK ASSOCIATIONS IN THE STATE OF WASHINGTON

Olympic Savings & Loan Association, Bremerton
 Lewis and Clark Savings & Loan Association, Clarkston
 Northland Savings & Loan Association, Kenmore
 Security Savings & Loan Association, Kent
 Guaranty Savings & Loan Association, Longview
 Skagit County Savings & Loan Association, Mount Vernon
 Island Savings & Loan Association, Oak Harbor
 Century Savings & Loan Association, Seattle
 Franklin Savings & Loan Association, Seattle
 Greenwood Savings & Loan Association, Seattle
 Northwest Guaranty Savings & Loan Association, Seattle
 Queen City Savings & Loan Association, Seattle
 Shoreline Savings & Loan Association, Seattle
 United Savings & Loan Association, Seattle
 Commerce Savings & Loan Association, Tacoma
 Community Savings & Loan Association, Wenatchee

Mr. Brumbach also mentioned that, in addition to the savings and loan guaranty stock associations attached to his statement, there are two other stock associations doing business in the State of Washington which were not included in the group represented by him. They are: Equitable Savings and Loan Association, with its home office in Portland, Oregon, and Highline Savings and Loan Association of Burien, Washington.

The CHAIRMAN. Thank you very much, Mr. Brumbach. Senator Bennett?

Senator BENNETT. No questions.

The CHAIRMAN. You are for some of the provisions of the bill, most of them; is that right?

Mr. BRUMBACH. We think there should be some regulation on the transactions between the holding company and the subsidiary insured institution.

The CHAIRMAN. And you would go along with the request that additional supervisory powers be granted?

Mr. BRUMBACH. Yes, registration, notice on the declaration of dividends.

The CHAIRMAN. Examination and investigation?

Mr. BRUMBACH. Yes, I think to a limited degree there, but I think consideration should be given to the use of certified public accountant's

statements before the association or the holding company has to incur the expense of an examination.

The CHAIRMAN. On page 3 of your testimony you point out the trend toward conglomerate mergers. Do you not believe there is a difference between, a basic difference between the financial and nonfinancial sectors of business? Don't you foresee the possible conflict of interest of savings and loan associations being permitted to join with other firms in a conglomerate holding company combine?

Mr. BRUMBACH. Well, I think that is probably a matter of business philosophy. And I can't see that there would be that conflict, as long as there is the authority for the FSLIC or the Board to examine and regulate the affairs of the subsidiary.

The CHAIRMAN. Near the end of your statement you say that this will greatly affect, you believe, the mutual companies as well. In what way?

Mr. BRUMBACH. I understand there are some mutual companies, the proxies of which are held by a separate corporation. I think under the definitions here they would come under the holding company.

The CHAIRMAN. Thank you very much, Mr. Brumbach. We appreciate your presentation.

The CHAIRMAN. The next witness is Mr. George L. Bliss, president and managing director, Council of Mutual Savings Institutions.

STATEMENT OF GEORGE L. BLISS, PRESIDENT AND MANAGING DIRECTOR, COUNCIL OF MUTUAL SAVINGS INSTITUTIONS, NEW YORK, N.Y.

The CHAIRMAN. We have your statement, it will be printed in full and you may proceed as you see fit.

Mr. BLISS. Mr. Chairman and members of the committee, my name is George L. Bliss, I reside at Mount Vernon, N.Y. I am president and managing director of the Council of Mutual Savings Institutions, the headquarters of which are in New York City. The council was organized in 1962 for the purpose (to quote from its constitution) of "advancing the distinctive and traditional activities of all mutual savings institutions." Its membership consists of mutual savings, building, or homestead associations located in some 35 of the States and the District of Columbia.

The first savings and loan associations organized in this country, back in 1831, were member owned, mutual institutions, and such has been their traditional method of operation. Comparatively recently, however, while using the same names and terminology as the mutuals, a relatively small segment (constituting less than 15 percent of the total) have turned to the capital stock form of corporate organization.

The mutual associations which comprise the membership of this council have been increasingly concerned over the promotional and expansion methods of these capital stock companies, and not without reason. Last fall, an analysis we made of the annual reports of the Federal Savings and Loan Insurance Corporation for the preceding 10 years (supplemented by news reports for the year 1966), revealed that privately owned capital stock companies, operating under the name "savings and loan association," had been responsible for more than 85 percent of the losses experienced by the Federal Savings and

Loan Insurance Corporation. We further cite the testimony of Chairman John E. Horne before a House Appropriations Subcommittee on February 1 of this year, in which he is reported as having stated that the Federal Home Loan Bank Board and the Federal Savings and Loan Insurance Corporation have "far more problems, relatively speaking, with stock associations than * * * with mutuals."

The problems thus posed have been aggravated by the introduction, in recent years, of holding companies owning one or more of these capital stock companies. Our members located in areas where the holding companies operate report that the following abuses not infrequently develop:

Upstream transfers of criticized assets from the controlled company to the parent company—the making of investments and other activities by a holding company, which would be unlawful if performed by one of its subsidiaries—the ownership by a holding company of subsidiaries engaged in other lines of business, thereby opening the door to conflicts of interest—and chain operation through the ownership of capital stock savings and loan companies located in more than one State, thereby effecting the equivalent of branch operation and evading statutes prohibiting interstate branching, where such prohibition exists.

It is our understanding that the purpose of the bill is to provide the Federal Savings and Loan Insurance Corporation with authority to prohibit such activities. We believe the pending bill accomplishes that objective, and it has the endorsement of this council.

We do, however, suggest two revisions of language, in the interest of clarification.

RECOMMENDATION NO. 1

Subparagraph (A) of paragraph (1) of subsection (a) of the bill—line 10 on page 1 and lines 1-4 on page 2 appears to us to unnecessarily list the specific types of institutions; namely, "A Federal savings and loan association, a building and loan, savings and loan, or homestead association or a cooperative bank," in the definition of an "insured institution." Limiting this definition to these specific types of institutions would exclude other types of institutions which might hereafter be authorized for insurance of accounts by the Corporation, unless someone remembers to propose a further amendment to this subparagraph at that time.

Accordingly, we respectfully suggest that this subparagraph be revised to read as follows:

(A) "insured institution" means an institution, the accounts of which are insured by the Federal Savings and Loan Insurance Corporation pursuant to the authority contained in subsection (a) of Section 403 of this Act.

RECOMMENDATION NO. 2

We strongly urge that paragraph (2) of subsection (a) of the bill—lines 7-24 on page 3 and lines 1-2 on page 4 be revised to clearly limit its application to capital stock savings and loan companies, in conformity with the stated objective of this bill.

Of the approximately 4,500 institutions in which accounts are insured by the FSLIC, about 2,000 are Federal savings and loan associations (all of which are mutual), approximately 1,800 are State-char-

tered mutual savings, building or homestead association—and the remaining 750 or so (all of them State chartered) are capital stock corporations, with ownership and control vested in the owners of such stock.

Let me emphasize that, in a mutual savings institution, there can be no "control," since it has no stock or equity interests. The standard charter and prescribed bylaws for Federal savings and loan associations provide, for example, (a) that all holders of savings accounts and all borrowers are "members," (b) that each such association shall operate under the direction of a board of directors, each of whom must be a member, (c) that the directors shall be elected at an annual meeting of the members, (d) that each owner of a savings account therein shall have one vote for each \$100 or fraction thereof in his savings account, (e) that, in addition, each borrower shall have one vote, (f) that no member may cast more than 50 votes, (g) that directors shall be elected for 3-year terms and (h) that the terms of approximately one-third of the directors shall expire each year. The statutes of the 50 States contain similar provisions, with only minor variations.

We do not accept the assertion, occasionally made, that "control" of a mutual institution can be effected by the use of proxies. In the first place, it is basic law that any proxy is revocable, and will be superseded by a proxy bearing a later date or by attendance in person at any meeting of the members. In most States, proxies are valid only for a specified period of time, in any event. Neither can "control" of a mutual institution be exercised by any individual or group since, as distinguished from their status in a capital stock corporation, each director of a mutual institution is responsible only to himself; he is a free agent and cannot be held to or bound by any program or set of policies dictated by anybody else.

To avoid the possibility of any future contention to the contrary, we recommend that this paragraph be amended by deleting the words "person" or "persons," wherever they appear, and the substitution of the words "company" or "companies," in a manner consistent with present paragraph (3) of subsection (a) of section 408, so that it would read as follows:

(2) for purposes of this section, a company shall be deemed to have control of—

(A) an insured institution if the company directly or indirectly or acting in concert with one or more other companies, or through one or more subsidiaries, owns, controls, or holds with power to vote, or holds proxies representing, more than 10 per centum of the voting shares of such insured institution, or controls in any manner the election of a majority of the directors of such institution; or

(B) any other company if the company directly or indirectly or acting in concert with one or more other companies, or through one or more subsidiaries, owns, controls, or holds with power to vote, or holds proxies representing, more than 25 per centum of the voting shares or rights of such other company, or controls in any manner the election or appointment of a majority of the directors or trustees of such other company, or is a general partner in or has contributed more than 25 per centum of the capital of such other company.

The CHAIRMAN. Thank you, Mr. Bliss. You have given us a very precise and straightout statement. We appreciate it very much, Any questions?

Senator Bennett?

Senator BENNETT. Mr. Bliss on the first page of your statement, in the third paragraph, you point out that in the year 1966 privately owned capital stock companies opening under the name of savings and loan associations have been responsible for more than 85 percent of the losses experienced by the Federal Savings and Loan Insurance Corporation.

You come from New York. In that same year did any of the mutual associations in New York have any problems in meeting their reserve requirements?

Mr. BLISS. I am not in a position to say. First, let me say this, Senator, this study was made in the year 1966, it covered 10 years. It was a 10-year study.

Now, of course, mutual associations build up reserves for losses. Every year, before the allocation of dividends to their members, they set aside a certain portion of their earnings as a reserve for possible future loss.

Senator BENNETT. I understand that.

Mr. BLISS. Now, in a given year, they may more than meet the reserve requirement, so that in years of lean earnings, they may draw on their undivided profits, in order to level out the rate of dividend they pay.

Senator BENNETT. You are not, personally, aware of the problems that we are faced with really by all savings and loan associations in 1966?

Mr. BLISS. I am very much aware of them. There were any number of associations which, in order to meet their reserve requirements and maintain rates have dividends which they felt were essential or desirable to pay, drew on their undivided profits.

Senator BENNETT. So this question of problems in 1966 was not limited to stock associations.

Mr. BLISS. No, the thrust of my statement, Senator, was that over a 10-year period, a study which we made in 1966, revealed that 85 percent of the losses to the Federal Savings and Loan Insurance Corporation were incurred by troubles in the stock companies.

Senator BENNETT. But your statement says, supplemented by news reports for the year 1966.

Mr. BLISS. Yes, that is quite technical. We had the official reports of the insurance corporation for 10 years and we added to that news clippings for the year 1966, for which the report was not yet available.

Senator BENNETT. I have no further comments, Mr. Chairman.

The CHAIRMAN. Anyhow, 85 percent of the losses came from stock companies?

Mr. BLISS. That is correct.

The CHAIRMAN. And 15 percent from mutuals.

Mr. BLISS. Less than 15 percent.

The CHAIRMAN. By the way, is it your opinion if we permit the holding companies to grow that mutuals will wish to convert to stock companies, there will be a tendency in that direction?

Mr. BLISS. We do not believe so.

The CHAIRMAN. Do you think it will remain about as it is now?

Mr. BLISS. The only strong desire we have on that subject is this. We don't have anything against stock companies, as such. We simply

feel they should use a different name than "savings and loan association."

The CHAIRMAN. I was just wondering if, in your opinion, the mutuals might have a tendency to convert to stock?

Mr. BLISS. We hope not and we believe not.

The CHAIRMAN. Why do you think so many of the stock companies had trouble with the bank Board?

Mr. BLISS. Well, in complete candor, a stock company which undertakes to pay the same rate of return on its savings accounts, and also make a profit for its stockholders, needs greater earnings than a mutual association. The basic principle of mutuality is that there are no stockholders to receive a return.

Now, in order to achieve a higher degree of earnings, it appears rather obvious from the record they have taken greater risks.

The CHAIRMAN. Am I correct in gathering from your statement that you see a danger that holding companies may destroy the local character of the savings and loan associations?

Mr. BLISS. Very definitely so.

The CHAIRMAN. Thank you very much, Mr. Bliss. We appreciate your contribution. Thanks to all of you.

At this point in the record we will insert, without objection, a letter from the First Brentwood Corp., Los Angeles, Calif.

(The letter follows:)

FIRST BRENTWOOD CORP.,
Los Angeles, Calif., June 2, 1967.

HON. JOHN SPARKMAN,
Chairman, Committee on Banking and Currency,
U.S. Senate, Washington, D.C.

GENTLEMEN: The purpose of this letter is to state the opposition of First Brentwood Corporation to Senate Bill 1542. First Brentwood Corporation is a Delaware corporation with principal offices at 12001 San Vicente Boulevard, Los Angeles, California. First Brentwood Corporation is the owner of all of the outstanding guarantee stock of Brentwood Savings and Loan Association and is, therefore, a savings and loan holding company within the meaning of Sections 11500 et. seq. of the California Financial Code and within the language of the amendments to the National Housing Act proposed by Senate Bill 1542.

Brentwood Savings and Loan Association has been engaged since 1924 in the savings and loan business in and around Monrovia, California (which is located approximately 16 miles east of downtown Los Angeles). The Association also maintains offices in downtown Los Angeles, in the communities of Woodland Hills and Brentwood in the City of Los Angeles, and in the City of San Marino, California. The Association has total assets of approximately \$165 million.

First Brentwood Corporation is a wholly-owned subsidiary of Jim Walter Corporation, headquartered at 1500 North Dale Mabry Highway, Tampa, Florida. Jim Walter Corporation is listed on the New York Stock Exchange, has approximately 15,000 shareholders, and is nationally diversified. Jim Walter Corporation and its subsidiaries have aggregate assets of more than \$500 million. Its subsidiaries include a manufacturing company (The Celotex Corporation), and oil company (South Shore Oil and Development Company), a sugar company (The South Coast Corporation), as well as interests in banking and other aspects of financing. Acquisition of First Brentwood Corporation's stock by Jim Walter Corporation qualified it as a savings and loan holding company under the above quoted provisions of the California Financial Code, and would also so qualify it under Section 408 of the National Housing Act as proposed by Senate Bill 1542.

The principal provisions of the proposed Bill which we oppose include that section requiring a *diversified* savings and loan holding company to divest itself, within a period of two years after enactment, of all activities not related to the savings and loan association. For a company such as Jim Walter Corporation the practical effect of the Act would require divestiture of Brentwood Savings and Loan Association.

The proposed Bill does not prevent ownership of insured institutions by *non-diversified* savings and loan holding companies. This implies recognition of the advantage of the holding company concept of ownership, principally the financial support the holding company can give the insured institution because of its superior ability in capital formation. This has operated to the demonstrated advantage of not only the savings and loan holding companies but also the savers of, and the public served by, the subsidiary institution so benefited. Both growth, by permanent contributions to capital, and liquidity, by the purchase of mortgage loans, are cited as two examples of financial support these additional holding company resources provided Brentwood Savings and Loan Association during the most recent three-year economic cycle.

We submit the diversified holding company, because of greater capital resources and, hence, reduced vulnerability to cyclical distortions in any single sector of the economy, logically has even greater capacity to support its savings and loan association subsidiary than its non-diversified counterpart.

The proposed Bill is discriminatory because it constitutes a *de facto* exemption of savings and loan associations holding Federal charters, except where a person identified with a holding company has proxy control of such a Federal association. Should an individual with proxy control of a Federal association but not identified with a corporate holding company be permitted diversified business ownership? We object to the inference that *only* the corporate entity is capable of abusing the public trust in its fiduciary capacity. Such discrimination is not justified.

If every action has a reaction, to eliminate diversified ownership of savings and loan associations suggests non-diversified ownership. But in what form? By whom? For what investment purpose? And what consideration does the proposed Bill give existing investors, the public, not only in holding company shares but also in any guarantee stock association, who seek a fair return on their investment suddenly in over-supply, if indeed there would be any demand at all under the circumstances? We suggest the imposed consequences of divestiture run counter to the historical development of capital formation in this country by viable, privately-owned business enterprises, and could result in both the destruction of a substantial segment of the savings and loan industry and the impairment of the financial strength of the Federal Home Loan Bank system and the Federal Savings and Loan Insurance Corporation.

Ironically, if the Association subsidiary of a diversified holding company is sound, Congress has already prevented its sale to the most logical purchaser. Section 408 of the National Housing Act prohibits a savings and loan holding company from acquiring control of another insured institution unless the Federal Home Loan Bank Board has determined that such transaction is advisable to assist in preventing the commencement or continuance of involuntary liquidation of the insured institution whose control is being acquired.

The history of diversified corporate businesses owning savings and loan associations reveals no abuses of the public trust. Therefore, we submit no need has been shown to require a diversified savings and loan holding company to divest itself of business interests unrelated to the savings and loan association subsidiary. On the contrary, we are firm in the belief that diversity is the great strength of the holding company concept, not its weakness.

We oppose another provision of the Bill which has particular significance to the diversified holding company, that section restricting holding company indebtedness. The many components of capital structure and formation uniquely available to the diversified holding company have already been alluded to. And to deprive any segment of that holding company complex of its sources of credit is to deny it normal business operation.

There are additional provisions in the Bill which are applicable to all savings and loan holding companies, diversified or not, which we believe also require examination by the Committee. For example, the requirement that no dividends may be declared by any subsidiary insured institution without 30 days advance notice intimidates the investor, in our free market system, as a source of capital. This provision is unnecessary because of net worth requirements imposed by law; control of abuses is available to the Federal Home Loan Bank Board under the authority of the Supervisory Powers Act of 1966.

While we find no inherent objection to registering savings and loan holding companies, the examination provisions of the Bill would duplicate state legislation already in force. In California, Sections 11550 et. seq. of the California Financial Code already require periodic reports by a savings and loan holding

company and subject it to examination by the State Savings and Loan Commissioner. Therefore, another tier of legislation, this one Federal, would impose additional costs measured by both time and money on top of existing costs, without commensurate increases in safeguards and controls.

Bill 1542 restates prior legislation which precludes the acquisition by any savings and loan holding company of another insured institution unless such acquisition will assist in preventing the commencement or continuance of involuntary liquidation of the acquired insured institution. Certainly undue concentration of savings and loan control can be prevented by Federal antitrust laws and legislation similar to the Bank Merger Act, and it seems clear many associations not bordering upon liquidation could be strengthened, and the public needs better served, by a measure of consolidation of the savings and loan industry through acquisition. If such acquisitions could be accomplished under a provision requiring prior approval by the Federal Home Loan Bank Board, the way would be left open for healthy mergers, as opposed to the present requirement of an association having to become what is known in the industry as a "basket case" before it becomes eligible for merger.

In summary, we believe there has not been demonstrated any need for this Bill, which would penalize severely the diversified holding company as well as other elements in the savings and loan industry. On the contrary, it has been demonstrated that a diversified holding company adds considerable strength to an insured institution in its capacity to serve the public and to merit the public trust. The entire savings and loan system would be strengthened, in fact, by expanding holding company ownership through approved mergers when the public interest is best served. We suggest the reasonable and constructive policy for the Congress to continue to pursue is that which encourages expanding the capability of the savings and loan industry to attract capital in a free, competitive market, including the savings of the public invested through the diversified holding company intermediary, thereby strengthening its private resources and reducing its reliance on already-burdened Federal government agencies.

Very truly yours,

DAVID C. GRIMES, *Vice President.*

The CHAIRMAN. Let me say this concludes the hearings, but the record will be kept open until June 16.

If there are any corrections, supplements, statements, or other statements to be placed in the record, let us have them by that date.

Thank you very much.

The committee stands adjourned.

(Whereupon, at 12 noon, the hearing was concluded.)

(The following correspondence was subsequently received by the committee:)

U.S. SENATE,
COMMITTEE ON BANKING AND CURRENCY,
Washington, D.C., May 31, 1967.

HON. JOHN SPARKMAN,
*Chairman, Senate Banking and Currency Committee,
New Senate Office Building, Washington, D.C.*

DEAR MR. CHAIRMAN: Please find enclosed a copy of a fine letter I have received from Mr. H. Laird McGregor, President of Hancock Savings and Loan Company, Findlay, Ohio, regarding S. 1542.

It would be appreciated if Mr. McGregor's comments could be incorporated in the record of the forthcoming hearings on this legislation.

Yours sincerely,

B. B. HICKENLOOPER.

(Enclosure.)

HANCOCK SAVINGS & LOAN CO.,
Findlay, Ohio, May 26, 1967.

HON. BOURKE B. HICKENLOOPER,
*New Senate Office Building,
Washington, D.C.*

MY DEAR SENATOR HICKENLOOPER: Having observed my father, J. Harry McGregor, in Congress for many years until his death in 1958, I am aware of the many self-serving and frivolous letters addressed to members of the Congress.

I therefore have refrained since that time of writing to members unless the matter was of serious and broad public interest. In my judgment this letter falls in this category.

I am writing you with reference to the proposed Savings and Loan Holding Company Amendments of 1967, S. 1542. We first heard about this Bill just a short time ago and understand it will soon be coming before your Banking and Currency Committee.

Although the writer is not familiar in detail with abuses that apparently have given rise to this Bill, from our own experience in this field we are seriously concerned that this Bill is a case of "using rubber gloves for leaky fountain pens". In other words, we believe that far more harm (particularly for smaller institutions) than good will result from its present provisions.

We submit that more effective regulation should be limited toward the apparently troublesome area—specific abuses of the relationships between the savings and loan association and its holding company. It seems to us that many of the provisions directed toward holding companies *per se* is much like using a shotgun where a rifle is appropriate. Based upon our own situation, the side effects of this Bill would result in serious consequences for many sound—even though small—operations such as our own and would have an overall adverse effect on the public interest.

We believe that some of the provisions in the Bill would seriously affect the effectiveness of many smaller savings and loans in rendering proper service to their community. The writer is personally associated with two small savings and loan associations, both owned by holding companies. We sincerely believe these are not only operated beyond reproach insofar as the public interest is concerned, but that their steadily improving performance is due to the effectiveness of leadership from its respective holding company.

We do not claim that all holding companies are good, but we do believe that the "shotgun" effect of the Bill will have unfortunate side effects damaging many sound operations. In our judgment the Bill as it now stands would make the operation of small holding companies so difficult that they would no longer be a viable method of ownership of savings and loans. Why not deal directly with the abuses apparently evidenced in the past by specific provisions instead of effectively condemning all holding companies? As has been proven in the banking field, the holding company arrangement often is the *most effective way of improving* the performance of lagging institutions—and particularly the smaller ones.

In particular, we would like to offer the following specific comments on the Bill:

1. In paragraph (a) relating to Definitions, with regard to the question of control in paragraph (b), we note that this provision refers to control by *both a company and a person*. Congress has seen fit in the Bank Holding Company Act to distinguish between control by a company *or* by persons. Control of more than one bank by a company requires registration under the Bank Act; however, it does not apply to more than one bank controlled directly by persons. We are puzzled as to why savings and loans should be given a different status than banks. Further, control of a savings and loan under this Bill is defined as owning more than ten percent of the voting stock, whereas the Bank Holding Company Act uses the test of twenty-five percent. Again, we wonder why different standards should be applied.

2. We agree with paragraph (b) that Registration and examination of holding companies are advisable. This provision in itself could well go a long way toward dealing with any abuses.

3. With regard to paragraph (c), Holding company activities, we agree that certain activities should be prohibited, but we again feel that the approach of the Bank Holding Company Act, whereby ownership of just one insured institution can co-exist with other activities, should continue to be permitted. In our own case where one of our holding companies owns both a commercial bank and a savings and loan institution, both operations and their services to the public have clearly benefited. Again it would seem to us that the proper approach to limit abuses would be to limit the type of transactions between such affiliates. As a practical matter, an extremely difficult situation for us as well as others would result in trying to unscramble the many presently existing holding companies with both a savings and loan and other subsidiaries.

4. We agree completely with paragraph (d) itemizing Prohibited transactions. This again is the type of approach we feel should be a part of this Bill rather than the overall "straightjacket" put on holding companies.

5. With regard to paragraph (e), Acquisition, it seems to us that the flat prohibition against mergers or acquisitions eliminates the possibility of many such actions that would clearly be in the public interest. We similarly feel that the prohibition against a holding company having more than one savings and loan is undesirable as it again permits no flexibility. Would it not be much more flexible, and still effective in preventing undesirable situations, to treat the questions of both mergers and holding more than one savings and loan in the same fashion as is done in the Bank Merger Act; that is, make them subject to approval by the supervisory agency and the Justice Department? For example, in our own case we have in mind a savings and loan merger which would not reduce competition one iota—yet it would clearly improve the customer service by both institutions. Again, why not consider each such case on its merits rather than by a flat prohibition which cannot possibly take into account a priori all of the factors relating to the public interest?

6. With regard to paragraph (f), we are in accord with an appropriate notice with respect to the Declaration of dividends.

7. With regard to paragraph (g), Holding company indebtedness, we do not understand how reasonable borrowing by the holding company necessarily endangers the subsidiary association, provided the earlier restrictions against excessive dividends and other ways of "milking" the association are in the Bill. In our own case we believe that the use by the holding company of borrowed money for the purpose of financing the acquisition of the savings and loan association has definitely proven to be in the public interest. Sound borrowing by the holding company is an important help to attract entrepreneurs who can supply capable management. The present Bill effectively prohibits borrowing to acquire ownership; potential buyers would thereupon be largely limited to wealthy and likely not too progressive owners. In the long run, we feel that such a limitation would result in stagnation of many associations.

8. In paragraph (i), Prohibited acts, we believe the prohibition in section (2) against any person or company having a significant interest in more than one institution in many cases again will not serve the public interest. Again referring to our own case, the know-how and experience gained in the operations of one association is being most helpful in improving the operations of a second institution recently acquired by essentially the same persons. Savings and loans are no different from other businesses in that their successful operation depends upon experienced and capable management. Particularly in smaller institutions, the scarcity of such skilled management is a critical factor. This provision of the Bill in effect makes it impossible for such talents to be used effectively in more than one institution. Again, the approach used by Congress in the Bank Holding Company Act, which has proven its effectiveness, would seem to be a much better way of dealing with any abuses without the undesirable side effects.

In summary we again feel that although the intent of the Bill to prevent abuses is a laudable one, the scope of its provisions are too far-reaching and will handicap the sound and progressive management of many stock savings and loans. Again we suggest that a better Bill considering the overall public interest would be limited to dealing specifically with the particular problems of concern. In our judgment the harm done by this Bill—particularly to the smaller institutions such as our own—would far outweigh the advantages gained. Again it would seem that this Bill is a case of "using rubber gloves for a leaky fountain pen."

To illustrate how greatly concerned we are about this Bill, if passed in its present form, we now believe it would be necessary to liquidate one of the savings and loan institutions I am associated with. As it is a sound institution, certainly this would not be in the public interest. We hope that this illustration will graphically show what we mean by inadvertent and undesirable side effects of this Bill.

It seems to us that it is unfair indeed to penalize the many smaller holding company operations who are sound because of the abuses of a few large ones. One suggestion we would make is to have some of the Bill's provisions not applicable to the smaller companies. A reasonable dividing line in the area of \$100 million in deposits might be appropriate. Although we well appreciate abuses are not limited to the larger companies, many of the Bill's present provisions clearly have arisen from concern about their operators. And, we believe the adverse effects of the Bill are to a great degree peculiar to the problems of the smaller institutions.

We trust the above will receive your consideration when this Bill comes before you. We would be pleased to furnish any additional information you might desire in this regard. In closing, it is our hope that Congress will give careful

study to the dangers in the present bill, and limit the scope of its provisions to serve its proper purpose without stifling legitimate activities of the smaller companies that our experience has shown are very much in the public interest.

Respectfully,

H. LAIRD MCGREGOR,
President.

QUEENS COLLEGE,
Flushing, N.Y., June 6, 1967.

HON. JOHN SPARKMAN,
*Chairman, Committee on Banking and Currency,
U.S. Senate, Washington, D.C.*

DEAR MR. CHAIRMAN: As Chairman of the Federal Home Loan Bank Board during the period 1961 to 1965, I became very much concerned with the serious and adverse influence the holding companies that control federally insured savings and loan associations had on their operations, and more generally the indirect adverse effects they had on the savings and loan industry.

I first attempted to get some of the people who controlled the larger holding companies to cooperate in the drafting of a holding company bill, but had no success. I then submitted a bill to the Congress, with administration approval in 1964, which in its major provisions was similar to S 1542, although the latter, I think, represents an improvement technically and substantively. I just finished reading the testimony Chairman John Horne presented to your Committee, and I concur fully in everything he said. The statistical information and data he presented to your Committee confirmed the fears I had at the time I was Chairman. It was for that reason that I persevered so hard to convince the industry, the administration and some members of Congress of the importance of enacting into law a strong savings and loan holding company bill.

The operations of some of the larger associations, especially those which are controlled by holding companies, have a deleterious effect on the operations of their competitors and influence the market in which they operate. It was my observation that it made the job of carrying on a good and sound operation difficult for many of their competitors. Also, some of the holding company operators were very active in industry affairs and often resisted most strenuously, or opposed the efforts of the Board and those of the forward-looking members of the industry to prevent, reduce or eliminate abuses and unsound practices in the industry. Some of the same people on the board of the San Francisco Bank consistently opposed the efforts of the Board in Washington to develop and carry out policies aimed at bring about sounder operations in the industry.

I urge you as strongly as I can, and I have no interest other than as one who is a strong supporter of the savings and loan industry and the Home Loan Bank system, to report and ultimately enact into law S 1542.

With all good wishes to you and my many other good friends on the Committee, I am

Sincerely yours,

JOSEPH P. McMURRAY,
President.

STATE OF MARYLAND DEPARTMENT OF BUILDINGS,
SAVINGS AND LOAN ASSOCIATIONS,
Baltimore, Md., June 12, 1967.

HON. JOHN SPARKMAN,
*Chairman, Senate Banking and Currency Committee,
U.S. Senate, Washington, D.C.*

DEAR SENATOR SPARKMAN: I am enclosing a copy of a statement on S. 1542—
"Savings and Loan Holding Company Amendments of 1967".

I urge the passage of this legislation as the same is in the public interest.

With very best wishes, I remain,

Sincerely yours,

ALLAN D. HOUSLEY,
Director.

The savings and loan business has so expanded in recent years, become so integrated with the financial structure and become so important a source of mortgage financing for the purchase and construction of homes that the business is affected with a substantial public interest. It, therefore, should be regulated

as a business affecting the economic security and the general welfare of the public.

S. 1542 now before the Senate Banking and Currency Committee gives legal recognition to this premise. It is designed to provide the Federal supervisory authority with controls to effectively safeguard the interests of stock associations which are subsidiaries of holding companies and to insure the integrity of the relationship between the parent holding company and its subsidiary.

The tremendous growth of savings and loan associations in the last decade naturally attracted the attention of investors to the growth potential of the stock of permanent stock associations. Control of sound institutions was acquired by companies organized for that specific purpose and companies engaged in or controlling the activities of affiliates operating in other business areas.

A basic issue began to crystalize when control of permanent stock associations became vested in entities outside and beyond existing regulatory authority and supervisory problems became increasingly evident.

Is the public interest in the savings and loan business sufficiently great to warrant more effective regulation of the operations of savings and loan holding companies?

It seems that the answer to this question is quite obvious. The magnitude of the contributions of the savings and loan industry to the economic security and general welfare of the public is such that the business must be properly regulated to insure that associations are soundly operated and financially secure.

At the present time a number of stock associations are controlled by holding companies which are, for the most part, free from regulation. Problems have arisen and the financial structure of the previously sound institutions have been undermined.

To prevent an increase in the types and in the gravity of the problems referred to in testimony presented to the Committee, the Federal supervisory authority must be provided with the proper tools to fully execute the responsibilities assigned by law. The minimum tools required to accomplish this objective and to regulate the operations of savings and loan holding companies are embodied in the provisions of S. 1542.

Persuasive arguments have been made to the Committee opposing the restrictions on the unrelated business activities of savings and loan holding companies. The substance of these arguments and others offered in connection with several other provisions of the Bill have the effect of diluting the intent and purpose of this legislation.

The interests of the general public are paramount to proprietary interests; S. 1542 should be enacted into law.

STATE OF MARYLAND,
DEPARTMENT OF BUILDING, SAVINGS & LOAN ASSOCIATIONS,
Baltimore, Md., June 16, 1967.

HON. JOHN SPARKMAN,
Chairman, Senate Banking and Currency Committee,
U.S. Senate,
Washington, D.C.

DEAR SENATOR SPARKMAN: I am enclosing a copy of the statement of the National Association of State Savings and Loan Supervisors on S. 1542, "Saving and Loan Holding Company Amendments of 1967."

The National Association of State Savings and Loan Supervisors, an organization established to represent the interests of designated State officials responsible for the supervision and regulation of state-chartered building, savings and loan associations, urges the prompt enactment of the above referenced legislation.

Sincerely yours,

ALLAN D. HOUSLEY,
President, National Association of State Savings & Loan Supervisors.

STATEMENT OF NATIONAL ASSOCIATION OF STATE SAVINGS AND LOAN SUPERVISORS

The National Association of State Savings and Loan Supervisors supports and urges the enactment of S. 1542, which will bring the operations of savings and loan holding companies within the scope of the regulatory authority of the Federal Home Loan Bank Board, acting for and on behalf of the Federal Savings and Loan Insurance Corporation.

The absence of federal and state statutes subjecting the operations of savings and loan holding companies to regulation has strictly limited the efforts of supervisory agencies to effectively safeguard the interests of subsidiary permanent stock associations.

As a result of the lack of regulatory authority, supervisory agencies have been unable to control certain types of transactions between holding companies and subsidiary associations and transactions involving the affiliates of the holding companies, which have weakened the financial stability of the subsidiaries.

The seriousness of the problems resulting from improper transactions between the subsidiary, the parent company and affiliates is such as to warrant the prompt enactment of legislation which will provide the Federal Home Loan Bank Board with adequate legal authority to control the operations of holding companies and the transactions with and involving their subsidiaries.

We recognize the concern that has been expressed in testimony before and in statements filed with the Committee with regard to Subsection (c) (2) of the Bill and the possible restrictive effect of this provision on the future growth of stock associations and family-controlled stock institutions. We believe, however, that any amendments that may be considered by the Committee with regard to this Subsection should not weaken the intent and purpose of this legislation.



STATEMENT OF NATIONAL ASSOCIATION OF STATE SAVINGS AND LOAN SUPERVISORS

The National Association of State Savings and Loan Supervisors supports and urges the enactment of S. 1013 which will bring the operations of savings and loan holding companies within the scope of the regulatory authority of the Federal Home Loan Bank Board, acting for and on behalf of the Federal Reserve and Federal Insurance Corporation.

The absence of Federal and state statutes subjecting the operations of savings and loan holding companies to regulation has steadily limited the efforts of supervisory agencies to effectively safeguard the interests of substantially permanent funds in such companies.

As a result of the lack of regulatory authority, supervisory agencies have been unable to restrict certain types of transactions between holding companies and subsidiary associations and transactions involving the affiliates of the holding companies which have weakened the financial stability of the subsidiaries.

All weaknesses of the problems resulting from the lack of uniformity between the subsidiaries, the parent company and affiliates is such as to warrant the prompt enactment of legislation which will provide the Federal Home Loan Bank Board with an adequate legal authority to control the operations of holding companies and the transactions with and involving their subsidiaries.

We reiterate the concern that has been expressed in testimony before and in statements filed with the Committee with regard to Subsection (c) (2) of the bill and the possible restricting effect of this provision on the future growth of stock associations and family-controlled stock institutions. We believe, however, that any amendment that may be considered by the Committee with regard to this Subsection should not weaken the intent and purpose of this legislation.