COMPETITION IN BANKING ACT OF 1980

HEARING

BEFORE THE

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

NINETY-SIXTH CONGRESS

SECOND SESSION

ON

S. 39

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

S. 380

TO AMEND THE BANK HOLDING COMPANY ACT OF 1956 TO LIMIT THE PROPERTY AND CASUALTY AND LIFE INSURANCE ACTIVITIES OF BANK HOLDING COMPANIES AND THEIR SUBSIDIARIES

H.R. 2255

TO AMEND THE BANK HOLDING COMPANY ACT OF 1956 TO LIMIT THE PROPERTY AND CASUALTY AND LIFE INSURANCE ACTIVITIES OF BANK HOLDING COMPANIES AND THEIR SUBSIDIARIES

JULY 1, 1980

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COMPETITION IN BANKING ACT OF 1980

TUESDAY, JULY 1, 1980

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

The committee met at 9:30 a.m. in room 5302, Dirksen Senate Office Building, Senator William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire, Morgan, Sarbanes, and Garn.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

The CHAIRMAN. The committee will come to order.

This morning we hold hearings on S. 39, to control the growth of bank holding companies by merger and from entering into nonbanking lines of commerce not directly related to banking.

The House recently passed by an overwhelming margin legislation to prohibit bank holding companies from selling insurance, H.R. 2255. That was by a 10 to 1 margin.

The House approach is more specialized than S. 39. It would retain a flexible approach to nonbank activities, allowing the Federal Reserve to determine which activities are directly related to banking. S. 39 would also prohibit the Comptroller of the Currency from approving an activity for national banks if the activity has been prohibited by the Federal Reserve as a permissible activity for bank holding companies. And S. 39 would prohibit bank acquisitions by banks already holding 20 percent of the banking assets in any State.

While S. 39 seeks to control all bank holding company growth, H.R. 2255 focuses on one activity—insurance—and attempts to proscribe the activity. This has been referred to as the negative laundry list approach.

What this committee must come to grips with in its consideration of all such legislation is what kind of a competitive environment does the committee seek to encourage.

Banks do have significant competitive advantages by virtue of their large deposit holdings and their ability to make loans. If they can offer commercial services, customers might prefer to purchase these services from banks in the hope of being in a better position to receive credit. We will explore the matter of tie-ins this morning.

Another factor which should be considered in these hearings is the impact such legislation may have on the shape of the financial industry in the future. Congress recently passed the Depository Institutions Deregulation and Monetary Control Act which at-

tempts to provide a healthier competitive environment for all financial institutions and better service to their customers.

I am sure many Senators might be interested in knowing—if and when this legislation is debated on the floor—how competition will be improved if the Senate enacts this legislation.

I look forward to the testimony this morning. Unfortunately, I will have to leave for a short time to testify before the Budget Committee and Senator Garn will take over, but I will return as promptly as I can. Senator Garn.

Senator GARN. Thank you, Mr. Chairman. I am anxious to get to the testimony and not delay the witnesses. I will just ask unanimous consent that my opening statement be placed in the record.

The CHAIRMAN. Without objection, so ordered.

[Senator Garn's opening statement follows as though read:]

OPENING STATEMENT OF SENATOR GARN

The committee will hear testimony today regarding several legislative proposals designed to restrict the size and activities of bank holding companies.

There has long existed in this country a separation between banking and other forms of commerce. This separation was developed in part because banking organizations, by virtue of their control over credit transactions, are in a position either directly or indirectly to exercise great influence over borrowers in connection with the purchase of nonbanking services. Furthermore, the pursuit of nonbanking activities would tend to divert bank resources and efforts away from their principal activity—banking.

The Bank Holding Company Act of 1956, as amended, provides a regulatory framework designed to restrict bank holding companies to those nonbanking activities which are closely related and a proper incident to banking. Under this standard, the Federal Reserve Board by regulation has permitted bank holding companies to become involved in the sale of credit related property and casualty insurance. Whether such activity was within the contemplation of Congress when it enacted the Bank Holding Company Act and its subsequent amendments is a matter which has been the subject of considerable litigation and is now before Congress once again.

There is no question that there is potential for abuses in any situation where a creditor may link the granting of credit to the provision of insurance or other services which a bank holding company may offer. Of course, in seeking to prevent abuses, we should be careful not to stifle legitimate competition.

This hearing provides the committee a new opportunity to determine the extent to which Congress should specify what nonbanking activity or activities are appropriate for bank holding companies; and I look forward to the testimony of the witnesses.

The CHAIRMAN. Our first witness this morning is Governor Charles Partee of the Federal Reserve Board. We expected Senator Durkin and if he comes in we will of course put him on.

Governor Partee, go right ahead. We hope you can confine your remarks to about 10 minutes or less and then we can get right into questions.

STATEMENT OF J. CHARLES PARTEE, GOVERNOR, FEDERAL RESERVE BOARD

Mr. PARTEE. Fine, Mr. Chairman.

I am glad to appear today before this committee to present the Federal Reserve Board's views on two banking bills that have been the subject of much attention and previous debate. One would limit the insurance activities of bank holding companies. The other would subject acquisitions of banking organizations to stricter standards than in the present antitrust laws and would tighten the rules for expansion into nonbanking activities by bank holding companies.

The proposed H.R. 2255 would prohibit the sale of credit related property and casualty insurance by bank holding companies with consolidated assets in excess of $50 million, with certain exceptions.

The exceptions are:

One. The sale of credit life, personal accident, and health insurance,

Two. The sale by finance company subsidiaries of BHC's of property and casualty insurance on property used as collateral for a loan of $10,000 or less, indexed to future increases in the consumer price index,

Three. The sale of general insurance in places of 5,000 population or less, or where the Board determines that insurance agency facilities are inadequate; and

Four. The sale of insurance pursuant to certain limited "grandfather" rights for organizations engaged in the activity prior to June 6, 1978, and a limited authority to continue to act as managing general agents with respect to insurance on real and personal property and group life insurance for the banking organization and/or its employees.

OPPOSITION TO BILL

The Board consistently has opposed this bill because it seems to us to be anticompetitive and discriminatory. Many creditors, including finance companies and retailers, are permitted to sell insurance in connection with their credit granting activities, but the proposed prohibitions would apply only to bank holding companies. In this respect the bill clearly discriminates against customers of BHC's because the finance company, retail and other sectors would remain free to offer property and casualty insurance. The bill also may be misdirected, since the available evidence suggests that any abuses are more likely to occur among nonbank lenders than in banking. A similar inconsistency exists in that the evidence clearly indicates that potential abuses associated with the joint offering of credit and insurance are more likely to occur in the sale of credit life than in the property and casualty field. Yet, the proposed legislation allows credit insurance but prohibits the sale of credit related property and casualty insurance.

The various exemptions also seem inconsistent with the purposes of the proposed bill and would appear to compound the inequities. The Board opposes both the $50 million asset size exemption and the $10,000 transaction exemption for subsidiary finance companies. Permitting an activity to be engaged in by a bank holding company or its subsidiary solely because of the asset size of the

bank holding company or the size of the transaction involved are not relevant criteria to determining whether an activity is closely related to banking. By employing such a standard, Congress would be abandoning some well established criteria that have been developed over the years by the courts and have come to be recognized as appropriate for determining whether a nonbanking activity is closely related to banking within the meaning of section 4(c)(8) of the act.[1] In addition, the effect of the $50 million asset size exemption would be to permit expanded sales of insurance by small bank holding companies. The majority of these companies is located in relatively concentrated markets where the potential for abuse is greatest since we would submit that market power is generally related to the relative rather than the absolute size of the organizations in such markets. In addition, the effect of lifting constraints on the scope of insurance agency activities for small bank holding companies and exempting finance company transactions of less than $10,000 probably would be to increase the volume of insurance sold by holding companies. In fact, over 60 percent of all bank holding companies would be able to expand the scope and volume of their activities to include transactions clearly unrelated to banking. This appears directly contradictory to the intent of the bill.

The Board's view continues to be that banking organizations should be allowed to sell credit related insurance, including property and casualty insurance to protect loan collateral. There are several reasons to believe that the benefits of such activity outweigh the possible adverse effects. First, permitting banks and bank holding companies to provide these services is likely to be procompetitive. Second, sales of insurance by subsidiary banks provides a useful and convenient service to the public, including sales at locations which may be poorly served by others. Prohibiting the activity for larger banking organizations would surely inconvenience at least some of the public—namely those borrowers who would be forced by the prohibition to look elsewhere for the needed insurance coverage.

ADDITIONAL LEGAL RESTRAINTS UNNECESSARY

Before commenting on specific provisions of S. 39, the Competition in Banking Act of 1979, it may be useful to make some general observations. Governor Coldwell testified before this committee in 1978 and I testified before the House Banking Committee last year on these same proposals. In both cases we indicated that the Board sees no need for additional legal restraints on the already closely regulated expansion by banking organizations.

First, there has been a noticeable trend toward deconcentration of domestic banking resources at the national level, as well as in many States and local markets. Most of the growth that generated concern about increased concentration in U.S. banking actually took place in the foreign sector. This growth masked the trend toward deconcentration of domestic banking assets while it actually represented an improvement in the competitive position of U.S. banking organizations in foreign markets.

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[1] *National Courier Association* v. *Board of Governors*, 516, F.2d 1229, 1237 (D.C. Cir. 1975), *Alabama Association of Independent Insurance Agents* v. *Board of Governors*, 533 F.2d 224, 241 (5th Cir. 1976), and *NCNB Corporation* v. *Board of Governors*, 599 F.2d 609 (4th Cir. 1979).

Second, bank holding company expansion in the nonbanking area has been strictly controlled. Only those activities that are closely related to banking and are a proper incident thereto have been authorized, and expansion has been mainly de novo rather than by acquisition of existing organizations. This form of expansion has been procompetitive and, on balance, has brought benefits to the public. In our judgment, the flexibility of the present regulatory system serves the Nation well and will continue to provide an appropriate regulatory framework for expansion of the financial sector.

I might add that passage of the Depository Institutions Deregulation and Monetary Control Act of 1980 has the potential for enhancing the competitive structure of banking markets for many financial services, both for depositors and loan customers. Its passage should further alleviate many of the concerns about concentration reflected in S. 39, and the increased competition in banking markets that will result should act as an additional deterrent to potential abuses of market power.

The appendix to my testimony sets forth the positions of the Board on the specific provisions of S. 39, except the section 601 which I would like to discuss briefly. The Board strongly objects to the additional hearing and administrative procedure requirements contained in this section.

Under section 601 the Board could be required to provide an adjudicative or trial-type hearing in nearly every 4(c)(8) application or rulemaking proceeding, whether or not there are disputed facts involved. This represents a step backward to the underlying burdensome and time consuming procedures of the Bank Holding Company Act prior to the 1970 amendments. The courts and other administrative law authorities have long recognized the distinction, established by the Administrative Procedure Act, between adjudication and rulemaking. Adjudication and a formal hearing may be required to establish disputed facts about particular parties, their activities, businesses, and property. On the other hand a rulemaking procedure is less formal because the issues do not typically relate to disputed facts. The precedents in administrative law demonstrate that the public interest is safeguarded and best served in rulemaking by avoiding the cumbersome and unreasonably lengthy procedures of formal adversary hearings.

Recognizing Congress imposition in 1970 of a time limit on the processing of 4(c)(8) applications, the Board has successfully accelerated its decisionmaking process using a variety of procedural tools consistent with the Administrative Procedure Act. These include a formal hearing where there are disputed questions of fact. We feel that these procedures assure that the best possible, informed, decision is made in the shortest period of time. Accordingly, we would strongly recommend that the present procedures be continued.

In closing, I would like to sound a note of caution. Our economy and financial system are changing rapidly. Demands for financial services are increasing even faster and new techniques are making it possible to meet such demands in increasingly efficient and innovative ways. In this rapidly changing environment we believe that adding to the rigidities of regulation would be a mistake. The present regulatory framework, while not perfect, has sufficient

flexibility to adapt as necessary to changes in technology and services offered—a flexibility that needs to be preserved if the public is to continue to be best served by our evolving financial system.

[Material accompanying the statement of Governor Partee follows:]

Appendix
Board Positions on Proposed Provisions of S.39
Not Discussed in Testimony

The Twenty Percent Limitation

One of the provisions of the bill establishes an outright prohibition of any bank merger or holding company acquisition of a bank in which the resulting company would control more than 20 percent of the banking assets in any state. The one exception would be where the proposed acquisition is necessary to prevent a bank failure and no lesser anticompetitive alternative is available. The Board seriously questions the desirability of such an absolute limit, especially in view of the wide differences in state banking structures and a lack of evidence that concentration is generally increasing at the state-wide level or in local markets. The Board is particularly concerned in those situations where modest foothold acquisitions or de novo entry would in fact tend to deconcentrate local markets and where such deconcentration would be prevented by this particular provision. It also would be misleading and inequitable to base the percentage restriction on total assets, rather than on those domestic assets generated from the local markets or the state. Large banking organizations, for example, have tended to concentrate during recent years on the growth of their national and international business, and in at least some cases their share of domestic business in local markets has decreased. The effect of the arbitrary 20 percent limitation would be to penalize those banks that had a significant portion of their assets outside

the state or U.S. and thus has little relevance to concentration or competition in local U.S. banking markets. In the Board's view, federal imposition of such a rigid overall constraint would interfere with the rights of the states to decide what type of banking structure best meets their particular needs. Finally it would also deny the Board and other agencies the needed flexibility to take into account unique competitive structures and other local factors associated with the given state. These would include the number and size distribution of competiting institutions, restrictions on geographical expansion, the extent and strengths of nonbank competition, and the general economic environment in the state.

Despite the Board's concern with the bill's asset limitation, there are other provisions pertaining to bank mergers and holding company acquisitions of banks which would provide useful clarifications of existing law. In particular, the Board favors those provisions which would permit denial of acquisitions even when the level of the possible anticompetitive effects do not constitute a violation of the antitrust laws, [or the 20 percent limitation], if the responsible agency believes that the proposed acquisition would not be in the public interest and the anticompetitive effects are not clearly outweighed in the public interest by the probable effect of the transaction in meeting community convenience and needs.

Mandatory Consideration of Relative Economic Size and Market Power

The addition of the mandatory consideration under Section 4(c)(8) of the disparity in size and economic power between the applicant organization and those firms engaged in the subject activity is presumed to focus attention on the potential for predatory economic

behavior. But the Board believes that any application involving such behavior could and should be denied under the present law's "unfair competition" or "undue concentration of economic power" criteria. The addition of the proposed size disparity criterion would tend to shift the analysis away from the competitive effects in markets to a focus on institutions, and this could prove counter productive to the public welfare.

Tightening of Standards for Section 4(c)(8) Acquisitions

Another feature of the bill is that it would tighten the "closely related" and "public benefits" standards for acquisitions of non-banking activities by bank holding companies under Section 4(c)(8) of the Act. The "closely related" test now contained in Section 4(c)(8) requires that a proposed activity be "so closely related to banking or managing or controlling banks as to be a proper incident thereto." In contrast, the new standard would require that a proposed activity be "so closely and directly related to banking or managing or controlling banks as to be a proper and necessary incident thereto." It is not clear what these additions would mean for the "closely related" test. One possibility is that it would limit permissible 4(c)(8) activities to "banking activities", that is, activities in which banks themselves generally can engage. If so, the existing list of permissible activities would be largely unaffected, since banks can now engage in all but two of the present 4(c)(8) activities, including such important ones as mortgage banking, consumer lending, leasing, factoring and data processing. But there are other possible interpretations of the proposed wording changes in the "closely related " test, and these different interpretations could have significantly different effects. The Board believes that it

is important to draft any wording changes in the "closely related" test so as to eliminate subsequent controversy over the meaning of the test.

In addition to the "closely related" test, the Act also requires that a proposed activity must "reasonably be expected to produce benefits to the public that outweigh possible adverse effects." The proposed bill would modify the requirement so that the activity "is likely to produce substantial benefits to the public which clearly and significantly outweigh possible adverse effects." The specific factors to be considered in determining substantial benefits and adverse effects would also be expanded.

The Board believes that the changes in the proposed "public benefits" test are unclear. More importantly, we are concerned that the proposed public benefits test would not serve the public as well as the existing test. Under the proposed new test, the Board would have to deny non-banking applications even if the benefits were positive but less than "substantial", or even if substantial benefits would only slightly outweigh adverse effects. The Board can approve such applications under the present standard, and we see no reason to deny the public the opportunity to derive benefits when there is a reasonable probability that these benefits, on balance, will outweigh any adverse effects.

The proposed legislation also expands the adverse factors enumerated in the Act by "risks to the financial soundness of a bank holding company or its banking subsidiaries" and "interfering with the primary responsibility of a bank holding company or its bank subsidiary to provide effective banking services to the public." The bill also specifies that the Board shall require bank holding companies and their subsidiaries to be capitalized and otherwise financed in a safe and

sound manner. These objectives certainly cannot be questioned. However, the Bank Holding Company Act already requires the Board in bank acquisitions to "take into consideration the financial and managerial resources and future prospects of the company or companies and the banks concerned." Similarly, Section 4(c)(8) of the Act requires the Board to consider such possible adverse effects as unsound banking practices in nonbank acquisitions. In carrying out both of these charges, the Board carefully considers the capitalization and overall financial condition of the holding company and its subsidiaries. Furthermore, as part of its ongoing responsibilities for supervising bank holding companies, the Federal Reserve conducts inspections of the parent companies and their nonbanking subsidiaries, examines subsidiary banks that are state member banks, and reviews the examination reports of other subsidiary banks that are examined by either the Comptroller of the Currency or the FDIC.

With respect to financial considerations, the Board has long held to the philosophy that bank holding companies should serve as a source of strength for their subsidiary banks. In some instances, the Board has obtained commitments from holding companies to supply additional capital to their subsidiary banks and has urged that nonbank subsidiaries be adequately capitalized. In 1974, when certain banking firms began to experience sharp increases in problem loan situations, the Board instituted a "go-slow" policy with respect to further expansion. Consistent with this policy, the Board denied a number of applications, some for the nation's largest banking organizations.

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With respect to the effects of expansion under Section 4(c)(8) on the provision of effective banking services to the public, most of the activities approved are specialized lending functions which could be performed within the bank, but are carried out more efficiently through a specialized nonbank subsidiary. The few activities approved which are other than specialized lending functions, such as data processing or credit life and disability insurance underwriting, are complementary to lending and would seem likely to enhance rather than interfere with the provision of effective banking services to the public.

On balance, it is the judgment of the Board that the addition of these two considerations to the list of adverse factors to be taken into account are not necessary and would not improve the regulatory process.

Mandatory Publication of Intra-Company Transactions Information

The bill contains a provision that would require each bank holding company to submit to the Board each year a report detailing the terms and conditions of all intra-company loans and investments. Moreover, the Board would be required to make such reports available to the public. The Board does not believe these provisions are necessary.

First, the Board is already receiving an intra-company transactions report on a quarterly basis from medium and large size bank holding companies. Second, bank examiners carefully review transactions between bank subsidiaries and the rest of the holding company system, and the Federal Reserve now periodically inspects the financial affairs of parent companies and nonbank subsidiaries. In the Board's judgment, these examinations and inspections, along with existing reports, are sufficient to supply the supervisory authorities with needed information on intra-

company transactions. In addition, the potential reporting burden associated with such a proposal would be substantial, especially since most intra-company transactions individually would not be material.

Prohibition of Preferential Financing of Non-bank Subsidiaries

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

Prohibition of National Banks to Engage in Activities Prohibited by the Board

In general, the Board believes that the adoption of this section would lead to an inflexible regulatory structure which would not be responsive to the differences between the regulatory concerns relevant to National banks, on the one hand, and nonbanking subsidiaries of bank holding companies on the other. The Comptroller of the Currency has primary responsibility for regulating the activities of National banks and that Office's judgment and expertise should not be subject to a regulatory veto of the Board. This would be the result in some cases since the section provides that a National bank may not engage directly or indirectly in any activity which the Board has determined by regulation or order to be an improper activity for bank holding companies.

Grandfather Provisions

In the event that Congress enacts the proposed prohibition on insurance agency activities in HR.2255, the Board would strongly support a grandfather provision and would urge that the effective grandfather date be the date the legislation was approved by the Congress. In our view June 6, 1978 would affect unfairly a number of bank holding companies. We would suggest the elimination of the prohibition against a holding company increasing to any significant degree the volume of business of its grandfathered nonbanking subsidiary. Finally, we would urge elimination of the requirement that suggests a small bank holding company might have to divest of its activities impermissible to companies in excess of $50 million once it exceeds the size limitation. Both provisions would tend to discourage the affected holding company subsidiary from competing aggressively for business and thereby serving as a meaningful alternative to help meet the needs of the public.

The CHAIRMAN. Thank you, Governor Partee.

Governor Partee, you're a brave man. You're standing up to a bill that passed the House 333 to 25.

Mr. PARTEE. Yes, that's right.

The CHAIRMAN. Obviously you're like a bull standing in the way of a locomotive. A bull who had a lot of courage but I don't know how much judgment he had.

Mr. PARTEE. It's a question of principle, Mr. Chairman.

The CHAIRMAN. If you're doing the right thing, that's your understanding of principle, and I think what we have to do obviously under these circumstances is shape the best kind of legislation we can, recognizing that there's an overwhelming feeling in the Congress, probably in the Senate the same as in the House, to provide some kind of difference between the entry of bank holding companies into insurance and banking into competition with the insurance companies.

PUBLIC BENEFITS

The insurance agents charge in their testimony that the Board has never rejected an application because a holding company failed to show approval of the application would be in the public interest. It also says that the Board processes applications where applicants do not even claim that approval would result in benefits to the public. What's your comment on those allegations? Do you agree that under the statute now they must show public benefits before an application can be approved?

Mr. PARTEE. No. We look for public benefits in the applications, but do not have to be shown if there are no anti-competitive effects and if the proposed acquisition is consistent with good managerial practices. We do like to see public benefits and look carefully for them. I don't regard the Board's authority as being strictly tied to the question of what are public benefits.

The CHAIRMAN. What's your comment on the charge that the Board has never rejected an application because the holding company failed to show that approval of the application would be in the public interest

Mr. PARTEE. I have no comment on that, Mr. Chairman. We look at the applications. We have a presumption that more competition is better than less competition. We think that there will generally be public benefits that would result from having more competition and, therefore, our inclination is to approve such applications.

As you know, in the credit-related insurance field, where there's an underwriting activity we look for and expect the holding company to promise to reduce rates below the maximum permitted by State law as a generality, and that's clearly a public benefit.

The CHAIRMAN. Now you have a very interesting statement in the appendix that you have in your statement. You indicate that any changes in the "closely related" to permit permissible nonbanking activities should be drafted to eliminate controversy over the substantive meaning of the term. You indicate that one possibility would be to limit nonbanking activities to banking activities in which banks themselves could generally engage.

Suppose we did just that, amend 4(c)(8) to engage solely in banking activities. Would the Federal Reserve support that kind of amendment?

Mr. PARTEE. I doubt it. I think we would like to see something a little broader than that because of the possibility of public benefits. If it were strictly banking activities, there are kinds of activities that banks can now engage in that would obviously not be permitted, and I think they have had a public benefit. But the fact is that we have gone very, very little beyond the range of activities already permitted to banks in authorizing activities for bank holding companies. So it comes pretty close.

I would like to have it clear, and I think the Board would like it clear, as to what is meant by the phrase "closely related."

The CHAIRMAN. As to what?

Mr. PARTEE. As to what is meant by the term "closely related." We would like to have good legislative history on that issue.

The CHAIRMAN. H.R. 2255 seeks to prohibit bank holding companies from marketing insurance. Financial bank laws already prohibit national banks from selling insurance. Our information is that saving and loan associations, mutual savings banks and finance companies do sell insurance.

Are you able to tell the committee which financial institutions other than banks sell insurance?

Mr. PARTEE. I think it's very general in the case of property and casualty insurance, but I don't have the facts on the matter.

The CHAIRMAN. If we do adopt the House bill, H.R. 2255, should it extend its prohibitions to thrifts as well as banks?

Mr. PARTEE. Yes, I think so. I think if we're going to do something in this area I think it ought to be done in a way that is evenhanded. If we are going to restrict competition in the insurance field, I think it ought to be done evenly.

SUPERVISION OF NONBANK VENTURES

The CHAIRMAN. Now the Independent Bankers Association says in its statement that their research of bank holding companies leads to the tentative conclusion that bank holding companies have not had a positive effect on the operating performance of nonbank affiliates and that more protection is needed for banks and bank holding companies, including closer supervision of nonbank ventures.

What's your comment on that independent bankers position?

Mr. PARTEE. Well, on the second part of the question, we are providing a good deal closer supervision of nonbank activities of bank holding companies than was originally contemplated and was originally a part of the concept of the 1970 act. The reason we are doing that, of course, is the experience with certain problem cases in the 1974–75 period. We now inspect large bank holding companies on a periodic basis, and we take a close look at the contribution, or lack of contribution, in the specific activities that affiliates of the holding company are making to the whole organization.

I think the regulator's stance has changed quite significantly in the last decade, Mr. Chairman. I do believe that it's a strange allegation that the changes in management and the changes in financial support that nonbanking activities have had when bank

holding companies have made acquisitions have contributed nothing to the activities of those concerns. I suspect it's the kind of thing that a person just says and it seems to me inconsistent with our notion of how the system works. I think that in most cases there was some rocky beginnings. You remember the bank holding companies moved particularly into the mortgage field. The timing was particularly bad on that but now I think that our view is the management of these concerns has been quite good by the bank holding companies as a general matter.

The CHAIRMAN. I'm going to yield to Senator Garn. In my absence, Senator Morgan will chair the committee.

Senator GARN. Governor Partee, in testimony last May on the Export Trading Company Act, the Federal Reserve Board cited the traditional separation of banking and commerce and the potential for unfairly favorable treatment of bank affiliated companies and their customers over the banks fiduciary responsibility to depositors as reasons not to permit bank holding company expansion into certain nonbanking activities. Why aren't these equally good reasons to prohibit bank holding companies expansion into the insurance business?

Mr. PARTEE. Well, Senator, I think that there's a considerable difference between the kind of management involvement in export trading companies than is contemplated here, with the simple act of offering as a service to the public, to the customer—offering an insurance policy to cover the loan collateral. That is, it seems to me in the first case that there could be conflicts between the bank and its general objectives and the needs of the trading company. In the second case I can see no possibility of such conflict.

Senator GARN. Well, I don't see the distinctions that you make there really. I think a lot of the reasons you gave or the Federal Reserve gave could apply here too. Obviously there are some differences.

Last year in our hearing on the Fed's tie-in study, the principal criticism leveled against the study by insurance groups was that it did not take into account other relevant studies, including the FTC's 1974 report to the Fed on insurance sales practices. In fact, an attachment to your written statement submitted at that hearing did refer to this criticism.

Discussing tie-in sales of credit and insurance, the FTC's 1974 report quoted the following from a finance company manager's memo as an example of the usual approach used by finance companies to insure tie-in insurance sales. I quote:

> All of the offices in the district should pay particular attention to the fact that the insurance sales trend is adverse and down, meaning that our mental approach to selling insurance is getting weaker. We are giving the customer more and more opportunities to turn it down rather than taking a firmer approach.

I recognize that this does not mean that every finance company or bank holding company uses such tactics. I'm certainly concerned about that statement though. I have said this before in hearings. I come into these hearings with some bias, having spent a good deal of my life, before getting into politics, in the insurance business, and I resented what is often referred to as competition. It is competition, but in many cases it was incredibly unfair competition because I knew what went on. Those of us who were working solely

to make our living by selling insurance had to do a selling job, and when you have a long list of forms signing up for a loan or for a mortgage or some other extension of credit, and in that ending process you sign this, sir, and you sign that, and suddenly you find out you've bought something. It was amazing to me over a number of years that those who had bought insurance in many cases did not know they had even bought any, and in other cases when you asked them to explain what they had purchased they had no idea whatsoever. They didn't know the terms. They didn't know whether it was whole life, whether it was credit life, whether it was decreasing term; and I think that has been rather widespread.

So a question I'd like to ask you about that is, how often are bank holding companies or finance companies subsidiaries examined?

Mr. PARTEE. Well, we generally examine or inspect the bank holding companies once a year if it has signficiant subsidiaries and if it has consolidated assets of $300 million or more.

I might say that I don't necessarily disagree with what you have just said, Mr. Garn, but I would point out to you that the indications of abuse have been in the finance companies much more than they have been in the bank holding companies. Finance companies, that is independent finance companies are not affected by this bill, and the abuses have been more common in the sale of credit life insurance, not in the sale of fire and casualty insurance, which is the subject of this bill.

So the bill is looking at areas where there haven't been abuses, rather than the areas where there may have been abuses.

Senator GARN. Let's get away from the word abuses.

Mr. PARTEE. I mean tie-ins or cases where the consumer doesn't know what he's buying.

Senator GARN. That has a bad connotation. I'm talking more about just the tie-in, if we want to call it that, but the lack—the salesmanship involved, and it's just easy to initial it and sign it as you go through the rest of the process. I don't think that in bank holding companies or finance companies that that is an unusual way they operate. I think that is the general way they operate. That was my experience over 10 years.

Mr. PARTEE. Yes.

CAPTIVE CLIENT

Senator GARN. I very rarely found a client who knew what they had bought, and their usual comment was, "Well, I signed up for it along with everything else." That's what I'm talking about as far as unfair competition. Banks can get a captive client. I don't ever remember having that situation when I was selling. I don't ever remember anybody calling me begging me to come out and see them. It took a great deal of work. Banks have had captive clients that were in banks for some other purpose and it's unfair I think to call it an abuse. It's a normal practice and I don't think that is very competitive. Yet most of your testimony and those who are opposed to any of these bills talk about fair competition. Well, I'd like somebody to tell me where the fair competition is when you get somebody trapped in an office, in a little sales office or some similar place, signing a bunch of forms; and in most cases there are a lot of these people who certainly are not qualified in the insur-

ance field. They know very little more about it than where to put the "x" for somebody to sign. Nobody is really addressing that tie-in in my opinion, and we have talked too much about abuses.

Mr. PARTEE. The lender, of course, has a legitimate interest in knowing the collateral is adequately insured.

So naturally, if you buy a car on credit or buy a house on credit or whatever, insurance is going to be needed. And the fact of the matter is that as between ordinary insurance agents and the lending institutions, the rate is probably not much different, and I think there would be a tendency for the customer to take it from the lending institution.

I might say that I bought a house on credit and a car on credit; and I certainly never took the insurance out through the lender, because the lender is not the cheapest place to get insurance by far. I can see what you mean, but I do believe the lender has a legitimate interest in seeing that there is insurance, proper insurance, on the collateral that's offered for the loan.

Senator GARN. Well, what you say I agree with. It's not the cheapest place to buy it. Where is the public benefit or the competition from that?

Again, one of the reasons that he can charge higher rates is because of the tie-in, because of the lack of explanation. It seems to me it's just the opposite of competition. There's a lot of noncompetitiveness in this type of operation. I'm not sure that any of these bills really address that particular problem. Nobody seems to want to address that lack of competitiveness.

As much as I have some problems in the areas I have outlined with tie-ins, I also have some problems with the legislation on the other side because you've obviously got some bank holding companies that have done a good job and have been in this for a long, long time—35, 40, 45 years in many cases—and before I can be for or against any of this legislation there's going to have to be some redefinition of the grandfather clause.

I think those on this committee, Senator Morgan particularly—we have had some battles on other types of legislation that have nothing to do with this—in the housing conference last year we were concerned about retroactive procedures. So although I come down basically on the side of the independent insurance agents, there are some provisions in the House bill that I think are extremely unfair to existing insurance operations and we are going to have to take a look at those grandfather clauses. I don't think we can jump from one extreme to the other either.

Mr. PARTEE. Yes. We do propose that the grandfather date be advanced from mid-1978 to something closer to the date of enactment of this bill, if it does go through, because it does stretch pretty far back to the middle of 1978.

Senator GARN. Governor Partee, I have four or five pages of questions and we have a lot of witnesses, so I'd like to submit the rest of my questions to you if they are not answered by your other testimony here, for your response in writing.

Mr. PARTEE. I would be happy to do that, sir.

Senator MORGAN. Governor Partee, first I thank you for coming. I will have some questions for the record too, but let me say in the beginning that the problem gives me a great deal of concern.

Whenever you have any entity that operates by and with a government granted special privilege, whether it's a monopoly or government credit or other privileges that are not afforded to other businesses, it does give me some concern.

I'm just as concerned about the Federal land banks and the credit companies engaging in insurance business as I am about bank holding companies.

Someone brought me a letter the other day from a Federal land bank, that had been written to a customer or to a person who had a loan, soliciting all of their insurance, and it seems to me, when you put the full faith and credit of the Government that belongs to all of us and if you use it that way, that does present a problem.

What do you define the holding company as, as you interpret it in this bill? What is a bank holding company as you interpret it and as this bill applies to it?

INTERPRETATION OF BILL

Mr. PARTEE. Well, the House bill would apply to the larger bank holding companies, with more than $50 million in assets. It would apply solely to the sale of accommodating property and casualty type insurance on the loan collateral that's provided. It would be either sales in association with bank loans or loans of other products of the holding company.

Senator MORGAN. Would it also apply to State chartered and regulated bank holding companies?

Mr. PARTEE. Yes; it would apply to all larger bank holding companies. Under 40 percent of the bank holding companies would be affected by this. The other 60 percent would be free because of one of the exemptions given.

Senator MORGAN. Are there State chartered bank holding companies?

Mr. PARTEE. Yes. All are effectively State chartered in that the holding companies are all incorporated in a State. But the holding companies are all approved and regulated by the Federal Reserve. I don't think the question of Federal and State charters is any problem.

Senator MORGAN. Are all bank holding companies regulated by the Federal Reserve?

Mr. PARTEE. That's right.

Senator MORGAN. Well, now, what does regulation Y apply to? Does it apply to banks or bank holding companies?

Mr. PARTEE. Regulation Y is the regulation issued by the Board regulating the activities of bank holding companies.

Senator MORGAN. All right. It limits banks to selling only credit related insurance and not general insurance?

Mr. PARTEE. That's right—bank holding companies.

Senator MORGAN. Well, does that prohibit a bank holding company from selling property insurance?

Mr. PARTEE. Bank holding companies are permitted to sell that insurance in connection with the extension of a loan while the loan is outstanding, because of the legitimate interest that the lender has in covering the collateral adequately, and to offer it as a convenience to the public.

Senator MORGAN. Would that be permitted under this bill?

Mr. PARTEE. For bank holding companies under $50 million; yes. For bank holding companies over $50 million; no.

In addition, the bank holding companies under $50 million would have some expanded insurance authorities. In the bill as it was passed by the House, bank holding companies under $50 million would have some expanded authority to sell insurance not connected with a loan transaction.

Senator MORGAN. But under this bill a bank holding company which is covered by it can sell credit life insurance?

Mr. PARTEE. Yes. That is not being affected in any way by this bill.

Senator MORGAN. But in your opinion, it could not sell property insurance or casualty insurance?

Mr. PARTEE. That's right.

Senator MORGAN. Even to the extent of a loan?

Mr. PARTEE. That's right. It's strictly a size discrimination, sir, that is included.

Senator MORGAN. Senator Garn mentioned the grandfathering clause and he and I both have been concerned about legislation which affects retroactively ongoing businesses.

Mr. PARTEE. Yes.

Senator MORGAN. How many of the present bank holding companies to which this would apply engage in the insurance business?

Mr. PARTEE. I don't think that I have those precise numbers, Senator Morgan. The grandfather date—it goes back some distance here to June 1978, or something like that. We do know that since then we have approved applications from between 30 and 50 organizations that would have to discontinue their insurance activity because they come after that rather remote grandfather date. We think that about 750 of the 2,300 bank holding companies would have grandfather protection as a result of that 1978 date. Then 30 to 50 would be excluded because of the bills grandfather date. Since then we have approved 30 to 50 that would have to discontinue the activity if the bill goes through the way the House has passed it.

Senator MORGAN. I haven't had a chance to refresh my recollection this morning, but this bill does apply to savings and loans?

Mr. PARTEE. No, sir; nothing other than large bank holding companies.

Senator MORGAN. It doesn't apply to credit unions?

Mr. PARTEE. No.

Senator MORGAN. Mutual savings banks?

Mr. PARTEE. No.

Senator MORGAN. Larger finance companies?

Mr. PARTEE. No.

Senator MORGAN. Even when they are affiliated with bank holding companies?

Mr. PARTEE. Affiliated finance companies are covered. They are given an exemption in this bill that they may write insurance on collateral up to $10,000; that is, if the loan amount is $10,000 or less, and that is indexed in the future with the cost of living. I presume the purpose of that is to permit the affiliated finance company to write automobile insurance, but it wouldn't cover large loans on mobile homes or boats or larger type items that the finance company might have financed.

Senator MORGAN. Under this bill, would a bank owned by a bank holding company be allowed to sell automobile casualty or collision insurance?

Mr. PARTEE. A bank owned by a bank holding company? It depends on the chartering authority, either the Comptroller of the Currency—it depends on the principal supervisor and the charter in the particular State it is operating in. The bank holding company could not offer it if it were over this size. Whether the bank could do it or not would depend on the State.

Senator MORGAN. It would depend on the State?

Mr. PARTEE. Yes. The different State laws in different States.

Senator MORGAN. All right. We'll pursue that a little later on, Governor Partee.

Mr. PARTEE. Yes. I think we can give you a more technical answer to that question.

Senator GARN. Senator Morgan, would you yield on that point?

Senator MORGAN. Yes.

Senator GARN. You asked a question whether thrifts and credit unions and so on would be included and I don't know whether you were here or not when Governor Partee responded to a question about he thought savings and loans should be involved as a matter of fairness. Although it isn't a particular of the bill, I think that opens up a whole new set of questions if the thrifts ought to be included too. I don't know how serious you were about that remark, but I just thought Senator Morgan—in the response he got from you on that question that they were not included, that there was at least a suggestion that they be covered.

Mr. PARTEE. Well, I would think if we're going to do it, if we're going to protect the independent insurance agent, we ought to do it in an evenhanded way rather than have a discriminatory piece of legislation which this looks to me to be.

Senator MORGAN. Governor Partee, do you see the problem we're talking about? Do you see the problem that insurance agents are complaining about?

Mr. PARTEE. Yes. I think Senator Garn expresses it very well and I'm sure if I were an insurance agent I would feel, by golly, I'm not getting my share of the business because there are some bankers there that are somehow or other getting those folks to take out insurance in connection with their loans.

Senator MORGAN. Well, as Senator Garn says, I don't know where I'm going to come down on that, but I am concerned. We've got a bank or bank holding company that's operated by virtue of a Government granted franchise or monopoly or whatever you want to call it, and the banks are limited in this given time. We say over 5,000 population or under 5,000 is excluded. So another bank can't come in and set up and compete with that bank, but 40 insurance agents can line up and down the street, and the trouble is that most people—and I'm included in that—when I need money, I feel like the bank is doing me a favor. Maybe it's because I need money so bad, but the mere suggestion by the banker that they'd like to write the coverage has a very persuasive effect. It does seem to me that there's a decided disadvantage with these holding companies or banks writing insurance. We'll come back to it later on.

Senator Durkin is here.

Mr. PARTEE. It's associated business that's done because, after all, the collateral has to have insurance on it. I can see that with an associated business you might prefer as a customer, as a matter of convenience, just to take the insurance out at the same time. It makes everything all square with the deal. But you're more likely to feel that you ought to give your business to the bank, I think, if you're talking about a small town bank where there are only a couple of banks than if you're talking about a city where there are lots of banks. This bill permits the small town banks to continue to do this. The small town bank holding companies can do it just as they always have—in fact do more than they have before. But in the big city where there are a lot of other choices available there, they will be excluded by the provisions of the bill.

Senator MORGAN. Isn't it true that most small town banks are not holding companies?

Mr. PARTEE. Well, there are quite a few that are. As I say, we have 2,330 bank holding companies. We estimate that more than 60 percent will be exempted by the terms of the House bill. That is, they have under $50 million in combined assets. So that's about 1,500 or so small bank holding companies almost all of which are located in small towns.

Senator MORGAN. Well, I yield to Senator Garn.

Senator GARN. Mr. Chairman, if I could ask one more question and then we'll let Governor Partee go.

Section 601 of S. 39 would require that all Board determinations on bank holding companies nonbanking activities applications be made on the record after opportunity for a hearing. Could you give me your opinoin of what practical effect this would have on the operation of the Federal Reserve, the number of applications you get, how many do you process, and the estimate of costs of giving that opportunity for a hearing?

Mr. PARTEE. Well, I think it would almost stop us, Mr. Garn. We have hundreds of applications. There are usually no disputed facts. They are offering products for competitive reasons or other reasons. I assume that very many more of those will go to formal adjudicative hearings and this would virtually stop the process of applications.

Senator GARN. So as to that provision of S. 39, you're absolutely opposed to obviously.

Mr. PARTEE. Very much so. I think it really sets the clock back and would add tremendously to our costs and the cost of the parties in this formal hearing process. It would be very, very costly, regressive, time consuming, and we feel must go out of the bill.

Senator GARN. Thank you. I'll make sure Senator Proxmire is made aware of your answer to my question.

Mr. PARTEE. All right. Thank you.

STATES RIGHTS

Senator MORGAN. One other question or statement, Governor Partee. There is a question, as I understand it—and I haven't had time as I said to refresh my recollection this morning—of the States rights. As I understand the law, the law does give to the States or reserves to the States the right to regulate the bank holding companies to the extent they were at the time the law was

enacted and thereafter. In other words, the enactment by the Congress of the Bank Holding Company Act of 1956 shall not be construed as preventing any State from exercising such powers and jurisdictions which it now has or may hereafter have with respect to banks, banks holding companies, and subsidiaries thereof. Do you know anything that would change that?

Mr. PARTEE. No. I think that's quite true. As a matter of fact, insurance activities which have been a popular subject within the States, are for bank holding companies very much restricted or prohibited in many States because of State actions.

Senator MORGAN. Do you understand this bill would preempt that right of those States that do regulate them or do not?

Mr. PARTEE. I don't believe that even on the State list that it would permit a bank holding company to sell property and casualty insurance because that would preempt in the sense of making it more restrictive I think.

Senator MORGAN. Thank you, Governor.

Gentlemen, Senator John Durkin is here and we will now hear from him at this time.

STATEMENT OF JOHN A. DURKIN, U.S. SENATOR FROM THE STATE OF NEW HAMPSHIRE

Senator DURKIN. Thank you, Senator Morgan and Senator Garn.

I appreciate the opportunity not only to testify but also the privilege of sitting in the committee for the questioning of Governor Partee. I realize you have a long witness schedule today and I realize also that the situation on the floor is such that the time is at a premium, so I will submit my full statement for the record and try to highlight the statement.

Mr. Chairman, I introduced legislation similar to S. 380 and H.R. 2255 in the last session and it passed the Senate without dissent and then died in the House. This year the House has passed similar legislation overwhelmingly and on June 25, 1980 I introduced the House version in the Senate to expedite the consideration of this legislation. I speak on this legislation as the former insurance commissioner of the State of New Hampshire for 5 years. One of the reasons that I'm in the U.S. Senate today was the fact that I was a very aggressive insurance commissioner and a very consumer oriented commissioner.

I want to stress from the outset that this is not a "Care Package" for the insurance industry. Rather the bill aims to preserve a very viable segment of our small business community. I also speak on the legislation as somebody who's spent almost 4 years working for the Comptroller of the Currency, spending many hours in the library down at the Treasury building researching bank legislation over the years.

The question came up on the 5,000 limitation in population of small towns. That was a compromise on the National Bank Act to get it through many, many years ago. It had no relevance other than that was the compromise necessary to get the legislation through. I, for one, would like to go further and eliminate that 5,000 person restriction and get the banks out of the insurance business in the small towns, but that would have picked up addi-

tional opposition and the reality of the situation is we don't want to pick up any more enemies than we already have.

I think what we have here is really the small independent businessman versus the large holding company. The independent insurance business, whether it be casualty agent or life agent, is one of the few ways today that somebody can start with their own initiative and with good service, hard work, and tending to the policyholders they can build a business for themselves and provide a service to the community.

SMALL AGENTS PROVIDE COMPETITION

As a former insurance commissioner I can tell you the agents are very, very competitive. They are small agents. They provide innovation. They provide service.

What we have here is really the competition between the distant, anonymous, impersonal holding company versus the agent who is there virtually 24 hours a day. When you bang up a car, who do you call? The agent, no matter what time of the day or night it is.

We have had the same problem with the direct writers versus the independent agents. Everybody likes to sell insurance, but nobody likes to service it except the independent agents. So I think we're talking about the net loss to the consumer with the big, impersonal holding company taking over the sale of insurance and we'll have a loss of service to the consumer. Eventually we'll have a loss of competition and there will be the upward pressure on the rates for property and casualty insurance and a lack of competition in the sale of life insurance. I'm very concerned about this type of undue concentration of economic power.

As the Senator from North Carolina said, when you go to the bank you're in a tough position, and I remember researching some of the national bank legislation and the story about the loan officer. The loan officer would ask anybody—"One of my eyes is a glass eye and if you can tell me which of my eyes is the glass eye I'll grant you the loan." The fellow looked at him and said, "Your left eye, sir." And he said, "Why? You're the first one that's guessed. How could you tell?" Well, he said, "That was easy. That's the most sympathetic one."

The tie-in of credit to insurance can be subtle. If you need a loan, if your business is in trouble—and with the interest rates we have had enough businesses are in trouble in this country—there's the implied pressure that you'd better get your insurance there if you can.

There is a sense of urgency. The Federal Reserve is beginning to open the floodgates. If we don't move now in this session we are going to lose an awful lot of small business independent agents who have provided a tremendous amount of service in every town, in every parish, in every county across the country.

So in the interest of time I would ask that my statement be printed in the record in its entirety. This is very important legislation from a small business point of view. I just don't think banks belong in the position of using their influence not only to sell insurance but eventually they will drive the independent agent out of the market and the ultimate loser in this country will be the consumer which we represent.

I'll be glad to answer any questions.
[Complete statement of Senator Durkin follows:]

STATEMENT OF SENATOR JOHN A. DURKIN

Ten years ago, Congress enacted the Bank Holding Company Act Amendments of 1970. At that time no one foresaw the expansion of bank holding companies into diverse nonbanking activities or the impact of this involvement in commercial activities. Consequently, insufficient limits were incorporated into the 1970 legislation.

I have again introduced in the Senate—along with Senators Church, Bentsen, Cohen, Bellmon and Tsongas—legislation (S. 2874) to prohibit bank holding companies from acting as agents or brokers in the sale of property, casualty, and certain forms of life insurance and to forbid bank holding companies from engaging in the underwriting of such insurance.

Without this legislation, the Nation's largest bank holding companies will drive thousands of small, highly competitive insurance agents out of business. The retail insurance industry is made up of thousands of small businessmen who provide personalized service at highly competitive prices. A reduction of competition in the retail insurance industry will harm consumers by driving up prices and reducing the variety of service. Years of Congressional inquiry into BHC insurance activities have demonstrated the anticompetitive impact of linking the sale of insurance with credit. Through the use of enormous amounts of capital and credit, BHC's have the ability to unfairly influence the purchase of insurance to the detriment of both agents and consumers.

Today, independent insurance agents across the country face unfair competition through the expansion of bank holding companies into areas of retail property, casualty, and life insurance. In fact, due to a recent Supreme Court ruling, the Federal Reserve Board is beginning to approve applications of bank holding companies desiring to enter the retail property, and casualty insurance area. This infringement on the insurance industry by large banking institutions is unfair to businessmen and consumers alike. My legislation will clearly limit the activities of bank holding companies in the retail property, casualty, and life insurance industry.

It is imperative that every effort be made to prevent the erosion of competition in the sale of property and casualty insurance. The retail property and casualty insurance industry is one of the few remaining areas of business where small, independent business entrepreneurs can, through initiative and perseverance, build viable businesses of their own. Unless this legislation is passed, even this industry will be barred to the entrepreneurs.

My legislation does not infringe on the current involvement of banks in the sale of credit life and credit disability insurance, nor does it change the national bank act that has allowed banks operating in communities of 5,000 inhabitants or less to sell property and casualty insurance. This legislation merely prevents the further encroachment of bank holding companies on non-banking areas of commercial activity.

The current situation is charged with some urgency, considering recent Court actions. Until recently pending Court actions delayed approval of applications for the entrance of bank holding companies into property and casualty insurance brokerage. Then, the Supreme Court let stand the lower court ruling that allowed the approval of such applications. As a result the Federal Reserve Board has begun to approve applications, initiating the end of competition in yet another segment of the American Business community.

A companion House bill, H.R. 2255, which was modified slightly in the House Banking Committee, passed the House on June 12 by a convincing 333 to 25 vote. To expedite Senate action on this important legislation I have introduced in the Senate a bill embodying the changes the House Banking Committee made in H.R. 2255.

The new bill contains everything in my original bill, S. 380, plus three new exemptions to the general prohibition of BHC insurance activities: First, a new exemption to permit BHC finance company subsidiaries to offer credit property insurance in connection with loans up to $10,000; second, an expanded grandfather clause to permit finance companies that were acquired by a BHC between June 1978 and June 1979 to continue any existing insurance activities; and third, an exemption to permit BHC's to act as managing general agents for the sale of insurance to the BHC and its employees. These added exemptions accommodate most established BHC insurance activities.

The need for this legislation is clear. Banking and commerce have been separated in this country as a matter of public policy for over 100 years. More specifically, years of congressional inquiry into BHC insurance activities have demonstrated the

need to keep separate the sale of insurance from extensions of credit. Through the use of enormous amounts of capital and credit, BHC's have the ability to unfairly influence the purchase of insurance to the detriment of both agents and consumers.

With the improvements made in the recently passed House bill, my legislation will help to end over 10 years of court and congressional controversy over permissible BHC nonbanking activities and the Fed's interpretation of existing law.

Because of my great concern for preserving the strength and resources this country possesses in the form of enterprising and independent businessmen, I am convinced that the power of financial institutions to displace these entrepreneurs be limited. My legislation does just that.

I urge this Committee to report out this legislation as soon as possible.

Senator MORGAN. Thank you. Senator Garn.

UNFAIR COMPETITION

Senator GARN. Senator Durkin, I just really have one question. Earlier in this hearing today with Governor Partee and in previous hearings over the years, I've expressed my sympathy for the legislation. I admit that I have some bias as a former independent insurance agent who made my living doing that for more than 10 years and I won't repeat myself other than to say I regretted the unfair competition.

That was my major problem, not competition, but the unfair competition, primarily due to the tie-in type problem. But I would like your response on the retroactive feature because as unfair as I think some of the competition was, I have always had trouble when we're dealing with business—as I said earlier, Senator Morgan and I have fought several battles before to stop retroactive legislation—but the House passed this legislation with a date going back to June 6, 1978, and when there are a lot of applications already in, that retroactive feature grandfather clause disturbs me considerably.

What is your feeling on going back and making legislation retroactive?

Senator DURKIN. Well, Senator Garn, I share your view on competition. I don't think anybody is concerned with fair competition and I think the record all across the country demonstrates the tremendous amount of competition amongst the insurance agents. If you're a businessman or a store owner on Elm Street in Manchester, there are several agents that want to sell you a different package and a detailed package and cut your premiums and so forth. So there is plenty of competition and, as you say, we want to eliminate the unfair competition.

My reading of the Bank Holding Company Act is that it was never intended to have the banks in the retail sale, if you will, of property, casualty and life insurance. So a number of us wrote the Federal Reserve Board in the waning days of the last session urging them not to grant the exemptions, urged a moratorium on applications.

So really, even though it appears on its face to be retroactive, I don't think it is. There was plenty of warning, but the number of applications have increased substantially as legislation works its way through since this bill was submitted. I think there is a rush to beat the legislation. So I don't think it's unfair when you take this into consideration. I think Congress intended the separation of credit and insurance in the banking legislation over the years. I

don't think in that sense that it is retroactive and I don't think it's unfair.

Senator GARN. Well, I would disagree with you that people were warned. Do you know how many years we go through legislation around here that never becomes law? We had the situation, the one that Senator Morgan and I were most concerned about, which was in the housing legislation. It was not in insurance. We had a situation where Congress was going back and making some provisions retroactive when we specifically before had done the exact opposite. We had forced builders and so on—developers—to refinance into the private sector at the earliest opportunity and then we were turning around, and although they had had plenty of warning, that had been talked about for some time, they had been warned. So I have a real problem with that.

I have a bias toward the independent insurance agents position. I admit that from my former position, but in trying to achieve some element of fairness, it is not fair to me on the other side then to go back and be retroactive. Although I will support the concept of the legislation, there is going to have to be some changes in the retroactive feature because I don't want to go from one extreme to another in trying to correct some unfairness to being unfair on the other side. In other words, what I'm saying is I think there has to be some reasonable balance because there are a lot of these holding companies that have been involved for as long as I have been alive, and to suddenly go back retroactively and put a no-growth policy in—if you're in business, if you're told you cannot grow, you cannot expand, you've effectively killed the business.

How do you recruit? How do you hire people? I think there have got to be some changes in the grandfather clause, but I appreciate your testimony.

Senator DURKIN. Of course, we in the Congress aggravated the problem by not moving to close the unintended loophole in the last session. It went through the Senate without opposition and then died in the House in the last night. So the Congress as a whole is partially responsible.

Senator GARN. Don't get me started on the problems of the Congress.

Senator DURKIN. I agree.

Senator MORGAN. Senator, let me ask you two questions.

First of all, what would be the problem with allowing a bank holding company to sell property or casualty insurance only to the extent of their loan, provided that the borrower was given an opportunity to provide his own insurance? Let's say I go down to the bank and I want to borrow $10,000 on my house. You can only extend insurance to the amount of the mortgage or we'll send you the insurance just to the extent of the loan.

Senator DURKIN. Well, I think in theory that might work fairly well, but never in the real world. They don't hand you a list of companies or agents that sell mortgage disability insurance. They want to sell it to you right then and there and they just happen to have at the next window the expert that can handle that. So I think theoretically your point is well taken, but I think in the real world there's that implied and sometimes expressed pressure to do one-stop shoping and, again, there's a question of intention. Does

the consumer realize that he could get maybe a better policy at a lower premium by calling two or three independent agents or does he think he really has to get it here to expedite the loan application? You're dealing in the psychology of terms and I'm not sure what your parameters are.

Senator MORGAN. One other question. I'm not sure you have farm credit much in New Hampshire, but have you had problems or complaints from agents and others with regard to farm credit organizations such as the land bank that use the commodity credit of the Government selling insurance?

Senator DURKIN. Well, as insurance commissioner, I put in an 800 number early on so anybody could call in with a problem and we have one in the State today and it's not a problem that's come to my attention.

Senator MORGAN. I mentioned before you came that my State is predominantly rural. A person brought to me a letter the other day from the Federal land bank soliciting property insurance coverage on all of his property. Would there be any objection if this bill as reported out incorporated this limitation in both systems?

Senator DURKIN. No. Any abuse that exists I would have no problem in incorporating an amendment to that effect. Again, we are interested in the same thing. The independent agent, the small businessman should not have to compete with all that economic power because there's no way he or she in the long run is going to win in such an equation and the ultimate loser is the consumer because once they control the distribution of insurance, once they eliminate the agent and incorporate part of the agent's commission into their profit structure, where are you going to have the agent when the house catches fire or someone falls down the stairs or you bang up the car and you're having trouble with a claim? Are they going to be as solicitous as they were? You know, the independent agent, you call them and if your car is hung up in a tree you say, "Can you help me out," and you'll get service. But I don't think you'll get service from that impersonal, large entity. It hasn't happened.

Senator MORGAN. Thank you very much.

Senator DURKIN. Thank you.

Senator MORGAN. According to our agenda, the following persons will appear in a panel so if you will come forward we'll try to work it out: Lee Gunderson, president, Bank of Osceola, Osceola, Wis., American Bankers Association; John E. Malarkey, State bank commissioner, State of Delaware, Conference of State Bank Supervisors; L. Thomas Bolger, president, McHenry State Bank, McHenry, Ill., Independent Bankers Association of America; and James M. Browne, president, Finance America, National Consumer Finance Association.

Gentlemen, why don't we go in the order listed. We'll be glad to hear you any way you came prepared to make this presentation. We will start off with Mr. Gunderson from the American Bankers Association.

STATEMENT OF LEE GUNDERSON, PRESIDENT, BANK OF OSCEOLA, OSCEOLA, WIS., ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION

Mr. GUNDERSON. Mr. Chairman and members of the committee, I am Lee E. Gunderson, president of the Bank of Osceola, Osceola, Wis., and president-elect of the American Bankers Association. The purpose of this statement is to comment on proposed legislation that would amend Federal laws governing bank mergers and holding company acquisitions, and the scope of activities of bank holding companies. The proposed bills are currently designated as S. 39, S. 380, and H.R. 2255.

The association's position is that a sufficient case has not been made for passage of any of these bills.

S. 39 would extend the reach of Federal law in determining the banking structure in each State by placing a percentage limitation on the relative size of banking organizations which might be permitted to expand through mergers and acquisitions. At the present time, percentage limitations are found in five States—Iowa, Missouri, New Hampshire, New Jersey, and Tenessee. The percentages in these five States differ over a range between 8 percent and 20 percent. Such variation is indicative of the diversity in banking structure among the States. It also argues against the idea that a uniform percentage limitation would be appropriate for all States. Although S. 39 would permit States to establish percentage restrictions below the proposed Federal limit of 20 percent, the practical effect, of course, would be to establish a Federal standard and to preempt State authority.

Advocacy of a Federal percentage limitation implies a belief that the States are not capable of dealing effectively with the issue of banking structure. The American Bankers Association regards the proposed percentage limitation as an issue incidental to any reconsideration of the McFadden Act. Our association is awaiting an opportunity to review the administration's study on the McFadden Act, which was requested by the Congress.

NEW REGULATORY BARRIERS

Additionally, S. 39 would pose new regulatory barriers to the expansion of multioffice banking organizations by subjecting bank mergers and holding company acquisitions to more stringent tests than currently prevail under section 7 of the Clayton Act. Bank mergers and holding company acquisitions are already subject to closer regulation than mergers and acquisitions in any other sector of our economy. Prior approval of the appropriate Federal bank regulatory agency is required. A detailed application, including data relevant to evaluation of the effects on competition and the effects on the public convenience and need, is required. Public notice is required, and opportunities are provided for the submittal of adverse comments from the public. State regulatory agencies are provided an opportunity to comment. The Justice Department is supplied with a copy of the application for review and comment with respect to competitive effects. A field investigation may be conducted by the Federal bank regulatory agency. If approved, the merger or acquisition cannot be consummated for a period of 30 days, during which the Justice Department has merely to file a

complaint in Federal district court to stay automatically the proposed merger or transaction until a trial de novo on the merits can be held.

The effects of all this close regulation of bank mergers and acquisition has been that concentration in most banking markets has decreased since 1966. Contrary to some statements that have been presented to this committee in 1976 and 1978, we emphasize that the trend in banking since 1966 has been toward less rather than more concentration.

The greater part of the growth of registered bank holding companies reflects two circumstances having no implication with respect to any change in concentration. One, at the time of the passage of the 1970 Amendments to the Bank Holding Company Act, there were approximately 1,100 bank holding companies which had been exempt from registration under the 1956 act. The registration of these previously exempt organizations in 1971 and 1972 greatly increased the reported deposit coverage of bank holding companies. This increase was merely a change in classification and was not an increase in the degree of concentration of control of banking resources. Two, after the 1970 amendments, a number of banks converted to the one-bank holding company form of ownership. These corporate reorganizations also contributed to the increase in the reported deposit coverage of bank holding companies but did not alter the degree of concentration of control of banking resources.

The data on concentration in banking simply do not support the proposition that banking should be subjected to stricter antitrust standards than those affecting business in general. Banking is now subject to the full reach of the antitrust laws, and supervisory procedures assure closer regulation of mergers and acquisitions than in any other sector of business. We believe this comprehensive process has been and continues to be very effective in preventing anticompetitive bank and bank holding company acquisitions, mergers or consolidations that would not be in the public interest.

The whole context within which concentration of banking resources is viewed is in a period of change as a result of the passage of the Depository Institutions Deregulation and Monetary Control Act of 1980. The provisions of the act expanding the powers of thrift institutions and credit unions, especially in the offering of interest-bearing transaction accounts, mean that these types of depository institutions will soon be able to offer a cluster of services very similar to the cluster of services offered by full service banks. The evolving situation is tantamount to large scale new entry into the business of banking. And, as a result, we believe that the guidelines utilized in the examination of market share standards of competition should be revised to reflect the realities of the present day banking industry, and that all financial institutions should be included in the evaluation of resource concentration. We think that further congressional consideration of the issue of concentration should be deferred until the changes in competitive structure resulting from the 1980 act are more evident.

In recent years, the American Bankers Association has repeatedly come before this committee to argue against Government intervention in banking and the mounting burden of regulation, to argue for liberalization of existing laws and regulations, and to

urge that greater latitude be provided for the working of market forces in the banking and financial system. There appears to be a growing recognition in this committee and in the Congress in general that the public interest would be served by less rather than more regulation. The proposed bills under consideration today are contrary to this progressive trend, and they seem therefore singularly out of place.

The consistent posture of the American Bankers Association is that increased competition should be accommodated by removing restrictions that impose competitive disadvantages on banks. Our membership has again and again indicated that they are not seeking protection from competition but are seeking a more level playing field on which to compete with themselves and with other types of financial institutions.

When considered together, section 301 and the findings and purposes section of S. 39 would virtually create a list of activities that would be prohibited to bank holding companies.

PROPOSALS DIMINISH COMPETITION

The intent of these proposals is quite clearly to diminish actual competition by banks and bank holding companies or to preclude the threat of such potential competition.

In formulating the 1970 Amendments of the Bank Holding Company Act, the Congress rejected the idea of placing specific statutory restrictions on the types of activities in which bank holding companies might engage. The Board of the Federal Reserve System was delegated authority to define activities, "so closely related to banking as to be a proper incident thereto." The Board has exercised its authority in a deliberate, responsible way. The Board's reasons for approving certain types of activities while rejecting certain other types of activities have been set forth in detail in administrative orders and in statements submitted on previous occasions to committees of the Congress. There is no need for the American Bankers Association to paraphrase what the Board has said on previous occasions about the specific restrictions that the proposed legislation would impose on types of activities. Our association's position is that the Board's actions since 1970 have justified the confidence expressed by the Congress in delegating authority to the Board.

Moreover, the restrictions proposed in S. 380 and H.R. 2255 with respect to insurance activities are obviously anticompetitive.

On February 27, 1978, the U.S. Supreme Court denied an appeal by the Independent Insurance Agents of America (IIAA) and in effect upheld an earlier ruling by the U.S. Fifth Circuit Court of Appeals supporting in large part the Federal Reserve's regulations permitting bank holding companies to broker certain types of insurance related to credit extensions. Since that decision, the issue has been raised again with respect to the apparent opportunity that banks have to "tie-in" sales of insurance with loans and other transactions. We believe the real issue, however, is whether or not Congress wishes to protect one segment of the insurance business from competition.

Tie-ins are unlawful and clearly so under both the antitrust laws and section 106 of the 1970 Amendments of the Bank Holding

Company Act. Even if they were lawful, tie-ins would be questionable business practice.

Our association also believes that section 601 and section 701 of S. 39 would lead to essentially the same anticompetitive results as the combined impact of section 301 and the findings and purposes section.

We believe a further aspect of S. 39 also merits comment. S. 39 would amend the Banking Holding Company Act not only to restrict the closely related activities of bank holding companies but also to restrict the activities of national banks. That is, the prohibition on specific activities would be extended to national banks. As has been indicated, our association opposes the idea of placing any of these specific prohibitions into statute. In addition, placing such restrictions on national banks would tend to create a competitive disparity between national banks and State banks.

There are other specific provisions in these proposed bills that are either unsatisfactory, not necessary, or quite obscure in their intent and meaning. Our overall assessment is that S. 39, S. 380, and H.R. 2255 would diminish competition and thereby harm the public interest, and should therefore be totally rejected.

Thank you, Mr. Chairman. I will be happy to respond to any questions the committee may ask.

[Complete statement follows:]

Testimony of

Lee E. Gunderson

on behalf of

The American Bankers Association

Mr. Chairman and members of the Committee, I am Lee E. Gunderson, President of the Bank of Osceola, Osceola, Wisconsin, and President-Elect of the American Bankers Association. The purpose of this statement is to comment on proposed legislation that would amend Federal laws governing bank mergers and holding company acquisitions, and the scope of activities of bank holding companies. The proposed bills are currently designated as S. 39, S. 380, and H.R. 2255.

The Association's position is that a sufficient case has not been made for passage of any of these bills. The membership of the American Bankers Association includes over 90 percent of the more than 14,500 full-service banks in the United States. While our members range in size from the very smallest to the very largest of full-service banks, close to 90 percent of them have assets of less than $100 million. Included are banks that have branch offices and banks that do not have branch offices, banks that are affiliated with bank holding companies and banks that are not affiliated with such companies, and banks that are closely held by individuals as well as banks that are widely owned by the public. On many issues, representation of this diverse membership requires reconciliation of conflicting interests and points of view. Throughout the history of the Association, which dates back to 1875, one of the most controversial issues we have addressed has been multi-office banking versus unit banking, sometimes characterized as the "banking structure" question.

In this long-running controversy the Association has sought to represent banking as a whole. The Association has resisted efforts by one or another groups or types of banking organizations to dominate the Association's policy positions. As a result, the Association has consistently favored public policies

that permit diversity and flexibility in the organizational forms in which banks operate. We think that the public interest has been better served by policies that permit diversity and encourage innovation in organizational forms than it would have been served by policies that would have cast all banking organizations in the same mold.

The American Bankers Association has come before this Committee many times on many issues to argue for preservation of the "dual banking system" -- that system whereby the Federal Government and the states share authority in the chartering and regulation of full-service banks. We have often emphasized that the "dual banking system" provides checks and balances to the concentration and abuse of regulatory power. We have also emphasized that the dual banking system is a framework of regulation that accomodates innovation and change in banking's response to the public convenience and need. We believe S. 39 would alter the role of Federal and state regulatory agencies in ways that would be damaging to the concept of the dual banking system.

Since the McFadden Act of 1927, it has been well-established public policy that each state determines whether or not banks in that state are permitted to operate on a multi-office basis. The McFadden Act itself dealt, of course, with the question of branching of national banks. The same public policy was clearly reflected in the Bank Holding Company Act of 1956. It left to each state the question of whether or not corporate ownership of banks would be permitted, and whether such ownership would be limited to one bank or be allowed to include two or more banks. While bringing bank holding companies under Federal regulation, the Act of 1956 maintained the role of the states in determining the extent of multi-office banking to be permitted within their respective jurisdictions.

S. 39 would extend the reach of Federal law in determining the banking structure in each state by placing a percentage limitation on the relative size of banking organizations which might be permitted to expand through mergers and acquisitions. At the present time, percentage limitations are found in five states -- Iowa, Missouri, New Hampshire, New Jersey, and Tennessee. The percentages in these five states differ over a range between 8 percent and 20 percent. Such variation is indicative of the diversity in banking structure among the states. It also argues against the idea that a uniform percentage limitation would be appropriate for all states. Although S. 39 would permit states to establish percentage restrictions below the proposed Federal limit of 20 percent, the practical effect, of course, would be to establish a Federal standard and to pre-empt state authority.

Advocacy of a Federal percentage limitation implies a belief that the states are not capable of dealing effectively with the issue of banking structure. The American Bankers Association regards the proposed percentage limitation as an issue incidental to any reconsideration of the McFadden Act. Our Association is awaiting an opportunity to review the Administration's study on the McFadden Act, which was requested by the Congress.

Additionally, S. 39 would pose new regulatory barriers to the expansion of multi-office banking organizations by subjecting bank mergers and holding company acquisitions to more stringent tests than currently prevail under Section 7 of the Clayton Act. Bank mergers and holding company acquisitions are already subject to closer regulation than mergers and acquisitions in any other sector of our economy. Prior approval of the appropriate Federal bank regulatory agency is required. A detailed application, including data relevant to evaluation of the effects on competition and the effects on the public convenience and need, is required. Public notice is required, and opportunities

are provided for the submittal of adverse comments from the public. State regulatory agencies are provided an opportunity to comment. The Justice Department is supplied with a copy of the application for review and comment with respect to competitive effects. A field investigation may be conducted by the Federal bank regulatory agency. If approved, the merger or acquisition cannot be consummated for a period of 30 days, during which the Justice Department has merely to file a complaint in Federal district court to stay automatically the proposed merger or transaction until a trial de novo on the merits can be held.

These procedures, enacted in 1966, have been very effective in preventing mergers and acquisitions that might be judged anticompetitive. The relatively high costs of preparing and filing applications discourage bank mergers and acquisitions that might be found to violate Section 7 of the Clayton Act. The competitive tests applied by the Federal bank regulatory agencies have tended to be more rather than less stringent than the prevailing standards under Section 7 of the Clayton Act, and the Justice Department has assiduously applied Section 7 standards to bank mergers and acquisitions.

The effect of all this close regulation of bank mergers and acquisitions has been that concentration in most banking markets has decreased since 1966. Contrary to some statements that have been presented to this Committee in 1976 and 1978, we emphasize that the trend in banking since 1966 has been towards less rather than more concentration.

In a report entitled "Geographic Expansion of Banks and Changes in Banking Structure" and published in March 1979, Stephen A. Rhoades, of the staff of the Board of Governors of the Federal Reserve System, has presented data on changes in concentration in 281 banking market areas. Eleven markets showed no change in concentration, 44 markets increases in concentration, and

226 markets showed decreases in concentration. On the average, concentration decreased by 5.23 percentage points in these 281 market areas. Other data published by the Federal Reserve indicates that the trend nationally has been toward less concentration of control of banking resources.

The impression that concentration has been increasing has been fostered by some proponents of S. 39 by selective use of data on the percentage of total bank deposits in banks affiliated with holding companies. For example, it has been said that the percentage of total deposits in banks affiliated with registered bank holding companies increased from 16 percent in 1970 to 71 percent in 1977. What this statement neglects to make clear, however, is that the number of registered bank holding companies increased from 121 in 1970 to 2,027 in 1977. That is, the number of registered bank holding companies increased by 15.8 times while their relative deposit share increased by only 5.4 times.

The greater part of the growth of registered bank holding companies reflects two circumstances having no implication with respect to any change in concentration. (1) At the time of the passage of the 1970 Amendments to the Bank Holding Company Act, there were approximately 1,100 bank holding companies which had been exempt from registration under the 1956 Act. The registration of these previously exempt organizations in 1971 and 1972 greatly increased the reported deposit coverage of bank holding companies. This increase was merely a change in classification and was not an increase in the degree of concentration of control of banking resources. (2) After the 1970 Amendments, a number of banks converted to the one-bank holding company form of ownership. These corporate reorganizations also contributed to the increase in the reported deposit coverage of bank holding companies but did not alter the degree of concentration of control of banking resources.

An analysis presented by the Federal Reserve in The Bank Holding Company Movement to 1978: A Compendium indicates that adjustment of reported data to take account of the growth in number of bank holding companies reveals a relatively small increase in the concentration of control of banking resources through bank acquisitions by holding companies. We estimate that only 12.8 percent of the total deposits of banks in 1977 were affiliated banks of multi-bank holding companies other than the lead bank of each company. Also, banks representing almost one-half of this 12.8 percent were already affiliates of holding companies in 1970. Therefore, only 6.8 percentage points of the 71 percent of deposits in bank holding companies in 1977 reflected bank acquisitions between 1970 and 1977.

Note should also be taken of the fact that some of the bank acquisitions by holding companies between 1970 and 1977 were corporate restructurings of arrangements whereby two or more banks had been linked through ownership by one person or by several closely related persons or where control was exercised through trustees. The conversion of such "chain banking" arrangements into holding companies did not alter the degree of concentration of banking resources.

Most of the acquisitions of banks by holding companies since 1970 have been of the "market extension" variety. That is, the bank being acquired has been in a different market area than the existing subsidiaries of the holding company. "Market extension" acquisitions tend to increase the apparent degree of concentration of banking resources in a state, but they do not increase concentration in local market areas. In interpreting the anti-trust laws, the courts have held that it is the degree of concentration in local market areas that is relevant to the measurement of the competitive effect of a bank merger or acquisition. Mergers or acquisitions that significantly increase concentration in

local market areas have been effectively prohibited in banking since 1963. It is not surprising, therefore, that holding company growth has not tended to increase concentration in relevant market areas and that the trend in such areas has been toward less concentration, as noted by Mr. Rhoades and other members of the Federal Reserve's staff who have studied this question.

Banking is one of the least concentrated sectors of American business. It is also a sector where competition has become increasingly intense over the past 10 to 20 years. Full-service banks have become much more aggressive in competing among themselves. Mutual savings banks, savings and loan associations, credit unions, consumer finance companies, mutual funds, and other financial institutions have come to compete directly with banks in the deposit and loan business. Foreign banks and financial institutions have brought an additional source of competition. Attached to this statement are several tables which indicate that the position of United States banks is declining relative to other types of domestic financial institutions.

These data indicate that concentration in the banking industry has been steadily declining for a number of years, and that the United States banking industry is significantly less concentrated than several other major United States industries. The market share of banks in total deposits held at depository institutions has been steadily declining in the post World War II period. Of course, the placement of funds at depository institutions is only one of several ways that financial intermediation takes place. Non-deposit liabilities placed at banks, thrift institutions, and many other types of financial intermediaries including finance companies, insurance companies, mutual funds, and pension funds are an increasingly important method of intermediation. Bank deposits have been steadily declining relative to these other liabilities of financial institutions. Demand deposits, the one product of these

institutions that until recently was unique to full-service banks, have declined from close to 37 percent of financial institution liabilities in 1949 to 10.0 percent in 1979. These data give no indication whatsoever of increasing bank power, or concentration. Nor do they indicate that banks are gaining at the expense of their competitors. If there is any trend, it is in the opposite direction.

The data on concentration in banking simply do not support the proposition that banking should be subjected to stricter anti-trust standards than those affecting business in general. Banking is now subject to the full reach of the anti-trust laws, and supervisory procedures assure closer regulation of mergers and acquisitions than in any other sector of business. We believe this comprehensive process has been and continues to be very effective in preventing anticompetitive bank and bank holding company acquisitions, mergers or consolidations that would not be in the public interest.

The whole context within which concentration of banking resources is viewed is in a period of change as a result of the passage of the Depository Institutions Deregulation and Monetary Control Act of 1980. The provisions of the Act expanding the powers of thrift institutions and credit unions, especially in the offering of interest-bearing transaction accounts, mean that these types of depository institutions will soon be able to offer a cluster of services very similar to the cluster of services offered by full service banks. The evolving situation is tantamount to large-scale new entry into the business of banking. We think that further Congressional consideration of the issue of concentration should be deferred until the changes in competitive structure resulting from the the 1980 Act are more evident.

In recent years, the American Bankers Association has repeatedly come before this Committee to argue against government intervention in banking and the mounting burden of regulation, to argue for liberalization of existing laws and regulations, and to urge that greater latitude be provided for the working of market forces in the banking and financial system. There appears to be a growing recognition in this Committee and in the Congress in general that the public interest would be served by less rather than more regulation. The proposed bills under consideration today are contrary to this progressive trend, and they seem therefore singularly out of place.

The consistent posture of the American Bankers Association is that increased competition should be accomodated by removing restrictions that impose competitive disadvantages on banks. Our membership has again and again indicated that they are not seeking protection from competition but are seeking a more level playing field on which to compete with themselves and with other types of financial institutions.

When considered together, Section 301 and the Findings and Purposes section of S. 39 would virtually create a list of activities that would be prohibited to bank holding companies. Section 301 would generally restrict the entry of bank holding companies into activities closely related to banking by altering the language of the present Bank Holding Company Act. This proposed legislation would limit bank holding companies to activities "so closely and directly related to banking or managing or controlling banks as to be as proper and necessary incident thereto" (new words underlined). Section 301 would also make the public benefits test more stringent by requiring "substantial benefits to the public which clearly and significantly outweigh possible adverse side effects." The Findings and Purposes Section of S. 39 would have Congress find that:

> o Bank holding companies have extended their services into product markets beyond those directly related to banking, thereby eroding the line between banking and commerce in the Nation: (i) in offering insurance agency and underwriting services, (ii) in offering leasing, accounting, travel, and courier services, (iii) in offering management

and data processing service, and (iv) in marketing securities; and

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

The intent of these proposals is quite clearly to diminish actual competition by banks and bank holding companies or to preclude the threat of such potential competition.

In formulating the 1970 Amendments to the Bank Holding Company Act, the Congress rejected the idea of placing specific statutory restrictions on the types of activities in which bank holding companies might engage. The Board of the Federal Reserve System was delegated authority to define activities "so closely related to banking as to be a proper incident thereto." The Board has exercised its authority in a deliberate, responsible way. The Board's reasons for approving certain types of activities while rejecting certain other types of activities have been set forth in detail in administrative orders and in statements submitted on previous occasions to committees of the Congress. There is no need for the American Bankers Association to paraphrase what the Board has said on previous occasions about the specific restrictions that the proposed legislation would impose on types of activities. Our Association's position is that the Board's actions since 1970 have justified the confidence expressed by the Congress in delegating authority to the Board.

The Committee should take note of the fact that the expansion of bank holding companies into the permitted, closely-related activities

has been accomplished substantially through the formation of new subsidiaries rather than by acquisition. From January 1971 through December 1979, bank holding companies formed 4,729 new companies to engage in closely related activities, compared to 594 approved acquisitions. The difference between the formation of new subsidiaries and expansion by acquisition was recognized by the Congress in 1970, and was clearly embodied in Section 4(c)(8) of the Bank Holding Company Act. For this reason, the formation of new subsidiaries requires a much simpler and less formal procedure (i.e, notification), unless it appears appropriate to apply more formal procedures. The proposed legislation does not distinguish between new formations and acquisitions. An important source of new competition in the permissible areas would thus be shut down, and the public would be the loser.

Moreover, the restrictions proposed in S. 380 and H.R. 2255 with respect to insurance activities are obviously anticompetitive.

On February 27, 1978, the U.S. Supreme Court denied an appeal by the Independent Insurance Agents of America (IIAA) and in effect upheld an earlier ruling by the U.S. Fifth Circuit Court of Appeals supporting in large part the Federal Reserve's regulations permitting bank holding companies to broker certain types of insurance related to credit extensions. Since that decision, the issue has been raised again with respect to the apparent opportunity that banks have to "tie-in " sales of insurance with loans and other transactions. We believe the real issue, however, is whether or not Congress wishes to protect one segment of the insurance business from competition.

Tie-ins are unlawful and clearly so under both the anti-trust laws and Section 106 of the 1970 amendments to the Bank Holding Company Act. Even

if they were lawful, tie-ins would be questionable business practice.

Our Association also believes that Section 601 and Section 701 of S. 39 would lead to essentially the same anticompetitive results as the combined impact of Section 301 and the Findings and Purposes Section. Section 601 of S. 39 would subject both the rulemaking and individual bank holding company application procedures of the Federal Reserve Board to the formal trial-type hearing requirements of Sections 556 and 557 of the Administrative Procedure Act. This would mean that all orders and regulations of the Federal Reserve Board under Section 4(c)(8) would have to be conducted on the record after opportunity for hearing. Section 701 of S. 39 would permit any interested person to petition the Federal Reserve Board "to commence a proceeding to consider the issuance, amendment or revocation of an order or regulation promulgated under the authority of Section 4(c)(8) of the Bank Holding Company Act." We think the increased burdens that would be created by these two sections would have stifling effects upon the entrance of bank holding companies into banking related activities.

We believe a further aspect of S. 39 also merits comment. S. 39 would amend the Bank Holding Company Act not only to restrict the closely related activities of bank holding companies but also to restrict the activities of national banks. That is, the prohibition on specific activities would be extended to national banks. As has been indicated, our Association opposes the idea of placing any of these specific prohibitions into statute. In addition, placing such restrictions on national banks would tend to create a competitive disparity between national banks and state banks.

There are other specific provisions in these proposed bills that

are either unsatisfactory, not necessary, or quite obscure in their intent and meaning. Our overall assessment is that S. 39, S. 380, and H. R. 2255 would diminish competition and thereby harm the public interest, and should therefore be totally rejected.

Thank you, Mr. Chairman, I will be happy to respond to any questions the Committee may ask.

Table 1

Share of Domestic Deposits Held by Largest U.S. Banking Organizations, Selected Dates, 1934-1977

Percent

	100 Largest Banking Organizations	10 Largest Banking Organizations
December 31, 1934[a]	56.7	23.7
December 31, 1940[a]	59.4	26.9
December 31, 1955	49.3	20.7
December 31, 1957	48.2	n.a.
December 31, 1960	49.5	21.2
December 31, 1961	49.4	n.a.
December 31, 1964	48.0	20.6
December 31, 1966	49.3	n.a.
December 31, 1968	49.1	20.4
June 30, 1970	49.9	19.9
June 30, 1972	46.8	19.1
December 31, 1973	47.0	n.a.
December 31, 1975	48.1	20.9
December 31, 1976	45.3	18.4
June 30, 1977	45.0	18.3
June 30, 1978	45.0	18.2
December 31, 1979	45.8	17.9

SOURCES: A Study by the Staff of the Board of Governors of the Federal Reserve System, The Bank Holding Company Movement to 1978: A Compendium, September, 1978, p. 246, and Federal Reserve Board.

a - Continental United States Only

n.a. - not available

Table 2

SHARE OF VALUE OF SHIPMENTS ACCOUNTED FOR BY THE 4 AND 8 LARGEST COMPANIES IN EACH MANUFACTURING INDUSTRY

1972

Industry	Value of Shipments (billions of dollars)	Percentage Accounted For By 4 Largest Companies	Percentage Accounted For By 8 Largest Companies
Motor Vehicles and Car Bodies	$42.9	93%	99%
Petroleum Refining	25.9	31	56
Blast Furnaces and Steel Mills	23.9	50	68
Aircraft	8.8	66	86
Electronic Computing Equipment	6.4	59	69
Tires and Inner Tubes	5.7	73	90
Malt Beverages	4.1	52	70
Cigarettes	3.7	84	(D)

D - Withheld to avoid disclosing figures for individual companies.

Source: Concentration Ratios in Manufacturing, 1972 Census of Manufactures, U.S. Department of Commerce.

Table 3

Total Deposits
of Selected Institutions
1949, 1964 and 1979

(Billions of Dollars)

	1949		1964		1979	
	Deposits	Pct of Total	Deposits	Pct of Total	Deposits	Pct of Total
Full Service Banks	$127.0	79.6%	$271.0	63.0%	$981.5	59.4%
Savings & Loan Associations	12.5	7.8	101.9	23.7	470.1	28.4
Mutual Savings Banks	19.3	12.1	48.8	11.4	145.6	8.8
Credit Unions	.7	.4	8.2	1.9	56.2	3.4
TOTAL	$159.5	100.0%	$429.9	100.0%	$1,653.4	100.0%

SOURCE: Federal Reserve Board, Flow of Funds Accounts

Table 4
Deposits by Institutions,
as a Percentage of
Total Financial Institution Liabilities
1949, 1964 and 1979

	1949		1964		1979	
	Billions of Dollars	As a Pct of Total	Billions of Dollars	As a Pct of Total	Billions of Dollars	As a Pct of Total
Full Service Bank Deposits	$127.0	51.5%	$271.0	34.9%	$981.5	31.2%
Thrift Institution Deposits	32.5	13.2	158.9	20.4	671.9	21.3
Other Liabilities*	86.9	35.3	347.2	44.7	1496.2	47.5
TOTAL Financial Institution Liabilities	$246.4	100.0%	$777.1	100.0%	$3149.6	100.0%

*Includes all non-deposit liabilities of commercial banks, savings and loan associations, mutual savings banks, and credit unions, plus all liabilities of other financial institutions. Other financial institutions include: Life Insurance Companies. Private Pension Funds, State and Local Government Employee Retirement Funds, Security Brokers and Dealers, and Finance Companies.

SOURCE: Federal Reserve Board, Flow of Funds Accounts

Table 5
Deposits by Type, as
as a Percentage of
Total Financial Institution Liabilities
1949, 1964 and 1979

	1949		1964		1979	
	Billions of Dollars	As a Pct of Total	Billions of Dollars	As a Pct of Total	Billions of Dollars	As a Pct of Total
Demand Deposits, Net	$90.3	36.6%	$143.4	18.5%	$313.5	10.0%
Time & Savings Deposits	69.2	28.1	286.5	36.9	1339.9	42.5
Other Liabilities*	86.9	35.3	347.2	44.7	1496.2	47.5
TOTAL Financial Institution Liabilities	$246.4	100.0%	$777.1	100.0%	$3149.6	100.0%

*Includes all non-deposit liabilities of commercial banks, savings and loan associations, mutual savings banks, and credit unions, plus all liabilities of other financial institutions. Other financial institutions include: Life Insurance Companies, Private Pension Funds, State and Local Government Employee Retirement Funds, Security Brokers and Dealers, and Finance Companies.

SOURCE: Federal Reserve Board, Flow of Funds Accounts

Senator MORGAN. Thank you very much. We'll go ahead and hear from all of you and have a colloquy with the whole panel then. Mr. Malarkey, we'll be glad to hear from you.

STATEMENT OF JOHN E. MALARKEY, STATE BANK COMMISSIONER, STATE OF DELAWARE, CONFERENCE OF STATE BANK SUPERVISORS

Mr. MALARKEY. Mr. Chairman, I am John E. Malarkey, State bank commissioner for the State of Delaware and vice chairman of the Federal Legislation Committee of the Conference of State Bank Supervisors, on whose behalf I am testifying today.

We are pleased to have this opportunity to comment on some of the provisions of bills before this committee because of their implications for the State segment of our dual system of State/Federal checks and balances.

H.R. 2255

The conference sees no need for the restrictions on the insurance activities of bank holding companies and their subsidiaries that are proposed by this bill. It should be pointed out that 22 States have enacted legislation placing restrictions on insurance activities of bank holding companies operating within their borders. This limiting action by the 22 States reflects their individual decisions that the interests of their respective citizens would best be served by such action. Conversely, 28 States have not seen fit to add restrictions to those insurance activities now permitted under the Bank Holding Company Act, reflective of their decisions that such activities are either necessary or that any further limitation in such area would not be in the best interests of their citizens.

Actions taken by the various States in this area are good examples of how our decentralized dual banking system operates. It is a manifestation of the individual State determining the form and structure of the banking industry within its respective boundaries.

We would, therefore, oppose H.R. 2255 which if enacted would preempt State law or regulation in those States which have not seen fit to embrace limitations such as those proposed in H.R. 2255.

With respect to those 22 States which have adopted legislation restricting bank holding company activities in the insurance field, it would appear there is a possibility that those State statutes would also be preempted to the extent they were inconsistent with the provisions of H.R. 2255, should this proposal become law as presently written.

This situation exists as a result of language contained in the decision of the U.S. Supreme Court on June 9, 1980, in the case of *Lewis* v. *BT Investment Managers, Inc.,* No. 79-45, volume 48 of Law Week, p. 4638. The Supreme Court indicated that section 7 of the Bank Holding Company Act may provide only limited protection to State laws which regulate bank holding company activities. While commenting that section 7 was intended, "To preserve existing (as of 1956) State regulation of bank holding companies even if they were more restrictive than Federal law," the Court also stated that under section 7a, "State could not enact legislation inconsistent with it (the act) and therefore nullify its effect." In view of the language by the High Court in this case, should the Congress enact H.R. 2255 into law, it should explicitly provide language therein spelling out the authority of the States to be more restrictive relative to insurance activities than would be permitted under H.R. 2255 or to prohibit entirely such activities for bank holding companies operating within their borders.

S. 39

One. The 20-percent limitation: The conference is opposed to the 20-percent banking asset ceiling proposed as a nationwide standard for bank mergers or acquisitions. Banking conditions vary from State to State, and the methods needed to protect the public interests in the respective States may also differ. Because of this some States have deemed it desirable to place diverse percentage limitations on bank expansion—for example, Tennessee has a 16.5-percent limitation, Iowa 8 percent, and Missouri 13 percent. To the extent these standards conflict with the 20-percent Federal limitation proposed by S. 39, actions taken by these States would presumably be overridden.

Today States can in a meaningful way influence and control their own banking structures, based upon local conditions and the local public interests. We believe this is a desirable situation; that it should not be altered as proposed, which would dilute State authority in this area and permit Federal bank regulatory authorities to determine banking structure within a State, under a nationwide norm that ignores individual State action in this area.

Two. The power to deny anticompetitive mergers and acquisitions not violative of specific statutory controls: If enacted, the proposed standards for bank mergers contained in S. 39 would inevitably lead to the kind of anomalous situation which was liti-

gated in the well-known case entitled *Washington Mutual Savings Bank* v. *Federal Deposit Insurance Corporation,* 482 F. 2d 459 (9th circuit 1973), in which the FDIC sought unsuccessfully to deny a proposed merger on the grounds that while it did not violate Sherman and Clayton Act standards embodied in the Bank Merger Act, it was potentially anticompetitive. The Court of Appeals for the Ninth Circuit reversed the FDIC's action on the grounds that the Corporation had exceeded its statutory authority. We are supportive of this judicial decision.

Three. Restrictions on the powers of national banks: The conference opposes provisions in S. 39 which would prohibit national banks or their subsidiaries from engaging in any activity which the Fed prohibits to bank holding companies under section 4(c)(8) of the Bank Holding Company Act. It is our belief that the Comptroller of the Currency as the chartering source of national banks and the primary regulator of such institutions, should be responsible for determining the scope of activities of such institutions, and that State banking departments as primary regulators of State chartered banks should exercise similar authority with respect to the banks which they charter. It is our view that the primary regulator of the lead bank in each bank holding company should also regulate the parent bank holding company; that a bank holding company should be examined and supervised as a single integrated unit.

Four. Power to regulate bank capital indirectly through holding company regulation: The conference opposes provisions in section 501 of S. 39 which would require that bank holding companies and their subsidiaries be capitalized and financed in a safe and sound manner as determined by the Fed. We are supportive of the judicial decision in the *First Lincolnwood Corp.* case, decided in 1977, in which the Court ruled that the authority to regulate the capital of banks has been reserved to the Comptroller of the Currency with respect to national banks and to the various State agencies with respect to State chartered banks.

Thank you Mr. Chairman.

[Prepared statement of Mr. Malarkey follows:]

STATEMENT OF MR. JOHN E. MALARKEY
ON BEHALF OF
THE CONFERENCE OF STATE BANK SUPERVISORS

Mr. Chairman, I am John E. Malarkey, State Bank Commissioner for the State of Delaware and Vice Chairman of the Federal Legislation Committee of the Conference of State Bank Supervisors, on whose behalf I am testifying today.

The Conference of State Bank Supervisors is the nationwide organization of state officials who serve as the primary chartering, examining and regulatory authority for approximately 10,500 state-chartered commercial and mutual savings banks with total assets of approximately $660 billion.

We are pleased to have this opportunity to comment on some of the provisions of bills before the Committee because of their implications for the state segment of our dual system of state/federal checks and balances.

H.R. 2255 (To Amend The Bank Holding Company Act of 1956 to Limit The Property, Casualty And Life Insurance Activities of Bank Holding Companies And Their Subsidiaries)

This bill would amend Section 4(c)(8) of the Bank Holding Company Act to provide that in the future it will not be permissible for bank holding companies to provide insurance as principals, agents or brokers unless such activities fall within the exceptions specifically enumerated in the bill.

The Conference sees no need for the restrictions that would be added to Section 4(c)(8) of the Bank Holding Company Act as proposed by H.R. 2255. Section 4(c)(8) now provides that a bank holding company may engage in a nonbank activity if it makes an

affirmative showing that the particular activity in question is "closely related" to banking and that carrying out the activity can reasonably be expected to produce benefits for the public that outweigh possible adverse effects. Subsequent to the 1970 amendments to the Bank Holding Company Act, the Federal Reserve Board has been more restrictive in permitting insurance activities of bank holding companies, and in carrying out its responsibilities under the Act as amended the Fed has generally required that a bank holding company affiliate show a direct relationship of the insurance activity to an extension of credit.

Against this backdrop, it should be pointed out that 22 states have enacted legislation placing restrictions on insurance activities of bank holding companies. This limiting action by the 22 states reflects the decision of those states that the interests of its respective citizens would be best served by enacting restrictions in that area.

Conversely, 28 states have not seen fit to add restrictions to those insurance activities now permitted under the Bank Holding Company Act, reflective of their decision that such activities are either necessary or that any further limitation in such area is not in the best interests of their citizens.

Actions taken by the various states in this area are good examples of how our decentralized dual banking system operates. It is a manifestation of the individual state determining the form and structure of the banking industry within its respective borders. We believe this is a healthy way of operating in a

country as large and diverse in its geographic, economic and demographic makeup as ours.

We would, therefore, oppose H.R. 2255 which if enacted would preempt state law or regulation in those states which have not seen fit to embrace those provisions enumerated in H.R. 2255 for insurance-type activities of bank holding companies.

With respect to those 22 states which have adopted legislation restricting bank holding company activities in the insurance field, it would appear there is the likelihood that those state statutes would also be preempted to the extent that they were inconsistent with the provisions of H.R. 2255, should this proposal become law as presently written.

The House Banking Committee Report (No. 96-845) dealing with H.R. 2255 states:

> What is more, Section 4(c)(8) of the BHC Act which is amended by H.R. 2255 continues to be subject to Section 7 of the BHC Act which preserves in the States their authority to regulate the activities of banks, bank holding companies, and subsidiaries thereof....
>
> Insofar as concerns Section 7 of the BHC Act, the committee also considered whether it would be appropriate for H.R. 2255 to contain specific language reserving to the various States their current authority to limit, or even prohibit entirely, the insurance activities of bank holding companies within their jurisdiction. It was determined that Section 7 of the BHC Act adequately preserves the authorities of the States to regulate the insurance activities of bank holding companies. As a result, specific language in that regard in the context of H.R. 2255 was determined to be unnecessary. (Pages 3-4 of Committee Report.)

However, language of the U. S. Supreme Court decision of June 9, 1980 in the case of Lewis v. BT Investment Managers, Inc. (#79-45, Vol. 48 of Law Week, Page 4638) may cast some doubt on

the continued validity of the House Banking Committee's interpretation of Section 7. While the Supreme Court did not specifically address itself to the question of federal preemption of state regulation under the Bank Holding Company Act, the Court did indicate that Section 7 may provide only limited protection to state laws which regulate bank holding company activities. Thus, the Supreme Court held that Section 7 was intended "to preserve existing (as of 1956) state regulation of bank holding companies even if they were more restrictive than federal law." However, the U. S. Supreme Court also held that under Section 7 a "state could not enact legislation inconsistent with it (the Act) and therefore nullify its effect."

Up until the present time, the states, in the view of the Conference, have not acted inconsistent with the Bank Holding Company Act because the Congress has not expressly defined the insurance activities which such holding companies could carry out. Now, however, it is proposed in H.R. 2255 that Congress should specifically designate those insurance activities which are permissible for bank holding companies. In light of the Supreme Court's BT Investment decision, such a specific enumeration of permissible insurance activities as proposed by H.R. 2255 would seem to preempt more restrictive regulation by the states notwithstanding Section 7 of the Bank Holding Company Act.

It is noteworthy that the House Banking Committee evidently agreed that under H.R. 2255 the states should be permitted to more stringently regulate, or even prohibit, bank holding company insurance activity. The House Banking Committee assumed that

Section 7 of the Act would accomplish this objective, and, therefore, that there was no need to include language such as that contained in Section 2 of the bill as reported out of the House Banking Subcommittee on Financial Institutions.[1/]

While we applaud the House Banking Committee's objective of preserving to the states this right to assert more stringent regulation in the insurance area, we believe that in view of the questions raised by the Supreme Court's BT Investment Company decision, if Congress should decide to enact H.R. 2255 it should explicitly provide in H.R. 2255 language spelling out specific authority to the states to impose provisions on bank holding companies and their affiliates that are more restrictive, or to prohibit entirely insurance activities that would be permitted under H.R. 2255.

S. 39--The Competition In Banking Act

Mr. Chairman, there are certain sections of this bill which, if enacted into law, would undermine the authority of the States, and their state banking departments, to establish policy on matters of diverse local interest, without a showing that such action would be warranted on the basis of overriding national considerations.

1/ "Sec. 2. The amendment made by the first section of this act shall not supersede existing State laws and shall cease to be effective with respect to any State on the date on which such State enacts a law which in substance contravenes the amendment made by the first section of this Act. (Committee Report, page 14).

(1) The Twenty Percent Limitation

Section 101 would impose a new criteria for all agencies to follow in their review of bank mergers. It would prohibit any bank mergers or acquisitions if the resulting bank or its parent holding company were to control more than 20% of the banking assets in a particular state, except where such action would be necessary to prevent a probable bank failure, and where no less anticompetitive alternative were available.

The motivation for this arbitrary asset ceiling is apparently based on the assumption that there is: (1) an unhealthy nationwide trend towards concentration in the banking industry; and that (2) a single, national norm of 20% would be appropriate for all states. Both assumptions appear unwarranted. In testimony before this Committee on March 7, 1978, relative to S. 72, a bill embodying this same provision, former FRB Governor Philip E. Coldwell stated:

> The bill's first finding is that there has been a continuing trend toward concentration of banking resources in the United States. However, recent Board studies fail to indicate that there has been a significant trend toward increased concentration of domestic banking resources nationally, statewide, or in most of the country's 400 most significant local banking markets. In fact, concentration appears to be declining. (Hearings before the Senate Banking, Housing and Urban Affairs on S. 72, page 16.)

The Conference is particularly concerned about the twenty percent banking asset ceiling as a nationwide standard because it is clear that banking conditions and public interest differ substantially from state to state. Because of this, some states have deemed it desirable to place diverse percentage limitations on bank expansion; (e.g., Tennessee has a 16.5% limitation, Iowa 8%, and Missouri 13%). To the extent these standards conflict with

the twenty percent federal limitation proposed by S. 39, actions taken by these states would presumably be overridden. S. 39 would contribute to greater concentration of banking assets in some states, not less as apparently intended by the bill

Furthermore, the proposed twenty percent standard is deficient in that it would not give recognition to competition by out-of-state banks. There are a number of Standard Metropolitan Statistical Areas which include portions of more than one state and in considering merger matters, the regulators should not ignore other financial institutions in the SMSA merely because they are chartered in a different state.

The law as it presently exists permits states in a meaningful way to influence and control their own banking structures, based upon local conditions and the local public interests. We believe this is a desirable situation and that it should not be altered in such a way as to dilute state authority or to permit the federal bank regulatory authorities to determine the banking structure in a state. It is our position that state banking authorities as the primary regulators of state-chartered banks should make bank structure decisions, including subject percentage limitations, with respect to those banks which they charter.

(2) The Power to Deny "AntiCompetitive" Mergers and Acquisitions Not Violative of Specific Statutory Controls

This proposal, as set forth in Sections 101 and 201, would grant extraordinary powers to the federal banking agencies and, to a greater extent even than the twenty percent limitation, would undermine the ability of states to regulate their banking structures. Authority would be given bank regulatory agencies to deny bank

or bank holding company transactions which would not violate the Sherman Act or the Clayton Act if the anticompetitive consequences of those acquisitions, mergers or consolidations were not clearly outweighed in the public interest by the probable effects of such transactions in meeting the convenience and needs of the community.

An illustration of the problem which could arise under this proposal is contained in the factual background of the well-known Washington Mutual case. (Washington Mutual Savings Bank v. Federal Deposit Insurance Corporation, 482 F. 2d 459 (9th Circuit 1973.) That case involved a proposed merger between Grays Harbor Savings and Loan Association, the smallest of four thrift institutions in the Aberdeen-Hoquiam area of Washington, and the Washington Mutual Savings Bank, headquartered 80 miles away in Seattle. Grays Harbor was typical of many small financial institutions in the country which face acute management problems at the end of their first generation of operations. Its two executive officers had been with the institution since its founding in 1924, and neither officer wished to continue in an active management role. For this reason, and because he deemed the merger pro-competitive, the Supervisor of Banking in Washington approved the merger.

The FDIC's regional officials on the West Coast reached conclusions consistent with those of the Washington Banking Department; and five of the eight members of the FDIC's staff-manned Board of Review concurred. The FDIC Board of Directors, however, denied the Grays Harbor application on the ground that, while it did not violate the Sherman and Clayton Act standards embodied in the Bank Merger Act, it was potentially anti-competitive. This action barred

the merger, which state and regional officials had deemed to be in the public interest, until the Court of Appeals for the Ninth Circuit stepped in to reverse the FDIC's action. The basis for the Court's decision was that the FDIC had exceeded its statutory authority.

Sections 101 and 201 would, however, remove all limitations on the authority of the federal banking agencies in acting upon merger and acquisition applications. If enacted, the proposed amendments inevitably would lead to the kind of anomalous situation evidenced in Washington Mutual - where federal regulators in Washington, D.C. sought to displace the judgment of state officials on an issue of local banking structure. Judgments of officials close to actual services rendered would appear to be better than those of officials in far away Washington, D. C. Sections 101 and 201 violate this important concept.

(3) Restrictions On The Powers Of National Banks

Section 401 of S. 39 would prohibit national banks or their subsidiaries from engaging in any activity which the Federal Reserve Board prohibits to bank holding companies under Section 4(c)(8) of the Bank Holding Company Act.

This proposal would constitute an unwarranted and major step towards restructuring the federal regulation of banks. It is our belief that the Comptroller of the Currency, as the chartering source of national banks and the primary regulator of such institutions, should be responsible for determining the scope of activities of such institutions, and that state banking departments as primary regulators of state-chartered banks should exercise

similar authority with respect to the banks which they charter.

Furthermore, it is our view that the primary regulator of the lead bank in each bank holding company should also regulate the parent bank holding company. It would appear to us that a bank holding company should be examined and supervised as a single integrated unit, and that the present fragmented supervision of bank holding companies and their bank and nonbank subsidiaries is inefficient and should be corrected.

(4) Power To Regulate Bank Capital Indirectly Through Holding Company Regulation

Section 501 would, as part of its provisions, require that bank holding companies and their subsidiaries be capitalized and financed in a safe and sound manner as determined by the Federal Reserve Board. Bestowing upon the Fed express supervision over the capital position of all subsidiary banks of BHCs represents a significant increase in the supervisory powers of the Fed and a significant diminution of the supervisory powers of the Comptroller of the Currency and the States.

For a number of years, the Federal Reserve Board has sought, with varying degrees of success, informally to regulate bank capital through its regulation of bank holding companies. This effort to usurp authority of the primary regulators; i.e., the Comptroller and the state bank supervisors, has clearly been disruptive of the efforts of the primary regulators, and beyond the authority of the Board.

This overreach by the Fed was a principal point in the First Lincolnwood Corporation case. First Lincolnwood Corp. v. Board

of Governors of the Federal Reserve System, 560 F.2d 258 (7th Circuit) (1977). This case involved a proposed acquisition by the First Lincolnwood Corporation, an Illinois corporation, of 80% of the stock of the First National Bank of Lincolnwood, Illinois. Because the Board was concerned over a possible weakened capital position of the Bank after acquiring the Bank's stock, and limitations upon First Lincolnwood's ability to resolve "any unforeseen problems that may arise at Bank," the Board denied the proposal as not being in the public interest.

The Court noted in this case that the proposed acquisition did not tend to undermine the financial structure of the Bank, nor was there any anticompetitive tendency present. The Court in setting aside the denial by the Board of the acquisition of the Bank and First Lincolnwood ruled that:

> But we do not find any indication that Congress meant the Board to go beyond this inquiry, and to consider questions of bank soundness and public need apart from how these would be altered by formation or enlargement of a bank holding company. These matters were already reserved to the Comptroller of the Currency in the case of national banks, or to various state agencies in the case of local banks. (Underlining added)

The Conference of State Bank Supervisors is supportive of the above judicial decision that the authority to regulate the capital of banks does now and should continue to reside with the primary regulators of banks, the Office of the Comptroller of the Currency for national banks and state banking departments for state-chartered banks.

Thank you, Mr. Chairman for this opportunity to express our views on these far-reaching legislative proposals. Although the

stated objectives of the bills are meritorious, we feel that to a disturbing degree they reflect efforts to bring about federal solutions to what we believe are non-problems. And, inevitably the proposed solutions, if enacted, would result in greater centralization of authority in Washington, D.C., with no clear showing that either local or national interests would be better served by such action.

Senator MORGAN. Thank you, Mr. Malarkey. Now we'll hear from Mr. Bolger and, Mr. Bolger, I forgot to introduce Mr. DuBois who is accompanying you, I believe from Minnesota. We are glad to have you with us.

STATEMENT OF THOMAS BOLGER, PRESIDENT, McHENRY STATE BANK, McHENRY, ILL., ON BEHALF OF THE INDEPENDENT BANKERS ASSOCIATION OF AMERICA, ACCOMPANIED BY PAT DuBOIS, PRESIDENT, FIRST STATE BANK, SAUK CENTRE, MINN.

Mr. BOLGER. Mr. Chairman, my name is Thomas F. Bolger. I am president of the Independent Bankers Association of America and president of the McHenry State Bank, McHenry, Ill. I am accompanied by Mr. Pat DuBois, a past president of IBAA and president of the First State Bank, Sauk Centre, Minn. I appreciate the opportunity to appear before this committee on behalf of the 7,300 members of IBAA to present our views on H.R. 2255, S. 2874, and S. 39.

IBAA is comprised of a large number of relatively small community banks. More than 80 percent of our banks have assets of $25 million or less, and over two-thirds are located in towns of under 5,000 population. Our banks are deeply involved in meeting the credit needs of agriculture, small business, rural housing, and the consumer.

The review of Federal Reserve policies with respect to bank holding companies has been the subject of scrutiny over the last few years by this committee. Our association has previously testified in support of Chairman Proxmire's Competition in Banking Act. Of paramount interest to us is that provision of S. 39 which would set a limitation on acquisitions by bank holding companies if the total deposits controlled by such a bank holding company reached 20 percent of total banking deposits in the State. Our attached statement addresses this issue.

Let me now turn to S. 2874 and H.R. 2255 and, as you know, the latter bill passed the House of Representatives by a vote of 333 to 25 a few weeks ago. Similar legislation passed both Houses of Congress overwhelmingly in the last Congress. Our association supports this legislation. Our reason for support is closely tied to the need for our banks to form one bank holding companies in order to provide a mechanism for the transfer of ownership of small banks and to the provisions of the bill permitting small bank holding companies to continue to sell insurance.

INVESTMENT INTEREST

The typical use of the one bank holding company is to facilitate the purchase of a bank by individuals. Over the last few years it is becoming increasingly difficult to have individuals purchase a bank without the use of a one bank holding company. The reasons for this are as follows. One there is now a limitation on the deduction of investment interest. In the past, a banker would borrow money to buy the bank and pay back the loan with his income from salary and bonuses. Since 1976, the ability to deduct the interest personally has been greatly limited. The one bank holding company is not subject to the interest expense limitation, and thus, if the debt is assumed by the bank holding company, the bank holding company can deduct the whole amount of the interest. Two, the second factor that has made it more difficult to purchase a bank is the increased interest rate and amortization requirements on bank stock loans. In the past, a banker could approach a lending bank and easily obtain financing to purchase a bank. The acquired bank would maintain its primary correspondent relationship with the lending bank, and the banker would borrow his acquisition loan at low interest rates. The banker would then pay the interest and make small principal payments on the loan. It was not unusual for the term of such a loan to be for 15 or 20 years. As this committee knows, the Financial Institutions Regulatory and Interest Rate Control Act of 1978 changed these loan practices by mandating that all loans for purchase of bank stock be made on such terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons. This change in bank acquisition loans has made it almost impossible to purchase a bank without the use of the one bank holding company.

It is in this context that the continuing ability of small one bank holding companies to sell insurance is extremely important. First, the sale of insurance does provide an important source of income for one bank holding companies. The necessity of utilizing this income for the repayment of bank stock loans has already been discussed. Additionally, this income must be used to meet the higher capital requirements imposed on small banks. For instance, based on June 1979 figures, the average capital-to-asset ratio for banks in the $0 to $10 million range was 10.95 percent. For banks in the $10 to $50 million range, the average was 9.04 percent. For banks in the $50 to $100 million range, the average was 8.60 percent. For banks in the $100 to $500 million range, the average was 8.2 percent. For banks in the $500 million to $1 billion range, the average was 7.72 percent. For banks in the $1 to $5 billion range, the average was 7.15 percent. For banks over $5 billion in assets, the average was 4.91 percent.

In other words, for every $100 growth in deposits a small bank must maintain $8 of capital as compared to less than $5 of capital for a large bank. Since small banks do not have access to the money market, capital must be generated internally—and insurance commissions represent an important source of this high capital requirement which is insisted upon by the regulators.

Finally, under some circumstances, the insurance commissions serve as a means of avoiding personal holding company taxation. If a closely held holding company owned by just a few people could

not form an insurance subsidiary, they would face a 70-percent penalty tax.

In conclusion, the IBAA supports this legislation as it passed the House of Representatives. We would be pleased to answer any questions you may have.

[Attachments to statement follow:]

ATTACHMENTS

Since 1956 a substantial number of independent banks have been absorbed by multibank holding companies. Failure to stem their growth by mergers and acquisitions will sap the strength and competitive vigor of the independent sector of commercial banking to the detriment of consumers in the communities they serve. These developments are of concern to IBAA because its membership is comprised of a large number of relatively small community banks. More than 90 percent of our member banks have assets under $50 million. About half of our members are located in communities of 5,000 or less; and 90 percent in towns and cities of less than 30,000. Most of our members are found in the middle third of the country, mainly the agricultural states of the midwest and southwest. Consequently, they are heavily involved in the financing of agriculture.

One of the principal objectives of federal legislation designed to regulate companies which manage and control banks, was to prevent the lessening of competition in the banking business. Congress believed that adequate safeguards should be provided against undue concentration of control of banking activities because of the importance of the banking system to the economy. National banking policy has been directed toward protecting and fostering the growth of independent unit banks. The holding company device, whereby

control of a group of banks has been acquired and the banks thereafter operated in effect as branches, has been a major factor in concentrating banking control into fewer banks. It was the declared view of Congress that independent competitive banking was being thwarted by indirect branch banking, through the holding company mechanism. Congress, in enacting legislation to regulate bank holding companies, sought to limit the ability of bank holding companies to increase the share of commercial banking in a particular area which could be brought under a single control and management.

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

The growth of bank holding companies since the Bank Holding Company Act was enacted by Congress clearly reveals its failure to restrain the growth and influence of bank holding companies. In the 20-year period 1959-1978, the number of registered multibank holding companies increased more than six-fold from 48 to 314; the number of banks and branches they operate rose almost ten times, from 1,380 to 13,083, and their depsoits multiplied 12 times from $27 billion to $338 billion.

The growth of bank holding companies has contributed to the growth of concentration of commercial banking. The

share of commercial bank deposits held by multibank holding companies rose from 18 percent in 1959 to 33 percent in 1978. Furthermore, the share of commercial bank deposits held by both one-bank and multibank holding companies in 1978 reached 67 percent. The largest multibank and one-bank holding companies have exerted the most influence in raising the level of concentration in commercial banking. In 1977, for example, 36 one-bank holding companies, each of which had deposits in excess of one billion dollars accounted for 63 percent of the aggregate deposits of all one-bank holding companies.

Probably the most accurate measure of bank holding company influence in commercial banking is revealed by the combined share of deposits held in 1977 by the 306 registered multibank holding companies and the 36 largest one-bank holding companies. These 342 bank holding companies controlled deposits of $699.1 billion, or 62 percent of the nation's commercial bank deposits.

Although Congress has consistently endorsed a national banking policy aimed at protecting and fostering the growth of independent unit banks, bank holding company legislation obviously has not been effective in carrying out this policy. The evidence reveals that the sharpest rise in the number of

multibank holding companies has occurred in the twelve unit banking states in which the preponderance of independent banks is found. At the end of 1978, there were 116 multibank holding companies in these states, compared with 29 in 1959--an increase of 300 percent. One of the principal reasons advanced for the growth of multibank holding companies in unit banking states is the prohibition of the establishment of full-service branches, whether de novo or by merger. The Bank Holding Company Act, by encouraging the creation of multibank holding companies, controverts a state's preference for unit banking as a state policy. To protect and foster independent unit banking and the integrity of state banking laws, bank holding company legislation should be made a more effective instrument for restraining the growth of multibank holding companies by merger and acquisition.

FEDERAL RESERVE BOARD ADMINISTRATION OF THE BANK HOLDING COMPANY ACT

The policies pursued by the Federal Reserve Board in administering the Bank Holding Company Act reflect a departure from the objectives Congress intended the Act to achieve. Instead of pursuing policies which would prevent an increase in concentration in banking and foster the growth of unit banks, the Board has sharply increased the number of multi-

bank holding companies; has permitted them to acquire a large number of viable independent banks; and has raised the levels of concentration in banking in many relevant banking markets.

Acquisitions by multibank holding companies increased dramatically, from 25 in 1967 to 341 in 1973. Similarly, the percentage of all bank mergers and acquisitions accounted for by bank holding companies rose from 16 percent to 74 percent. In 1977 multibank holding companies accounted for over 54 percent of all bank mergers and acquisitions although they accounted for 27 percent of the nation's banking offices and 35 percent of total U.S. banking deposits.

The Board has fostered large banking organizations capable of offering banking services on a statewide basis by favoring the formation of multibank holding companies by the large dominant banks in local markets and encouraged their growth by mergers and acquisitions in the belief that banks must be larger to achieve economies of scale.

The assumption that most independent banks could not achieve maximum levels of efficiency and portfolio diversification essential to the improvements of bank performance has not been borne out by a number of studies. A recent

study by the Federal Reserve Bank of Chicago found that banks affiliated with holding companies do not achieve economies of scale beyond those available to independent banks of the same size. Therefore, economies of scale can not be considered a factor outweighing the anticompetive effects of a proposed multibank holding company acquisition.

Opposition to the Board's pro-bank holding company policy was expressed by a minority of the Board in several instances contending that the Board's policy of approving acquisitions of viable independent banking organizations by large multibank holding companies was inconsistent with the Congressional mandate to prevent further concentration of banking resources in a few larger organizations.

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

A 1979 fed staff study focused on the general proposition that bank holding company participation in banking markets would have procompetitive effects and lead to superior overall market performance found that: (1) bank holding company banks in major banking markets (184 SMSAs) were not generally aggressive competitors and may have weakened rivalry and deteriorated market performance; (2) it was uncertain that some of the benefits claimed in bank holding company acquisitions will, as a general rule, materialize; (3) banking authorities or federal and state legislatures should not generally assume that adopting the holding company approach to liberalizing banking laws will yield long-run public benefits in individual bank performance or improved rivalry and performance of banking markets; and (4) while bank holding companies may not be harmful to the public interest, they may not yield important public benefits in either their banking or nonbanking activities.

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

The determination of non-bank activities closely related to banking which bank holding companies are permitted to enter is a responsibility of the Federal Reserve Board under Section 4 (c)(8) of the 1970 amendments to the Bank Holding

Company Act. By late 1974, after approving 21 general classes of nonbank activities as being permissible for bank holding companies, the Board took a more cautious stance. The Board then found it would be desirable for bank holding companies to slow their diversification and direct their energies principally toward strong and efficient operations within their existing modes.

Initially, it was the Board's view that banking management needed to move away from thinking like bankers and to think instead like corporate managers looking out over a related set of businesses which included one or more banks. More recently, however, the majority of the Board has opted for a policy which would restrain bank holding companies from adding to their debt burden by acquiring leveraged companies requiring periodic infusions of capital.

Although research on the non-bank financially related firms that have been acquired by bank holding companies is limited, the tentative conclusion reached is that bank holding companies have not had a significant positive effect on the operating performance of non-bank affiliates.

Bank holding company legislation needs to provide more protection for the banks in the holding company from the risks of nonbanking affiliates; and to provide for closer supervision and regulation of the soundness of nonbank ventures entered into by bank holding companies.

65-630 O—80——6

Senator MORGAN. Thank you very much. Now Mr. Browne from the National Consumer Finance Association. We are glad to have you, Mr. Browne.

STATEMENT OF JAMES M. BROWNE, PRESIDENT, FINANCE AMERICA, ON BEHALF OF THE NATIONAL CONSUMER FINANCE ASSOCIATION, ACCOMPANIED BY ROBERT EVANS, SENIOR VICE PRESIDENT AND GENERAL COUNSEL; AND WILLIAM FENSER, SENIOR VICE PRESIDENT AND GENERAL COUNSEL

Mr. BROWNE. Mr. Chairman and members of the committee, my name is James M. Browne, and I am a member of the executive committee of the National Consumer Finance Association (NCFA). The NCFA is a national trade association organized in 1916 to represent companies engaged in the consumer credit business. We have approximately 800 member companies which operate more than 15,000 offices serving the public across the country. Of those member companies, 32 are subsidiaries of bank holding companies and operate some 3,500 offices. I am also president of one of those companies, Finance America Corp., which is a wholly owned subsidiary of BankAmerica Corp.

Our comment today focuses on a single issue which is addressed in S. 380 and H.R. 2255: The restriction placed on the sale of credit-related personal property insurance. Aside from credit life and credit disability, this is the only other insurance we sell, and we sell it only in connection with a specific credit transaction. It covers only the collateral which is security for the loan and is written only for the term of the underlying obligation. We do not, nor can we, offer lines of general insurance to the public.

While it is true that both S. 380 and H.R. 2255 now incorporate a specific exception which allows finance company subsidiaries to offer single-interest credit property insurance on transactions of $10,000 or less, we do not generally offer single-interest coverage, nor is there any demonstrated need for the $10,000 limitation. We therefore continue to oppose these measures.

LACK OF EVIDENCE

This brings us to what we perceive to be the major shortcoming in the efforts to pass this legislation: Simply, no credible evidence has been introduced in support of it. We recognize that Congress is not bound by evidentiary limitations, and may well act on policy choices or other considerations. Nevertheless, extraordinary measures such as S. 380 and H.R. 2255—which are inherently anticompetitive and discriminatory—would seem to require extraordinary justification, but we find none in the record.

THE ISSUES: COMPETITION; EQUAL PROTECTION

A large number of businessmen—a group calling themselves independent insurance agents—are asking the Congress to grant them special immunity from competition in the insurance marketplace. Not immunity from all competition of course, only competition from a limited section of the financial community, "large" bank holding companies. And, not on all types of insurance either,

only credit-related property insurance. Thus, two rather narrow issues present themselves: Should the Congress—contrary to manifest public policy favoring competition in the marketplace—act here to restrict competition, and further, should Congress—notwithstanding constitutional guarantees of equal protection—single out an ill-defined, narrow subclass of financial institutions for restrictive treatment while the vast remainder of its competing creditors are left free to sell credit-related property insurance without limitation.

The independent agents and the bills sponsors would deny that these are even issues. First, they say, there are many activities which bank holding companies may not engage in; these are known as commerce, as opposed to banking, and public policy has long been to separate the two. Second, they believe that large bank holding companies—assets exceeding $50 million—have such dominant economic power that tying of insurance to credit transactions is inevitable.

BANKING VERSUS COMMERCE

The proposed restriction on bank holding companies is justified on the theory that banking must be separated from commerce. This merely begs the issue. Banks—and other financial institutions—have traditionally protected their assets through insurance and collateral requirements. The earning power of the obligor—often the only source of repayment—is protected through life and disability insurance, while collateral securing the credit is covered by property insurance.

The independent agents concede that it would be appropriate to continue to allow bank holding companies to sell credit life and credit disability insurance, which they say are: Forms of insurance that have traditionally been sold by lenders. Given the fact that the sale of credit life and credit disability insurance can rather easily be integrated into loan transactions, and that lenders have historically offered such lines of insurance, it appears appropriate for legislation to continue to permit these activities.[1] No such concession is made, however, for credit property insurance, although the same reasoning applies.

We would ask, since when has credit property insurance, which has been sold by all types of financial institutions for more than half a century, become nontraditional, or, in the words of the bills proponents, commerce instead of banking? At one time prior to the 1970 Bank Holding Company Amendments, BHC's could sell property and other insurance which was not related to credit transactions. The 1970 act terminated such authority, however, and the Federal Reserve Board amended regulation Y to restrict the sale of property insurance to specific credit transactions, but with some leeway to continue the insurance in force for the convenience of the consumer after the credit transaction terminated. Even this modest departure was held not closely related to banking by the

[1] Bank holding company legislation and related issues: Hearings on H.R. 2255, H.R. 2747, H.R. 2856, and H.R. 4004, Before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance of the House Committee on Banking, Finance, and Urban Affairs, 96th Congress, 1st Sess. 65 (1979) (Statement of Edward J. Kremer).

5th circuit in 1976,[2] and since that time, regulation Y has permitted the sale of credit-related property insurance only. Thus, when the credit transaction terminates, the insurance must terminate, making it impossible to sell it at other times as an independent commercial activity.

As any agent knows, if you cannot renew an insurance policy, much of the profit potential is lost. This may explain why banks have less than 2 percent of the national automobile insurance market, although they have more than 50 percent of the new car financings. Likewise, they are estimated to have less than 4 percent of the homeowners casualty insurance market.[3]

NCFA submits that the present requirement in regulation Y that all insurance sold be credit related—that is, for the term of the credit only—with its resultant limitations on serving the consumer on an ongoing basis, removes such activities from the realm of commercial activity. We are simply not in the business of selling casualty and property insurance to the general public.

ECONOMIC POWER OF LARGE BHC'S

Now, it is clear that, if larger bank holding companies are coercing their customers to purchase insurance from them contrary to Truth-in-Lending Act requirements, or State anticoercion statutes, or whatever, then as a way of preventing an unfair marketing practice, there might be justification for doing away with the privilege of selling such insurance altogether. The proponents of this legislation would have us believe this is the case, urging that bank holding companies whose assets exceed $50 million—why not $25 million, or $100 million?—could use their economic power to coerce borrowers to purchase credit property insurance from them. The argument is always stated in the hypothetical, with no proof offered to distinguish the marketing practices of such BHC's from those of other financial institutions, or even banks in general.

In response to this, it must be obvious that a small bank in a small town dealing with a single customer on one automobile policy has just as much economic leverage over that customer as does a larger bank in a large town.

So again, the argument merely begs the issue. The question is, what happens in real life? The fact is, we don't know, because the agents have given us no data, or even any collection of cases. On the other hand, the FRB study on tie-ins between the granting of credit and the sale of insurance reveals that some customers of all financial institutions surveyed felt insurance was required, as follows: Banks, 12.1 percent; credit unions, 26.3 percent; finance companies, 23.2 percent; and retailers, 10.8 percent.[4] While this does not prove that large bank holding companies do not tie, it does indicate that a great deal more proof is needed before these compa-

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[2] *Alabama Association of Insurance Agents, Inc.* v. *Board of Governors of the Federal Reserve System*, 533 F.2d 224 (5th Cir., 1976), *on rehearing*, 558 F.2d 729 (1977), *cert denied*, 435 U.S. 904 (1978).

[3] *Public Policy Considerations for Open Competition in the Purchase of Insurance*, p. 46 (Golembe Associates, Inc., 1979).

[4] Staff Studies, Board of Governors of the Federal Reserve System, *Tie-Ins Between the Granting of Credit and Sale of Insurance by Bank Holding Companies and Other Lenders*, p. 32 (1979).

nies can be singled out as a class for exceptional, restrictive treatment.

It should also be pointed out that credit property insurance may lawfully be, and often is, required; it is only the choice of insurer or agent that must be given. Since the questions did not distinguish between different forms of credit insurance, or whether the requirement related to the insurance or the choice of agent, it is impossible to draw any conclusions about tying from the above data.

In short, the legislative record leaves us in a position of surmising about the actual marketing practices of bank holding companies and their subsidiaries. This, we respectfully submit, falls far short of what is needed to support such discriminatory legislation against equal protection arguments.

IMPACT ON SMALL BUSINESS

Finance companies owned by bank holding companies also provide inventory or floor-plan financing for small businesses, dealers and distributors throughout the country. Our industry, for example, offers insurance against burglary and theft for that inventory. In most large metropolitan areas, insurance against those perils is simply not available from an independent insurance agent. The proposed law would prohibit us from offering that valuable benefit and protection for the small business proprietor. One, and perhaps the only, practical and convenient source of such insurance would be removed from the marketplace.

TRUTH-IN-LENDING EXPERIENCE

Supporters of these bills reason that even though the antitrust laws prohibit tie-ins, there must be some reason to justify the absence of litigation concerning forced insurance sales and conclude that the public is too intimidated by the banks to even raise the issue. Those supporters overlook the fact that the Truth-in-Lending Act provides a penalty for creditors who would choose to require that property insurance be purchased only through them; in such case, the insurance premium would have to be included in the disclosed finance charge. NCFA member companies do not require that property insurance be purchased through them and therefore do not include property insurance premiums in the finance charge.

We have searched the case law on Truth-in-Lending and do not know of one reported decision on this issue, and our own experience at Finance America discloses that the issue has been raised only twice in those 10 years and never has the issue been decided against us.

Aside from the provisions of such law, it is simply not our policy to force customers to purchase insurance from us. At my own company, during 1978, we entered into almost 250,000 consumer loan transactions and sold property insurance in only 42,300 instances, or only 18 percent of the transactions. If we are indeed forcing our customers to purchase insurance coverage from us, we certainly have not been very successful.

THE PUBLIC INTEREST

Supporters of this legislation talk about the adverse impact on their business of bank holding company activities in this area of insurance, but do not support those allegations with any figures. Nor, do they demonstrate that the price of credit property insurance offered by bank holding company finance companies is not competitive. Nor, do they demonstrate that such insurance is not in the best interests of the consumer. No argument has been made by the independent insurance agents that they can offer the same insurance at the same convenience and for the same benefit of the consumer or the customer. In fact, the interests of the public seem entirely overlooked in these proceedings. How can that public benefit when the effect of the proposed legislation is to remove one competitor from the marketplace, to take away from the consumer one of the alternative choices?

I am not aware of any evidence that bank holding company finance companies have engaged in the practice of so-called redlining in providing credit property insurance. To the contrary, most of us provide such insurance by virtue of a group policy which spreads the risk and therefore involves little or no underwriting. While the independent insurance agent may have moved to the suburbs, many of our customers have not, and credit property insurance is oftentimes the only insurance they can get. Will the disadvantaged laborer who still resides in the inner city seek out an independent insurance agent to fulfill his needs, and would he be successful even if he tried? Should he be denied the loan if he is unsuccessful?

CONCLUSIONS

S. 380 and H.R. 2255 provide immunity from competition where more is needed, unfairly discriminate against a limited creditor class, and deprive the consumer of a convenient and valuable source of credit-related insurance. Even assuming that the proponents of this legislation could come up with substantial evidence in support of it, clearly the present record does not overcome the strong public policies favoring competition and equal protection under law. We urge you to reject these measures.

Senator MORGAN. Thank you very much, Mr. Browne.

Before we go into questioning, I'm going to ask Senator Eagleton to introduce Mr. Brain, and then we'll question the panel.

STATEMENT OF THOMAS F. EAGLETON, U.S. SENATOR FROM THE STATE OF MISSOURI

Senator EAGLETON. Thank you very much, Mr. Chairman.

It's my pleasure to introduce one of the witnesses who will be appearing before your committee this morning, Mr. Donald Brain. He's the president of the Independent Insurance Agents of America and also the president of Brain & Fritson, Inc. of Kansas City, Mo.

He has served in various capacities on the executive committee of the IIAA since 1975.

I ask unanimous consent that a more extended introduction be printed at the appropriate point in the record.

Senator MORGAN. Without objection, so ordered.

Senator EAGLETON. Thank you, Mr. Chairman.
[Complete statement follows:]

STATEMENT OF SENATOR THOMAS F. EAGLETON

Mr. Chairman, it is my pleasure to introduce one of the witnesses who will be appearing before your Committee this morning, Mr. Donald Brain. Mr. Brain is the President of the Independent Insurance Agents of America and is also President of Brain and Fritson, Inc. of Kansas City, Missouri. He has served in various capacities on the Executive Committee of the IIAA since 1975. He also has held the position of president and then state national director of the Independent Insurance Agents of Missouri.

Mr. Brain began his insurance career in 1948 when he joined W. B. Johnson & Company as an associate broker. He became a general partner 4 years later. In 1963, he started an agency brokerage office with his present partner in Kansas City.

He received his CPCU designation in 1952 and was the first president of the Kansas City Chapter of the Society of CPCU, founded that same year. He is the first individual to serve as national president of both the IIAA and the Society of CPCU.

For his service to the Independent Insurance Agents of America, Mr. Brain received the Presidential Citation in 1976. In addition, he was named "Insurance Man of the Year" the highest award bestowed by the Independent Insurance Agents of Missouri.

Mr. Chairman, it is my pleasure to introduce to you and the members of the Banking Committee Mr. Donald Brain, President of the Independent Insurance Agents of America.

The CHAIRMAN. Mr. Gunderson, your arguments favor competition with respect to insurance activities. What benefits will the public derive from allowing the holding companies to engage in insurance activities? Will cost be reduced and will the public be given better service and, if so, how will that be accomplished?

SERVICES ARE KEY FACTOR

Mr. GUNDERSON. Well, I think certainly that services are a key factor. There's a convenience factor; and, while there's no way you can quantify specifically what would happen on the cost, I think that certainly where more competitive forces are at work they serve to reduce costs.

The CHAIRMAN. Don't you have a very competitive situation now in insurance? Aren't there literally thousands of insurance salesmen in virtually every kind of activity vigorously, aggressively competing?

Mr. GUNDERSON. I'm sure that's true.

The CHAIRMAN. The argument there is that they compete on a level playing field where they don't have the advantage that banks have to some extent as a credit provider. Obviously, the principal credit provider in the community has an advantage with respect to some people who might feel they would be in a better position to get a loan if they buy their insurance from a bank.

Mr. GUNDERSON. There are a lot of theoretical discussions on that, but we have seen very few instances where a person really has been forced, you might say, into taking insurance.

In my own bank we offer insurance and yet we find time and time again the people will go and obtain their insurance elsewhere, and that's fine.

The CHAIRMAN. I'm sure that's true. I wasn't talking about coercion. I'm talking about at least tacit or implicit advantage that a bank has. If I'm a prudent borrower and there's a credit shortage and I want to stand in well with my loan officer, I would be more

inclined to buy insurance from him if I had the feeling that might put me in a better spot to borrow money.

Mr. GUNDERSON. I think the thing we need to keep in mind is that banks, particularly in this highly competitive environment we are in now, are not looking just at that insurance. They are looking at the opportunity to provide all of the financial services to customers and they certainly aren't going to try to jeopardize that by forcing or implying that the customers might do better if they have the insurance with the bank.

The level playing field we're talking about, it seems like, once again, banking is being singled out to give up something we're offering. Insurance companies and others are more and more offering services that banks have traditionally offered. Also, along with it, banking is being singled out without any regard to other types of financial institutions or financial intermediaries.

Mr. BROWNE. Senator, could I make a comment with respect to finance companies? Finance companies offer primarily the same type of insurance. Unfortunately, under this bill, the finance companies that will be owned by bank holding companies would not be able to sell that insurance whereas the competitive finance company down the street could sell that same insurance, and it puts us at a complete competitive disadvantage in dealing with our peers, with the other finance companies, and I don't know whether that's intended, but I think that's discriminatory in our case.

The CHAIRMAN. That's a good point unless you can make the argument that the finance companies that are part of the holding company in many cases have an advantage because of the superior financing and because they belong to a larger organization.

STATES PASS RESTRICTIONS

Mr. Malarkey, let me ask you, you point out in your statement that 22 States have passed restrictions on insurance activities of bank holding companies, while 28 have not.

Mr. MALARKEY. That's correct.

The CHAIRMAN. What were the reasons that 22 States enacted legislation? Was it primarily from the fear of tie-ins and credit and insurance?

Mr. MALARKEY. I would assume, Mr. Chairman, that they felt it was in the best interest of their State, the industry within their State, and in the best interest of their citizens. I know legislation was proposed in my State and it failed. It was not enacted.

The CHAIRMAN. What has been the experience in the States adopting the prohibitions and what hard evidence, if any, is there that their banking systems are more competitive than in States where there is no prohibition?

Mr. MALARKEY. I don't think we said that their banking systems are more competitive, Mr. Chairman. I think we said that in the case of 22 States that enacted some restrictions they felt these restrictions were needed within their area. I don't think we compared that their banking systems were more competitive than the other 28 States.

The CHAIRMAN. In the States in which there is a prohibition, are the prohibitions usually on banks or bank holding companies only

or do the prohibitions include finance companies, savings and loan associations, and commercial banks?

Mr. MALARKEY. I'm not sure I have a complete answer to that question, Mr. Chairman. The way we looked at it was bank holding companies. We found 22 States.

The CHAIRMAN. You couldn't generalize?

Mr. MALARKEY. We could get that information if you like.

The CHAIRMAN. We would like to have that for the record. That would be very helpful.

[The following letter was received from CSBS:]

CSBS
CONFERENCE OF STATE BANK SUPERVISORS

OFFICE OF THE EXECUTIVE VICE PRESIDENT-ECONOMIST

July 18, 1980

Honorable William Proxmire
Chairman
Committee on Banking, Housing
and Urban Affairs
Room 5300 Dirksen Building
Washington, D.C. 20510

Dear Chairman Proxmire:

RE: H.R. 2255

On July 1, 1980, John E. Malarkey, State Bank Commissioner for the State of Delaware, presented testimony before your Committee on behalf of the Conference of State Bank Supervisors pertaining to H.R. 2255, a bill to limit insurance activities of bank holding companies. During the question and answer portion of that hearing, you asked, "In the states in which there is a prohibition, are the prohibitions usually on banks or bank holding companies only, or do the prohibitions include finance companies, savings and loan associations, and commercial banks?"

State statutes which restrict or prohibit insurance activities apply to depository institutions such as banks, mutual savings banks, savings and loan associations and bank holding companies, with the exception of Connecticut, Massachusetts and New York where mutual savings banks may offer life insurance not related to a loan. Rhode Island is the only state we are aware of whose restrictions on insurance activities are applied to both depository and non-depository lending institutions.

Sincerely,

Lawrence E. Kreider

Lawrence E. Kreider
Executive Vice President -
Economist

LEK:drj

1015 EIGHTEENTH STREET, N.W. • WASHINGTON, D.C. 20036 • (202) 296-2840

The CHAIRMAN. Mr. Bolger, you mentioned your support of H.R. 2255 which allows holding companies with assets of less than $50 million to engage in insurance activities. You mentioned the need of small bank holding companies for the funds of these activities to help service acquisition, debt and maintain the small bank's capital base. As the capital ratios of the larger banks are weaker than small banks, this would argue for large institutions to be given the same authority. Why should large holding companies be precluded from engaging in these activities if smaller organizations aren't?

Mr. BOLGER. Traditionally, our association has always been opposed to further expansion of banking assets and banking positions. I think that the large bank holding companies have access to the capital markets that the small bank does not have. The only place a small bank can increase capital, or one of the very few, is through retained earnings, where that is not the case with the large bank.

The CHAIRMAN. There seems to be a greater need for increasing the capital base in the big banks and the big bank holding companies than the small ones.

Mr. BOLGER. I agree with you.

The CHAIRMAN. This might be one way of doing it.

Mr. BOLGER. I don't know if that would be the way of doing it. I think we would like to have more of the regulators and the Congress agree with you that the large banks should maintain the same capital ratios that our size banks are required to maintain.

The CHAIRMAN. Mr. Browne, in your testimony you indicate that bank holding companies offer types of insurance such as burglary and theft for inventory and serve areas especially the inner-city that are not serviced by the insurance industry. H.R. 2255 provides an exception if the bank holding company can demonstrate that inadequate insurance facilities exist in an area. So that's a comment on the effectiveness of that exception to insure that the insurance needs of all people can be met. Is there any reason why the holding companies would not use this exception?

Mr. BROWNE. Senator, I think the problem would be to demonstrate that the insurance is not available. It may take time and effort and cost and more expense to prove that you come under that exception.

The CHAIRMAN. Well, that exception is espcially designed for that purpose and these larger institutions that serve the big cities usually have the capacity to do that. Senator Morgan.

Senator MORGAN. Mr. Chairman, I only have a couple questions.

Mr. Malarkey, as I read section 7 of the Bank Holding Company Act, it provides that the act shall not prohibit or restrict the State from regulating bank holding companies. Is that your interpretation of it?

Mr. MALARKEY. That is, sir.

Senator MORGAN. Suppose this Congress passes this bill. Would you think it would be within the prerogative of the State to then provide a holding company that could sell insurance notwithstanding the passage of H.R. 2255?

Mr. MALARKEY. I don't think so, Senator. If I understood your question, in other words, would the State of Pennsylvania, which I

happen to know does restrict, could they say a holding company could sell insurance? In my opinion, they could not.

Senator MORGAN. In other words, you think H.R. 2255 would prevail and be the paramount law?

Mr. MALARKEY. Yes.

Senator MORGAN. So, in other words, if we pass this act we would in effect be preempting section 7 of the Bank Holding Company Act insofar as it relates to regulation of selling insurance?

Mr. MALARKEY. It would seem to be that way to me, Senator.

Senator MORGAN. Since I know that the Conference of State Bank Supervisors has been very concerned about the preservation of the dual banking system, that gives me some concern.

CERTIFICATE OF CONVENIENCE AND NECESSITY

Mr. Chairman, I only have another question or two. Mr. Browne, I notice you were right harsh with the insurance agents contention about competition. You said they really wanted to eliminate competition. I assume you operate under the laws which provide finance companies with the protection of the convenience and necessity clauses or something of that kind. Would you have any objection if we provided that general insurance agents could engage in the finance business?

Mr. BROWNE. We would have no objection to that if they were subjected to the same rules and regulations.

Senator MORGAN. In other words, if they had—I'm talking about if we provide they could do it without any certificate of convenience and necessity. In other words, we don't limit their competition, just say you can sell insurance. You can go into the finance business.

Mr. BROWNE. As you know, Senator, the finance companies are highly regulated at the State level and if the insurance agents became subject to the same rules and regulations at the State level as the finance companies.

Senator MORGAN. And it's also highly regulated to the extent to prohibit other people from entering the business too, isn't it?

Mr. EVANS. Senator Morgan——

Senator MORGAN. Answer me and tell me, don't you have to have a certificate of convenience and necessity in most States and isn't that generally considered on how many finance companies there are in the town?

Mr. EVANS. Senator, maybe I can help you on this. There are probably less than a handful, maybe five or six, States which continue to require convenience and necessity. In most States you can enter freely into the finance business upon the requisite capital which is fairly small. There are no convenience and necessity requirements except in very few northeastern States.

Senator MORGAN. Well, there is in North Carolina.

Mr. EVANS. Well, yes, in North Carolina.

Senator MORGAN. I get a little sick and tired of some of you, and especially some of you from the Bank of America, who keep coming up here and want more and more independence except in those laws which protect you, and I think I detected that in your statement, and I frankly don't agree with you.

Mr. BROWNE. Senator, I didn't mean or intend it that way.

Senator MORGAN. Didn't you say that what the insurance agents wanted was protection from competition while you up here are protected from competition certainly in many States?

Mr. BROWNE. Well, as Mr. Evans said, I think we are not protected from competition in the majority of the States.

Senator MORGAN. Well, the Bank of America is, isn't it?

You can't go into the banking business in a single State of America without a special grant or franchise of a certain kind of monopoly, can you, and yet every time the Bank of America comes up here, this is the same sort of stuff I hear. There's a certain arrogance of economic power which I hear from you and I detected that in your statement. I have no further questions.

The CHAIRMAN. Senator Sarbanes.

Senator SARBANES. Thank you, Mr. Chairman.

Gentlemen, I want to get clear in my own mind first the structure of the organizations for which you speak.

ABA STRUCTURE

Mr. Gunderson, you say that the American Bankers Association has as members over 90 percent of the more than 14,500 full service banks in this country; is that correct?

Mr. GUNDERSON. That is correct, Senator.

Senator SARBANES. And who are not members?

Mr. GUNDERSON. Well, there's no particular pattern to it. Like any trade association, some people would choose to join or not to join for whatever reasons they might have, but out of the 92 percent we have I would say a balanced mix of the entire banking structure in this Nation. So there's no particular one group that doesn't belong.

Senator SARBANES. Among those who are not members, is there any particular pattern?

Mr. GUNDERSON. No, sir. We have all size banks. We have community banks. We have large banks. I think it's a representative—certainly a representative mix of the industry.

Senator SARBANES. Now to what extent does your membership and that of Mr. Bolger's organization overlap?

Mr. GUNDERSON. In many cases it would be duplicate memberships. I happen to be a member of his organization also.

Senator SARBANES. Well, Mr. Bolger, why don't you tell me a bit about your membership.

Mr. BOLGER. Senator, if I could, I would defer to Mr. DuBois who has been active in the association family from the beginning. I think he could address it much better than me.

Mr. DUBOIS. Mr. Chairman, the Independent Bankers Association 50 years ago was organized for the purpose of trying to provide some veil of protection for the small operators, small business, small bankers, and we have continued to do that. The Independent Bankers Association membership differs from the ABA in that most of the major bank holding companies and most of the banks that are in States which permit branching are not members of the Independent Bankers Association. We basically have our membership in States that permit one bank holding companies or are independent or are in what we call unit bank States.

Senator SARBANES. To what extent do you think your membership overlaps with the membership of the ABA? Do you have any idea?

Mr. DUBOIS. I suspect that probably 90 to 95 percent of our membership would be members of the ABA.

Senator SARBANES. Mr. Malarkey, does your statement represent an approved statement of the conference?

Mr. MALARKEY. Yes, it does, Senator.

Senator SARBANES. And by what process is that arrived at?

Mr. MALARKEY. Well, I guess it's more a process of consensus than anything else. We are constantly taking positions. We have a Federal legislation committee which reviews all Federal legislation. I happen to be vice chairman of it, Senator, and we feel that the views we put forth in all cases—while the 50 States are unique and you can never be unanimous—but it does represent a consensus.

Senator SARBANES. On what basis is one able to say this is a statement for the conference? What internal decisionmaking procedures within the conference enables you to make that assertion?

Mr. MALARKEY. Well, the legislation goes out to the committee, as I indicated, and last it's always the measure of getting on the telephone and talking to individual bank commissioners to get their views on it.

Senator SARBANES. Does the Federal legislation committee have the authority to make decisions and to make presentations which in effect are the presentations for the Conference of State Bank Supervisors?

Mr. MALARKEY. I don't know that the committee does, but certainly the board of directors and the executive committee would have that power, Senator.

Senator SARBANES. And they have, in some formal way passed on this statement?

Mr. MALARKEY. This is the statement representing the views of the conference, Senator.

Senator SARBANES. Mr. Browne, I was interested in the membership of the National Consumer Finance Association. You say you have 800 members?

Mr. BROWNE. Yes, Senator.

Senator SARBANES. And those 800 members operate some 15,000 offices across the country. Is that right?

Mr. BROWNE. Yes.

Senator SARBANES. Of the 800 members, 32 of them are subsidiaries of bank holding companies?

Mr. BROWNE. Yes, sir.

Senator SARBANES. And those 32 subsidiaries operate 3,500 of the 15,000 offices, is that correct?

Mr. BROWNE. Correct, Senator.

Senator SARBANES. In your business, what measure do you use to judge how big you are vis-a-vis your other competitors in the consumer credit business? What sort of standard do you use?

Mr. BROWNE. The basic measurement, Senator, is the gross outstanding of the individual company. Another measurement are the number of offices that they have. I would say the principal measurement is the gross outstanding, the receivables.

Senator SARBANES. Of the 32 subsidiaries of bank holding companies which operate not quite 25 percent of the offices, what percent of the gross outstanding do they have?

Mr. BROWNE. I'm not sure of that. I can certainly get it for you.

Senator SARBANES. Do you have any idea?

Mr. BROWNE. It is not a significant—it's not more than 30 percent of the total. I think it would be less than that, but I would prefer to get you the accurate number.

Senator SARBANES. Would it be roughly accurate to say that within the National Consumer Finance Association the subsidiaries of the bank holding companies represent about 4 percent of the companies, not quite 25 percent of the offices and about 30 percent of the gross outstanding?

Mr. BROWNE. I would prefer to get a more accurate number on the outstandings. The individual units that are part of bank holding companies and are members of the NCFA are not the most significant members in the NCFA. I think the largest bank holding company that is a member of the NCFA would be in the cateogry of 12 to 15 largest, and then it would get substantially less than that after that. The larger members are independent companies or not members of the bank holding companies.

Senator SARBANES. Mr. Gunderson, are you more concerned about the imposition of Federal limitations upon bank mergers within the State as it relates to the 20 percent standard than you are about the continued ability of the banks to engage in the insurance business as that's restricted by H.R. 2255?

Mr. GUNDERSON. Senator, we are concerned about both of them.

Senator SARBANES. Well, I assume that.

Mr. GUNDERSON. We are very much concerned about both of them because we feel that——

Senator SARBANES. Which one concerns you more?

Mr. GUNDERSON. I would say we are about on a par with both of them, Senator.

Senator SARBANES. Would there be a split in your membership on that issue and, if so, on what basis?

Mr. GUNDERSON. Well, obviously in a diverse industry like banking you aren't going to get a 100-percent accord on anything simply because of the mix, but as part of our process in arriving at positions we do have a representative group both in our Government Relations Council and what we call our Leadership Conference. It's a cross-section of all banking representing community banks, medium size banks, unit banks, holding company banks, and these are the people that develop our policy and we feel that they are representative of banking in this country.

Senator SARBANES. Mr. Malarkey, in your view should the definition of related to banking be set at the State level or the Federal level?

Mr. MALARKEY. Activities related to banking, Senator?

Senator SARBANES. Yes.

Mr. MALARKEY. Of course, it's my feeling, sir, that that is a local option and it would be better done on the State level.

Senator SARBANES. Do you other gentlemen agree with that?

Mr. BOLGER. Well, traditionally, our association has always supported the States rights, although the holding company activities

are governed by the Federal Reserve Board, and we have no objection to that as long as they are kept within reason.

Certainly we would agree with Mr. Malarkey that in many cases questions can better be solved at the State level, in banking and all types of legislation.

Senator SARBANES. Do you agree with that, Mr. Gunderson?

Mr. GUNDERSON. Our association has as a strong position that we are in support of the dual banking system and under the current laws of the State to determine what they feel is best for their own respective States. We have another concern. We are going into a time when the entire banking structure issue in this country is going to be undergoing an examination and evaluation. To pass this type of legislation at this time would diminish the ability to do it objectively.

INTERSTATE BRANCHING

Senator SARBANES. What's your position on interstate branching?

Mr. GUNDERSON. Up to this point we have supported the laws that are in place under McFadden and Douglas.

Our Leadership Conference will be evaluating all of this, as I mentioned in the testimony. We are waiting for the administration report to come out so that we can use that as a focal point and we will be looking at it and reviewing it, but until then the way we arrive at positions on any matters is going through this process, the leadership process, which is representative of the industry.

Senator SARBANES. What about the Edge Act Corporation?

Mr. GUNDERSON. In what respect, Senator?

Senator SARBANES. Well, I'm trying to demonstrate how inconsistent you are on the question whether you want the States or the Federal Government to control and regulate these matters and whether your position changes when the Fed's standard is perceived to be more advantageous to your position. That's essentially the point of the question. I might as well lay it out for you.

Mr. GUNDERSON. We have not gone on record recently with a formal position on the Edge Act in general.

Senator SARBANES. You guys are pretty good. You don't have any formal positions.

Mr. GUNDERSON. We will have, Senator. We are now considering changes in regulation K, as proposed by the Federal Reserve Board.

Mr. BOLGER. Senator, I can tell you that the IBAA is totally opposed to interstate branching and any further concentration as not being in the consumer interest.

Senator SARBANES. I have a note here that my time is up. Thank you, gentlemen. Thank you, Mr. Chairman.

The CHAIRMAN. I have no more questions if you would like to pursue it.

Senator SARBANES. No, thank you, Mr. Chairman.

The CHAIRMAN. Thank you very, very much, gentlemen. We appreciate it very much.

Our final witness this morning is Mr. Donald C. Brain, president of Brain & Fritson, representing the Independent Insurance Agents of America. Mr. Brain has already been introduced by Senator Eagleton and we are happy to have you. Mr. Brain, if you would

introduce your colleagues, I would appreciate it, and then if you could take about 10 minutes or so we'll go right into questions.

STATEMENT OF DONALD C. BRAIN, PRESIDENT, BRAIN & FRITSON, INC., KANSAS CITY, MO; INDEPENDENT INSURANCE AGENTS OF AMERICA, ACCOMPANIED BY JEFFREY YATES, ASSISTANT GENERAL COUNSEL; THOMAS WILSON, WILKINSON, CRAGUN & BARKER; JOHN W. SCHIMINGER, RUSSELL HOWARD, DAVID ROLAND, AND EDWARD KRAMER

Mr. BRAIN. Thank you, Senator. My name is Donald C. Brain. I'm president of the Independent Insurance Agents of America and I earn my living as a retail property and casualty insurance agent in Kansas City, Mo., I am accompanied here on my right by Mr. Jeffrey Yates, who is our assistant general counsel and associate executive vice president, and by Mr. Thomas Wilson. Sitting with me at the witness table are individuals who represent the property and casualty and life insurance industrys and, with your permission, Senator, I would like each of them to identify himself and his organization.

Mr. HOWARD. I'm Russell Howard. I'm president of Howard Insurance Agency in Massachusetts and president of the National Association of Professional Insurance Agents.

Mr. SCHIMINGER. I'm John Schiminger, senior vice president of Riggs, Counselman Michaels & Downes, Inc. of Baltimore, Md., and a member of the National Association of Casualty and Surety Agents, and I'm here on behalf of Philip Cochran who I believe gave you a written statement in support of S. 2874 and H.R. 2255.

Mr. BRAIN. I'd also like to introduce two prominant local insurance agents, David Roland from Racine, Wis.; and Edward Kramer from Salisbury, Md.

Now, in addition to the groups that we have introduced at this table, the legislation before this committee is endorsed by the National Association of Life Underwriters and the Mortgage Insurance Companies of America.

My organization, IIAA, is a national association representing approximately 126,000 independent property and casualty insurance agents operating in all 50 States and the District of Columbia.

The purpose of this hearing is for your committee to receive testimony regarding S. 39, S. 2874, and H.R. 2255.

S. 39 would amend the National Banking Act and the Bank Merger Act in ways we believe would be beneficial to the public interest. Nevertheless, IIAA and the other organizations represented here today have long maintained that there exists an urgent need for the Bank Holding Company Act to be amended specifically to prohibit large bank holding companies from acting as underwriters and agents in the sale of property and casualty insurance and most forms of life insurance.

Unfortunately, S. 39 does not contain such a specific prohibition. S. 2874 and H.R. 2255 on the other hand do.

For that reason, we would like to use our limited time available to discuss those two bills.

S. 2874 and H.R. 2255 would specifically prohibit bank holding companies from engaging in most insurance activities. The language of the two bills is identical. H.R. 2255 has already passed the

House by the overwhelming margin of 333 to 25. For the reasons mentioned in our formal statement, which we respectfully request be included as part of the record of these hearings, we urge the committee in the strongest possible terms to report the specific insurance prohibition to the full Senate as soon as possible.

The language of that prohibition is the result of months, indeed years, of work and compromise on this issue so vital to preserve competition in the retail insurance industry as we know it today and to protect the ability of the public to purchase insurance from the source of its own choice.

CRITICISMS ABOUT INSURANCE PROHIBITION

During the course of the legislative process essentially five criticisms have been made about the insurance prohibition. Rather than repeat material contained in our formal written statements, I would like to use my limited time to respond to those criticisms.

The first criticism that the insurance prohibition is anticompetitive, this is not so. Because of bank holding company resources and control over credit transactions, borrowers will purchase insurance from them for reasons having nothing to do with lower price or better service. Thus, bank holding companies have no incentive to offer the customer lower prices or better service. Bank holding companies control the overwhelming majority of financial resources in our Nation. In 1978 the 100 largest bank holding companies controlled assets of more than $900 billion. In contrast, the total assets of the entire 4,047 savings and loan associations and the 100 largest finance companies was only half of that, $436 billion. Thus, if bank holding companies were permitted massive entry into the retail insurance business, the effect on small businesses would be devastating.

Since 1864, there has existed in our economy a separation between banking and other forms of commerce. As a part of that separation, national and State banks have not been permitted to engage in the sale of property and casualty insurance and most forms of life insurance. The bank holding company mechanism provides a loophole by which banking institutions can avoid those traditional proscriptions.

The sense of S. 2874 is to close that loophole and thus impose the same restrictions on bank holding companies insurance activities as are applied to other State and national banks.

The second criticism is that the insurance prohibition discriminates unfairly against large bank holding companies having assets of more than $50 million and those with less than $50 million are excluded.

It must be emphasized that the vast majority of bank holding companies having total assets of $50 million or less are located in towns having populations of less than 5,000. As such, these institutions would be permitted to sell insurance under the 5,000 population exemption in the bills and exemptions that bring the Bank Holding Company Act in conformity with the National Bank Act and an exemption that nobody has ever complained about.

The provision is important to small banking institutions to ease transfer of ownership.

The third criticism is that the insurance prohibition constitutes an unwarranted intrusion into the rights of the various States to regulate insurance and bank holding company activities. That argument is simply false.

In the first place, this legislation only restricts the authority of bank holding companies to engage in certain nonbanking activities. Because of the power of bank holding companies to dominate and radically restructure nonbanking markets, this legislation is banking legislation. It is not insurance legislation.

Furthermore, section 7 of the Bank Holding Company Act specifically retains in the States their authority to regulate activity in the bank holding companies and their subsidiaries. States would retain their authority to enact legislation that is more restrictive than is contained in the bill before this committee.

The fourth criticism, this legislation would prohibit bank holding companies from acting as agents in areas where agents have allegedly not provided adequate insurance.

This argument is completely specious. The Federal Reserve Board's insurance regulations have for the last 10 years permitted bank holding companies to sell insurance where there are inadequate insurance facilities. This proposed legislation would retain that provision. No bank holding company has ever sought insurance authority based on that regulatory provision.

The fifth criticism, there exists no evidence that insurance agents will be driven out of business as a result of bank holding company entry into the insurance business.

To the contrary, at least two authoritative documents predict major adverse effects on insurance agents as a result of bank holding company entry into the business. One is the Federal Reserve Board's own tie-in study which was the subject of hearings before this committee last June 14. It documents a dramatically unfair competitive advantage that bank holding company agents would have over the present marketing systems.

Second, there is court case testimony by a bank holding company that within 4 years of operating an insurance agency it expected to sell insurance in connection with 27 percent of the holding company's loans and be one of the 10 largest agencies within the State.

The only reason there is not greater bank holding company penetration of the insurance market today than there might otherwise have been has been the efforts of IIAA and others to preserve the traditional separation between banking and commerce, but time is running out.

DRAMATIC RISE IN APPLICATIONS

Recent court decisions give the Federal Reserve Board carte blanche to approve bank holding company applications to engage in the insurance business with little or no showing of net benefit to the public. In just the past 2 years alone, even when prohibitive legislation was pending, bank holding company insurance applications have risen dramatically. Without this legislation this year the dam will burst and the bank holding companies will spread across the country to take full advantage of their credit-related competitive edge. Within a decade most small insurance agencies would be

forced out of business, not because their products are inferior or priced too high, but because consumers would feel compelled to buy insurance from their bank to protect their loan relationship.

By that time enactment of this legislation would be too late and this underscores the urgency of enacting it this year. The House has already passed a balanced measure that takes care of everybody's legitimate interest. I urge you to do likewise and to pass the bill unamended.

Thank you for providing us with this opportunity to present our views. We would be pleased to answer any questions, Mr. Chairman.

[Oral remarks and complete statement follow:]

ORAL REMARKS OF

DONALD C. BRAIN

PRESIDENT OF THE

INDEPENDENT INSURANCE AGENTS OF AMERICA, INC.

ON BEHALF OF

Independent Insurance Agents of America, Inc. Professional Insurance Agents, National Association of Life Underwriters, National Association of Casulaty and Surety Agents, Mortgage Insurance Companies of America, Mutual Life Insurance Companies

BEFORE THE

COMMITTEE ON BANKING, HOUSING

AND URBAN AFFAIRS

OF THE

UNITED STATES SENATE

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

MY NAME IS DONALD C. BRAIN. I AM PRESIDENT OF THE INDEPENDENT INSURANCE AGENTS OF AMERICA. I EARN MY LIVING AS A RETAIL PROPERTY AND CASUALTY INSURANCE AGENT IN KANSAS CITY MISSOURI. I AM ACCOMPANIED TODAY BY JEFFREY YATES, ASSOCIATE EXECUTIVE VICE PRESIDENT AND GENERAL COUNSEL OF IIAA, AND BY THOMAS WILSON OF WILKINSON, CRAGUN, AND BARKER, IIAA'S WASHINGTON COUNSEL.

SITTING WITH ME AT THE WITNESS TABLE ARE INDIVIDUALS WHO REPRESENT A BROAD RANGE OF THE PROPERTY AND CASUALTY AND LIFE INSURANCE INDUSTRIES. WITH THE COMMITTEE'S PERMISSION, I WOULD LIKE TO HAVE EACH ONE IDENTIFY HIMSELF AND THE ORGANIZATION THAT HE REPRESENTS.

ALSO HERE ARE DAVID ROWLAND, RACINE, WISCONSIN, AND EDWARD KREMER SALISBURY, MARYLAND.

IN ADDITION TO THE GROUPS REPRESENTED AT THIS TABLE, THE LEGISLATION BEFORE THIS COMMITTEE IS ENDORSED BY THE NATIONAL ASSOCIATION OF LIFE UNDERWRITERS, AND THE MORTGAGE INSURANCE COMPANIES OF AMERICA.

MY ORGANIZATION, IIAA, IS A NATIONAL ASSOCIATION REPRESENTING APPROXIMATELY 126,000 INDEPENDENT PROPERTY AND CASUALTY INSURANCE AGENTS OPERATING IN ALL 50 STATES AND THE DISTRICT OF COLUMBIA.

THE PURPOSE OF THIS HEARING IS FOR THE COMMITTEE TO RECEIVE TESTIMONY REGARDING S. 39, S. 2874 AND H.R. 2255. S. 39 WOULD AMEND THE BANK HOLDING COMPANY ACT AND THE BANK MERGER ACT IN WAYS THAT WE BELIEVE WOULD BE BENEFICIAL TO THE PUBLIC INTEREST. NEVERTHELESS, IIAA AND THE OTHER ORGANIZATIONS REPRESENTED HERE TODAY HAVE LONG MAINTAINED THAT THERE EXISTS AN URGENT NEED FOR THE BANK HOLDING COMPANDY ACT TO BE AMENDED SPECIFICALLY TO PROHIBIT LARGE BANK HOLDING COMPANIES FROM ACTING AS UNDERWRITERS AND AGENTS IN THE SALE OF PROPERTY AND CASUALTY INSURANCE AND MOST FORMS

OF LIFE INSURANCE. UNFORTUNATELY, S. 39 DOES NOT CONTAIN SUCH A SPECIFIC PROHIBITION. S. 2874 AND H.P. 2255, ON THE OTHER HAND, DO. FOR THAT REASON, WE WILL USE THE LIMITED TIME WE HAVE AVAILABLE TO US TO DISCUSS THOSE TWO BILLS.

S. 2874 AND H.R. 2255 WOULD SPECIFICALLY PROHIBIT BANK HOLDING COMPANIES FROM ENGAGING IN MOST INSURANCE ACTIVITIES. THE LANGUAGE OF THE TWO BILLS IS IDENTICAL. H.R. 2255 HAS ALREADY PASSED THE HOUSE BY THE OVERWHELMING MARGIN OF 333 TO 25. FOR THE REASONS MENTIONED IN OUR FORMAL STATEMENTS -- WHICH WE RESPECTFULLY REQUEST BE INCLUDED AS PART OF THE RECORD OF THESE HEARINGS -- WE URGE THE COMMITTEE IN THE STRONGEST POSSIBLE TERMS TO REPORT THE SPECIFIC INSURANCE PROHIBITION TO THE FULL SENATE AS SOON AS POSSIBLE. THE LANGUAGE OF THAT PROHIBITION IS THE RESULT OF MONTHS -- INDEED, YEARS -- OF WORK AND COMPROMISE ON THIS ISSUE SO VITAL TO PRESERVE COMPETITION IN THE RETAIL INSURANCE INDUSTRY AS WE KNOW IT TODAY AND TO PROTECT THE ABILITY OF THE PUBLIC TO PURCHASE INSURANCE FROM THE SOURCE OF ITS OWN CHOICE.

DURING THE COURSE OF THE LEGISLATIVE PROCESS, ESSENTIALLY FIVE CRITICISMS HAVE BEEN MADE ABOUT THE INSURANCE PROHIBITION. RATHER THAN REPEAT MATERIAL CONTAINED IN OUR FORMAL WRITTEN STATEMENTS, WE WILL USE THE LIMITED TIME AVAILABLE TO RESPOND TO THOSE CRITICISMS.

THE FIRST CRITICISM:

THAT THE INSURANCE PROHIBITION IS ANTI-COMPETITIVE. THIS IS NOT SO. BECAUSE OF BANK HOLDING COMPANIES' RESOURCES AND CONTROL OVER CREDIT TRANSACTIONS, BORROWERS WILL PURCHASE INSURANCE FROM THEM FOR REASONS HAVING NOTHING TO DO WITH LOWER PRICE OR BETTER SERVICE.

THUS, BANK HOLDING COMPANIES HAVE NO INCENTIVE TO OFFER THE CONSUMER LOWER PRICES OR BETTER SERVICE. BANK HOLDING COMPANIES CONTROL THE OVERWHELMING MAJORITY OF FINANCIAL RESOURCES IN OUR NATION. IN 1978, THE 100 LARGEST BANK HOLDING COMPANIES CONTROLLED ASSETS OF MORE THAN $900 BILLION. IN CONTRAST, THE TOTAL ASSETS OF ALL 4,047 SAVINGS AND LOAN ASSOCIATIONS AND THE 100 LARGEST FINANCE COMPANIES WAS ONLY HALF THAT -- $436 BILLION. THUS, IF BANK HOLDING COMPANIES WERE PERMITTED MASSIVE ENTRY INTO THE RETAIL INSURANCE BUSINESS, THE EFFECT ON SMALL BUSINESSES WOULD BE DEVASTATING.

SINCE 1864, THERE HAS EXISTED IN OUR ECONOMY A SEPARATION BETWEEN BANKING AND OTHER FORMS OF COMMERCE. AS PART OF THAT SEPARATION, NATIONAL AND STATE BANKS HAVE NOT BEEN PERMITTED TO ENGAGE IN THE SALE OF PROPERTY AND CASUALTY INSURANCE AND MOST FORMS OF LIFE INSURANCE. THE BANK HOLDING COMPANY MECHANISM PROVIDES A LOOPHOLE BY WHICH BANKING INSTITUTIONS CAN AVOID THOSE TRADITIONAL PROSCRIPTIONS. THE ESSENCE OF S. 2874 IS TO CLOSE THAT LOOPHOLE AND THUS IMPOSE THE SAME RESTRICTIONS ON BANK HOLDING COMPANIES INSURANCE ACTIVITES AS APPLY TO STATE AND NATIONAL BANKS.

THE SECOND CRITICISM IS THAT THE INSURANCE PROHIBITION DISCRIMINATES UNFAIRLY AGAINST LARGE BANK HOLDING COMPANIES, SINCE

BANK HOLDING COMPANIES HAVING TOTAL ASSETS OF $50 MILLION OR LESS ARE EXCLUDED. IT MUST BE EMPHASIZED THAT THE VAST MAJORITY OF BANK HOLDING COMPANIES HAVING TOTAL ASSETS OF $50 MILLION OR LESS ARE LOCATED IN TOWNS HAVING POPULATIONS OF LESS THAN 5,000. AS SUCH, THOSE INSTITUTIONS WOULD BE PERMITTED TO SELL INSURANCE UNDER THE 5,000 POPULATION EXEMPTION IN THE BILLS -- AN EXEMPTION THAT BRINGS THE BANK HOLDING COMPANY ACT IN CONFORMITY WITH THE NATIONAL BANK ACT, AND THAT NO ONE HAS EVER COMPLAINED ABOUT. THE PROVISION IS IMPORTANT TO SMALL BANKING INSTITUTIONS TO EASE TRANSFER OF OWNERSHIP.

THE THIRD CRITICISM:

THE INSURANCE PROHIBITION CONSTITUTES AN UNWARRANTED INTRUSION INTO THE RIGHTS OF THE VARIOUS STATES TO REGULATE INSURANCE AND BANK HOLDING COMPANY ACTIVITES. THAT ARGUMENT IS SIMPLY FALSE. IN THE FIRST PLACE, THIS LEGISLATION ONLY RESTRICTS THE AUTHORITY OF BANK HOLDING COMPANIES TO ENGAGE IN CERTAIN NON-BANKING ACTIVITIES, BECAUSE OF THE POWER OF BANK HOLDING COMPANIES TO DOMINATE AND RADICALLY RESTRUCTURE NON-BANKING MARKETS. THIS LEGISLATION IS BANKING LEGISLATION; IT IS NOT INSURANCE LEGISLATION. FURTHERMORE, SECTION 7 OF THE BANK HOLDING COMPANY ACT SPECIFICALLY RETAINS IN THE STATES THEIR AUTHORITY TO REGULATE THE ACTIVITIES OF BANKS, BANK HOLDING COMPANIES AND THEIR SUBSIDIARIES. STATES WOULD RETAIN THEIR AUTHORITY TO ENACT LEGISLATION THAT IS MORE RESTRICTIVE THAN IS CONTAINED IN THE BILLS BEFORE THIS COMMITTEE.

THE FOURTH CRITICISM:

THIS LEGISLATION WOULD PROHIBIT BANK HOLDING COMPANIES FROM ACTING AS AGENTS IN AREAS WHERE INSURANCE AGENTS HAVE ALLEGEDLY

NOT PROVIDED ADEQUATE INSURANCE. THIS ARGUMENT IS COMPLETELY SPECIOUS. THE FEDERAL RESERVE BOARD'S INSURANCE REGULATIONS HAVE FOR THE LAST TEN YEARS, PERMITTED BANK HOLDING COMPANIES TO SELL INSURANCE WHERE THERE ARE INADEQUATE INSURANCE FACILITIES. THIS PROPOSED LEGISLATION WOULD RETAIN THIS PROVISION. NO BANK HOLDING COMPANY HAS EVER SOUGHT INSURANCE AUTHORITY BASED ON THAT REGULATORY PROVISION.

THE FIFTH CRITICISM:

THERE EXISTS NO EVIDENCE THAT INSURANCE AGENTS WILL BE DRIVEN OUT OF BUSINESS AS A RESULT OF BANK HOLDING COMPANY ENTRY INTO THE INSURANCE BUSINESS.

TO THE CONTRARY, AT LEAST TWO AUTHORITATIVE DOCUMENTS PREDICT MAJOR ADVERSE EFFECTS ON INSURANCE AGENTS AS A RESULT OF BANK HOLDING COMPANY ENTRY INTO THE BUSINESS. ONE IS THE FEDERAL RESERVE BOARD'S OWN TIE-IN STUDY, WHICH WAS THE SUBJECT OF HEARINGS BEFORE THIS COMMITTEE LAST JUNE 14. IT DOCUMENTS DRAMATICALLY THE UNFAIR COMPETITIVE ADVANTAGE BANK HOLDING COMPANY AGENTS WOULD HAVE OVER THE PRESENT MARKETING SYSTEMS.

SECONDLY THERE IS COURT CASE TESTIMONY BY A BANK HOLDING COMPANY THAT WITHIN FOUR YEARS OF OPERATING AN INSURANCE AGENCY, IT EXPECTED TO SELL INSURANCE IN CONNECTION WITH 27% OF THE HOLDING COMPANY'S LOANS AND BE ONE OF THE TEN LARGEST AGENCIES WITHIN THE STATE.

BUT THE OBVIOUS REASON THERE IS NOT GREATER BANK HOLDING COMPANY PENETRATION OF THE INSURANCE MARKET TODAY THAN THERE MIGHT

OTHERWISE BE HAS BEEN THE EFFORTS OF IIAA AND OTHERS TO PRESERVE THE TRADITIONAL SEPARATION BETWEEN BANKING AND COMMERCE.

BUT TIME IS RUNNING OUT. RECENT COURT DECISIONS GIVE THE FEDERAL RESERVE BOARD CARTE BLANCHE TO APPROVE BANK HOLDING COMPANY APPLICATIONS TO ENGAGE IN THE INSURANCE BUSINESS WITH LITTLE OR NO SHOWING OF NET BENEFIT TO THE PUBLIC.

IN JUST THE PAST TWO YEARS ALONE -- EVEN WHILE PROHIBITIVE LEGISLATION WAS PENDING -- BANK HOLDING COMPANY INSURANCE APPLICATIONS HAVE RISEN DRAMATICALLY. WITHOUT THIS LEGISLATION THIS YEAR, THE DAM WILL BURST AND THE BANK HOLDING COMPANIES WILL SPREAD ACROSS THE COUNTRY TO TAKE FULL ADVANTAGE OF THEIR CREDIT-RELATED COMPETITIVE EDGE. WITHIN A DECADE MOST SMALL INSURANCE AGENCIES WOULD BE FORCED OUT OF BUSINESS -- NOT BECAUSE THEIR PRODUCTS ARE INFERIOR OR PRICED TOO HIGH, BUT BECAUSE CONSUMERS WOULD NEVER GET OUT OF THE BANK HOLDING COMPANIES' DOORS TO EXPERIENCE THE BENEFITS OF COMPETITION. BY THAT TIME, ENACTMENT OF THIS LEGISLATION WOULD BE TOO LATE, AND THIS UNDERSCORES THE URGENCY OF ENACTING IT THIS YEAR. THE HOUSE HAS ALREADY PASSED A BALANCED MEASURE THAT TAKES CARE OF EVERYONE'S LEGITIMATE INTEREST. I URGE YOU TO DO LIKEWISE, AND PASS THE BILL UNAMENDED.

THANK YOU FOR PROVIDING US WITH AN OPPORTUNITY TO PRESENT OUR VIEWS. WE WOULD BE PLEASED TO ANSWER ANY QUESTIONS THE COMMITTEE MAY HAVE.

Statement of

DONALD C. BRAIN

PRESIDENT

INDEPENDENT INSURANCE AGENTS OF AMERICA, INC.

Mr. Chairman and Members of the Committee:

My name is Donald C. Brain. I am President of the Independent Insurance Agents of America, Inc. ("IIAA"). I make my living as a retail property and casualty insurance agent in Kansas City, Missouri. I am accompanied at this hearing by Jeffrey M. Yates, IIAA's Associate Executive Vice President and General Counsel, and by Thomas E. Wilson of Wilkinson, Cragun & Barker, IIAA's Washington counsel.

IIAA welcomes this opportunity to offer its views on S. 39, S. 2874 and H.R. 2255. As the Committee is aware, on June 12, 1980, H.R. 2255 passed the House of Representatives by the overwhelming margin of 333 to 25. That bill and S. 2874, which contain identical language, would prohibit bank holding companies and their subsidiaries from acting as underwriter, agent or broker in the sale of most forms of property and casualty and life insurance. The prompt enactment of the restrictions contained in those bills is vital to the preservation of the current vitality of the retail property and casualty insurance industry and to the continued well-being of the insurance purchasing public which for so many years has been well served by the current structure of that industry. As a result, we are grateful to the Committee for inviting us to express our views on matters of such importance to our economy in general, and to the insurance industry in particular.

I. Introduction

A. Description of IIAA

IIAA is a national association of independent property and casualty insurance agents. The association is composed of 51 state associations (including the District of Columbia) that represent more than 34,000 insurance agencies and approximately 126,000 insurance agents across the country. Members of IIAA are small businessesmen. They vary greatly in size, but over half have incomes of less than $150,000 per year. In fact, the retail insurance industry is one of the few remaining sectors of our economy where an entrepreneur can go into business for himself and, with initiative and hard work, build a business into a going concern. The agents are proud of being part of an industry in which small business organizations have been able to serve the insurance needs of the public efficiently. This success is attributable to the efficiencies of competitive retail markets that are characterized by large numbers of insurance agencies that are conveniently located to serve the public's insurance needs.

B. Bank Holding Company Entry Into the Industry

IIAA has long been committed to the preservation of the high level of competition that currently prevails in the retail property and casualty insurance industry. In that connection, we have been concerned with the continuing attempts by large banking organizations to gain entry into the industry. The essence of our concern in that the enormous resources of banking organizations, coupled with their control over the decision of whether to extend or withhold credit, provides them with the capacity to

exercise an unusual amount of influence over the choice made by borrowers when nonbanking services are sold in conjunction with extensions of credit. Our fear comes down to this: For reasons having nothing to do with lower price or better service, bank holding companies have the power to determine the source from which insurance is purchased by bank customers. As a result, the public would lose the freedom it currently has to select the insurance professional of its choice on the basis of price, product, service and convenience, rather than on the basis of protecting its relationship with a bank. Also, large-scale holding company entry would inevitably force substantial numbers of non-affiliated insurance agencies into mergers or out of business altogether. This, in turn, would eventually result in a dramatic reduction of competition in our industry.

C. Litigation

After the Bank Holding Company Act of 1956 ("BHC Act") was amended in 1970, IIAA's concerns prompted it to oppose certain applications by various bank holding companies to be permitted to engage as agents in the sale of property and casualty insurance activities. Eventually, the merits of six such applications were examined in adjudicatory proceedings. The Administrative Law Judge who heard the evidence essentially concluded that approval of those applications could not reasonably be expected to result in benefits to the public. Nevertheless, the Federal Reserve Board approved all the applications. IIAA sought review of those decisions in the United States Court of Appeals for the Fifth Circuit. In 1976, the Court upheld the Board's

decision regarding two of those applications, and the Supreme Court declined review. 1/ On the remaining applications, however, the Court came to a different conclusion. On March 19, 1979, the Court held that, in approving the applications, the Board had not paid adequate heed to the public benefits requirements of the BHC Act. 2/ For that reason, the Court remanded those cases to the Federal Reserve Board for further proceedings. Thereafter, three of the four bank holding company applicants that remained in the proceedings withdrew their applications. The fourth applicant modified its application to take into account various restrictions imposed by Florida law and the application was approved.

D. The Record Has Already Been Made

During the pendency of the litigation, IIAA repeatedly presented its case to Congress. In the House, testimony was presented to the House Banking Committee in oversight hearings held in 1975. Testimony was again presented in connection with the so-called Committee Print in 1976, and in connection with the Safe Banking Act of 1977. In the Senate, IIAA presented more than 150 pages of testimony and exhibits to this Committee in hearings on S. 2721 in 1976. In 1978, IIAA again testified, this time regarding S. 72. More recently, this Committee received

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1/ See Alabama Association of Insurance Agents, Inc. v. Board of Governors of the Federal Reserve System, 533 F.2d 224 (5th Cir. 1976), on rehearing, 558 F.2d 729 (1977), cert. denied, 435 U.S. 904 (1978).

2/ See Florida Association of Insurance Agents, Inc. v. Board of Governors of the Federal Reserve System, 591 F.2d 334 (5th Cir. 1979).

substantial additional testimony on the bank holding company insurance issued on June 14, 1979, when it held hearings on the Federal Reserve Board's so-called tie-in study. 3/ Therefore, a substantial record has long existed supporting the need for specific exclusion of bank holding companies from participation in the insurance industry.

Legislation very similar to the insurance prohibition contained in S. 2874 and H.R. 2255 was acted upon by both houses of Congress during the 95th Congress. In the context of Title XIII of the Financial Institutions Regulatory Act of 1978 (H.R. 13471), the House voted to enact the specific insurance prohibition by the overwhelming margin of 252 to 72. In the context of the Robert F. Kennedy Medallion Bill (H.R. 8389), the Senate approved an insurance prohibition by unanimous consent. In other words, as recently as the last Congress, both houses of Congress voted overwhelmingly in favor of an insurance prohibition similar to the one contained in the bills that are before this Committee. The will of Congress on this issue was thwarted two years ago only as a result of the extraordinary situation presented by Congress' need to consider other urgent matters before it adjourned.

Most importantly, on June 12, 1980 -- just three weeks ago -- the House of Representatives approved H.R. 2255, a bill this Committee has before it today, by nothing less than 333 to

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3/ See Hearings on Tie-Ins of the Sale of Insurance by Banks and Bank Holding Companies Before the Senate Banking Committee, 96th Cong., 1st Sess. (1979).

25. The time for Congress to enact this vital legislation is now. It should not tolerate any attempt to have its will thwarted yet again. S. 2874 and H.R. 2255 offer the opportunity to enact legislation that is in the interest of the consumer and of small independent businessmen. To permit such legislation to be derailed by factors having nothing to do with the merits of the issue the legislation addresses in two Congresses in a row is unthinkable.

E. The Situation is Getting Worse

Since the overwhelming vote in favor of Congressman Hanley's and Senator Durkin's insurance prohibition during the 95th Congress, bank holding companies have continued to enter the insurance industry. We estimate that, since October of 1978, the Board has processed and approved approximately 200 holding company applications to enter the property and casualty insurance business, thereby permitting more than 40 holding companies to sell insurance out of literally hundreds of offices in at least 25 states.

As important as the total number of applications that have been approved is their changing nature. With increasing frequency, these applications are being made by the largest bank holding companies in the nation and contemplate sales of insurance across the full range of holding company activities (banks, mortgage companies, finance companies), instead of on a more limited basis. What is more, the Board is processing and approving applications where applicants have not even claimed that approval of the applications would result in benefits to the

public. The Board's refusal to require insurance applicants to uphold their burdens under the BHC Act extends even to cases where insurance agents have specifically requested that public benefits be shown. Recently, the United States Court of Appeals for the District of Columbia Circuit refused to set aside Federal Reserve Board approval of several bank holding company insurance applications, even though the sole basis for approving one of those applications was a one-inch-by-six-inch notice that appeared in one newspaper on one day.

The public benefits test that Congress wrote into law in 1970 simply does not work. As far as we are aware, the Board has never rejected a bank holding company application because the holding company failed to show that approval of the application would be in the public interest.

Therefore, we urge this Committee in the strongest possible terms to report S. 2874 to the floor of the Senate as soon as physically possible.

II. Sales of Insurance By Bank Holding Companies Is Not In the Public Interest

A. Background

At least since 1864, the nation's banking legislation has required separation between banking and other forms of commerce. Since the establishment of the national bank system, Congress has prohibited national banks from engaging in any activity that was not banking or an incidental power of banks. 4/

4/ See National Bank Act, ch. 106, § 8, 13 Stat. 101 (1864) (current version at 12 U.S.C. § 24 (1976)).

When Congress enacted the BHC Act and the 1970 Amendments thereto, it continued and extended this principle. 5/ Consequently, the BHC Act generally prohibits bank holding companies from owning the shares of any company that is not a bank. 6/ The limited exceptions to this prohibition appear in Section 4 of the BHC Act, with the principal exception contained in subsection (c)(8). 7/ Section 4(c)(8) essentially provides that a bank holding company may engage in a nonbanking activity if, and only if, it can make an affirmative showing that (i) the particular activity in which it wishes to participate is "closely related" to banking, and (ii) its participation in the activity can reasonably be expected to result in benefits to the public that outweigh possible adverse effects. 8/ It is IIAA's view that bank holding companies applying for permission to sell property and casualty insurance cannot meet these statutory requirements.

B. Bank Holding Companies Have the Power to Compete Unfairly with the Natural Occupants of the Property and Casualty Insurance Industry

Banking institutions are the principal source of commercial credit in our economy. As such, they dominate a vital element of the economy. Their control over loans provides them with a unique opportunity to influence where borrowers purchase

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5/ S. Rep. No. 1084, 91st Cong., 2d Sess. 2-3, reprinted in [1970] U.S. Code Cong. & Ad. News 5520-21; S. Rep. No. 1095, 84th Cong., 1st Sess. 11-14 (1955).

6/ 12 U.S.C. § 1843(a) (1976).

7/ Id. at 1843(c)(8) (1976).

8/ Id.

any nonbanking service that might be sold in conjunction with extensions of credit. For these reasons, bank holding companies should be restricted from engaging in nonbanking activities (including the sale of insurance), unless a compelling justification can be provided for departing from the well-established norm.

Ironically, the principal concern of IIAA was expressed with admirable clarity by the Federal Reserve Board ten years ago. In 1969, in testimony before the Financial Institutions Subcommittee of the Senate Banking Committee, the Board acknowledged that:

> [B]ecause of the inferior bargaining position of the debtor, he may be susceptible to the loan officer's "suggestions" concerning choice of coverage, premium rates, insurer and agent. As a result, the debtor easily may receive the impression that his loan application may be more favorably considered if he follows such suggestions. 9/

The danger recognized by the Federal Reserve Board was later underscored by Congress in the Conference Report issued with the 1970 Amendments to the BHC Act. It is there acknowledged that:

> Tie-ins occur where a customer is forced or induced to accept other products and services along with that product which he seeks. Such tie-ins may result from actual coercion by a seller or from a customer's realization that he stands a better chance of securing a scarce and important commodity (such as credit) by "volunteering" to accept other products or services rather than seeking them in the competitive market place. In either case, competition is adversely affected, as customers no

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9/ Hearings on Consumer Credit Insurance Act of 1969 (S. 2764) Before the Subcomm. on Financial Institutions of the Senate Banking Comm., 91st Cong., 1st Sess. 163 (1969).

longer purchase a product or service on its own economic merit. 10/

The concerns expressed by both the Board and Congress have in fact proved to be well-founded. Experience since the 1970 Amendments clearly indicates that lending institutions do indeed have the power to compete with retail property and casualty insurance agents in ways that are inconsistent with the public interest. Most often, evidence of coercion in the sale of insurance does not manifest itself in borrower complaints. The very thing that provides the lender with the power to coerce (that is, the lender's power to grant or withhold credit) is likely to make an offended borrower reluctant to make a formal complaint. Furthermore, even if such complaint is made, actual coercion would be extremely difficult to prove. Even if such proof were possible, the amount that the borrower could reasonably expect to recover in insurance premiums would be negligible -- certainly not enough in most instances for the borrower to risk jeopardizing his relationship with the lender. Under these circumstances, it is hardly surprising that large numbers of complaints have not been made. Nevertheless, despite Federal Reserve Board assertions to the contrary, some complaints have been filed. In his testimony on the Board's so-called tie-in study before this Committee last June, Mr. Lewis Goldfarb of the Federal Trade Commission noted that not only have such complaints

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10/ H.R. Rep. No. 1747, 91st Cong., 2d Sess. 18 (Conference Report), reprinted in [1970] U.S. Code Cong. & Ad. News 5569.

been filed, but the Board has received notice of those complaints from both consumers and the FTC. 11/

Regardless, ample evidence does exist that both coercive and voluntary tying do occur. For example, consider the following letter that appeared in testimony before this Committee on S. 72 in 1978:

> I regret very much the incident concerning "Mr. X." I based my decision regarding this matter on what I thought to be the best interest of "Mr. X" and the bank. As I indicated to "Mr. X", our bank could not accept the loan unless we were allowed to write the credit life insurance. As I discussed by phone, the primary reason for this request to write the insurance, was because this action increased the return of income on the loan by a good margin. Had our bank been denied this additional income, we could not have approved the loan. Because of the extremely tight credit situation, I feel "Mr. X" would not have obtained the loan elsewhere. Therefore, I believe our bank to be doing "Mr. X" a service by granting this type of loan under these circumstances, with credit as tight as it is at the present.
>
> I can still appreciate and understand your reasoning and regret that "Mr. X" saw fit to cancel his policy with your company. I am hopeful this situation will not occur again in the future. 12/

In 1976, Hanna and Kremer Insurance Inc., one of our Maryland member agencies, received the following letter:

> Dear Bill: The purpose of this letter is to clear up any misunderstanding that may have arisen as a result of the recent changes in our insurance program. We instructed you to

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11/ See, e.g., Hearings on Tie-Ins, etc., supra, at 124.

12/ Hearings on Competition in Banking Act of 1977 Before the Comm. on Banking, Housing, and Urban Affairs of the U.S. Senate, 95th Cong., 2d Sess. 377-78 (1978).

> discontinue the automobile dealer's physical damage coverage in the package policies that you have so that we could obtain this coverage through "X" bank. As you know, "X" bank does the financing on our new car inventory. This in no way indicates dissatisfaction of your service or that of the company "X". As I explained to you, we feel that we have to place the coverage with the bank because we so frequently request special favors of them. Even if their premium were to prove a little higher, we would still feel obligated in this way. Please also be assured that this in no way implies that the bank has forced us to make this change in our insurance program. Best regards.

These letters are examples of both coercive and voluntary tying at work. The second letter dramatically illustrates why borrowers are not likely to complain, even if they do feel that they have been coerced. That letter also graphically points out the disincentive that banking institutions have to sell insurance at lower costs. It is clear from the letter that, even if the insurance sold by the bank costs more, more consumers may be willing to pay the additional amount simply to protect their credit relationship.

And there is more. In 1974, the Federal Trade Commission issued a study that revealed that significant amounts of tying exist between sales of insurance and extensions of credit. The FTC study states with respect to one complaint:

> The consumer complaint . . . is typical of the type of credit insurance complaint the Division receives from consumers. The complainant, an unmarried attorney, sought to finance the purchase of a car by obtaining a bank loan. He asserts that when he arrived at the bank to pick up his check he was told that no loan would be made unless he "elected" credit insurance. Since the consumer had obligated himself to purchase the car the next day, he signed the insurance election in order

> to obtain the loan and unsuccessfully attempted, at a subsequent time, to obtain a refund of unearned insurance premiums. 13/

The FTC study also provides insight into why few complaints of explicit tying are ever received.

> Once a consumer has signed the credit insurance election, he is without a remedy and has little hope of proving before a court that he did not elect the coverage. Even a complaint to a regulatory agency, including the Federal Trade Commission, will produce action only if the incident is part of an identifiable and deliberate, company-wide pattern of conduct. In addition, the investigation of such practices is a time-consuming one requiring the regulatory agency to gather and analyze insurance sales data and interview large numbers of consumers. Agency action will normally come so late in time as to have no effect on the consumer's own transactions. 14/

Perhaps the best evidence of the lack of incentive of bank holding companies to operate insurance agencies in ways that are consistent with the public interest is provided in the Federal Reserve Board's tie-in study on which this Committee held detailed hearings last year. That study purported to show that explicit tying between the granting of credit and the sale of credit-related insurance is "practically non-existent," and that implicit pressures brought by lenders on borrowers are neither "very strong nor widespread in the industry." The factual information revealed by the study, however, failed to support those conclusions. For one thing, the study showed that 62.2 percent

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13/ Statement of the Staff of the Division of Special Statutes of the FTC on Credit Insurance Sales Practices and Section 106(b) of the Truth in Lending Act, at 1 (Nov. 1974).

14/ Id. at 2.

of consumers surveyed (almost two-thirds) had in fact purchased insurance in conjunction with an extension of credit, even though such insurance is typically not required as a condition for a loan. Furthermore, more than 25 percent (one out of four) stated that, when credit was extended to them, they were told that the purchase of credit insurance was either required or strongly recommended. 15/

We will not dwell on the numerous deficiencies contained in the foregoing study, particularly in light of the exhaustive hearing record already amassed by this Committee in that regard. Suffice it to say that the conclusions arrived at in the Board's study have been so thoroughly discredited that Chairman Proxmire was led to inform then-Board Chairman G. William Miller that the study appeared to "whitewash the severe tie-in facts [it] uncovered." 16/ For that reason, Chairman Proxmire suggested that the study be entirely redone. 17/ As far as we are aware, the Board has not repeated the study, nor does it currently have any plans to do so.

15/ As a general rule, lenders do not require borrowers to have credit insurance as a pre-condition to receiving a loan. In contrast, lenders generally do require borrowers to show evidence that they have physical damage insurance on loan collateral before a loan will be consummated. As a result, the opportunity for tying in the case of property and casualty insurance might even be greater than with respect to credit life insurance. Under these circumstances, only the specific prohibition that is contemplated by the bills under consideration by this Committee can adequately protect the public interest.

16/ Id.

17/ Letter to G. William Miller, Chairman, Federal Reserve Board, from Senator William Proxmire, Chairman, Senate Banking Committee, at 2 (July 11, 1979).

The evidence, therefore, that bank holding companies have the power in derogation of the public interest to compete unfairly in the sale of property and casualty insurance with the natural occupants of that industry is long-standing and overwhelming. That evidence, by itself, justifies the enactment of the specific bank holding company insurance prohibition contained in the bills under consideration by this Committee.

C. Bank Holding Company Affiliated Insurance Agencies Are Placed in A Conflict of Interest Posture

Typically, banking organizations enumerate the insurance coverages that they will require to protect collateral as a pre-condition to an extension of credit. The interests of the lender, however, in wanting to have the collateral protected, are often different from those of the borrower. As such, a bank holding company affiliated insurance agent is placed in a classic conflict of interest posture between the bank holding company by which he is employed and the prospective borrower he is called upon to advise.

This situation can perhaps best be illustrated by an example. A prospective borrower enters an office of a bank holding company seeking a loan that will permit him to purchase a new car. As a pre-condition to making the loan, the bank will typically require that the car be covered by at least physical damage insurance. The bank will prefer that the customer carry the highest amount of insurance possible -- that is, the insurance with the lowest deductible -- particularly since the expense of the insurance will be borne by the borrower. In many instances,

however, the financial situation of the borrower may be such that it would be unwise for him to pay the increased premiums associated with a low deductible. If the borrower is properly advised, he will probably choose to have insurance with a higher deductible, thereby permitting him to pay a lower insurance premium. In this situation, it seems unlikely that a bank holding company affiliated insurance agent will advise the prospective borrower to insist on the higher deductible, lower cost insurance. To render such advice would undercut the position of the bank holding company.

There are many additional examples that might be given. Nevertheless, the foregoing situation clearly demonstrates the bank holding company affiliated agent is placed in a conflict of interest posture. As such, the insurance advice that he gives to consumers will in many situations be qualified and tainted by the interests of the holding company, rather than the interests of the consumer, who very often will not be fully apprised of all of his insurance options. The letter received by the Hanna and Kremer agency and alluded to previously makes it clear that even if the borrower knows he is paying more for insurance than he needs to, he may still buy it through the holding company in order to protect his credit relationship. 18/

D. Bank Holding Company Affiliated Agencies Will Not Provide Greater Public Convenience

When the BHC Act was amended in 1970, Congress conditioned approval of bank holding company applications to engage in

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18/ See p. 11-12, supra.

nonbanking activities upon the ability of the holding companies to show that their participation in the particular activity would, overall, result in benefits to the public, such as greater convenience, gains in efficiency, and increased competition. 19/ In the proceedings that have taken place to date, the bank holding companies simply have not been able to make that showing.

For example, the overwhelming majority of bank holding insurance applications have contemplated the sale of insurance through an agency that is located at the headquarters of the holding company. That agency would serve insurance customers to whom loans are made out of offices located across the state of the holding company's residency. Several of the proposals have even contemplated using this centralized agency structure with regard to insurance sales to be made to consumers in different states. In other words, a consumer who receives an extension of credit out of a banking office in Mobile, Alabama, would have to deal with insurance agents located in the holding company corporate headquarters in Birmingham. This would be true even though that customer may have a local insurance agent in the immediate vicinity of the holding company banking subsidiary. Under this structure, sales of insurance are manifestly inconvenient to the public. 20/ Also, one of the principal functions

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19/ See 12 U.S.C. § 1843(c)(8) (1976).

20/ The obvious inconveniences to the public associated with the centralized agency proposal led the Court of Appeals in the Alabama case to determine that the Board's determination that approval of the application in that case would result in greater convenience was not supported by substantial evidence. See 533 F.2d at 247.

of an insurance agent is to provide claims services when loss occurs. Under the proposals put forth by the bank holding companies, adequate claims services would be unattainable.

E. Bank Holding Company Affiliated Agencies Will Not Provide Gains in Efficiency

Bank holding company insurance applicants have for the most part avoided making any serious claims that approval of their applications would result in increased competition on the basis of price. Bank holding companies seeking to enter the insurance industry under current law ask for authority to act as independent agents. As such, they would be subject to the same rating structures as non-affiliated agents. In that capacity, there would be little opportunity for the holding companies to affect the price of insurance they sell. Consequently, permitting bank holding companies to engage in insurance activities cannot have the beneficial effect of lowering costs to consumers. Furthermore, the power of lending institutions to control credit transactions removes any incentive that they might have to compete with non-affiliated insurance agents on the basis of price. Nevertheless, insurance customers are likely to be willing to purchase insurance from affiliated insurance agencies, even at a higher price, in order to protect their credit relationships with the banks. 21/ Moreover, the evidence indicates that, regardless of the price at which an affiliated agency may offer insurance,

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21/ Reference is made to the letter quoted on page 11 where an insured admitted that he would be willing to pay a higher price for insurance sold through a lender in order to protect his relationship with his primary source of credit.

it will make substantial sales of insurance to bank affiliated customers. 22/

One would think that the price at which a bank holding company intends to offer insurance would be a primary consideration in determining whether approval of its application would be in the public interest. When it promulgated its current insurance regulation in 1971, the Board apparently thought it was. At that time, it expressed the expectation that:

> [A]ny holding company or subsidiary that acts as an insurance agency on the basis of the new regulatory provision will exercise a fiduciary responsibility -- that is, by making its best efforts to obtain the insurance at the lowest practicable cost to the customer. 23/

Since the insurance regulation was promulgated, however, the Federal Reserve Board has unfortunately never enforced that portion of its regulations.

F. Bank Holding Company Affiliated Agencies Will Not Provide Increased Competition

Neither will approval of bank holding insurance applications increase competition in the insurance agency industry. In fact, quite the contrary is so. The power that bank holding companies have over credit transactions provides them with an unfair competitive advantage over the natural occupants of the insurance industry. Since, as a result of that power, banks are

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22/ In this connection, in the Georgia case, the holding company admitted on the record that after four years of operation it would have one of the ten largest insurance agencies in the State of Georgia, even though it did not intend to offer insurance at prices as low as many non-affiliated agencies.

23/ 36 Fed. Reg. 15,525, 15,526 (1971).

likely to sell substantial amounts of insurance anyway, they also have the least amount of incentive to sell insurance at a lower price or to provide superior service. Furthermore, the bank holding company insurance proposals to date have contemplated increasing the number of insurance agents in a given state by only one or two. Those agents, operating out of centralized locations, would sell insurance to customers throughout the bank holding company's system across the state. The notion that such proposals are likely to increase competition in the retail insurance industry is unpersuasive.

Additionally, the question of whether bank holding companies can reasonably be expected to introduce increased competition in the retail insurance business was carefully considered by the Administrative Law Judge during the proceedings held in 1973. In those cases, the Judge rejected the applicants' claims that increased competition would occur in the event their applications were approved. His conclusion was to the contrary. Specifically, he found that, in locations where the applicants' banking subsidiaries control substantial deposits, the independent insurance agents would be subjected to "destructive competition." 24/ He also concluded that voluntary tie-ins of insurance sales with extensions of credit were almost inevitable, particularly in times of tight money. He further found that, in markets where insurance agents would be forced to compete with "double-barreled financial conglomerate[s] . . . the independent commission

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24/ Recommended Decision, Alabama Financial Group, Inc., FRB Docket IA-10, at 16 (Feb. 7, 1974).

agents would have difficulty surviving." 25/ In this regard, the Judge concluded that "the clientele [of large bank holding companies] that would probably be subtly influenced to divert [insurance business away] from Atlanta independent agents is so large that many of the latter could be driven out of business or forced to merge into larger units resulting in decreased competition." 26/ Ultimately, the Judge concluded as follows:

> The proposition reduced to its simplest terms comes down to this: if a bank, large in its community, using predominantly depositors' funds as capital, is authorized to compete against mostly small insurance enterprises by soliciting its debtor-clientele, it is possible, even probable, that the Mom and Pop agency will be driven into merger or out of business entirely; and, to this extent, the American dream of a land of opportunity where every man and woman, with some skill and good luck, can become a proprietor or a partner, rather than merely a clerical employee or an insignificant stockholder, will fade further. 27/

Thus, the Administrative Law Judge concluded that approval of the applications could not reasonably be expected to result in benefits to the public that would outweigh possible adverse effects.

III. Effect of the Insurance Prohibition Contained in S. 2874 and H.R. 2255

S. 2874 and H.R. 2255 would prohibit bank holding companies from engaging as principal (underwriters) or agent or

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25/ Recommended Decision, First National Holding Corp., FRB Docket IA-8, at 28 (Jan. 14, 1974).

26/ Id.

27/ Recommended Decision, FRB Docket IA-10, at 19-20 (emphasis added).

broker in the sale of property and casualty and certain types of life insurance. The Federal Reserve Board has consistently determined that, under current law, the underwriting of ordinary life and property and casualty insurance are impermissible activities for bank holding companies. 28/ The exception to this rule relates to the underwriting of credit life and credit disability insurance. 29/ To the extent S. 2874 and H.R. 2255 prohibit insurance underwriting, therefore, they merely codify existing law.

The first exemption contained in these bills would continue to permit bank holding companies to underwrite and act as agent or broker in the sale of credit life and credit disability insurance -- forms of insurance that have traditionally been sold by lenders. Given the fact that the sale of credit life and credit disability insurance can be rather easily integrated into loan transactions, and that lenders have historically offered such lines of insurance, it appears appropriate for legislation to continue to permit those activities. Nevertheless, the Federal Reserve Board should carefully scrutinize the circumstances under which such insurance is sold in order to assure that the insurance is not tied to extensions of credit.

The second exemption in these bills would permit finance company subsidiaries of bank holding companies to continue to act

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28/ See, e.g., TransAmerica Corporation, 43 Fed. Res. Bull. 1014 (1957); NCNB Corp., FRB Form H.2, No. 19 (1978). See also Alabama Financial Group, Inc., 39 Fed. Reg. 25,548, 25,550 (1974) (mortgage guaranty insurance).

29/ See 12 C.F.R. § 225.4(10) (1979).

as agent (but not underwriter) with respect to sales of declining balance credit property insurance that provides coverage against loss or damage to any property standing as collateral on an extension of credit. The sales of such insurance under this exemption, however, would be permissible only with respect to loans of $10,000 or less (as adjusted by the Consumer Price Index ("CPI")). This exemption would permit finance companies that are affiliated with bank holding companies to continue to assure repayment on a loan where the collateral associated with that loan is a relatively small item of personal property. The insurance sold would repay the lender the outstanding balance of the loan in the event of default of the borrower and destruction of the collateral. This exemption seems appropriate since it would permit bank holding company finance company affiliates to protect their interest in the loan while, at the same time, permitting consumers to continue to seek insurance advice from insurance professionals under circumstances where the value of the loan collateral would almost make it imperative for the consumer to have a more flexible form of insurance than is contained in declining balance credit property insurance policies.

The third exemption would permit bank holding company affiliates to engage in any insurance in a place where the population does not exceed 5,000 (as shown by the last preceding decennial census). This exemption is intended to conform the permissible insurance activities under the BHC Act with those

permitted under the National Bank Act. 30/ The exemption would limit bank holding company sales of insurance in "small towns" to those circumstances where the holding company has its principal place of banking business in a community of 5,000 or less. As such, the exemption is consistent with the Federal Reserve Board's current regulation relating to sales of insurance in "small towns."

The third exemption would also except from the insurance prohibition bank holding company sales of insurance in communities where a bank holding company applicant, after notice and opportunity for a formal hearing on the record, demonstrates that there are inadequate insurance agency facilities. This provision is justifiable by the fact that it is in the public interest for people in all communities to have access to adequate insurance agency facilities. For that reason, if any bank holding company can demonstrate that a particular place is not being adequately served, such holding company should be permitted to enter the insurance agency business and thereby provide a service needed by that community.

The fourth exemption is the legislation's grandfather clause. It would permit bank holding companies that were lawfully engaged in insurance activities on June 6, 1978 (the date during the 95th Congress when the Financial Institutions Subcommittee of the House first enacted an insurance prohibition) to continue those activities. The exemption would grandfather only

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30/ See 12 U.S.C. § 92 (1976).

the activities in which specific bank holding companies were actually engaged on the grandfather date. After June 6, 1978, those activities would not be permitted to expand in terms of lines of insurance, location of insurance outlets, or types of loans or subsidiaries with respect to which that insurance could be sold. In order for the grandfather clause to be meaningful, it is essential that it be configured in this way. It is also imperative that the June 6, 1978 grandfather date remain unchanged. In this connection, it should be emphasized to this Committee that since shortly after June 6, 1978, the Federal Reserve Board has routinely informed bank holding company applicants to enter the insurance agency business that pending legislation might make it necessary for them to cease those insurance activities at a future date. As such, no bank holding company that has entered the business since that date can complain that it has been taken by surprise or otherwise treated unfairly. Simply put, those holding companies assumed the risk that the legislation under consideration by this Committee might become law.

The fourth exemption also exempts from the prohibition insurance activities pursued by finance companies that were acquired by bank holding companies between June 6, 1978 and June 6, 1979. This provision was added by the House Banking Committee in order to grandfather two bank holding company finance company insurance operations that were owned by bank holding companies prior to the June 6, 1978 date and were transferred on Federal Reserve Board order to other bank holding companies shortly after

that date. The House Committee felt that such transfers by themselves should not operate to disqualify the acquiring bank holding companies from continuing the insurance activities of the subsidiaries that were conducted by the transferring bank holding companies prior to June 6, 1978. 31/

The fifth exemption would permit bank holding companies to engage in any insurance agency activity where the activity is limited solely to supervising on behalf of insurance underwriters the activities of retail insurance agents who sell fidelity and property and casualty insurance on the assets used in the operation of the bank holding company or any of its subsidiaries. The exemption would also permit supervision of sales of group insurance that protects the employees of the bank holding company. This exemption recognizes a unique situation prevailing in Texas, where Texas law in certain circumstances permits bank holding companies to act as so-called "managing general agents" and thereby to receive commissions for supervising retail agents who sell insurance on behalf of insurance underwriters on the assets and personnel of the holding company. It is reported that several bank holding companies in Texas are already operating as managing general agents with respect to their own risks.

Finally, the last exemption would except from the proscription in the bill insurance agency activities conducted by bank holding companies having total assets of $50 million or less. This exemption would facilitate the transferability of

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31/ H. Rep. No. 845, 96th Cong., 2d Sess. 5-6 (1980).

small bank holding companies. For purposes of this exemption, the size of the bank holding company is to be judged on the assets of the entire holding company system, not just the value of the investment and other assets as carried on the books of the holding company itself. This exemption, as well as the first, third, and most of the fourth exemptions were contained in the bill that was approved by the Senate by voice vote during the 95th Congress.

IV. The Need for Enactment of a Specific Insurance Prohibition Is Urgent

It is absolutely vital that the insurance prohibition contained in S. 2874 and H.R. 2255 be enacted into law immediately. Bills more stringent than these were passed during the 95th Congress by an overwhelming majority in the House (252 to 73) and by voice vote in the Senate. Just three weeks ago, the House passed H.R. 2255 by an even more lopsided majority than Title XIII of H.R. 13471 two years ago (333 to 25). In the meantime, the Federal Reserve Board continues to process and approve bank holding company insurance applications. In many cases, bank holding companies are achieving entry into the property and casualty insurance business without even a claim, much less a showing, that approval of their applications will result in benefits to the public.

The case for enactment of the specific insurance prohibition contained in these bills has been made repeatedly before this Committee and other committees and subcommittees of Congress. The entire bank holding company insurance problem has been the source of expensive and disruptive litigation for more

than 10 years. Private litigants, the Board and Congress have had to expend enormous resources in connection with this problem. The only way to avoid further expenditures is for the insurance prohibition contained in S. 2874 and H.R. 2255 to be enacted into law immediately. The threat to the independent agency system and to the public interest in general is grave -- and it is getting worse. Late relief to the public and to insurance agents on this issue is no relief at all.

Again, IIAA thanks the Committee for the opportunity to express its views on these very important matters.

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

Mr. Brain, H.R. 2255 proposes to grant an exception to bank holding companies with assets of over $50 million from the insurance prohibition. You spent some time justifying that and yet it seems to me that the same argument of tie-ins of credit and insurance would apply just as much, maybe even more, in a small town as it would in a big city. After all, the options and availability of credit are likely to be smaller or fewer in a small community than a big one.

So if it shouldn't apply for the larger banks, why should it apply to the smaller ones? Is this simply a matter of being practical and getting your coalition together that rolled it through the House?

OPPOSED TO TIE-IN SALES

Mr. BRAIN. It's a combination of things. I would like to go on record that we are opposed to tie-in sales wherever they appear as such. We think from a practical standpoint and tradition in the business the smaller banks have had the opportunity to sell insurance. We think the breach happened when the larger banks through the bank holding company suddenly got on a different footing than they had formerly been under the National Bank Act and we think the situation should be restored to where it was.

Smaller banks in smaller towns of 5,000 have been traditionally allowed to be in the insurance business as a matter of service to those communities. Now we have felt that we have no objection to that.

The CHAIRMAN. Well, nevertheless, it seems to me that that would be a kind of competition that's very difficult for the insurance agents that operate in the small communities.

Mr. BRAIN. I think there's a different sense of competition in a smaller community. There is more of a sense of personality and the people know each other. When you get into a larger community and with a large bank you get into an impersonality conflict that changes the ball game completely.

The CHAIRMAN. Now this committee is very concerned about the possible abuses that occurred with tie-in insurance and granting of credit. If banks were required to provide the customer with a notice that the insurance can be canceled at no penalty after credit

was received, would this, in your opinion, resolve the problem at all?

Mr. BRAIN. No, sir. I think on page 11 and 12 of our formal testimony we have given you some information about the history of tie-ins.

One of the problems is that once a customer has a loan and the bank has approved his credit and sold him the insurance, the return premium on the insurance is so negligible that it's hardly worth the insurer's trouble at that point to go out and begin quarreling with the bank and he may feel in his own mind to some degree he jeopardizes his situation or loan capacity with the bank under those circumstances.

The CHAIRMAN. Now this bill would limit the activities of only a portion of the holding companies in the country. It would not limit at all the activities of other financial institutions such as savings and loans, savings banks, nonholding companies, and finance companies and so forth.

Why should that one segment of the industry be precluded from engaging in insurance activities and not the other financial institutions?

Mr. BRAIN. Senator, I guess this is from a practical standpoint. We recognized that what happened was under the bank holding company that a new situation was introduced into the world and we're trying to meet that one as our primary target at this point. We feel it is vital that we come up with an answer to that particular problem at this time.

The CHAIRMAN. Is there abuse, in your judgment, on the part of S. & L.'s and savings banks and nonholding company finance companies and so forth?

Mr. BRAIN. Well, I suspect in a general statement, although I have no documented evidence as to that, we could not comment on that. We were not asked to. But I suspect anywhere credit is granted there could be abuses, but that may depend on the personalities of the people dealing in it.

The CHAIRMAN. Now the savings banks in New York have entered the life insurance market as I understand it and they offer life insurance at a considerably lower cost than the insurance companies do. You indicate in your testimony that increased competition in the banking industry would not lead to lower costs for the public—in that case it does—but would lead to higher costs. If tie-ins are effectively regulated, what's the basis for your assumptions?

Mr. BRAIN. Well, I believe in our review of those applications that have been filed with the Federal Reserve Board that I do not believe—and I will defer this to counsel in a moment—but I do not believe there's been a statement made that the purpose of doing it was to sell lower cost insurance.

The CHAIRMAN. That may not have been the purpose of the statement, but isn't it a fact or is it?

Mr. YATES. I'm not so familiar with the New York situation. What we base our concern on is the record on credit life, including certain credit property coverages and the fact that is why the most totally regulated lines of all insurance lines and the argument if the banks enter the business competition will somehow be en-

hanced I think is a total fallacy because the customer is going to buy insurance for reasons entirely unrelated to the price of the insurance and the service, and I think when you say competition is going to be enhanced, you have to keep in mind the record for credit life and credit disability.

Mr. HOWARD. Senator, may I speak to that? In Massachusetts, savings banks life insurance has been a fact of life for many years. It is true that the cost is significantly less than it is in the industry market.

One of the major reasons for that is a tax treatment which is entirely different than that imposed on the private industry.

The CHAIRMAN. Well, that's interesting. You can see that the cost is less and to that extent the public gets a benefit, but you say it's because of an unfair competitive advantage inasmuch as their tax treatment is a more favorable one in terms of premium taxes and in terms of corporate taxes.

TIE-IN ABUSES

Mr. Brain, Mr. Browne—you may have heard him testify just a few minutes ago—has indicated in his testimony that bank holding companies prior to the 1970 amendments to the Bank Holding Company Act could sell property and other insurance. Is there any evidence that tie-in abuses occurred or that independent insurance agents were forced out of business under that law?

Mr. BRAIN. Again, I would refer you, Senator, to pages 10, 11 and 12 of our formal testimony which I think you have on file, and prior to 1970, I'm not certain I can say. Can I defer to Mr. Wilson?

Mr. WILSON. Senator, prior to 1970 amendments, there were a relatively small number of bank holding companies, principally in the Midwest, that were permitted to go into the property and casualty insurance business.

In terms of the evidence that they produced, really the sample was relatively small and, furthermore, it's extremely difficult—we have been with this issue now for 10 years—it's extremely difficult to get any evidence because of the same reasons that the bank holding company is going to be able to sell the insurance for reasons having nothing to do with price and better service it's very unlikely that the consumer is going to come forward and complain about it and there have been admittedly relatively few complaints, although there have been complaints, notwithstanding the statement in the Federal Reserve tie-in study to the contrary.

The CHAIRMAN. I just have one other question, Mr. Brain. Holding companies, I understand, can only sell insurance that's credit related. They cannot renew policies once a loan is made. Insurance agents can offer a customer a full range of insurance and service all the customer's needs, so it would appear this would give insurance agents a competitive advantage over holding companies. What's your reaction to that?

Mr. BRAIN. Well, a good many businesses, Senator, maintain almost an open line of credit with their financial institutions on an ongoing basis, and as a consequence would be eligible for insurance in perpetuity, so to speak, under that provision in their loan arrangement.

I don't think that's a drastic curtailment to most significant banking customers as it would appear.

Mr. WILSON. Senator Proxmire, another thing to keep in mind, one of the advantages of the bank holding company is that you can put into the bank holding company system a whole range of financial institutions. For example, the mortgage company, if you have a big commercial loan, the initial extension of credit may come from the commercial bank and it will be short or medium term. If it's to build something that's going to involve permanent financing, generally the permanent financing would be done through the mortgage companies. The bank holding companies are permitted under the Fed's regulations to sell insurance in connection with the servicing of those loans which may go on for 30 years.

The CHAIRMAN. Senator Garn.

Senator GARN. Thank you, Mr. Chairman.

Mr. Brain, I just have one question and it's following up on what I have been talking about all day. I won't repeat myself because I have said it two or three times and I've said it over 3 or 4 years in various hearings.

I'm absolutely sympathetic to what the intent of this legislation is. I have stated many times how I have been a victim of tie-in sales myself, so I understand the problem. I wasn't put out of business by any means, but certainly I lost some business by what I considered to be unfair competition. However, again, I feel very, very strongly about this retroactive business.

The grandfather clause in both the House and the Senate version does go back to June 6, 1978 and that disturbs me and I might just as well put it out on the table. I don't believe in going backwards. That is a fundamental principle that applies with me and Senator Morgan on all sorts of legislation that comes before this committee that we have fought with the House on and I don't think it's fair to change the rules backward and I'm concerned about that.

I wish you would address yourself to that retroactive situation. It seems we are going from unfair to unfair and not stopping in the middle of the fair balance of resolving this problem, and again I say that as a former insurance agent who's totally sympathetic to what you're trying to accomplish.

Mr. BRAIN. Senator, I appreciate your views. First of all, the June 6 date came because that was the time that our original bill was introduced and due to some quirks of circumstance was not able to get reconciled between the House and Senate as you know.

Since that time, every application that has been processed by the Federal Reserve has been notified by them that they in effect were entering the insurance business at their own peril, that in effect they should recognize that there was pending legislation with this date on it and that they should behave or act accordingly with that prior notice.

So it cannot come as a surprise to anybody. They have been well advised that this legislation is pending, that it was being pursued, and the Federal Reserve itself brought that to their attention?.

Senator GARN. Well, that's the same answer Senator Durkin gave, but I would just repeat, there are a lot of things we talk about over and over and take years to enact, and I understand the problem and it goes back to my mayor days too. I remember

working on such things, totally apart from this, as how you would say to Little League people about public lands that weren't being used at the time that you'd say to some Little League or Boy Scout group that they could use the land and we'd put it in writing. It doesn't make any difference; 8 or 10 years later they come back and they're mad about it and it's retroactive. The perception is not good. But let me just say that this year we enacted a moratorium on the acquisition of U.S. banks by foreign banks and also in the International Banking Act of 1978 the grandfather date shows it was that of the Senate markup on the bill, even though similar legislation had passed the House twice before.

It seems to me a little bit inconsistent, if not unfair, that Congress is going to provide foreign interests more generous grandfather rights than U.S. banks. So there's a lot of other instances as I've said where legislation passed the House twice but what we used was the date the Senate did it. I'm dealing with a principle that has nothing to do with this particular issue, but again, issues that we deal with, and Senator Proxmire has heard me fight on that issue in committee last year. So that's my problem and I don't know that you can respond any more, but I want you to understand what my feelings are.

APPLICATIONS UNDER GRANDFATHER CLAUSE

Mr. BRAIN. If I may say one thing, I think since that date, a significant number of large bank holding companies have filed tentative applications with the Federal Reserve which we think was an effort by them to get under an amended grandfather clause. There would be a substantial entrance of major bank holding companies into our business under a grandfather clause under a date different from that pending application. They have been simply waiting to see if the grandfather clause would be changed some way so they could invade our business.

Senator GARN. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Morgan.

Senator MORGAN. Mr. Brain, I have two or three problems with the bill. Basically I'm sympathetic to what you're trying to get at, but there are two problems that I'm concerned with.

One is that it seems to be discriminatory. It applies to the bank holding companies over a certain size and I can understand the reasonable classification of 5,000 or $50 million, but a city of 5,000 or a bank holding company of $50 million on the basis, as you point out, it is smaller, it's more of a personal relationship and it's an accepted classification in the Bank Holding Company Act. But it doesn't apply to savings and loans. It doesn't apply to the big automobile financing companies.

And I notice in your statement that you filed with the committee a couple of the letters that are in that statement refer to automobile collision insurance. So I go on and enumerate several others that Mr. Ashley said over in the House that he—a study had been made which indicated that bank holding companies held only about 2 percent of the insurance. Now he also pointed out that in New Jersey the Supreme Court had held a similar law unconstitutional on the grounds it was discriminatory.

Now how do you reconcile these things?

Mr. BRAIN. Well, let me address myself first to the fact that you indicate we do not embrace all the possibilities. I guess, Senator, the best way I could answer that is with an old proverb: The best of the enemy, the better; and I think you do what you can and what's better you should do. A journey begins with a single step. You have to do what's practical.

As to the second part of your question as to the New Jersey Supreme Court, I think I need a practicing attorney to address that, and I'd be glad to have Mr. Wilson answer that.

Mr. WILSON. Senator, the situation in New Jersey was very different. The language in that bill was very different from the language that is being proposed in H.R. 2255 or S. 2874.

The thing that the court was most concerned about in the New Jersey case was that the language in the New Jersey bill exempted from the insurance prohibition in that bill finance companies that were affiliated with insurance companies. Everybody else was excluded and the judge took the position, well, look, there's no rational basis for that, and because you've got finance companies that the insurance industry was taking itself out of the situation. It wasn't evenly applied to all institutions similarly. So it was a very different bill than this.

Senator MORGAN. My second concern—and I don't know if there's any answer to it—but as Senator Garn said, I want you to know—is the preemption of the States rights or the State laws. I think it's generally known that my position has been and has always been that the Federal Government has far more to do than it can do and that institutions can best be regulated by the State where the legislators or Government officials are much closer to the people and in banking, until recently, this separation of power between the States and the Federal Government has been pretty well preserved. Even the old National Bank Law back in the 1860's did it.

Now in section 7, the States were given the right to regulate bank holding companies and so forth and you've got how many—22 or 26 States that have enacted laws, and I guess there are other States that have rejected these laws.

Now if we enact this law, aren't we really saying to the States, well, you know, we gave you this right, but we really don't like what you're doing so we're going to preempt it and take it over ourselves?

Before you answer that, let me say that we have had some very difficult situations with regard to usury laws. For instance the State of Arkansas has a 10-percent limitation in its constitution and it was posing a real problem, but I opposed the preemption of that as vigorously as I could and, to my knowledge now—I'm sure I've voted for some premption provisions in some of the many, many laws I've voted for—but to my knowledge, I have not voted for the preemption of any State laws. And how can I reconcile that position in this bill?

Mr. BRAIN. Senator, I don't believe our organization yields to anybody on our support of the right of States to regulate business. However, we believe that the circumstances that brought about the necessity for this kind of an act were created by the Federal Congress and through the Federal Bank Holding Company Act.

Had the Federal Bank Holding Company not been created, the States wouldn't have had bank holding companies that could do this. There are no State bank holding companies. Therefore, as a result of a Federal act, it almost seems we need a Federal answer to it is the best way I can respond to that part of your question.

Mr. YATES. I would add that I think State law has already been preempted. Before the bank holding company vehicle was developed, in over 40 States, State banks could not sell insurance, and now by selling it through either the holding company or an affiliate that's not a bank they can now sell insurance. In the same way, the National Bank Act only permitted sales of insurance in communities under 5,000. Today, because of the Bank Holding Company Act, that restriction can be gotten around.

LOOPHOLES CREATED

So it's important to stress—and this is one of the reasons we are focusing on the bank holding company law—we believe the bank holding company law has created loopholes by which current State banking laws and the National Bank Act are being changed and what we are asking in this bill is that banks that are a part of the bank holding companies be treated the same way as State banks and national banks are.

The CHAIRMAN. Senator Morgan, will you yield for a minute? I'm going to have to leave and if you will take over the chair I would appreciate it.

Senator MORGAN. Well, you don't dispute the fact, though, that States can now regulate this matter of bank holding companies, all of them, whether the bank holding companies are a State bank or a national bank?

Mr. YATES. No, and our firm opinion is that section 7 would retain the power of the States to enact more restrictive legislation, but it seems to me that essential to the Federal Bank Holding Company Act is the whole concern of what nonbanking activities bank holding companies should be able to engage in because of their strong economic power and their ability to dominate and radically restructure other nonbanking markets, and I think the Federal Congress should continue to be concerned with that.

Senator MORGAN. Well, if you want to make a two-way street, you say that the States would still have the right to make it more restrictive. Would you be willing to give the right to the States to make it less restrictive if they chose to?

Mr. BRAIN. Senator, one of the things that comes about—I have had some little experience in my own State. But banks when they appear before a State legislature contemplating some restriction on their ability to go in the insurance business point to this act as a Federal endorsement of the fact that they should have the right to go into the insurance business, that if the Federal Government perceives that they should, why should the State interfere; and they have used this testimony before State committees on this basis.

Senator MORGAN. Well, that's part of the point. That's a problem I have.

Mr. WILSON. Senator Morgan, if I could just address that point, if you let the States expand the insurance activities bank holding

companies could engage in, what you would be doing is you would be letting the legislatures of 50 States tell the Federal Reserve Board insofar as concerns insurance what closely related to banking means, and it would be chaotic for the Federal Reserve Board which would retain the responsibility of regulating activities of bank holding companies to determine what that meant and so it would be unworkable.

Senator MORGAN. Well, don't we do it now? Don't you have 22 or 26 States that have said it with regard to insurance?

Mr. WILSON. They have said that the Bank Holding Company Act says the Federal Reserve Board can let these people do only what is closely related to banking. The Federal Reserve Board has interpreted that to mean as far as insurance is concerned let the banks do certain things. These bills would not change section 7 of the act in any way. That provision of the act permits the legislatures to make laws that are more restrictive than the Bank Holding Company Act and not less, and this bill wouldn't change that.

Senator MORGAN. Thank you.

Senator SARBANES. Gentlemen, let me just pursue the line of questioning here that Senator Morgan was addressing in the closing part of his inquiry period.

In effect, what happened is that the Bank Holding Company Act as interpreted by the Federal Reserve permitted bank holding companies to engage in activities which heretofore they had not been able to engage in either under the National Bank Act or under State banking acts. Isn't that correct?

Mr. BRAIN. That's correct.

Senator SARBANES. Now it may be the case that section 7 of the Bank Holding Company Act would allow the States to preclude or limit such activity. Is that how you interpret it?

Mr. BRAIN. Correct.

Senator SARBANES. But the fact is that the burden of exercising shifted the authority contained in section 7 with the enactment of the Federal Bank Holding Company Act. In other words, before the Federal legislation was enacted, there weren't bank holding companies and therefore you did not have them engaged in this activity. Now there are bank holding companies, and the act has been interpreted to permit them to engage in this activity. Therefore, if a State does not want them to do so, the State now has to take an affirmative action to preclude it. Is that not correct?

Mr. BRAIN. That's correct.

Senator SARBANES. So from your own perspective, you find yourselves in a situation where this activity was previously not permitted, and Federal legislation now made it permissible. It is true it can be precluded, but in order to accomplish that, you now have to obtain affirmative State action. Is that not the case?

Mr. BRAIN. We must take the initiative, Senator, yes.

Senator SARBANES. In effect what you are saying is now rather than seeking affirmative action in each of the 50 States using section 7 of the Bank Holding Company Act, you are seeking Federal legislation to cover it. You are responding to the problem in this way because you perceive it as having been imposed upon you by or having resulted from Federal legislation in the first place. Would that be a fair summary of your position?

Mr. BRAIN. I think that's a reasonable summary, yes.

Senator SARBANES. Now, Mr. Brain, I want to just make a different sort of comment here. Senator Eagleton said to me that you were an extremely able and thoughtful person, and I must say to you I think your statement and your responses here this morning have reflected that.

Mr. BRAIN. Thank you, sir.

Senator SARBANES. Whether or not I agree with every aspect of your position is beside the point. You have been a very effective witness and you have certainly brought out everything Senator Eagleton said about you.

Mr. BRAIN. Thank you, and I'll drop Senator Eagleton a note.

Senator SARBANES. I'm a little interested in knowing more about your organization, about the national association. Would you take some time to put that on the record? It might help me. I take it your people are all independent businessmen.

Mr. BRAIN. Yes, sir.

Senator SARBANES. They are not the managers or the representatives or the agents for some large company where decisions are handed to them from somewhere else; they make their own decisions at the local level. Is that correct?

Mr. BRAIN. Our people I think—and I always worry about saying completely, but I should say overwhelmingly, predominantly, to use the strongest word I can think of, Senator, are people who operate their own independently owned business in a community in which they are residing and have their business.

Senator SARBANES. You say that is some 35,000 agencies across the country?

Mr. BRAIN. Well, it's between 34,000 and 35,000 agencies and let me explain just for the record, sir, when we talk about agencies, we are talking about a business entity. For instance, in my agency there are a number of people. So, for instance, in the 34,000 or 35,000, there are some 126 licensed insurance people doing business. There could be several people in one office. There could be only one. There could be varying size of offices.

Senator SARBANES. Let me address two points that came up this morning. I'm interested in your thinking on them. One was the assertion made by the previous panel that no instances could be cited of coercion with respect to placing insurance business with the bank holding companies. I take it that your response is at least in part the examples cited on pages 10 through 12 of your testimony?

Mr. BRAIN. Yes, sir.

SHIFTING BUSINESS TO BANK

Senator SARBANES. I was particularly interested in the example at the bottom of page 11 and the top of page 12 because it seemed to me to underscore a point the chairman made in the course of his questioning. The customer or agency shifting his business to the bank says, "As you know, *x* bank does the financing on our new car inventory. We feel we have to place the coverage with the bank because we so frequently request special favors of them. Please also be assured that this in no way implies that the bank has forced us to make this change in our insurance program."

It seems to me that from the bank's perspective it's quite possible that they may in fact see this as not forcing or requiring something. What you have is a lot of people acting out of their own perception of their self-interest, which leads them to take this course of action—sort of saying that it would probably be to their advantage.

Now questions probably would not leave anything specific that the bank had done to lead them to such a decision and I assume the bank in question would be able to deny they had done anything specific. How much of this sort of pattern of behavior do you think exists?

Mr. BRAIN. Senator, first of all, with your permission, the gentleman who received that letter is in our audience. I might like to ask Mr. Kramer from Salisbury, Md. if he has any comments.

Mr. KRAMER. No. I think the Senator understands the situation exactly the way it is, although there are some other ramifications later on in that the automobile dealer involved found out he did not have the level of coverage he thought he had, in addition to the price difference.

Mr. BRAIN. I think what it amounts to, Senator, a great many people who, needing a line of credit or money from a bank, when they go to the bank and the banking officer says to them,"We have an insurance agency on the third floor. We'd like to have them just look at your insurance or something," he'll say, "Would it help things if I bought the insurance from you?" It's sort of an involuntary or a very subtle form of coercion, but it does exist and it cannot be denied.

Senator SARBANES. I want to ask you about the date question. It's your view, as I understand it, that in effect applicants were placed on notice of a possible change at that time by the Federal Reserve, and therefore, if they went forward, they did it aware of the risk of legislation. Is that correct?

Mr. BRAIN. Yes, sir.

Senator SARBANES. Second, I take it to be your position, in addressing the situation as you see it, that that date becomes important because the number of entrants since then or the number of potential entrants lined up to come in is very long and indeed. Is that correct?

Mr. BRAIN. And they are major bank holding companies, Senator, that have filed an application and the Federal Reserve Board in some cases has said to them, "Why don't you wait to see what happens," and they said, "OK, but leave our application on file so we'll be on record in the event this changes." So there would be a significant entry.

I think one of the questions you have to ask yourself is—and I recognize that nothing is perfect—perfection is difficult to achieve—but would it be more equitable to allow them in or would it be more equitable to the other banks to make all bank holding companies on the same footing? You have to look at there's going to be a discrimination against some of the others about the delays. I think there's a question both ways.

Senator SARBANES. What about the issue raised about other financial institutions, S. & L.'s and so forth?

Mr. BRAIN. Well, Senator, we are dealing with the bank issue at this time.

Senator SARBANES. Do you see these other areas as a problem, or is the amount of financial power lying behind these institutions not significant enough that you see it as a problem?

Mr. BRAIN. Well, Senator, first of all, a building and loan confines itself to certain segments of transactions. A commercial bank and particularly a major bank holding company with the billions of dollars of assets they have and their position where they have their tentacles in every stream of commerce are in a unique position to influence them which the building and loan is not. We feel the greater danger is there.

Senator SARBANES. Well, gentlemen, this has been a very helpful panel. Is there any comment you'd like to add before I adjourn the meeting?

Mr. BRAIN. Senator, we'd like to thank you for the courtesy to appear here and we stand available if you need more information. We would be delighted to submit either written testimony or whatever you need. Thank you.

Senator SARBANES. The hearing stands adjourned.

[Whereupon, at 12:25 p.m., the hearing was adjourned.]

[Additional material received for the record follows in the appendix:]

65-630 O—80——10

APPENDIX

96TH CONGRESS
1ST SESSION

S. 39

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

IN THE SENATE OF THE UNITED STATES

JANUARY 15, 1979

Mr. PROXMIRE introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

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A BILL

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

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

SECTION 1. This Act may be cited as the "Competition in Banking Act of 1979".

FINDINGS AND PURPOSES

SEC. 2. Congress finds that—

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

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

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

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

STANDARDS FOR BANK MERGERS

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

"(5) The responsible agency shall not approve—

"(A) any proposed merger transaction which would result in a monopoly, or which would be in furtherance of any combination or conspiracy to monopolize or to attempt to monopolize the business of banking in any part of the United States, or

"(B) any other proposed merger transaction whose effect in any section of the country may be substantially to lessen competition, or to tend to create a monopoly, or which in any other manner would be in restraint of trade, unless it finds that the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served, or

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

able failure of a bank and that a less anticompetitive alternative is not available.

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

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

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

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

held, and subpenas to that end may be served in any district by the marshal thereof.

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

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

STANDARDS FOR BANK HOLDING COMPANY ACQUISITIONS OF BANKS

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

"(c) The Board shall not approve—

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

conspiracy to monopolize or to attempt to monopolize the business of banking in any part of the United States, or

"(2) any other proposed acquisition or merger or consolidation under this section whose effect in any section of the country may be substantially to lessen competition, or to tend to create a monopoly, or which in any other manner would be in restraint of trade, unless it finds that the anticompetitive effects of the proposed transaction are clearly outweighted in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served, or

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

failure of a bank and that a less anticompetitive alternative is not available.

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

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

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

"(2) The district courts of the United States have jurisdiction to prevent and restrain violations of paragraph (1) of

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

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

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

STANDARDS FOR BANK HOLDING COMPANY ENTRY INTO BANK RELATED ACTIVITIES

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

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

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

"(B) is likely to produce substantial benefits to the public which clearly and significantly outweigh possible adverse effects. For the purposes of this subparagraph, (i) the term 'substantial benefits to the public' includes increased competition over the course of time and greater con-

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

(b)(1) Notwithstanding the provisions of subsection (a), and subject to the provisions of subparagraph (2) of this subsection, a bank holding company may continue to engage in

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

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

a bank holding company or its banking subsidiary to provide effective banking services to the public.

UNIFORM APPLICATION OF STANDARDS GOVERNING ENTRY INTO BANK RELATED FIELDS

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

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

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

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

STANDARDS FOR SOUND AND COMPETITIVE FINANCING OF NONBANKING ACTIVITIES

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

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

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

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

report. The Board shall make such reports available to the public.".

ADMINISTRATIVE PROCEDURES AND JUDICIAL REVIEW

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

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

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

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

"(2) No application made under section 4(c)(8) shall be held or considered to be an application for an initial license

within the meaning of subsection (d) of section 554 of title 5 of the United States Code.

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

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

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

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

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

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

"(A) a finding that a particular activity conducted on the part of a bank holding company or its subsidiary

fails to conform to the scope of the activity for which Board approval was originally given;

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

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

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

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

petition, it shall publish in the Federal Register its reasons for such denial.

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

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

EFFECTIVE DATE

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

96TH CONGRESS
1ST SESSION

S. 380

To amend the Bank Holding Company Act of 1956 to limit the property and casualty and life insurance activities of bank holding companies and their subsidiaries.

IN THE SENATE OF THE UNITED STATES

FEBRUARY 7 (legislative day, JANUARY 15), 1979

Mr. DURKIN (for himself and Mr. TSONGAS) introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

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A BILL

To amend the Bank Holding Company Act of 1956 to limit the property and casualty and life insurance activities of bank holding companies and their subsidiaries.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 4(c)(8) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(c)(8)) is amended by striking the period at the end of the first sentence thereof and adding the following: ", but for purposes of this subsection it is not closely related to banking or managing or controlling banks

for a bank holding company to provide insurance as a principal, agent or broker except (i) where the insurance is limited to assuring repayment of the outstanding balance due on a specific extension of credit by a bank holding company or its subsidiary in the event of the death or disability of the debtor; or (ii) any insurance agency activity in a place that (A) has a population not exceeding five thousand (as shown by the last preceding decennial census), or (B) the bank holding company, after notice and opportunity for a hearing, demonstrates it has inadequate insurance agency facilities; or (iii) any insurance activity engaged in by a bank holding company or any of its subsidiaries pursuant to an application which was approved prior to June 6, 1978; or (iv) any insurance agency activity engaged in by a bank holding company, or any of its subsidiaries which bank holding company has total assets of $50,000,000 or less: *Provided, however,* That such bank holding company and its subsidiaries may not engage in the sale of life insurance or annuities except as provided in (i) or (ii) above.".

96TH CONGRESS
2D SESSION

H. R. 2255

IN THE SENATE OF THE UNITED STATES

JUNE 16 (legislative day, JUNE 12, 1980)
Read twice and referred to the Committee on Banking, Housing, and Urban Affairs

AN ACT

To amend the Bank Holding Company Act of 1956 to limit the property and casualty and life insurance activities of bank holding companies and their subsidiaries.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 4(c)(8) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(c)(8)) is amended by striking out the period at the end of the first sentence and inserting in lieu thereof the following: ", but for purposes of this subsection it is not closely related to banking or managing or controlling banks for a bank holding company to provide insurance as a principal, agent, or broker except (A) where the insurance is limited to assuring repayment of the outstanding balance due

on a specific extension of credit by a bank holding company or its subsidiary in the event of the death or disability of the debtor; (B) in the case of a finance company which is a subsidiary of a bank holding company, where the insurance is also limited to assuring repayment of the outstanding balance on an extension of credit in the event of loss or damage to any property used as collateral on such extension of credit and, during the period beginning on the date of the enactment of this subparagraph and ending on December 31, 1980, such extension of credit is not more than $10,000 and for any given year after 1980, such extension of credit is not more than an amount equal to $10,000 increased by the percentage increase in the Consumer Price Index for Urban Wage Earners and Clerical Workers published monthly by the Bureau of Labor Statistics for the period beginning on January 1, 1980, and ending on December 31 of the year preceding the year in which such extension of credit is made; (C) any insurance agency activity in a place that (i) has a population not exceeding five thousand (as shown by the last preceding decennial census), or (ii) the bank holding company, after notice and opportunity for a hearing, demonstrates has inadequate insurance agency facilities; (D) any insurance agency activity that was lawfully engaged in by (i) a bank holding company or any of its subsidiaries on June 6, 1978, or (ii) a finance company which became a subsidiary of a

bank holding company through acquisition during the period beginning on June 6, 1978, and ending on June 6, 1979; (E) any insurance activity where the activity is limited solely to supervising on behalf of insurance underwriters the activities of retail insurance agents who sell (i) fidelity insurance and property and casualty insurance on the real and personal property used in the operations of the bank holding company or any of its subsidiaries, and (ii) group insurance that protects the employees of the bank holding company or any of its subsidiaries; or (F) any insurance agency activity engaged in by a bank holding company, or any of its subsidiaries, which bank holding company has total assets of $50,000,000 or less: *Provided, however,* That such bank holding company and its subsidiaries may not engage in the sale of life insurance or annuities except as provided in subparagraph (A), (B), or (C).".

Passed the House of Representatives June 12, 1980.

Attest: EDMUND L. HENSHAW, JR.,
Clerk.

By THOMAS E. LADD,
Assistant to the Clerk.

AMERICAN BANKERS
INSURANCE GROUP
600 Brickell Avenue, Miami, Florida 33131 (305) 374-2244

STATEMENT OF

AMERICAN BANKERS INSURANCE GROUP

ON S. 380 AND H.R. 2255

BANK HOLDING COMPANY PROPOSALS

TO THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

UNITED STATES SENATE

July 1, 1980

Submitted By:

William J. O'Halloran
Senior Vice President

M. Ray Niblack
Washington Liaison

American Bankers Insurance Company is one of the largest underwriters of credit property insurance in the United States. This is insurance on collateral that secures installment credit. It is often offered to consumers who are unable to obtain casualty insurance for a variety of reasons.

S. 380 as written would restrict arbitrarily the writing of such insurance and would provide no effective alternative to it. We feel that this is a disservice to many consumers and is competitively unfair since it would only prohibit the issuance of such insurance by certain lenders who happen to be subsidiaries of a class of bank holding companies, while allowing those companies who are not subsidiaries of bank holding companies to continue to issue such insurance.

Credit Property Insurance

Credit property insurance, while not a major part of the general casualty insurance business, is very important to those who use it. A typical example of persons affected is that of renters or persons living in "redlined" areas, such as exist in many American cities, where obtaining a homeowner's or tenant's policy to protect their household goods may be nearly impossible.

Such consumers often purchase their household furnishings on credit with those furnishings serving as the collateral on the loan. If the items purchased and serving as collateral are lost for any reason—fire, vandalism, theft, flood—and there is no insurance on them, the goods are lost, but the payments are still due.

Our insurance replaces those purchases. Thus, the collateral is preserved to protect the lender, and the purchaser is not faced with being deprived of his goods or managing double payments to replace them.

The average credit property premium per policy last year was $53.00. This insurance is offered without any of the usual underwriting considerations. It is offered at the same state-regulated premium to all as a part of the credit transaction without regard to occupation, age, location, or any other considerations. Also, the purchaser is given a thirty-day period to provide evidence of substitute insurance, at which time his premiums are refunded in full.

Insurance agents cannot economically offer this insurance at the premium amount mentioned above. In addition, they would be required to underwrite in detail each and every policy. Indeed, the insurance agents themselves previously testified that they have no objection to the exclusion of credit life and accident and health because such insurance is traditional and serves a public purpose which they cannot duplicate. We think credit property insurance, in this respect, is wholly analogous.

In fact, this insurance was designed to fill a gap that agents could not. In addition, because of the detailed underwriting requirements and small premiums per policy, the mainstream insurance carriers are not interested in serving this market, even if the agents desired to do so.

Insurance Default Coverage

Another program of American Bankers Insurance Group that would be affected is our insurance default program. This insurance is offered through mortgage companies to cover instances where the normal homeowner's insurance policy on a mortgaged property has, for whatever reason, been cancelled or not renewed, and the owner either does not replace the policy, or as is often the case, cannot find replacement coverage.

The homeowner is notified of the void in coverage and asked to replace the policy. If he cannot replace the policy, American Bankers Insurance Group will duplicate the coverage for one year or until the situation can be remedied.

This program is acceptable to the Department of Housing and Urban Development. Once again, we have a program that provides protection to people who may be caught by the unfortunate circumstance of being in an area where the obtaining of usual homeowner's coverage through insurance agents is either difficult or impossible.

Questions of Equity—Business and Consumers

American Bankers Insurance Group does not pretend to be knowledgeable in all aspects of the issues involved in bank holding company activities, but we are puzzled as to the need for the prohibition contained in S. 380. We think it should be obvious from this and other testimony that credit property insurance in no way poses a threat to the activity of independent insurance agents, any more than the exempted credit life and accident and health insurance.

Additionally, the bill raises other serious questions of equity. Not only does the bill single out lenders who happen to be subsidiaries of bank holding companies for restriction, but it further singles out those lenders who happen to be subsidiaries of a bank of a certain size. The bill excludes from its restrictions all bank holding companies with assets of $50,000,000 or less—a substantial majority of the bank holding companies in the United States. Thus, only a certain class of bank holding companies would be covered by the bill without, in our opinion, any basis having been established for such discriminatory treatment. In addition, a wide range of lenders who are not bank holding companies or subsidiaries are untouched.

This raises the possible effect on the consumer who may wish, for whatever reason, to borrow from a particular lender and desires the insurance coverage. However, if the lender he chooses is a subsidiary of a bank holding company, he would be forced to go to another lender or obtain coverage himself. If the consumer opts for the latter choice, we think he will certainly incur a much higher cost—if he can get the coverage at all.

For the reasons stated here, we believe S. 380 to be defective. Indeed, we have cited only those defects which affect us and our clients in ways which we believe the Congress does not intend. For instance, the result of passage of S. 380, as is, would be to aggravate an already unconscionable redlining problem in many American cities—a result we feel certain is not intended. There may be many other side effects of which we are unaware.

McCarran-Ferguson Act

We know the provisions of S. 380 have been around for a long time in one form or another, but we hope that this Committee will not feel disposed to move precipitously. Even though this is bank holding company legislation, ipso facto, it is legislation affecting insurance—a complex regulatory field which Congress under the McCarran-Ferguson Act has heretofore left to the states. What the Congress has done, it can undo, but we believe that any such action should be taken in a most deliberate manner and with great caution.

During these hearings a number of questions have arisen about "abuses" of insurance offered through lending institutions. Truth-In-Lending legislation plus the positive reaction of state insurance commissions to consumer protection has resulted in state regulation of a prevailing nature which minimizes the occasion for abuses of lender-offered insurance. These regulations are tailored to what the states see as in the best interests of their particular constituents in their particular states. This legislation in part would preempt those local decisions whether the state insurance departments like it or not.

American Bankers Insurance Group urges this Committee not to report this bill, at least not without extensive further study. Or if the bill is reported, it should contain, in fairness to the affected business operations and in the consumer's interest, a simple amendment to exclude from its restrictions all credit-related insurance.

ASSOCIATION of BANK HOLDING COMPANIES

DONALD L. ROGERS
PRESIDENT

730 FIFTEENTH STREET, N.W., WASHINGTON, D.C. 20005
(202) 393-1158

June 13, 1980

Honorable William Proxmire, Chairman
Committee on Banking, Housing
and Urban Affairs
Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

I am writing to advise you of our Association's opposition to the insurance industry monopoly bill, H.R. 2255, and its companion Durkin bill, S. 380, which are pending before your Banking Committee. Perhaps it is more persuasive for you to know that all the interested government agencies share our concern, including the Federal Reserve Board, Treasury Department, Comptroller of the Currency, Justice Department, Federal Trade Commission and State Bank Supervisors.

If your committee does decide to take up this legislation, we respectfully request that public hearings be held and that representatives of our Association, as well as the government agencies and consumer groups, be given an opportunity to present their views. We believe it is important that the full impact of the elimination of our member companies as potential competitors in the offering of property and casualty insurance should be thoroughly explored. I am enclosing a brief analysis of some of the issues involved, and I particularly call your attention to the very unfair "grandfather" clause, which is retroactive to June 6, 1978.

Thank you for your consideration of our request.

Sincerely yours,

Donald L. Rogers

DLR:jlm

Enclosure (1)

6/13/80

ASSOCIATION OF BANK HOLDING COMPANIES
730 Fifteenth Street, N.W.
Washington, D.C. 20005

Analysis of
Insurance Industry Monopoly Bill, H.R. 2255
As Approved by the House

Introduction

The insurance industry monopoly bill, H.R. 2255, is pending before the Senate Banking Committee, but no hearings have been scheduled. The bill was drafted by the Independent Insurance Agents of America and represents the culmination of a multimillion dollar campaign to overturn previous decisions of the Congress, the Federal Reserve Board, and the United States Supreme Court.

The bill is opposed by the Association of Bank Holding Companies, American Bankers Association, Federal Reserve Board, Treasury Department, Comptroller of the Currency, Justice Department, Federal Trade Commission, and State Bank Supervisors because of its basic anticompetitive nature.

General Prohibition

The bill would amend section 4(c)(8) of the Bank Holding Company Act to declare that it is not closely and directly related to banking for a bank holding company to provide insurance as a "principal, agent, or broker" and then lists seven exceptions to the general prohibition. The primary purpose of the general prohibition is to eliminate bank holding companies as potential competitors to insurance agents by preventing bank holding companies from selling property and casualty insurance to their customers in connection with loans made to them. Bank holding companies already are prohibited from selling insurance to the general public except in communities having a population of less than 5,000 or without other insurance sources.

It is not clear why the general prohibition extends to a "principal" since insurance agents or brokers are never "principals." Even though the Federal Reserve Board does not permit bank holding companies to act as principals in regard to life insurance, it may very well be that the insurance agents are acting on behalf of the large life insurance companies who want a statutory prohibition against competition, but prefer to remain in the background because of McCarran-Ferguson Act implications. A similar preoccupation with protecting life insurance companies from competition is seen in the last clause of the bill, which will be discussed below.

It should be noted that the prohibition applies only to bank holding companies and does not apply to other financial institutions selling insurance, such as, savings and loan associations, and their holding companies and service corporations; mutual savings banks; credit unions; finance companies; mortgage banking companies; and securities brokers.

Credit Life Insurance Exception

Bank holding companies would be permitted to continue to provide credit life insurance and credit accident and health insurance to their loan customers.

Finance Company Exception

Finance company subsidiaries of bank holding companies would be permitted to offer up to $10,000 in property and casualty insurance to their loan customers.

Insurance on Own Employees

Bank holding companies would be permitted to act as agents for insurance on their own employees and their own nonbank subsidiaries.

5,000 Population Exception

Bank holding companies would be permitted to have insurance agencies in any place with a population of less than 5,000. The precedent for this exception is found in the 1916 statute giving national banks the same authority.

Inadequate Facilities

Bank holding companies would be permitted to have insurance agencies in any city, town or village where it can be demonstrated that the insurance agency facilities are inadequate. This exception seems to recognize that there are certain situations where bank holding companies can fill a vacuum, such as where the insurance agents have "redlined" inner-city neighborhoods.

Grandfather Clause

Bank holding companies would be permitted to continue any insurance activity "lawfully engaged in" on June 6, 1978, which is the date a House subcommittee first voted on this issue. The use of a date retroactive more than two years is contrary to past precedents in amendments to the Bank Holding Company Act and other banking legislation and is obviously unfair. The most recent precedent for a "grandfather" clause is the Depository Institutions Deregulation Act of 1980, where the date of the Conference Committee action, March 5, 1980, was used in connection with the trust company and foreign acquisition moratoria. Another recent precedent is in the International Banking Act of 1978 where a current year date was used. Similarly, contrary to precedent, no protection is given to applications pending on June 6, 1978. Also, the provision fails to take into consideration insurance activities which were "grandfathered" in 1956, 1966 and 1970, and where there was never any occasion to have an application approved by the Board.

Finally, and also contrary to past practice, no provision is made for equitable tax treatment for shareholders of bank holding companies which would be required to divest their post-June 6, 1978, insurance activities and thereby suffer losses.

$50 Million Exception

Bank holding companies with $50 million or less in assets are exempted from the general prohibition on insurance agency activities except that they may not sell life insurance. This loophole was sponsored by the Independent Bankers Association of America and means that 60 percent (1,243) of all bank holding companies would be permitted to engage in a full range of insurance agency activities with the general public except for life insurance. It also opens the door for the 10,000 banks with less than $50 million in assets to organize one bank holding companies and take advantage of this loophole. The logic of saying that insurance agency activities are closely related to banking when engaged in by a bank holding company with $50 million in assets, or less, but is not closely related if the bank holding company has $51 million in assets, or more, is difficult to comprehend. As mentioned in the discussion under "General Prohibition," special care is taken in the bill to protect life insurance companies from competition even from small bank holding companies.

States' Rights

Twenty-three states have enacted statutes governing the insurance activities of bank holding companies. This bill would override these statutes, and, for the first time, there would be a federal preemption of state insurance laws.

The importance of this precedent was recognized by several members of the House Banking Committee who sponsored the following provision:

"SEC. 2. The amendment made by the first section of this Act shall not supersede existing State laws and shall cease to be effective with respect to any State on the date on which such State enacts a law which in substance contravenes the amendment made by the first section of this Act."

However, the House Committee rejected this amendment by a 22 to 21 vote.

ASSOCIATION of BANK HOLDING COMPANIES

1981 JUN 27 AM 11:52

DONALD L. ROGERS
PRESIDENT

730 FIFTEENTH STREET, N.W., WASHINGTON, D.C. 20005
(202) 393-1158

June 26, 1980

Honorable William Proxmire, Chairman
Senate Committee on Banking, Housing
and Urban Affairs
Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

We were distressed to learn that your Banking Committee's hearing July 2 on H.R. 2255 and S. 39 has been rescheduled for July 1. Unfortunately, our Association's Chairman Paul Mason has a prior commitment for that day and will not be able to testify on our behalf.

I am enclosing Mr. Mason's testimony on H.R. 2255 and S. 39 together with an analysis of H.R. 2255; a discussion paper entitled "The Role of Insurance in Bank Holding Company Activities"; and a detailed statement on S. 39. We respectfully request that these documents be made a part of the record of the July 1 hearing.

If for any reason the July 1 hearing is rescheduled for a later date, we would appreciate being notified and given the opportunity to testify.

Sincerely yours,

Donald L. Rogers

DLR:slg

Enclosures

cc: Paul Mason

ASSOCIATION OF BANK HOLDING COMPANIES

Statement to
Senate Committee on Banking, Housing and Urban Affairs
in Opposition to
H.R. 2255 and S. 39
July 2, 1980

Mr. Chairman and members of the Committee, my name is Paul Mason, and I am president of the First United Bancorporation, Inc., Fort Worth, Texas. I am appearing here today in my capacity as chairman of the Association of Bank Holding Companies. Accompanying me is Donald L. Rogers, president of our Association.

I am submitting for the record three documents detailing our opposition to H.R. 2255 and S. 39, and I ask that they be printed as part of my testimony. I would like to use the limited time allotted to us to discuss the broader implications of this legislation.

The two bills have one common denominator - their purpose is to restrict competition. H.R. 2255 takes the narrow approach of specifically eliminating bank holding companies as competitors in the property and casualty insurance business while S. 39 takes the broad approach of restricting bank holding companies and banks as competitors in the entire range of financial services.

We submit that these bills cannot be reconciled with the basic tenet of the Depository Institutions Deregulation Act of 1980 of promoting more competition between financial institutions and less regulation. These bills are a throwback to the old concepts of carving out special sanctuaries to protect financial institutions from their competitors. As a matter of fairness, it is difficult to rationalize the grant of new powers to thrift institutions a little more than 3 months ago with the proposals here to take away powers that bank

holding companies and banks have enjoyed for many years. Obviously, the "level playing field" theory is not promoted by this legislation.

There are several specific points I would like to make.

1. Consumers are the Losers. The big losers in this legislation are the consumers. By eliminating bank holding companies and banks as potential sources of financial services, the consumers will be denied the possibility of more convenient, more efficient and less costly services.

2. Inflationary Impact. The elimination of competition makes it easier to raise prices and, therefore, this legislation tends to be inflationary at a time of double-digit inflation. As the White House pointed out in October 1978 ". . ., it is especially important that the pressure of individual groups that seek government measures to protect them against domestic and international competition be resisted."

3. No Growth Policy. By freezing the expansion of both the bank and the financially related activities of the most progressive element of American banking, this legislation represents a "no growth" economic policy. Since bank holding companies have about 67 per cent of the country's banking deposits, the American public will suffer as a result of a more stagnant economy.

4. Perpetuating Monopolies. By prohibiting bank holding companies and banks from providing certain financial services, this legislation will help perpetuate existing monopolies. Have the members of the financial services industry supporting this legislation served America so well that they should be given a statutory grant of immunity from competition forever?

5. Big is Bad. This legislation incorporates the much debated and rejected concept that "big is bad" despite the fact that banking is one

of the least concentrated major industries in America. The supreme irony is that the principal impact will be on regional banking organizations like mine and not on money center institutions.

6. Corruption of Act. As the name implies, the Bank Holding Company Act was designed to regulate bank holding companies. Rather than proposing straight forward amendments to the National Bank Act, this legislation attempts to corrupt the purpose of the Bank Holding Company Act by making it apply to national banks.

7. Discriminatory and Unfair. This legislation is discriminatory and unfair because it arbitrarily singles out bank holding companies for prohibitions and restrictions not applied to any other financial institutions. What ever happened to the constitutional doctrine of "equal protection of the laws"?

8. Unfair Competition. Over the past 10 years, our competitors have repeatedly alleged that they are the victims of unfair competition from bank holding companies. We, as well as the Federal Reserve Board and the Justice Department, are still waiting for concrete evidence to support such allegations of violations of the law.

9. Harm to Competitors. Vague allegations have also been made that the business of competitors has been harmed by bank holding companies. Yet upon investigation it is found either that bank holding companies are not even in the business, e.g. mortgage guaranty insurance and travel agencies, or the portion of the business conducted by bank holding companies is miniscule, e.g. automobile leasing, insurance, and securities.

10. Opposition of Government Agencies. Every federal government agency that has been given an opportunity to comment on the legislation of this nature has opposed it because of its blatantly anticompetitive and

anticonsumer nature. We believe their views should be heard and be given great weight.

11. More Regulation. This legislation would further add to the regulatory burden of bank holding companies and banks at a time when the Administration, the Congress, and this Committee have endorsed the principle of deregulation.

12. "Grandfather" Dates. Both bills violate the principles of equity and fairness by using retroactive "grandfather" dates. In one case, a 1978 date is used, and in the other a 1975 date is proposed - contrary to all past precedents of this Committee.

Conclusion

We regret to being forced to present such a negative position. We would have preferred to have had the opportunity to support constructive and progressive measures, such as the Federal Reserve Board's bill, S. 1047, to modernize Section 23A of the Federal Reserve Act; or to have the opportunity to discuss the desirability of establishing a national policy on emergency acquisitions of failing financial institutions; or to explore the possibility of permitting bank holding companies to consolidate with other bank holding companies in contiguous states. Hopefully, as your Committee moves further into the new era of competition and deregulation, subjects like these will have a higher priority and disputes between competitors will be left to the marketplace for final decision.

ASSOCIATION OF BANK HOLDING COMPANIES

The Role of Insurance in Bank Holding Company Activities
May 1979

Introduction

There is a great deal of misunderstanding prevalent about the role of insurance in bank holding company activities. This is reflected in such comments as, "Banks should stay out of the insurance business." The fact is that banks and bank holding companies are not now in the insurance business, nor could they enter the business. The role of insurance for bank holding companies is an extremely limited one, clearly defined and enforced by the Federal Reserve Board's Regulation Y on the one hand, and by the courts on the other. What is permissible for bank holding companies is a small list of insurance activities that must be related to an extension of credit.

For example, bank holding companies, with one exception, are prohibited from selling any kind of insurance to the general public. Moreover, bank holding companies may not sell or engage in:

1. Life insurance;

2. Insurance premium funding, i.e., the combined sale of mutual funds and insurance;

3. Insurance for the bank holding company; and

4. Insurance for nonbank subsidiaries of the holding company.

Bank holding companies are currently permitted to sell:

1. Credit life and credit accident and health insurance sold in connection with extensions of credit. (This type of insurance, which is not in controversy, may also be underwritten by bank holding companies.)

2. Property and casualty insurance sold in connection with extensions of credit. (For example, insurance protecting an automobile or home purchased with a loan from an affiliated bank.)

3. Insurance for banking subsidiaries of the holding company.

4. Insurance to the public in towns under 5,000. (The Federal Reserve Board has been directed by the Fifth Circuit Court of Appeals to proceed with making findings of fact to support the validity of this authority.)

In imposing such narrow restrictions on the insurance activities of bank holding companies, the Fed has been guided by the legislative history of the Bank Holding Company Act. Prior to the enactment of the original Bank Holding Company Act (in 1956), bank holding companies had been selling insurance as part of their general banking functions. In the years between 1956 and the 1970 amendments to the Act, the Fed consistently interpreted the law as authorizing bank holding companies to engage in certain insurance agency activities. The 1970 amendments to the Act authorized the Board to continue to authorize the sale of insurance by bank holding companies under approximately the same conditions as had prevailed prior to 1970.

Early in 1971, the Fed, in conformance with the just-enacted amendments, launched a rulemaking proceeding which included a hearing devoted specifically to insurance agency activities. All parties had a full opportunity to present their views at this hearing. The Board issued an insurance ruling under Regulation Y in August 1971. Following a number of requests by insurance agents and their trade associations, the Board authorized a series of hearings before an administrative law judge in 1973. Once again, interested parties were permitted a full opportunity to be heard. The administrative law judge

subsequently handed down a decision, and the Board issued a final decision in July 1974. On July 30, the Independent Insurance Agents of America filed suit in the U.S. Circuit Court of Appeals for the District of Columbia challenging the Board's decision. This suit was later consolidated with a similar suit pending in the Fifth Circuit, which ruled in 1976 and 1977 in favor of the Board in nearly every aspect. The IIAA later asked the Supreme Court to review the Fifth Circuit Court of Appeals' decision. This request was denied in February 1978.

The independent insurance agents and their trade associations thus have been making the same arguments without avail for ten years. Having failed to convince Congress to eliminate the sale of property and casualty insurance by bank holding companies in 1969 and 1970, they launched a concerted -- and expensive -- effort to block the Federal Reserve Board's approval of the same activities. Now, after the expenditure of millions of dollars, the same independent agents and their trade associations have come full circle once again, asking Congress to prohibit the sale of property and casualty insurance by bank holding companies, an action Congress refused to take in 1970.

* * *

1. Immunity from Competition

Legislation pending in Congress prohibits bank holding companies from selling property and casualty insurance to their loan customers. Bank holding companies already are prohibited from selling to the general public insurance that is not credit-related (except in towns of under 5,000, as mentioned in the Introduction).

The effect of these proposals is to immunize insurance agents from the very modest competition that now exists with bank holding companies. Borrowing customers of bank holding companies will still

need to obtain insurance -- which typically covers collateral, such as an automobile or a home -- offered in connection with a loan. These consumers will simply have to find another source for such insurance. It is clearly the hope of the independent insurance agents that the consumer will choose an independent agent, but, as will be seen later on, there is no guarantee that this will in fact be the case. In fact, the odds are increasingly against this happening because of price competition from "direct writer" companies.

We believe there is a total absence of the kind of overriding concerns that should be present before Congress acts to protect a segment of business from competition. Congress should endorse vigorous, fair competition, rather than creating sanctuaries for a few privileged businessmen.

It is worth noting that other types of financial intermediaries have not been hesitant about entering the insurance business. To our knowledge, no efforts have been made to stop them via restrictive federal legislation. Following are several examples.

In a message to shareholders dated February 27, 1978, Finn M. W. Casperson, chairman of the board of Beneficial Corporation, had this to say about Beneficial's insurance activities:

> The growth of our Insurance Group is an excellent example (of profit). The Group's original purpose was to provide credit life and health insurance protection for customers of the Consumer Finance Subsidiaries, and that excellent source of business has enabled the insurance operation to develop considerable financial strength of its own. Now the Group is in a position to use that strength in other fields of insurance -- to reinsure coverages and to acquire blocks of business . . .

In an interview published in the New York Times for December 11, 1978, Harry Jacobs, the new chairman and chief executive officer of Bache Halsey Stuart Shields Inc. said his firm was going into the

insurance business. "Product line diversification will be a key element in the growth of the firm," Mr. Jacobs said, " and we feel that selling insurance is part of what we should do as a diversified financial service company."

Finally, in the August 8, 1977, issue of Business Week, there was a feature article on Merrill Lynch & Co. entitled "The Bull in Banking's Shop." The thrust of the article was the ventures by Merrill Lynch into consumer banking. Almost as an aside, the article noted that: "Merrill's insurance subsidiary, Family Life Insurance Co. (with $3.9 billion of insurance in force), whose policies are now sold mainly through savings and loan associations, is also likely to expand beyond its 16-office network, as it broadens its product line."

It appears that no matter what action Congress may take on behalf of the independent insurance agents, there is no way that will render them safe from the inroads of aggressive competitors.

2. No Evidence of Unfair Competition

Over the past ten years, the independent insurance agents have repeatedly alleged that they are victims of unfair competition from bank holding companies. They have, however, failed to substantiate their case.

For example, the agents have complained that loan customers of bank holding companies are coerced to buy insurance from the company at the same time that they obtain a loan.

This allegation ignores that fact that coercion is illegal. Section 106(b) of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1972) prohibits a bank from extending credit . . .

. . . on the condition or requirement --

* * *

> (2) that the customer shall obtain some additional credit, property, or service from a bank holding company of such bank, or from any other subsidiary of such bank holding company . . .

In all the years that the question of bank holding companies' insurance activities have been in dispute, the insurance agents have not produced a single instance of an illegal tie-in.

In fact, in January of this year, the Insurance Producers Political Action Committee in Bellevue, Washington, issued a bulletin to insurance agents in Washington State pleading for any "example of abuses by financial institutions." "We need examples we can document and if possible, clients who will be willing to testify . . . The need for this information is urgent." Apparently, the plea did not produce the intended result, because a restrictive bill sponsored by the independent insurance agents in Washington failed to pass this year.

Not only have the independent insurance agents failed to come up with any evidence, but the agency entrusted with the enforcement of the anti-tie-in provision, the Justice Department, has found that the law is being complied with. In 1972, Donald I. Baker, then Director of Policy Planning in the Department's Antitrust Division, said:

> The Department of Justice supported section 106 in 1970 as a useful and workable provision. We are delighted to see this indicated by broad-scale compliance since then.1/

In September 1977, Chairman St Germain of the Subcommittee on Financial Institutions Supervision, Regulation and Insurance queried the Department about Mr. Baker's statement. A month later, the Department responded:

1/ "The Bank Holding Company Amendments Revisited," speech by Donald I. Baker, Director of Policy Planning, Antitrust Division, Department of Justice, to the Governmental Affairs Conference, American Bankers Association, Washington, D.C., July 20, 1972.

> . . . In view of the lack of a need for actual enforcement efforts, and of the lack of significant complaints of violations, we believe that the general compliance noted by the Department in 1972 is continuing.2/

The Department's conclusion is entirely consistent with a study conducted by the staff of the Federal Reserve Board and released in October 1978. It is entitled "A Study of Tie-Ins Between the Granting of Credit and Sales of Insurance by Bank Holding Companies and Other Lenders." The authors reported that a canvass was made of the consumer complaint files of the Board, and that "no complaints had been filed since 1970 alleging violation of section 106 of the Bank Holding Company Act Amendments of 1970 by either businesses or consumers."

Perhaps the most significant result reported in the Fed study was new evidence, based on a comprehensive survey of consumers, that led the authors to conclude:

> . . . The relatively low proportion of loan customers, especially those of retailers or commercial banks, who perceive pressures, either explicitly or implicitly, to make the joint purchase is not consistent with the hypothesis that involuntary tying is widespread. This conclusion is given further support by the very high rate of approval of the service and by the high proportion of customers who do not regard the service as expensive.

This is now the second broad study of consumer credit practices to have arrived at the same result. Another major study, conducted by Ohio University and cited in the Fed's study, also found no support for the tying allegations. The similarity of the conclusions of these two major studies should be enough to lay this question to rest.

A footnote to this discussion may be in order. Under the Truth in Lending regulation of the Fed (12 C.F.R. §226.4(a)(6)), lenders

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2/ Hearings on H.R. 9086, Subcommittee on Financial Institutions Supervision, Regulation and Insurance of the House Committee on Banking, Finance and Urban Affairs, Part 3, September 19, 20, 21 and 22, 1977, page 1577.

must include the cost of insurance in the computation of the finance charge "unless a clear, conspicuous, and specific statement in writing is furnished by the creditor to the customer setting forth the cost of the insurance if obtained through the creditor and stating that the customer may choose the person through which the insurance is to be obtained." Thus, every borrower obtaining a loan covered by Truth in Lending enjoys the protection of receiving a written statement regarding his or her rights to obtain insurance from any source.

3. Harm to the Business

The insurance agents argue that because of the "unfair" competition they face from bank holding companies, their business is being harmed. There is, again, no evidence to support this allegation.

In fact, a witness for the IIAA said as much at hearings before the Senate Banking Committee on June 23, 1978. At that time, the witness was asked for data to show the growth or decline of the independent agents' business relative to bank holding companies.

The spokesman replied:

> Well, since the 1970 amendments, based on the initiative of the IIAA, there have been relatively few bank holding companies that have succeeded in getting into the business. So we really don't have that much experience . . .

While we can state unequivocally that bank holding companies are causing no significant harm to the insurance agents, their business is undeniably suffering from competition from other sources. The best evidence of this is contained in an article entitled "The Last Manifesto," by Tom C. Johnson, executive vice president of the Florida Association of Insurance Agents, and published in the November 1978 issue of Independent Agent magazine. The article summarizes a presentation Mr. Johnson made to the September 1978 annual meeting of the IIAA.

In his article, Mr. Johnson told the agents they have lost forever their formerly dominant share of the personal property and casualty insurance business. Competition -- in the form of "direct writers" such as GEICO, State Farm, Nationwide, Allstate, Prudential and Metropolitan -- have carved out a larger and larger portion of the market, using mass advertising and lower prices. As a result, the direct writers now have over half of the automobile insurance market, and their share of the homeowners' insurance market is nearing forty percent. These gains, Mr. Johnson emphasized, have come at the expense of the independent agents.

The causes, according to Mr. Johnson, are clear. He told the agents:

> Your system does not demand top efficiency. Your system does not encourage new production. Your system does not encourage new methods. Your price is too high.

Mr. Johnson's comments underline an ironic fact.

While the independent agency system is reeling from competition from within the insurance industry, Congress is being implored to underwrite the system against competition from bank holding companies, whose market share is so slight it wasn't even mentioned by Mr. Johnson.

4. Exemption from the Antitrust Laws

The McCarran-Ferguson Act exempts insurance from the restrictions imposed by the Sherman and Clayton Acts. It is ironic that the independent agents are seeking to use federal law, from which they are immune, to foreclose competition from bank holding companies. This is a case of wanting it both ways -- exemption from federal regulation on the one hand, and protective legislation on the other.

The National Commission for the Review of Antitrust Laws and Procedures recommends (in a report dated January 21) that the current broad antitrust immunity for the insurance business be repealed. It recommends that state regulatory authorities place maximum reliance on competition in pursuing their regulatory objectives. It also said further study of the insurance business should be undertaken by relevant congressional committees or by a special presidential commission.

The commission said: "The justification for antitrust immunity and of state regulation (of insurance) must . . . be evaluated in light of present industry conditions and emerging concerns about the role of competition in achieving particular social goals." Regulation, the commission said, "should eliminate competition only when truly essential to the achievement of articulated public objectives, and the regulatory techniques chosen should operate in the least anti-competitive manner possible."

These standards should be used to evaluate the merits of the insurance agents' bill. We believe it is impossible to reconcile the public's gains from competition in the insurance marketplace with the agents' protectionist bill.

Moreover, we submit that at a time when the entire antitrust treatment of the insurance industry is being called into question, it is not appropriate for Congress to move ahead with another layer of competitive protection for this industry. We believe the insurance agents' bill should only be considered in the context of the pending reexamination of the McCarran-Ferguson Act, and should not be enacted independently of such a reexamination.

5. Single Interest Legislation

This bill is clearly discriminatory. It singles out bank holding companies as the only financial institutions to be subject to restriction. The bill does not address the insurance activities of other competitors, including savings and loan associations, their holding companies and their service corporations; mutual savings banks: credit unions; finance companies; and mortgage bankers. The insurance activities of all of these institutions are either totally free of federal regulation or, if regulated, go beyond the limited scope of the activities allowed bank holding companies by the Federal Reserve Board.

For example, mutual savings banks in New York State are famous for their life insurance sold to depositors, and this form of life insurance is often cited as a "best buy" for consumers. Fortunately for the savings banks and their customers, there is no federal regulation of this type of insurance at all, and the bill would have no effect on it.

Savings and loan service corporations' insurance activities are quite broad. These S&L service corporations are authorized by the Federal Home Loan Bank Board to engage in: "(ix) Serving as insurance broker or agent, primarily dealing in policies for savings and loan associations, their borrowers and accountholders, which provide protection such as homeowners', fire, theft, automobile, life, health, accident and title, but excluding private mortgage insurance." (12 C.F.R. 545.9-1(a)(4)(ix).) According to the General Accounting Office, there were approximately 2,000 S&L service corporations at the end of 1976. (GAO Report to Congress, June 14, 1978, page i.) Why is it in the public interest to ban bank holding companies from selling

property and casualty insurance to their loan customers while S&L's, via their service corporations, may continue to sell such insurance to both their loan and savings customers?

The Federal Home Loan Bank Board's regulations for S&L holding companies permit them to engage in "(2) conducting an insurance agency or escrow business." (12 C.F.R. 584.2(b)(2).) Again, the question must be raised as to the reason for permitting competitors of bank holding companies to continue to engage in a business that would be prohibited for bank holding companies themselves.

These examples show the legislation is discriminatory. There is no public interest argument of which we are aware that would justify such discriminatory treatment, and, indeed, we believe there is no constitutional basis for denying one business equal treatment under the laws.

6. Insurance Redlining

The question of whether the independent insurance agents of America are able or willing to sell insurance to large numbers of households in the United States has received considerable attention in recent months. So far as we know, the question has not been answered, while many problems have been found to exist.

It is ironic that this legislation bars bank holding companies from serving many of the same individuals who up to now have found obtaining property and casualty insurance to be difficult and expensive. There has been a trend in some areas, for example, of insurance agents moving out of central cities to suburban locations while failing to serve the households remaining behind. Perhaps the most vivid case of such actions occurred in Chicago in 1976. The episode, which amounted

to a crisis in the availability of homeowners' insurance in large parts of Chicago, was described in detail in a report dated September 6, 1977, that was submitted to the Illinois Department of Insurance by Anton R. Valukas and Richard C. Bollow. The report, entitled "Discrimination in the Sale of Homeowners' Insurance in Illinois," found that:

> Many Chicagoans are in fact being treated as second class citizens in the insurance market . . . (Homeowners seeking to modernize their dwellings) are unable to find agents in their areas who will write homeowners insurance . . . If neighborhoods in Chicago, East St. Louis and elsewhere in this State are to remain viable, homeowners in these areas must be able to obtain insurance coverage at reasonable rates.3/

If Congress wishes to assure the provision of insurance services to all qualified Americans, then it must face the question of whether the American agency system is adequate to the task. The Valukas Report and the HUD study (see footnote 3/) raise serious doubts that it is.

The Association of Bank Holding Companies is not suggesting that the sale by bank holding companies of property and casualty insurance will lead to the solution of the problem of insurance redlining, but we do say that banning our companies from the market is no way to help. Also, under the Community Reinvestment Act, bank holding companies have a legal requirement to serve their communities; no such requirement exists on the part of insurance agents or underwriters.

It should be noted that by denying bank holding companies the opportunity to serve their customers in this area, Congress would be taking away from bank holding companies an activity which would help fulfill their commitment under the CRA. Protection of a declining

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3/ The above quotation is cited on pages 31-32 of Insurance Crisis in Urban America, a report prepared by the Office of the Federal Insurance Administrator, U.S. Department of Housing and Urban Development, May 24, 1978.

industry thus would be given precedence over the implementation of this new law.

7. President's Anti-Inflation Program

Enactment of this bill is contrary to the President's Anti-Inflation Program. The White House on October 24, 1978, issued a "White Paper" on the anti-inflation program. Under the heading of "Regulatory Policy," the paper said:

> During the last decade, we have expanded our efforts to protect the environment and the health and safety of workers and consumers. These goals are central to our welfare. But they are not free. Regulations designed to achieve these goals add to costs and hence to consumer prices. We must not abandon our regulatory goals, but we must attain them without imposing unnecessary burdens.
>
> It is vital that equal attention be paid to decisions that impose costs on the public through raising private sector prices as to those that involve the expenditure of funds through the budget . . .
>
> At a time when inflation is the number one economic problem, it is especially important that the pressure of individual groups that seek government measures to protect them against domestic and international competition be resisted.

The Association of Bank Holding Companies believes that this legislation clearly falls in the category of "measures to be resisted." Congress is being asked to reward a business by granting it competitive protection even though there is ample evidence that consumers would benefit from more competition in the insurance market.

8. Opposition of the Regulatory Agencies

The Federal Reserve Board, the Comptroller of the Currency and the Treasury Department opposed enactment of similar legislation in 1978. Furthermore, a spokesman for the Justice Department, in testimony on restrictive bank holding company legislation in the Senate, cautioned against enactment of protectionist legislation.

An excellent summation of agency objections is contained in a letter dated June 16, 1978, to Congressman Ashley from Chairman Miller of the Federal Reserve Board. Chairman Miller said:

> . . . It has been recognized by the Board and the Federal courts that the sale of the above-described types of insurance (property and casualty insurance) by bank holding companies and their subsidiaries provides benefits to the public and encourages competition within the insurance industry. Furthermore, the Board has found no evidence to the contrary and believes that the authority for bank holding companies and their subsidiaries to engage in this activity should be continued . . .
>
> It has been the Board's experience that the sale by bank holding companies and their subsidiaries of many of these types of insurance is pro-competitive and offers benefits to the public, such as the convenience and efficiency of purchasing insurance and securing a loan in one transaction, and in making one payment that includes both a loan payment and the insurance premium. Furthermore, in the nearly eight years of proceedings with respect to this activity, there has been no evidence of any specific violation of the anti-tie-in provisions of section 106 of the Bank Holding Company Act resulting from the combination of the making of loans and the sale of insurance by a bank holding company or its subsidiaries.
>
> There is also no empirical evidence supporting the need for a limitation on the insurance activities of bank holding companies at this time. Preliminary results from a forthcoming Board staff study of bank holding company insurance activities suggests that while 60 percent of the responding institutions authorized to engage in the insurance agency business offer property and casualty insurance, 91 percent of these are doing so under the permanent or ten-year grandfather provisions in section 4(a)(2) of the Bank Holding Company Act. There are several reasons for this lack of bank holding company activity in the insurance business. Board rulings under section 4(c)(8) have provided that the only kind of insurance bank holding company subsidiaries may currently provide to the public is the type of insurance directly related to an extension of credit . . .
>
> Also, 15 States, including New York, Georgia, California, Florida, and Pennsylvania, now prohibit or severely limit bank holding companies from engaging in insurance activities other than credit life and credit accident and health. It would appear, therefore, that the involvement of bank holding companies in the property and casualty insurance industry is not significant and their presence where noted is limited in scope by Board rulings and State laws. Thus, to restrict their presence still further would not be in the public interest since it would foreclose forever whatever opportunity might exist for additional competition in the insurance business.

7/2/80

Association of Bank Holding Companies

Statement to
Senate Committee on Banking, Housing and Urban Affairs
in Opposition to
S.39

The Association of Bank Holding Companies is a voluntary trade association established in 1958 to represent bank holding companies regulated by the Federal Reserve Board ("Board") pursuant to the Bank Holding Company Act of 1956 ("Act"). We agree with the Board, the Comptroller of the Currency and the Federal Deposit Insurance Corporation that the provisions of S. 39 would drastically change the future regulation of bank holding companies and banks. Members of the House Banking Committee shared our concern and rejected these proposals during the consideration of the Financial Institutions Regulatory Act in June 1978, by such an overwhelming vote that no House action is scheduled this year.

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

Bank Holding Companies Prior to 1956

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

During the 1930's and '40's, bank holding companies grew moderately in size and number. After World War II, concern was expressed by the federal banking agencies and by some members of the Congress that the unregulated acquisition of banks and nonbanking businesses by bank holding companies could cause potential problems in the future. These concerns led to the enactment of the Bank Holding Company Act of 1956.

The 1956 Act

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

The 1966 Amendments

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

(c) The Board shall not approve —

(1) any acquisition or merger or consolidation under this section which would result in a monopoly, or which would be in furtherance of any combination or conspiracy to monopolize or to attempt to monopolize the business of banking in any part of the United States, or

(2) any other proposed acquisition or merger or consolidation under this section whose effect in any section of the country may be substantially to lessen competition, or to tend to create a monopoly, or which in any other manner would be in restraint of trade, unless it finds that the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served.

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

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

We believe this process, while costly to the applicant holding companies, fully meets the Congressional concern expressed in the Act to carefully weigh as to each application: (1) the competitive consequences; (2) the financial and managerial resources and future prospects of the institutions involved; and (3) the convenience and needs of the communities to be served. To propose further restrictions on bank

holding company acquisitions suggests that the existing provisions and related administration are inadequate. Our Association believes very strongly that the present statutory safeguards have proven more than adequate to protect the public interest. We believe the evidence provided by the Board's administration of the Act supports this view. It is incumbent on proponents of additional restrictive proposals to come forward with more than undocumented assertions that the operation of present law is inadequate.

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

The 1970 Amendments

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

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

(1) Regulation of One-Bank Holding Companies. The Amendments extended the provisions of the Act to cover corporations and partnerships owning or controlling one bank. The impact of this provision is illustrated by the fact that the number of bank holding companies regulated by the Board increased during the first year of the Board's administration of the 1970 Amendments from 121 companies (as of December 31, 1970) to 1,567 a year later. Since 1971, the number of bank holding companies registered with the Board has increased at a much slower rate and at the end of 1978, there were 2,222 registered companies.

It is important to recognize that much of the "growth" in bank holding company assets that has occurred in recent years has simply been the result of the decisions of bank managements to reorganize into a holding company format. Obviously, when a

bank converts to a one-bank holding company, that action adds nothing to aggregate concentration in local, state or national banking markets. This fact is so central to our discussion that we will comment on it in greater detail.

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

Because of the evolution of the Act and the efforts by the Board to conscientiously administer it, a wealth of data has been assembled that has been utilized by researchers to develop measures to indicate degrees of competition in markets for banking and other services offered by bank holding companies. A recent study, "Concentration Ratios and Commercial Banking: Use and Limitations", commissioned by our Association and conducted by Golembe Associates, illustrates the limited value of using ratios to measure concentration. Another study, by Samuel H. Talley of the Board's staff, reporting on trends in aggregate concentration in banking, deserves the particular attention of the Committee. Mr. Talley found that,

during the period 1968 to 1975, nationwide concentration (the per cent of total domestic deposits held by the 100 largest banking organizations) fell 1.1 percentage points, from 49.0 to 47.9 per cent. This contrasts with the experience of the period 1957 to 1968, when nationwide concentration rose slightly from 48.2 per cent to 49.0 per cent.

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

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

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

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

moderate incomes." (Senate Committee on Banking and Currency, Hearings on One Bank Holding Company Legislation of 1970, May 14, 1970, page 142.)

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

It is important to note that section 4(c)(8), as amended in 1970, requires the Board in passing on each individual application to engage in a "closely related" activity to determine also:

> . . . whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices . . .

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

(a) Insurance premium funding — that is, the combined sale of mutual funds and insurance

(b) Underwriting life insurance that is not sold in connection with a credit transaction

(c) Real estate brokerage

(d) Land development

(e) Real estate syndication

(f) Management consulting for nonbanking organizations

(g) Property management not part of trust activities

(h) Acting as travel agent

(i) Savings and loan association

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

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

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

The Board's decisions on numerous applications are replete with examples of its insistence on the need for applicants to demonstrate how their proposals are

expected to benefit the public. The Board has required specifics. Broad generalities are not sufficient.

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

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

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

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

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

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

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

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

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

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

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

In March 1973, the Board announced that the hearings requested by the insurance agents on the pending insurance agency applications would be held before an administrative law judge (hearing examiner). The hearings were held beginning June 11, 1973. The administrative law judge rendered a decision on one application September 7, 1973, and on five other applications November 9, 1973. The Board in January 1974 approved one of these applications, subject to certain conditions, and the insurance agents filed a petition for a review of the Board's decision with the Court of Appeals. In September 1977, that court rendered a final decision, and in February 1978, the Supreme Court denied certiorari. Subsequently, the Board approved additional applications in July 1974 and September 1974, with the last group of approvals being announced July 14, 1975. These decisions were also appealed by the insurance agents to the Courts.

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

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

Needless to say, we believe Congress should focus on ways of permitting regulatory decisions to be more timely. More timely decisions will save money, and hold out the promise of increased competition, leading to benefits to the consumer in lower costs and wider choices. At the very least, Congress should not encourage measures that will increase paperwork, raise costs, and promote delays in regulatory actions. Today's economy is not working the way our economy did ten or twenty years

ago, and some of the blame has to go to the enormous increases in work and costs needed to accomplish relatively simple objectives, such as opening a new business. Our nation simply cannot afford to allow federal regulatory policy, no matter how well meaning, to stifle competition, smother businessmen in paperwork, and raise prices.

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

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

We are pleased that there has been no change in the Justice Department's view since that time, as is shown by the statement of Russell T. Baker, Jr., Deputy Assistant Attorney General, that:

> ". . . we believe that the general compliance noted by the Department in 1972 is continuing." (Subcommittee on Financial Institutions Supervision, Regulation and Insurance, House Committee on Banking, Finance and Urban Affairs, Hearings on The Safe Banking Act, H.R. 9086, Part 3, September 20, 1977, p. 1577.)

Bank Holding Companies Today

We believe that the overall goals Congress sought in enacting the 1956 Bank Holding Company Act, and the subsequent amendments to the Act, have been achieved. We believe the Board should be commended for its accomplishments in administering the Act over the years and particularly for its conscientious implementation of the Act as broadened by the 1970 Amendments. There is no doubt that bank holding companies are subject to detailed and comprehensive regulation, but regulation resulting in

clear benefits to the economy in the addition of new services and jobs. We supported the Board's proposals contained in the Financial Institutions Regulatory Act of 1978, for additional penalties and remedies, which enhanced the execution of the Act. Beyond that, the Congress should encourage the Board to administer the Act with the foremost aim of allowing bank holding companies to better serve the public.

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

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

Employees of bank holding companies benefit as well. The bank holding company provides its employees with all of the advantages of larger organizations, including

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

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

Comments on S. 39

We believe that the record outlined above regarding the regulated activities of bank holding companies leads inexorably to the conclusion that S. 39 is not needed and would be detrimental. The Board's stewardship of its responsibilities under the Act has been characterized by cautious, conscientious and, when appropriate, firm administration. The Board has moved with characteristic expertise and care in authorizing formations of bank holding companies and in approving acquisitions of banks by the regulated companies. In addition, we believe the Board has administered the provisions of section 4(c)(8) in an extremely conservative manner. In fact, we see little likelihood that the Board will permit any significant expansion of bank-related activities any time soon. Virtually all of the bank-related activities approved up to now have been functions that banks have carried on themselves for decades.

In light of the close and constant supervision and oversight of the Board, and the conservatism of its regulatory policy, it would be unfortunate if the Board were foreclosed from acting at some future time to approve activities for bank holding

companies that seem well suited to them and that promise public benefits. The only beneficiaries of such a rigid policy would be other businessmen who are not subject to federally imposed restrictions on their activities. Certainly, consumers would gain nothing from a deliberate federal policy of limiting competition.

Let us turn now to a section-by-section commentary on the bill.

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

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

In considering local banking markets — which are the basic competitive units — the degree of concentration varies. Where significant degrees of concentration exist, however, the cause can frequently be traced to artificial limitations imposed on new entrants into those markets. A typical impediment would be a restrictive state branching law or a law against multiple bank holding companies. The effect of these laws over time has been to insure pockets of monopoly and to reinforce tendencies toward undue concentration. The remedy for this ill lies in removing the artificial barriers preventing competition among banks while continuing to assure that the resulting competition will be fair.

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

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

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

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

Among the services criticized in section 2(c) of the bill are the "offering of insurance agency and underwriting services". We have noted elsewhere the vigorous opposition to bank holding company entry into this area from the insurance agency business. It might be useful to observe, for example, that the Board, in permitting limited insurance agency activities, has allowed an insurance agency of a bank holding company to offer any kind of insurance in communities under 5,000 population. But

this parallels an authority for banks that has been in the National Bank Act since World War I. In communities over 5,000, however, the sale of insurance to the public by bank holding companies is strictly limited to insurance related to credit or services supplied by them or their subsidiaries, and allows other insurance sales only as a "convenience" so long as the premium income from such sales "does not constitute a significant portion of the aggregate insurance premium income of the bank holding company." Furthermore, the Board has ruled that "a significant portion" may be no more than 5 per cent of the aggregate, and has outstanding a proposal that would be even more restrictive.

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

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

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

Section 2(c) also lists among the criticized activities "travel . . . courier . . . and . . . management" services. The Board has ruled that travel agency services are impermissible for bank holding companies. The Board has allowed bank holding companies to provide limited courier services typical of the kind that banks have operated, but carefully hedged to protect the interests of competitors. Bank holding

companies also may offer management consulting advice, but only to unaffiliated banks, and subject to elaborate restrictions to guard against improper influence. Management consulting, of course, is a normal correspondent banking service.

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

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

Twenty Per Cent Test

Moving now to the substantive provisions of the bill, sections 101 and 102 establish a novel antitrust standard. The bill would flatly prohibit mergers or acquisitions where the resulting bank or company controls more than 20 per cent of the banking assets of its state. There is, clearly, no similar federal standard applicable in any other industry. The justification or logic for applying this simplistic standard to external banking expansion escapes us. As we see it, enactment by Congress of this standard would "freeze" the external growth of 29 bank holding companies scattered throughout the country from Massachusetts to Washington. What public policy objective would be served by doing so is not made clear in the bill, but it would remove as competitors in certain geographic areas a few bank holding

companies and banks. We believe it would be a mistake to substitute a mechanical standard for the careful examination by the federal bank regulatory agencies and the Justice Department of each application. Examination must include an analysis of each relevant market in the light of the various factors affecting entry into that market.

The limitations of applying a mechanical percentage test is illustrated by the fact that the proposed 20 per cent test would restrain only eight of the 25 largest banking organizations. In our three largest money centers, the 20 per cent test would have an impact on only one banking organization each in New York City and San Francisco, and would affect two organizations in Chicago. Thus the restraints fall principally on regional banking organizations in states such as Arizona, Georgia, Idaho, Maryland, Minnesota, Montana, New Mexico, North Carolina, Oregon, Rhode Island, South Carolina, South Dakota and Utah, where growth offers potential for competition with money center banks in the national market. We submit that it is not in the public interest to suppress the growth of regional banking. We note that the Board, the Comptroller of the Currency and the Federal Deposit Insurance Corporation also oppose this simplistic approach, and it was rejected by the House Banking Committee.

Another proposal in S. 39 would allow the bank regulatory agencies the discretion to go beyond present antitrust standards and the new 20 per cent standard to deny mergers or acquisitions having "adverse effects on competition . . . not clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served." This is a very amorphous standard, and would result in endless litigation as the courts attempted to define its parameters. We see no purpose to be served in adding to the burden of the courts when existing antitrust standards are working effectively. It also runs directly counter to the antitrust philosophy set forth in the "Gray's Harbor" decision (Washington Mutual Savings Bank v. Federal Deposit Insurance Corporation, 482 F. 2d 459 (9th Cir. 1973)).

New Section 4(c)(8) Restrictions

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

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

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

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

The bill purports to protect the existing bank related activities of bank holding companies with a "grandfather" clause in section 301(b)(1). However, precious little comfort is provided by this provision since the "grandfather" date is November 1, 1975 — almost 5 years ago. Thus, the literally hundreds of section 4(c)(8) activities established over recent years would be subject to divestment within 90 days after the enactment of the bill. The chaos among bank holding companies as they attempted to meet the new standards of this bill would be equalled only by the confusion engendered in the financial services industry generally as noncomplying subsidiaries were thrown on the market under "fire sale" conditions. It should be further noted that even if the bank holding company could retain a bank related activity, its growth would be forever frozen because the bill states "such a bank holding company shall not permit the scope or size (in terms of volume of business) of those activities to expand to any significant degree." It would be difficult to find a comparable provision in any banking statute as punitive and unfair.

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

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

Capitalization of Subsidiary Banks

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

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

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

It should also be noted that the Board requested in the last Congress that Section 23A be revised and modernized. Chairman Proxmire has introduced a bill,

S. 1047, to implement the Board's proposal, which we support, and that bill is pending before this Committee.

New Procedural Requirements

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

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

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

Enforcement by Individuals

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

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

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

To be noted also is the recent action of the Congress, requested by the Board and supported by our Association, that extended to section 4(c)(8) matters specifically, the Board's "cease-and-desist" authority under the Financial Institutions Act of 1966. Criminal penalties have always been provided for violations of the law or regulations or orders of the Board, as well as provisions for court review of Board actions, as previously noted and new civil penalties were authoried by the Congress in 1978.

Clearly, there is no more need for section 701 than for section 601, and, like section 601, section 701 would provide further aid and comfort to competitors of bank holding companies in their continuing attempts to stifle efforts of bank holding companies to provide needed alternative sources of financial services to the consuming

public. Obviously, these burdensome procedural requirements run counter to the purported desire of the Administration and the Congress to promote deregulation. A detailed discussion of these two onerous sections is contained in a Golembe Associates study entitled "Administration of the Bank Holding Company Act: An Evaluation of the Procedural Sections of S. 72, 'Competition in Banking Act'".

Conclusion

We believe the enactment of the Depository Institutions Deregulation Act of 1980 ushered in a new era favoring increased competition in the financial services industry. We submit that this bill is a throwback to the pre-1980 concepts of limiting markets and carving out enclaves of financial services protected from competition. This bill should be assigned a place alongside Regulation Q in the burial ground for outmoded and anticonsumer legislation.

NEWS RELEASE

Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219

For: RELEASE (202) 447-1800

Date: July 1, 1980

STATEMENT OF

JOHN G. HEIMANN

COMPTROLLER OF THE CURRENCY

BEFORE THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

U.S. SENATE

July 1, 1980

We are pleased to have the opportunity to present our views on S.39, S.380 and H.R. 2255, proposed amendments to the Bank Holding Company Act and Bank Merger Act. The essential common thrust of these bills is to protect certain financial servicers from the rigors of competition by the imposition of arbitrary statutory limits on the growth of bank holding companies and upon their activities in certain areas generally viewed as being closely related to banking.

The enactment of these proposals will, in our opinion, result in the undesirable reduction of competition in our financial system. Government should protect competition--not competitors. We believe that the existing statutes provide better protection against undue concentrations of financial resources and effectively separate banking activities from non-banking

activities that clearly involve potential conflicts of interest. We strongly oppose the enactment of this legislation. In these times of economic uncertainty, our depository institutions must retain their flexibility to respond effectively to increasing competition by other financial intermediaries in order to assure the continued viability of our banking system. Congress should reject the imposition of arbitrary restraints upon the healthy competitiveness of banks and holding companies.

At least since the enactment of the Glass-Steagall Act in 1933, banking in the United States has developed around the principle of the separation of banking and certain other forms of commerce. Essentially, the Glass-Steagall Act prohibits member banks of the Federal Reserve System from acquiring the stock of non-banking corporations. The Act does not, however, apply the principle of the separation of banking and other types of commerce to corporations that own or control banks. That is, investments by bank holding companies in non-banking activities were not restricted under that law. As a result, in order to avoid undue concentration of economic power through the unimpeded and unregulated expansion of bank holding companies, Congress passed the Bank Holding Company Act of 1956 and subsequent amendments to, among other things, restrict the permissible scope of holding company activities to certain types of business which are closely related to banking.

There has been, not surprisingly, a continuing legislative struggle regarding the conduct of bank holding companies. The issues which were discussed during the debate of the Bank Holding Company Act of 1956 and the subsequent amendments have surfaced again in this Committee's deliberations. The proponents of this legislation, much like their predecessors, argue that legislation is necessary to prevent undue economic concentration of financial resources and ostensibly to foster a competitive market balance between banks and other financial intermediaries. With these intentions in mind, legislation has been proposed to further restrain the growth of holding companies in areas which traditionally have been permitted as banking related. We believe that the thrust of these bills is essentially misguided.

The Proposed 20% Standard

S.39 would amend Section 3(c) of the Bank Holding Company Act of 1956 to prohibit, without further inquiry into other competitive considerations, any acquisition by a bank holding company, if as a result of such a transaction, the acquiring or resulting company would control over 20 percent of the total banking assets held by all banks and bank holding companies located in the state. S.39 would also amend Section 18(c)(5) of the Bank Merger Act of 1966 to prohibit a merger transaction by a bank, if as a result of the transaction the acquiring or resulting bank would hold more than 20 percent of the total

assets held by all banks located in the state. These amendments presumably are premised both upon the desire to prevent the indiscriminate acquisition of independent banks by holding companies or larger banks merely for the sake of expansion and upon the belief that undue levels of economic concentration occur when a single institution achieves a greater than 20 percent state-wide market share.

An apparent premise of the bill is that the concentration of financial resources measures the level of competition in a particular market. That is, if a potential entrant--either a holding company or a bank--has sizable financial resources, its entry through an acquisition will result in decreased competition in the market. Size alone should not be determinative of the potential effect of an acquisition upon competition. Rather, the organizaation, experience, and personnel of a particular acquirer may stimulate change and enhance competition in a particular market.

We do not believe any rigid numerical constraint, such as the proposed 20 percent figure, should be used in restraining the economic growth of all banking institutions. Furthermore, most banking markets are local and not defined by political boundaries. The existing antitrust laws specifically recognize the need to inquire into the unique market conditions of any enterprise in determining the competitive effects of a particular

corporate merger or acquisition. Concentration is one--and not necessarily the most important--measure of competition in a particular market. In our view, a rigid statutory limitation on concentration cannot adequately reflect the many market variables which must be considered in reviewing any given transaction and is not an appropriate device to assure the maintenance of competitive banking markets. Moreover, under the existing laws regulatory authorities have substantial influence in shaping the structure of banking markets through their actions upon charter, branch, merger and holding company applications. Our policies regarding the disposition of such structural applications have as their goal the achievement of a maximum degree of competition between financial institutions consistent with the maintenance of a sound banking system.

Additionally, the proposed banking assets test fails to consider the size and strength of nonbank competitors in the financial sector--factors which should be considered in determining the degree of competition in a particular market.

The Bank Holding Company Act and the Bank Merger Act incorporate, with minor modifications, the antitrust standards applied to all businesses in the United States as the relevant criteria for determining whether unwarranted economic concentration will result in a particular market from a merger or acquisition. The banking industry should not, in our opinion, be

subject to more stringent antitrust regulation than that required by other lines of commerce.

Proposed Constraints Upon Bank-related Activities

Section 301 of S.39 would amend Section 4(c)(8) of the Bank Holding Company Act to significantly constrain the authority of the Federal Reserve Board to authorize bank-related conduct by holding companies. The proposed legislation provides that non-bank companies may be acquired by holding companies only after the Federal Reserve Board has specifically determined the particular activity is so "closely and directly" related to banking or managing or controlling banks as to be a "proper and necessary" incident thereto, and, is likely to produce "substantial" benefits to the public which "clearly and significantly" outweigh possible adverse effects.

Additional restrictions upon the entry of bank holding companies in bank-related activities are unnecessary in view of the existing regulatory scheme. The Federal Reserve Board, through Regulation Y, has properly permitted holding companies to engage only in activities which are closely related to banking. There has been no convincing showing, in our opinion, that the Federal Reserve Board has improperly permitted holding companies to engage in a non-banking related activity.

It must be realized that banking, like other service industries, is constantly changing to meet the expanding needs and demands of its customers and to adopt new technology to assure the delivery of better and more efficient services to the public. We believe that the proposed legislation would unnecessarily narrow the possibilities of bank holding company expansion and would actually promote a concentration of financial resources among non-bank competitors. Financial services are not static. They should be permitted to evolve with the structure of financial institutions. We believe that the proposed limitation upon the competitiveness of one class of financial intermediaries may artificially act as a barrier to the introduction of new services necessary to ensure the competitive viability of our financial system.

Proposed Regulatory Duplication

Section 401 of S.39 would effectively provide that national banks be treated as bank holding companies for the purposes of Section 4(c)(8) of the Bank Holding Company Act. That is, national banks would be prohibited from engaging in those bank-related activities in which bank holding companies are not permitted to engage. Such legislation would result in a basic change in the National Bank Act. The enactment of these provisions would have the effect of prohibiting national banks from participating in several currently permissible bank-related

activities which under the National Bank Act include any activity which is held by the Comptroller to be "incidental" to carrying out the business of banking.

We are unable to determine without further review the full implications of these proposed amendments. The most obvious impact of one of the proposed restrictions, however, would be to adversely affect the availability of financing to state and local governments by precluding national banks from underwriting general government obligation issues of states and municipalities. Moreover, since the proposed provisions affecting national banks' activities currently contain no grandfathering clause, the legislation if enacted in its proposed form could have the disastrous effect of requiring immediate divestiture of bank-related activities by certain institutions, possibly at substantial losses.

We do not believe that the Federal Reserve Board should be solely empowered to determine the permissible scope of the activities of national banks. The proposed legislation would in our opinion, only cloud the regulatory authority over national banks. The Office of the Comptroller of the Currency, as the regulator of national banks, should retain the authority to determine which activities are incidental to the business of banking in the national banking system.

One of the primary features in the evolution of the dual banking system has been the ability of institutions to elect a charter which allows a bank the authority to best service the needs of its customers. While the concept of competitive equality has to a large extent permeated banking, certain distinct differences exist between the powers of national banks and some state-chartered institutions. This diversity among institutions has encouraged change and innovation. The proposed legislation may tip the balance of the dual banking system in favor of state-regulated financial institutions. That is, while national banks would be barred from competing in certain activities, state institutions not affiliated with bank holding companies may yet be permitted to continue in those activities under their state regulatory schemes.

Section 501 of S.39 would amend Section 4 of the Bank Holding Company Act by adding a new subsection to require that the Federal Reserve Board, in connection with a holding company's application to engage in a particular activity and the ongoing supervision of bank holding companies, determine that the holding company and its subsidiaries are adequately capitalized and financed in a sound manner. Secondly, Section 501 would require that holding company subsidiaries refrain from preferential lending in favor of their parent corporations or other affiliated subsidiaries. In our opinion, these provisions are unnecessary. The Federal Reserve Board already undertakes to review these

matters in the performance of its responsibilities. Moreover, the uncertain language of the proposed provisions may inadvertently confuse the issue of regulatory responsibility regarding the capitalization of national banks. We firmly believe that the Comptroller's Office, as the chartering authority and on-going supervisor of national banks, should have the sole responsibility in this matter.

The proposed provision regarding preferential lending practices is duplicative of existing statutes and regulations. As you know, legislation enacted by the Congress in 1978 (Title I of FIRA) prohibits preferential lending by banks to insiders including their parent holding companies and their non-bank affiliates. Any further restrictions upon inter-affiliate transactions by non-bank subsidiaries should, in our opinion, be carefully considered in light of the need for a free flow of funds within a holding company organization. We do not believe that the proposed additional restrictions have been demonstrated to be justified.

Insurance Activities

H.R. 2255 and S.380 would similarly amend the Bank Holding Company Act of 1956 to restrict the insurance activities of bank holding companies, with certain exceptions.

The offering of credit-related insurance by banks and bank holding companies provides borrowers with an especially convenient source for a service that benefits borrowers and promotes competition among, and equitable treatment of lenders. We, therefore, believe that the offering of property and casualty insurance in conjunction with specific credit transactions, by banks and bank holding companies is a public convenience and may result in significant consumer savings.

The most frequently alleged problem associated with credit insurance sales by lenders including banks, thrift institutions, finance companies and retail lenders is the potential for abusive tying of the sale of insurance with the granting of credit. This problem arises when borrowers have no alternative sources of credit or when a lender takes advantage of borrowers' ignorance or lack of understanding about alternative credit insurance options. The problem is mitigated as markets for lending and for the provision of insurance become more competitive.

The Bank Holding Company Act Amendments of 1970 were adopted to specifically address this concern. That law prohibits a bank from extending credit or varying the terms of the credit on the condition that the customer obtain some additional service from the bank, including insurance. Prior to 1970, tying arrangements were illegal under the antitrust laws only if the lender had appreciable economic power in the market for the tying product,

that is, credit. Because most markets have several financial institutions, one bank would seldom have sufficient market power to establish an antitrust violation. The 1970 amendments made tying arrangements by creditors illegal regardless of the degree of market power a bank or bank holding company might possess. Thus, banking is subject to a stricter antitrust standard on tying arrangements than other industries, including other competing nonbank lenders.

Restricting the sale of credit-related insurance by subsidiaries of bank holding companies would do little to address the issue of tie-ins. Indeed, by eliminating one important source of competition among providers of credit and credit-related insurance, such an approach could aggravate a tie-in problem. In our view, a better solution would be to provide for adequate disclosure of credit insurance costs and to prohibit coercive practices on the part of all consumer lenders while assuring competitive markets for the provision of credit and insurance.

The ready availability of property and casualty insurance coverage from independent agents and other institutional insurers substantially reduces the likelihood of the kinds of troublesome practices that have occurred in some instances in the sale of credit life and health insurance by lenders. Although we have not conducted a specific study of the public benefits that are

realized from allowing bank holding companies to sell property and casualty insurance, it is reasonable to expect that the enhanced competitiveness of banks and other lenders in this market contribute to the competitive pressures on prices and services, thus resulting in improved benefits for consumers. Additionally, the simple convenience afforded by one-step shopping and combined billing for a loan and related insurance coverage at a bank are important potential benefits. Some nonbank creditors, including thrift institutions and retailers, now offer this convenience to their customers.

We believe that the proposed prohibition on the sale of credit-related property and casualty insurance by bank holding company sbusidiaries (including consumer finance subsidiaries on loans over $10,000, and mortgage banking and other subsidiaries) would be inappropriate and contrary to the best interests of consumers. Instead, such sales should be allowed to continue subject to monitoring by the appropriate federal banking agencies. To the extent that certain real or potential problems exist regarding credit-related insurance, regulatory remedies short of arbitrary prohibitions are available. Statutory prohibitions on insurance activities of bank holding companies, such as proposed in S.380 and H.R. 2255, should not be enacted. Bank holding companies are effectively regulated in such activities by the Federal Reserve Board through Regulation Y. We believe it is preferable and more effective to control such bank

holding company activities through regulation rather than by statute. Regulations provide the flexibility essential for the expansion of bank holding companies into services necessary for their viability as competitors in a financial marketplace composed of bank and non-bank financial intermediaries.

H.R. 2255 would also arbitrarily discriminate among certain sizes of institutions. That is, the bill would permit certain expanded insurance activities to be engaged in by bank holding companies with $50 million or less in assets, but prohibit such activities by larger institutions. We know of no justifiable rationale for so discriminating between holding companies on a basis of size alone. The proposed exclusion of larger bank holding companies and their subsidiaries would unjustifiably eliminate a significant segment of competition from the marketplace. The public would thereby be denied the benefits of their competition.

In conclusion, we would like to reiterate our belief that competitive markets and avoidance of undue concentration of economic power are best achieved by permitting free entry. In our opinion, the proposed legislation is in many ways overly restrictive and, therefore, essentially anticompetitive. More particularly, S.39, S.380 and H.R. 2255 would undesirably inhibit bank growth and necessary diversification as well as deny to the public the benefits of competition among financial

intermediaries. The federal regulatory structure should remain sufficiently flexible to respond to the financial needs of bank customers and to foster economic growth.

We believe, therefore, that inflexible statutory restrictions such as the proposed 20 percent state-wide market share limitation on mergers and acquisitions and prohibition against any single class of lenders from engaging in insurance activities should be rejected. Federal policy should encourage both safety and soundness of financial institutions through diversification and growth and the delivery of cost efficient and convenient financial services to the public. The Congress should not artificially restrain the beneficial competitiveness of banks or bank holding companies.

Statement
by

Irvine H. Sprague, Chairman
Federal Deposit Insurance Corporation

I appreciate the opportunity to present to your Committee the views of the Federal Deposit Insurance Corporation on certain aspects of bank holding company activities.

We believe that the method of supervision and regulation of bank holding companies is our most pressing supervisory concern. During your Committee's consideration last year of S. 332, the "Consolidated Banking Regulation Act of 1979," I testified in favor of a major revision of the supervision of bank holding companies. Certain provisions of the legislation before you today raise many of the same concerns. In that connection, I would like to present our case again for an overhaul of bank holding company supervision.

The major shortcoming of the current system is that supervision is divided among three agencies. The Federal Reserve Board has the dual role of regulating bank holding companies and of examining State member banks which are subsidiaries of holding companies. However, multi-bank holding companies often include national banks, which are supervised by the Comptroller of the Currency, and State nonmember banks, which are within the supervisory purview of the FDIC.

Experience since the enactment of the 1970 amendments to the Bank Holding Company Act — including some major bank failures involving holding companies -- has demonstrated convincingly that a holding company is a single economic entity and should be supervised as such.

The Federal Financial Institutions Examination Council is acting upon this premise and is working hard within the parameters of existing law to improve the coordination of bank holding company supervision. I believe that the Council has made substantial progress in a very difficult area, and I look forward to continued improvement. I would ask the support of your Committee

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for changes in the statutory framework to permit us to achieve a more comprehensive revision of bank holding company supervision.

Overall, the FDIC is seeking a system in which the supervisor of the lead bank (or the only bank, as appropriate) be assigned the supervision of the holding company itself and its nonbank affiliates and that the lead supervisor be authorized to coordinate the examination of the other bank affiliates by their respective supervisors. Under this arrangement, the entire holding company would be examined and monitored as a unit, but each bank component would be examined by its primary regulator.

The Federal Reserve would retain its present role of determining permissible activities for holding companies and their nonbank affiliates. The Federal Reserve would also continue to be responsible for approving holding company formations and acquisitions.

Under our proposal, the three bank regulators would continue to exercise predominant authority within their respective statutory jurisdictions; that is, the Comptroller and the Federal Reserve would continue to supervise the Nation's largest banking organizations; the FDIC would continue to supervise the smaller but more numerous groups.

The gain will be an improved ability to scrutinize all components of a bank holding company simultaneously. We would hope to be able to avoid any situation in which a bank which is sound in and of itself could be forced into failure by the activities of another component of the same holding company.

For example, we would want to avoid repetition of the 1976 Hamilton Bancshares case in which that Chattanooga, Tennessee, holding company brought down its lead bank, Hamilton National Bank, a fundamentally sound institution, by causing its mortgage loan subsidiary to sell to the bank participations in

more than $80 million in problem mortgage loans. The same year saw the failure of another lead bank, American City Bank and Trust Company, N. A., of Milwaukee, Wisconsin, and the assisted purchase of a third, the Palmer First National Bank and Trust of Sarasota, Florida -- both involving unsound lending practices of the nonbanking affiliates of their respective holding companies.

In another case two years earlier, the Beverly Hills National Bank, which was solvent, had to be sold to satisfy the short-term commercial paper obligations of its parent, Beverly Hills Bankcorp of Beverly Hills, California. The case involved a civil action stemming from alleged confusion of corporate identity of the bank with the bank holding company by the holders of the holding company's commercial paper.

These are the lessons of experience. We have made great strides since then in improving supervision, and these efforts are continuing.

SPECIFIC LEGISLATION

You have asked for our comment on specific legislation pertaining to bank holding companies -- S. 39, the "Competition in Banking Act," introduced by yourself, Mr. Chairman; S. 380, amendments to the "Bank Holding Company Act of 1956," introduced by Senator Durkin; and H. R. 2255, insurance activities of bank holding companies, the bill which passed the House 333-25 June 12.

First, I would like to review briefly the provisions of the three bills.

S. 39, COMPETITION IN BANKING ACT

S. 39 would amend the Bank Holding Company Act and the Bank Merger Act to place a limit on bank acquisitions and to further restrict the nonbanking activities in which bank holding companies may engage.

The proposed legislation would prohibit any bank or bank holding company from gaining control of more than 20 percent of the total assets held by all banks located in a particular State through the acquisition of a bank or a bank merger, except if necessary to prevent a bank failure where no less competitive alternative solution is available; it would also require that bank holding companies restrict their nonbank activities not only to those that are "so closely related to banking . . . as to be a proper incident thereto," as provided in present law, but also to those that are "directly related to banking . . . so as to be a . . . necessary incident thereto." Section 2(c) of the bill would make a congressional finding that bank holding companies "have extended their services into product markets beyond those directly related to banking," citing a listing of various services.

S. 39 would also tighten the existing public benefits test applicable to bank-related activities of bank holding companies. One significant portion of this provision is a new criterion that the Federal Reserve "shall take into consideration the relevant economic size and market power of the bank holding company and that of those with whom the affiliate would compete." Other portions of this provision would (1) make it necessary that the activity be "likely" rather than "reasonably be expected" to produce benefits to the public; (2) make it necessary that the activity be likely to produce increased competition over time and not just in the short run as apparently intended by present law; (3) require that the beneficial effect of the activity "clearly and significantly outweigh" adverse effects, not just "outweigh" as provided under existing law; (4) provide that the activity not have a tendency to lead to an undue concentration of "economic or financial" resources and not just "economic resources" as provided in present law; (5) provide that the activity not lead to decreased

competition over time and not just in the short run. In addition, this provision would add two further standards for the public benefits test, namely a finding that the activity not risk the financial soundness of the bank holding company or its banking subsidiaries and that the activity not interfere with the primary responsibility of the bank holding company or its banking subsidiary to provide banking services to the public.

Further, the bill would prohibit national banks or their subsidiaries from engaging in activities in which the Federal Reserve does not permit bank holding companies to engage and would give to the Federal Reserve the authority to impose capital adequacy requirements on bank holding companies and all their subsidiaries (including banking subsidiaries which are not presently under the direct supervision of the Federal Reserve).

S. 380, AMENDMENTS TO THE BANK HOLDING COMPANY ACT OF 1956

S. 380 would prevent bank holding companies from providing insurance as a principal, agent or broker except —

1. where insurance is limited to repayment of the outstanding balance due on a specific extension of credit by a bank holding company or its subsidiary in the event of the death or disability of the debtor;

2. an insurance agency activity in a place with a population of 5,000 or less or in an area which the bank holding company, after notice and opportunity for a hearing, demonstrates has inadequate insurance facilities; or

3. an insurance activity engaged in by a bank holding company or any of its subsidiaries pursuant to an application which was approved prior to June 6, 1978; or

4. an insurance agency activity engaged in by a bank holding company with assets of $50 million or less, except that the sale of life insurance or annuities by such holding companies or subsidiaries is subject to the conditions of Points 1 and 2.

H. R. 2255, INSURANCE ACTIVITIES OF BANK HOLDING COMPANIES

H. R. 2255, which passed the House 333-25 on June 12, contains all the provisions of S. 380 and incorporates two additional exceptions that permit insurance activities if --

1. in the case of a bank holding company's finance company subsidiary, the insurance is limited to assuring repayment of an extension of credit where collateral for the credit extension is damaged and if the amount of credit does not exceed $10,000 (this figure being adjusted to the Consumer Price Index, such indexing starting January 1, 1980); or

2. the insurance agency activities are limited to supervising on behalf of insurance underwriters the activities of retail insurance agents who sell fidelity and casualty insurance on the bank holding company's personal and real property, or that of its subsidiaries, and group insurance for the employees of the bank holding company or its subsidiaries.

CONCENTRATION OF BANK RESOURCES

We share the concern reflected in S. 39 about the potential for undue concentration of bank resources and economic power within a limited number of banking organizations. This concern is a prime guiding objective of our day-to-day bank supervisory and regulatory activities. We believe that sound, healthy competition is good for banks and the banking public.

The issue before the Committee is whether a law can be framed that would establish a fair and effective test of concentration of bank resources that can be applied throughout the Nation. The measure proposed by S. 39 -- 20 percent of bank assets in a State -- is a useful basis for consideration. There may be questions as to whether 20 percent is the most appropriate number and whether the State alone should be the geographic entity. These are matters for the Committee to consider.

Our staff has raised a number of concerns about individual provisions of the legislation. The staff notes that any numerical limit has the inherent disadvantage of being construed as a permissible minimum rather than the prohibitive maximum that it is intended to be. Under this theory, bank holding companies may seek actively to acquire up to the permitted 20 percent of a State's banking assets, which, in the ultimate, could result in an oligopoly of five large bank holding companies controlling all the assets in a State.

The FDIC staff also suggests more flexibility for agencies to carry out the law. For example, the staff recommends that regulators considering a proposed merger should have the latitude to determine whether de novo or foothold entry by a large banking organization into a highly concentrated market would have the effect of improving competition. Under a flat numerical limit, agencies could be precluded from even considering such an application.

Another provision would permit agencies to disregard the 20-percent limit when they find "that immediate action is necessary to prevent the probable failure of a bank and that a less anti-competitive alternative is not available." The FDIC staff expresses concern that this exception to the 20-percent limit is not broad enough to permit an agency to approve a merger in which one of the candidates is weak but does not require "immediate

action . . . to prevent a probable failure," even though such a merger may be in the public interest.

CAPITAL ADEQUACY

The capital adequacy provision of S. 39 raises the broad issue of bank holding company supervision. The provision would permit the Federal Reserve to prescribe capital adequacy requirements for State nonmember banks supervised by the FDIC if such banks are subsidiaries of a holding company. We share the concern evidenced in this bill with respect to capital adequacy in the banking system. Capital adequacy considerations are a major guidepost in our day-to-day supervisory and regulatory operations. However, we believe that a change of the nature proposed by S. 39 should be considered within the context of the comprehensive revision of bank holding company supervision as I have discussed.

BANK-RELATED ACTIVITIES

Portions of S. 39 would establish additional tests which the Federal Reserve would have to satisfy in making its determinations on whether a given nonbank activity of a bank holding company is "bank-related" and therefore permissible.

S. 380 and H. R. 2255 deal exclusively with the insurance activities of bank holding companies, establishing a broad prohibition on such activities with certain exceptions.

All this legislation would seek to modify the Federal Reserve Board's administration of Section 4(c)(8) of the Bank Holding Company Act, as amended in 1970, under which the Board determines, within certain statutory parameters, permissible nonbank activities of bank holding companies. Such authority was vested in the Federal Reserve after extensive congressional deliberation, including consideration of an alternative approach involving a statutory listing of specifically prohibited holding company activities.

We agree with the purpose of Section 4(c)(8). We do not believe that bank holding companies should be free to undertake any enterprise they desire without regulatory approval.

The Federal Reserve Board, in carrying out its statutory mandate, has done an admirable job responding to the challenge in a very difficult area. In making determinations of "bank-related" activities under the law and the implementing Regulation Y, the Board has established a record of generally well-considered, prudent and appropriate decisions. We cannot find sufficient basis to make a case for change.

Section 401 of S. 39 would permit the Federal Reserve Board to prohibit national banks from engaging in bank-related activities that the Board determines are improper for bank holding companies. Since national banks are supervised by the Comptroller of the Currency, this provision would constitute an additional example of realignment of a given supervisory power by this legislation. We prefer that any revision of supervisory authorities be considered on a comprehensive basis.

CONCLUSION

We hope our comments will be useful to you in your consideration of the legislation before the Committee today.

First Security Corporation
LARGEST INTERMOUNTAIN BANKING ORGANIZATION
POST OFFICE BOX 30006, 79 SOUTH MAIN STREET
SALT LAKE CITY, UTAH 84125

SPENCER F. ECCLES
PRESIDENT

June 27, 1980

The Hon. William Proxmire
Chairman, Senate Committee on Banking,
Housing and Urban Affairs
5300 Dirksen Senate Office Building
Washington, D.C. 20510

Re: Statement on H.R. 2255

Dear Senator Proxmire:

This statement is submitted with the request that it be included as part of the record in connection with a hearing before your Committee on H.R. 2255, scheduled for July 1, 1980. A separate statement is being provided with regard to S. 39, scheduled for hearing at the same time.

We respectfully request that additional hearing dates be provided in connection with H.R. 2255. The present hearing time was scheduled within approximately two weeks after the House of Representatives passed H.R. 2255 (sometimes called herein the "House Bill"). The advance notice time for the hearing is simply too short. It would be meaningful to your Committee as well as to all other interested persons to provide an additional hearing time in order to permit selected witnesses to prepare definitive testimony for presentation before the Committee regarding the underlying facts and the public policy considerations relevant to H.R. 2255.

We respectfully register with your Committee our firm opposition to H.R. 2255, for the reasons stated below. We invite the attention of the Committee to the following:

1. FIRST SECURITY CORPORATION. First Security Corporation was organized in 1928 as one of the oldest multi-state multi-bank holding companies in the nation and became engaged in certain insurance agency activities as early as 1931. First Security Corporation and its subsidiaries continue to engage in such activities in a manner consistent with the provisions of the Bank Holding Act of 1956, as amended, and Regulation Y of the Federal Reserve Board as interpreted and administered by the Board. While this present statement is made on behalf of First Security Corporation, we believe that the views stated herein also reflect similar opinions held by a wider range of financial institutions in this country with similar lawful insurance activities. The provisions of H.R. 2255 vitally affect the interests of this corporation and of many others similarly situated. For purposes of this statement, "lender affiliated independent insurance agents" refer to those independent agents (not employed directly by insurance underwriters) who have some affiliation through agency ownership, control or other employment with bank holding companies, banks or other lender institutions. Other insurance agents are "unaffiliated."

2. PUBLIC BENEFITS.

(a) Policy Matters. The House Bill appears to be based upon the falsely-conceived notions that (i) the public would benefit from the restrictions contained in the Bill, and (ii) substantial coercion exists relative to purchase of insurance services from lender affiliated agents. We strongly submit that no evidence exists or can be presented to the Committee, or has been presented to any other governmental body which has dealt with these matters in the past, which would support such notions. On the contrary, we earnestly believe that it is of great benefit to the public to permit lenders to provide for the consumers' choice and option certain group insurance enrollment or single policy coverage opportunities not only for credit life, credit disability and mortgage redemption insurance, but also for vehicle or other collateral, property damage and public liability coverage, homeowners or other casualty insurance on permanent residences, mobile homes or business property involved in the particular financing arrangement. It is beyond question that such insurance is valuable to consumers, as well as to the lenders. This Committee will understand that the convenience of the consumer is greatly served by the practical ability, at the consumer's option, of obtaining the desired insurance services at or near the lender's place of business. If the consumer chooses, any desired coverage can be obtained through other agents with whom the

consumer wishes to confer separate from dealings with the lender. The public is well subserved by preservation of such consumer choices, many of which would be utterly destroyed by enactment of the House Bill.

(b) Legal Matters. The desirability of preserving options for consumers in connection with obtaining insurance or other related services from lenders is clearly upheld by existing law. The Bank Holding Company Act amendments of 1970 (84 Stat. 1766) added Section 106 which provides in pertinent part:

> * * * (b) A bank shall not in any manner extend credit, lease or sell property of any kind, or furnish any service or fix or vary the consideration for any of the foregoing, on the condition or requirement - (1) that the customer shall obtain some additional credit, property or service from such bank other than a loan, discount, deposit, or trust service; (2) that the customer shall obtain some additional credit, property or service from a bank holding company of such bank, or from any other subsidiary of such bank holding company; * * * (12 U.S.C. § 1972).

Similar restrictions are contained in Regulation Y, 12 C.F.C. § 225.4(c). Clearly, the Federal Reserve Board has the power, and has implemented regulations pursuant to the power, to prevent any coercion by a bank in connection with a loan by which the customer would be required to purchase insurance from the bank or an affiliated agency.

In consumer credit transactions Regulation Z (12 C.F.R. § 226.4(a)(5), consistent with the requirements of § 106(b) of the Truth-in-Lending Act, requires that insurance premiums in a consumer credit transaction be part of the finance charge unless the insurance coverage is not required by the creditor as a condition to the credit, the customer gives specific signed authorization regarding the insurance and is advised by clear and conspicuous disclosure that the customer has the right to obtain the insurance either through the creditor or through any other person, with the proposed premium cost clearly stated. Through this form of disclosure, each customer is expressly advised that insurance may be obtained through an outside agent, if insurance coverage of any nature is part of the credit transaction. From our observations, banks carefully conform to the requirements granting consumers such options in insurance matters.

The House Bill is very anti-consumer in attempting to destroy the right of lenders to offer, and the right of consumers to purchase insurance directly through the lender in connection with credit transactions. Not only are the provisions of the House Bill unnecessary to accomplish any public good, but they represent direct conflicts with other provisions of law in the protection of consumers. The Senate Committee should not permit itself to be used for the self-interest of unaffiliated independent insurance agents in enacting legislation which would be clearly detrimental to a much broader range of members of the public.

3. COMPETITION.

(a) Policy Matters. A persistent policy in favor of enhanced competition pervades American law, including the Congressional and regulatory enactments relative to banking and insurance. Moreover, the entire antitrust law system fosters fair competition as an inducement to provide options for consumers and thereby increase both the availability and the quality of services. As suggested above, availability of credit-related and incidental insurance from lenders is pro-competitive and of immense benefit to the public. It is important for the Committee to recognize that lender affiliated independent insurance agents under Section 4(c)(8) of the Bank Holding Company Act have no "open market" solicitation for insurance in direct competition with unaffiliated agents. The lender affiliated agents provide insurance services immediately available at the choice of the consumer and only in connection with credit transactions, rather than competing "on the street." This provides fair competition fully consistent with our cherished American traditions and applicable law.

(b) Effect of Bill. H.R. 2255 is highly anti-competitive. It effectively destroys one segment of healthy and fair competition in depriving lenders of the power to offer services except in the most restrictive conditions. We bring to the attention of your Committee a recent state court decision which is very compelling on the general subject of unconstitutional and anti-competitive legislation. On August 8, 1979, the New Jersey Superior Court, Appellate Division, declared unconstitutional a New Jersey statute prohibiting certain categories of lending institutions from obtaining insurance agent's licenses except in certain restrictive circumstances. ADA Financial Service Corp. et al v. New Jersey, No. A-2656-77. While that decision clearly relates solely to a state statute, it is a classic example of the willingness of courts to declare invalid

such anti-competitive, discriminatory and unconstitutional legislation in the specific area where unaffiliated independent agent groups are attempting to strangle the right of lenders to offer consumer options in that portion of the insurance business which originates with to credit transactions. Your Committee should not endorse H.R. 2255 which carries such vulnerability.

We bring to your attention also a letter dated February 28, 1980, from John G. Heimann, Comptroller of the Currency, addressed to the Hon. John J. LaFalce of the House of Representatives, copy enclosed. The Comptroller is of the clear opinion that to allow banks and bank holding companies to provide credit-related insurance is in the best interest of the public, and that the statutory provisions of H.R. 2255 impose restrictions which are anti-competitive and discriminatory.

4. GRANDFATHER CLAUSE. In a feeble effort not to impair existing organizations and obligations associated therewith by legislative fiat, the House Bill has as one of the exemptions from its operations a so-called "grandfather clause." This clause exempts any insurance agency activity that was lawfully engaged in by a bank holding company or any of its subsidiaries on June 6, 1978. The effect of such clause is very vague and potentially detrimental to any existing insurance activities of bank holding companies or their subsidiaries. While the word "activity" seems to be picked up from the use of such word in Regulation Y describing non-banking business activities, yet in the context of this grandfather clause, the potential consequences are very striking. For example, it is unclear whether any existing insurance agency activity may continue to grow internally without dollar volume limitations, or whether such existing organizations could expand in terms of the insurance services offered, the location of insurance offices, or the types of loans or subsidiaries with respect to which the insurance would be sold. While a part of the House Committee Report attempts to play-down the restrictions under the grandfather clause, it is obvious that many serious questions would arise relative to the existing organizations. The insurance industry, as with nearly all businesses in the modern American world, seeks to provide new product lines and different kinds of insurance for the benefit of consumers from time to time. If an existing bank or affiliate under a bank holding company offers a specific form of credit life, credit disability, mortgage redemption, casualty, liability or homeowners' policy in the present market, and if during the coming years the insurance underwriters offer new and different forms of any of such alternate coverages, the affiliated independent agent would be prohibited under the provisions of the

House Bill from expanding the product line to include such new consumer choices. Accordingly, even with the grandfather clause, H.R. 2255 serves as a punitive legislation against existing affiliated independent insurance agents. Again, your Committee should not participate in such strangulation of existing business and should not approve the House Bill.

5. UNCONSTITUTIONAL DISCRIMINATION. One of the most serious reasons for which your Committee should reject the House Bill is its high vulnerability to constitutional challenge. Because it expressly denies equal protection to bank holding companies, H.R. 2255 is unconstitutional. The Bill carries discriminatory effects in at least two areas: (i) the Bill attacks only bank holding companies and affiliates, without dealing with other lenders; and (ii) the Bill contains an arbitrary, capricious and irrational size catagorization by exempting from most of the restrictions of the Bill any bank holding companies and subsidiaries having total assets of $50,000,000.00 or less. It would be ludicrous indeed for the Senate to conclude that credit-related insurance activities of bank holding companies of $50,000,000.00 or less are related to banking, proper incidents thereto, and for the public benefit consistent with standards of the Bank Holding Company Act, but that the same activities of larger companies are not so related, proper and beneficial. The very attempt to create an arbitrary size categorization creates the most rank form of discrimination and underscores our position that the entire House Bill is fraught with such serious objections that it should not be approved by your Committee.

In addition, the discriminatory provisions relating to total company size are in conflict with the more traditional, rational and defensible determination that bank holding companies in communities of less than 5,000 population may engage in insurance agency activities without the restrictions of the Bill. The public policy considerations underlying that exemption are of long-standing and are well-known, i.e., small communities are often not adequately served by unaffiliated independent insurance agents and a certain logic of public policy should permit the banking institutions in such communities to provide insurance services. H.R. 2255, with both the arbitrary size provision and the 5,000 population provision opens up a great deal of potential confusion regarding the rights of state and national banks to offer insurance services in small communities without regard to size but in large communities only if the agency is affiliated with a holding company of less than $50,000,000.00. Such potential for confusion should not be permitted.

6. STATES' RIGHTS. The Tenth Amendment to the U.S. Constitution provides:

> The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.

Consistent with that constitutional mandate, Section VII of the Bank Holding Act of 1956, as amended, provides:

> The enactment by the Congress of the Bank Holding Company Act of 1956 shall not be construed as preventing any State from exercising such powers and jurisdiction which it now has or may hereafter have with respect to banks, bank holding companies, and subsidiaries thereof.

Notwithstanding the clear intent of Congress in adopting that provision, H.R. 2255 purports to deny any banks affiliated with bank holding companies the right to offer insurance other than in the highly restrictive conditions stated in the Bill, irrespective of the public policy of individual states which may be reflected through state legislative enactments. The well-known McCarran-Ferguson Act preserves to the states the right to control the insurance business. H.R. 2255 flies in the teeth of that Act. The original version of the House bill contained a Section 2 which expressly stated that the amendments of Section 1 would not supersede existing state laws, and would cease to be effective with respect to any state on the date on which a state would enact a law substantially contravening the amendments of the Bill. That states' rights provision was omitted by the House. The Bill in its present form, therefore, opens abundant opportunity for conflict between state and federal legislation with respect to insurance agency activities of bank affiliates, and such conflicts with existing constitutional and statutory conflicts should not be permitted.

7. EXISTING LEGISLATION IS SUFFICIENT. We urge the Senate Committee to conclude that the existing provisions of the Bank Holding Company of 1956, Regulation Y, Truth-in- Lending Act, Regulation Z, the Sherman Act, the Clayton Act and other applicable provisions of law are presently sufficient to provide protections for the consumers against any possible coercive activity of lenders and also to provide standards of fair

competition between affiliated insurance agents and unaffiliated independent agents. We further bring to the attention of the Committee the fact that since the 1970 amendments to the Bank Holding Company Act, the types of insurance agency activities permitted have become somewhat more restrictive by regulation of the Federal Reserve Board requiring a direct relationship to an extension of credit. The Board's actions with regard to implementation and interpretation of Regulation Y were upheld in part and basically clarified by the Fifth Circuit Court of Appeals in Alabama Association of Insurance Agents v. Board of Governors of the Federal Reserve System, 533 F.2d 224 (5th Cir. 1976), on rehearing, 558 F2.d 729 (1977), cert. den., 435 U.S. 904 (1978). No additional leglislation is needed in order to assure consumer choices in insurance services related to credit and to provide fair competition. Certainly, no legislation is needed which provides so much opportunity for dispute, misunderstanding and litigation, including the constitutional challenges, as would be sponsored by the Congress if the Senate Committee, and the Senate, should adopt H.R. 2255. Accordingly, we urge that the House Bill not be approved by your Committee.

Respectfully,

FIRST SECURITY CORPORATION

Spencer F. Eccles
President and Chief Operating Officer

Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219

February 28, 1980

Dear Mr. LaFalce:

Thank you for your letter of February 26, 1980, affording us an opportunity to comment on H.R. 2255. That bill would amend the Bank Holding Company Act to restrict the credit-related insurance activities of certain banks and bank holding companies, and permit bank holding companies with assets of $50 million or less to engage in a broad range of insurance activities. This Office has long opposed the adoption of arbitrary legislative restraints upon the ability of banks to compete in providing credit-related services to their customers. We believe that existing statutory and regulatory mechanisms short of outright prohibition are adequate to maintain the competitive equilibrium between bank and nonbank competitors. Allowing banks and bank holding companies to provide credit-related insurance is, in our opinion, in the best interest of the public. Competition unfettered by statutory constraints is the best assurance of increased consumer convenience and reduced costs for insurance that is purchased in conjunction with consumer loans.

We believe that any statutory prohibition imposed upon credit-related insurance activities of banks and bank holding companies would be essentially anti-competitive. Moreover, as you have noted, Section 1(E) arguably involves constitutional concerns by arbitrarily discriminating against certain institutions.

More significantly, however, the proposed increase in regulation of insurance activities at the federal level constitutes a significant departure from the existing principles of the McCarran-Ferguson Act. That law provides generally that the business of insurance shall be regulated by the states. We suggest that the Congress further consider the implications of such a departure prior to enacting H.R. 2255.

We appreciate the opportunity to comment on the bill. I want to reemphasize our opposition to the bill as being essentially anti-competitive and arbitrarily discriminatory in the manner in which it affects various lenders.

Sincerely,

John G. Heimann
Comptroller of the Currency

The Honorable
John J. LaFalce
House of Representatives
Washington, D.C. 20515

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LARGEST INTERMOUNTAIN BANKING ORGANIZATION
POST OFFICE BOX 30006, 79 SOUTH MAIN STREET
SALT LAKE CITY, UTAH 84125

SPENCER F. ECCLES
PRESIDENT

June 27, 1980

The Honorable William Proxmire
Chairman, Senate Committe on
Banking, Housing and Urban Affairs
5300 Dirksen
Senate Office Bldg.
Washington, D.C. 20510

Re: Statement on S. 39

Dear Senator Proxmire:

It is our request that this letter be made part of the record in connection with the hearing on S. 39 scheduled for July 1, 1980. A separate statement has been submitted relative to HR 2255, for which a simultaneous hearing is scheduled.

Respectfully, we state our opposition to S. 39. In explanation of some of the reasons for such opposition, we invite the attention of your Committee to the following considerations:

1. FACTUAL PREMISES. The proposed findings and purposes stated in section 2 of the Bill are based on unsound and unsupported assumptions. For example, subsections (a) and (b) deal with the purported concentration of banking resources into fewer hands and a purported increasing share of banking resources under control of holding companies. Assuming, for purposes of argument, that the growth of bank holding companies has been significant, it is unfair to characterize by the "tone" of the wording in subsections (a) and (b) that the growth of bank holding companies and the resulting concentration of resources is patently illegal and undesirable. The provisions totally ignore the fact that most bank holding companies are publicly owned, and that

large numbers of shareholders own an interest in the subsidiary banks indirectly through ownership of holding company stock. We believe that if statistical facts were presented regarding these matters they would show that even with a growth in the number of bank holding companies, the ownership of such companies and the indirect benefit from banking and other subsidiaries cross a very wide range of the American populace.

Subsection (c) incorrectly characterizes the facts. For example, under applicable regulations of the Federal Reserve Board bank holding company subsidiaries have not been authorized to furnish accounting and travel services, and can provide leasing, courier services, management, data processing services and securities marketing only under severe restrictions. Furthermore, section 4(c)(8) of the Bank Holding Company Act requires that before such nonbanking activities can be engaged in by holding company subsidiaries, the Federal Reserve Board must determine that such activities are closely related to banking or to the business of managing and controlling banks.

Subsection (d) is certainly not well-founded in alleging that credit resources have been misallocated by bank holding companies and that the Federal Reserve has not adequately protected the public interest. On the contrary, we submit that regulations and interpretations of the Federal Reserve Board have been more restrictive with respect to activities with non-banking subsidiaries of bank holding companies than the public interest really requires.

2. BANK MERGER AND ACQUISITION STANDARDS.

(a) Discriminatory Effect. For purposes of this discussion we will deal together with section 101 of the Bill, which amends section 18(c)(5) of the Federal Deposit Insurance Act, and section 201 of the Bill which amends section 3(c) of the Bank Holding Company Act of 1956. These provisions of the Bill attempt to provide standards for bank mergers and acquisitions which are substantially more restrictive and limiting for banks and bank holding companies than are similar restrictions under the Federal antitrust laws with respect to other areas of commerce. In doing so, the Bill becomes constitutionally vulnerable by denying equal protection under the law to banks and bank holding companies. The severity of the standards becomes particularly evident with reference to the third subparagraph of each of the relevant sections prohibiting any mergers or acquisitions under which the resulting bank would hold more than 20 percentum of the

total assets held by all banks located in the same state, with the single exception where the responsible agency finds that such merger or acquisition is necessary in order to prevent the failure of a bank. No other line of commerce in the nation is subject to such arbitrary prohibitions. To declare in one legislative stroke that a certain characteristic of a banking market constitutes a per se violation of antitrust standards, and to follow that up with the provisions of sections 102 and 202 declaring such markets per se illegal, creates unduly restrictive, discriminatory and unfair standards. Those provisions blatantly ignore many important considerations which the regulatory agencies should be entitled to review, including, but not limited to, the following:

(1) Especially in smaller population states where not as many banking institutions exist, an organization may have 20 percent of the banking resources in a state without tending to create an absolute or shared monopoly or an oligopoly, substantially lessen competition, or result in undue concentration. Even a small number of institutions of varying sizes can produce vigorous competition and consumer options.

(2) Under the McFadden Act national banks are subject to certain restrictions imposed by state law on state banks, particularly with reference as to whether or not branch banks are permitted or the limitations on branching. Banking markets differ very strikingly in their performance, depending on whether branch banking is allowed within certain geographical areas, statewide, or not at all. In a state where statewide branching is allowed, banking organizations might have a large share of the statewide market without creating any adverse anti-competitive effects, for the statewide market is broken down into many small communities where the specific competition from other banks, whether large or small, can be intense for all competitors. Whereas, in states where only unit banks are permitted without branching, the banks tend to concentrate their resources, efforts and competitive effects in a smaller market area where a high market share may result in undue concentration or domination of the banking market performance.

(3) Somewhat related to the differing markets depending on whether branches are allowed, but extending into other areas of economic analysis, is the real

question of defining the relevant banking market. The determination based upon a statewide percentage market share is not always meaningful. The responsible federal banking agency must determine whether the relevant market is a city, a county, a standard metropolitan statistical area ("SMSA"), or any combination or submarkets of the foregoing.

(4) Statutory definition of a prohibited merger or acquisition based on percentage market share may very well eliminate totally a very legitimate and pro-competitive de novo entry which a responsible agency will allow. For example, a bank holding company may wish to organize a newly chartered bank in a community requiring additional banking services for the benefit of the public. If such community is already concentrated with only one, two or three other institutions, or if the community is larger with many institutions but economically sound enough to support an additional competitor, the de novo entry represents a very pro-competitive step in the banking market. Or, a de novo entry may occur in a market not being served, even on a sub-marginal profit basis, but for the public benefit. To deny a large banking organization the opportunity of creating such de novo entry by prohibiting the acquisition of the new entry based on a statewide percentage market share constitutes unfair discrimination, becomes both anti-competitive and anti-consumer, and shackles the judgments of the responsible agencies.

(5) Under the Bank Merger Act, the Federal Deposit Insurance Act and the Bank Holding Act, the responsible federal agency, whether the Comptroller of the Currency, the Federal Deposit Insurance Corporation or the Federal Reserve Board, has clearly mandated responsibilities to review the competitive effects of mergers and acquisitions under existing law. Adding the new restrictive standards and prohibitions under S. 39 will deny the responsible federal agencies the opportunity of determining, with their own respective expertise, the proposed merger or acquisition and the relevant market wherein the following matters are to be considered:

> Market structure, or concentration and elimination of potential competition;

Market structure, with reference to elimination of existing competition;

The desirability of de novo or foothold acquisitions and the pro-competitive effects thereof;

Extra-structural considerations, such as actual performance of banks in the market, the needs of the market, the variety of public interest factors, the desirability of permitting local banks to develop larger deposits or other fund sources for larger borrowers, or other relevant factors.

We believe that the Federal Reserve Board, for example, has already initiated procedures for review of the competitive aspects of bank mergers and acquisitions which achieve all of the public policy goals which Congress can reasonably expect. The FDIC and the Comptroller of the Currency have done likewise. The role of the Federal Reserve Board itself is somewhat underscored by a policy statement issued by the Board in connection with a recent amendment to Regulation Y pursuant to the Change in Bank Control Act of 1978. In a commitment similar to its commitment under the Bank Holding Act, the Board said that its objectives in administering the new act ". . . are to enhance and maintain public confidence in the banking system by preventing identifiable serious adverse effects resulting from anti-competitive combinations of interests, inadequate financial support, and unsuitable management in the institutions involved." The Board added that it ". . . will disapprove transactions that are likely to have serious harmful effects." (44 Federal Register 7120, 7229, February 6, 1979).

No need has been demonstrated for creating the more restrictive, prohibitive, unfair, discriminatory and unconstitutional standards provided by S. 39. Accordingly, the Bill should not be favorably recommended by the Committee and should not be considered by the Senate.

(b) Terminology and Standards. As a relevant side comment, we wish to point out that some of the terminology in S. 39 is inconsistent with terminology recently adopted by the Federal Financial Institutions Examination Council regarding terms to be used in competitive factor reports and uniform guidelines

among the supervisory agencies. A copy of the joint news release dated June 13, 1980 is attached.

3. BANK RELATED ACTIVITIES.

(a) Substantial Benefits Test. Section 301(a) of S. 39 is objectionable because it adds new and restrictive tests relative to the authority granted to the Federal Reserve Board to permit bank holding companies to engage, through subsidiaries, in various other activities which are directly related to banking or managing or controlling banks. The proposed amendment to subsection (8)(a)(B) of section 4(c) of the Bank Holding Company Act requires that the Board determine that a nonbanking activity is likely to produce "substantial benefits" to the public. It will be observed that under the existing provisions of section 4(c)(8) the Board must consider whether performance of the proposed activity by an affiliate of the holding company can reasonably be expected to produce "benefits to the public" such as greater convenience, increased competition, or gains in efficiency. We strongly submit that it is appropriate for the Board to make its determination of benefits to the public, but that to require "substantial" as a condition precedent to a section 4(c)(8) activity would virtually strangle the holding companies and place an unfair burden on the Board itself. Having in mind that the Board already denies many applications for nonbanking activities of holding companies where the financial soundness of the proposed subsidiary, or of the holding company itself, is insufficient to warrant expansion of the holding company's activities, we believe that the Board is properly administering its duties under the present law and that the standards are sufficiently restrictive to permit the Board abundant authority for monitoring the nonbanking activities.

(b) Grandfather Clause. Section 301 of S. 39 has a so-called "grandfather clause" by which "nonbanking activities of bank holding company subsidiaries existing as of November 1, 1975, may be continued." However, the bill has an absolutely incredible restriction by providing under such grandfather clause that ". . . such a bank holding company shall not permit the scope or size (in terms of volume of business) of those activities to expand to any significant degree." Certainly the only rational approach is that if a nonbanking activity is presently legal for a bank holding company subsidiary, both the activity and the relevant subsidiary should be permitted to grow in the ordinary course of business through expansion of volume of business along with the anticipated growth of the bank holding company itself. No business can remain

static, and if a nonbanking activity is not permitted to grow in normal course, it will be strangled sufficiently that it will actually regress and die. It should not be the intent of Congress to serve as the executioner of bank related activities which have been established and are providing valuable services to the public as well as benefit to the bank holding companies and the affiliated banks. For example, an affiliated insurance agency which provides credit life, credit disability, and mortgage redemption insurance to customers of the affiliated banks in connection with loan transactions cannot continue its business if the commission income from an expanded number of customers cannot increase commensurate with the expanded volume of loans through the affiliated banks. Again, the legislative stroke of pen should not warrant the death knell of any legitimate bank holding company corporate child.

4. NATIONAL BANKS. Under the guise of "uniform application of standards governing entry into bank related fields" section 401 of S. 39, proscribes the activities of national banks and effectively handcuffs the Comptroller of the Currency with regard to bank related activities and operating subsidiaries. The Comptroller would thus become bound by regulations and orders of the Federal Reserve Board with regard to nonbanking activities for holding companies, and could not authorize national banks or their subsidiaries to engage in activities beyond the dictates of the Federal Reserve Board. As a matter of governmental policy, it is improper to bind the Comptroller to the decisions of the Board with regard to national bank activities.

Moreover, section 401(a)(1) and (2) of the Bill would require termination, after a regulation of the Federal Reserve Board or an order entered following the effective date of the Act, of any preexisting activity of national banks or their operating subsidiaries which would subsequently be found by the Board to be improper Section 4(c)(8) activities. It is a highly objectionable legislative maneuver to permit the Board through regulation or order to set standards which would be retroactive in terminating lawful activities of national banks and their subsidiaries.

5. INTERCOMPANY LOANS. Section 501 of S. 39 provides, among other matters, that subsidiaries of bank holding companies must refrain from discriminating in favor of the parent or affiliated subsidiaries in the making of loans or other conditions of credit. Such restriction is not necessary. The provisions of section 23A of the Federal Reserve Act limits, to a sufficient extent, extensions of credit between affiliates in the banking

industry. The subject provision of the Bill is also objectionable in requiring reports from holding companies each year relative to all intercompany loans and investments, which reports would be public. It is simply not the business of the public to know such details of business arrangements between affiliated companies. It serves no useful purpose to the public, except undesirable "fishing expeditions". The Board itself, along with other responsible agencies, can monitor through appropriate examinations whether any other provision of law is violated with reference to intercompany transactions between parent and subsidiary.

6. ADMINISTRATIVE PROCEDURES. Section 601 of the Bill adds a proposed section 9(b) to the Bank Holding Company Act requiring that all board determinations (whether by order or regulation) under section 4(c)(8) shall be made on the record after opportunity for hearing. Such provision is unduly burdensome and limiting to the discretion of the Board. Under present practice the Board has outlined many kinds of nonbanking activities which can be approved through delegation to the respective Federal Reserve Banks or which can be approved by the Board itself, if outside the delegated authority, on the basis of the submissions of the applicant. Members of the public are invited to comment and are advised through notices published in the Federal Register. Many of these approvals are, and should be, routine and perfunctory where no unusual financial, economic or legal matters are at issue. The Board should not be required to have to have a hearing on all such applications. To order such in this legislation is to move contrary to the intent evidenced by Congress earlier this year. The Depository Institutions Deregulation and Monetary Control Act of 1980 (H.R. 4986, P.L. 96-221, March 31, 1980), under Title VIII, charged the regulatory agencies with the responsibility of simplifying regulations and making procedures and rules more uniform between them. Now to invite more proceedings is to take a step backward.

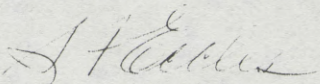
The same comment applies to the provisions of section 701 of S. 39 where members of the public are literally invited to contest more frequently the orders and regulations of the Federal Reserve Board and to commence civil actions under subparagraph 4 in order to test the validity or desirability of the various proceedings challenged. Members of the public have a right already to respond to the published notices of various proceedings before the Board. To give them an additional right to petition the Board to overturn matters that have already been determined is to invite litigation and to create confusion which is wholly improper and unnecessary.

FIRST SECURITY CORPORATION

Based on all of the foregoing considerations, we earnestly submit that the Senate Committee not approve S. 39.

Respectfully yours,

FIRST SECURITY CORPORATION



By Spencer F. Eccles
President and Chief Operating Officer

Joint News Release

Comptroller of the Currency
Federal Deposit Insurance Corporation
Federal Reserve Board

For immediate release June 13, 1980

The Federal bank supervisory agencies have adopted proposed recommendations made to them by the Federal Financial Institutions Examination Council regarding terms to be used in competitive factor reports and uniform guidelines for internal control of the foreign exchange activities of commercial banks.

The agencies adopted, as standard terminology to be used in their assessment of competitive factors in proposed bank mergers, the following terminology:

Monopoly (requiring disapproval).

Substantially Adverse (precludes approval unless anti-competitive effects of the proposed merger are outweighed by benefits to the public in meeting the convenience and needs of the community to be served).

Adverse (the proposed merger has anti-competitive effects material to the decision that would not preclude approval).

No Significant Effect (anti-competitive effects, if any, are not material to the decision).

The agencies adopted recommended uniform guidelines for commercial banks on internal control of their foreign exchange operations covering policy documentation, internal accounting controls and audit documentation. The text of the guidelines was published by the Council at the time they were proposed, in May and will be published in a forthcoming issue of the Federal Register.

# # # # # # # # # # # #

STATEMENT OF THE
INVESTMENT COMPANY INSTITUTE
BEFORE THE
SENATE COMMITTEE ON BANKING
HOUSING AND URBAN AFFAIRS
ON S. 39, H. R. 2255 AND S. 2874

July 7, 1980

The Investment Company Institute is the national association of the American mutual fund industry. Its membership includes 519 open-end investment companies ("mutual funds"), their investment advisers and principal underwriters. Its mutual fund members have assets of about $92 billion and have approximately 8.3 million shareholders.

The Institute is pleased to submit this statement on the "Competition in the Banking Act of 1979", S. 39. The Institute has testified before this Committee in the past in connection with similar legislation, including S. 72.

We support enactment of S. 39, H. R. 2255 and S. 2874.* In particular, we support enactment of Sections 301(a) and 401 of S. 39 which would reinforce and tighten the tests contained in Section 4(c)(8) of the Bank Holding Company Act relating to the permissible non-banking activities of national banks and bank holding companies. These provisions would prevent banks from using the holding company device as a means for unbridled bank expansion into other lines of commerce and for circumventing the Glass-Steagall Act's specific prohibitions against bank securities activities.

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* We support H. R. 2255 and S. 2874 which deal specifically with the marketing and underwriting of insurance by bank holding companies, because it represents a significant step in restricting banks from dominating areas of commerce that are not related to the business of banking.

Indeed, the introduction of S. 39 affords Congress the opportunity to make it clear that banks and bank holding companies are prohibited from engaging in specific non-banking activities, including:

- sponsoring or advising mutual funds
- sponsoring or advising closed-end investment companies
- sponsoring automatic investment plans
- sponsoring or advising real estate investment trusts
- selling interests in common trust funds other than to true personal trust accounts
- mass-merchandising interests in collective pension funds.

For over 100 years, the federal banking laws have sought to prevent commercial banks and their affiliates from engaging in securities activities. This long-standing position has been based on Congress' concern that bank involvement in the securities business inevitably will result in problems for the banks engaging in these activities, and hence for the entire American economic system. Indeed, as far back as 1911, in a formal opinion to the Attorney General, the Solicitor General opined on the legality of a national bank's establishment of an "investment company," the shares of which were made available ratably to the shareholders of the bank, were tied to the bank's own securities, and further were pledged in trust to the operating trustees of the investment company. The Solicitor General condemned the arrangement as a violation of the national banking laws, which, he said, required that "the bank shall be conducted as a bank pure and simple and not as a promoting agency of speculative investment companies."* (Emphasis supplied). This

* 75 Cong. Rec. 9899-9904 (1932).

concern has been based on three factors -- the unfair competitive advantages enjoyed by banking institutions, the historic undue concentration of economic power in a few huge banking institutions and the need for an uncompromised national banking system.

Yet many of the nation's leading commercial banks and bank holding companies often with the active assistance of the federal banking agencies, have repeatedly sought to subvert Congress' clear mandate:

- by forming securities affiliates in the early 1900s in order to circumvent the National Banking Act of 1864;
- by the Comptroller's persistent attempts in the 1960s to permit commercial banks to sponsor mutual funds;
- by bank sponsorship of REITs in the early 1970s;
- by the Federal Reserve Board's 1972 regulation authorizing bank holding companies to advise open-end funds and to both sponsor and advise closed-end funds;
- by the Comptroller's 1972 action permitting national banks to aggressively mass merchandise securities to the vast retirement plan market;
- and by the American Bankers Association's current campaign to completely repeal the Glass-Steagall Act and to return to the dangerous pattern of the 1920s.

Congress must deal with this recalcitrance. Legislation is needed to reaffirm the policies and restrictions of the Glass-Steagall Act, the Bank Holding Company Act of 1956 and the Bank Holding Company Act Amendments of 1970. Congress should make it clear that commercial banks and their affiliates are totally prohibited from sponsoring, organizing, controlling and advising every type of pooled investment fund other than traditional bank common trust funds. Such legislation would not be novel or revolutionary. It would simply carry out the

historic national policy of separating the business of banking from the promotional activities of the securities business.

Bank Securities Activities Add to Concentration of Economic Power

Concern over the undue concentration of economic power in the hands of a few huge banking institutions has formed a major basis for past Congressional efforts to prohibit bank entry into non-banking areas of the economy. Last year, when the Court of Appeals for the District of Columbia struck down Federal Reserve Board regulations purportedly authorizing bank holding companies to sponsor investment companies, it found that in enacting the 1970 amendments to the Bank Holding Company Act:

> "Congress was deeply concerned that the economy was becoming structured along the lines of the Japanese 'Zaibatsu' system, in which economic power was concentrated in a few gigantic power centers. This concern for the structural integrity of the economy would be present even if there were fully adequate safeguards against abuse of the subsidiary bank's economic power. Yet the Board's action in the present case, permitting bank holding companies or their affiliates to control the investment decisions for large pools of capital, would seem to portend the type of centralization of power that Congress feared in the 1970 Amendments."*

Senator Proxmire has underscored these concerns over the growing concentration of economic power in the hands of a few gigantic banking institutions:

> "Bank holding companies dominate our banking system. They now control over 70 percent of all banking deposits. The largest of these have experienced explosive growth. During the 25-year period from 1950 to 1975, the 10 largest of these institutions increased their control of all bank deposits in the Nation from under 20 percent to about 30 percent. Moreover, many State and local banking markets are highly concentrated with a few bank holding companies dominating banking activities."**

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* Investment Company Institute v. Board of Governors of the Federal Reserve System, No. 77-1862, slip opinion at 39-40 (D.C. Cir. March 30, 1979) (footnotes omitted).

** Remarks of Senator Proxmire introducing S. 39, 125 Cong. Rec. S236 (daily ed. Jan. 19, 1979).

Hearings before committees of both houses of Congress have produced evidence confirming the validity of Senator Proxmire's concerns over the undue concentration of economic power. For example, the Institute's testimony before the House Subcommittee on Financial Institutions Supervision, Regulation and Insurance offered the following statistics:

"- Commercial bank assets now stand at about one trillion dollars, while trust assets of these banks are now over $500 billion. These assets exceed those of all other financial institutions combined.

- Of institutions reporting to the SEC, banks hold over 52% of all common stock controlled by institutional investors -- $150 billion out of a total of $206 billion.

- Bank holdings of common stock listed on the New York Stock Exchange amount to almost $140 billion or about 16% of the total value of all listed stock.

- Bank holdings of common stock show a high degree of concentration. The top seven banks hold over $48 billion representing about one-third of holdings by all banks.

- Bank holdings of common stock show a significant potential for control of individual companies. Over 14% of the total value of these bank holdings represented 5% or more of the value of the outstanding stock of particular companies.

- In 21 states, banks affiliated with a bank holding company control over 20% of total banking assets in each state."*

Clearly, the increasing concentration of economic power in a few financial center banks threatens our very economic system; S. 39 would reduce the use of this power in non-banking areas of the economy.

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* Statement of the Investment Company Institute on H. R. 2747 Before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance of the House Committee on Banking, Finance and Urban Affairs, June 27, 1979, at 4-5 (footnotes omitted).

Unfair Competitive Advantages

The ability of banks to lend their deposits to millions of individuals and institutions makes them the dominant source of credit in the United States. Because they are the dominant source of credit, banks have the power to tie the availability of credit to the receipt of other business from individuals and firms that depend upon bank loans. This unique power gives commercial banks an inherently unfair competitive advantage over all other businesses in the offering of non-banking products and services. Senator Proxmire has stated:

> "Unfair competition arises because many customers will prefer to give their commercial business to a bank which also dispenses credit, even at a higher price, rather than to purchase their services from a non-bank competitor. Tie-in sales, whether coerced or voluntary, distort our economy and free market. This distortion means that trade is no longer carried out on the basis of price, quality, and service but on the basis of hoped for favortism."*

No where is the unfair competitive advantage enjoyed by banks more evident than in the management of private pension plans. Despite widespread belief that banks have not provided investment results equal to those of other investment managers,** banks have dominated the field. A recent study conducted by the Industrial Union Department, AFL-CIO, showed that of the top 7 investment managers of union pension plans, 5 were banks. Morgan Guaranty Trust Co. of New York ranked number 1. The study reported:

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* Remarks of Senator Proxmire supra.

** See Bogle and Twardowski, "Comparative Equity Investment Performance: Banks, Investment Counselors, Insurance Companies and Mutual Funds" Financial Analysts Journal, January/February, 1980. Also see "Equity Investment Performance: Banks v. Mutual Funds During the Decade of the Seventies", J. Sumanski, Investment Company Institute, May 1, 1980.

> "One of the study's more intriguing revelations concerned significant intercorporate relationships. An examination of boards of directors, principal debt-holders, and principal stockholders suggests that these relationships could have an impact on fund management decisionmaking. For example, nine out of the ten surveyed companies had interlocks with J. P. Morgan & Co. (parent of Morgan Guaranty Trust Co. of New York); five companies had strong debt relations with this bank, and in five cases, Morgan's Trust Department controlled more than one percent of the studied companies' stock. Of the ten surveyed companies, each had one or more major financial relationships with Morgan... More significantly, in each of seven companies, at least one key financial institution holding a major bloc of stock or debt, also was a fund manager for the same company."* (Emphasis in original).

The AFL-CIO is not the only group to identify this problem. An editorial in a magazine specializing in pension affairs stated last year:

> "What is an observer to think when he sees a roster [of major pension managers] composed almost entirely of banks, most of which have languished near the bottom of the investment performance tables for almost a decade?
>
> "Would he be unjustified in suspecting that the poorly performing banks are maintained as managers more for what they can do for the corporation than what they can do for the plan beneficiary?
>
> "Many observers suspect that some large banks have maintained their pension clients over the past eight or nine years mainly because they have commercial ties with those clients. To complicate the issue, clients fear corporate relations will be jeopardized if they fire the banks as pension fund managers."**

Safety of the Banking System

A sound banking system is a fundamental imperative to a sound economy. A financial crisis which affects our banks will undoubtedly have a disastrous ripple

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* Pensions, A Study of Benefit Fund Investment Policies, Industrial Union Department, AFL-CIO, May 1980, at 17-18.

** "Investing Solely in Interest of Beneficiaries," Pensions & Investments, January 1, 1979, at 6.

effect on our entire economy. Our historic national policy separates banks from the securities business, a business which by its very nature is, in varying degrees, speculative. The recent story of the real estate investment trusts sponsored by banks and bank holding companies offers graphics and contemporary proof of the wisdom of this policy.

In 1971, reversing an earlier decision, the Federal Reserve Board authorized bank holding companies to sponsor REITs. Within two years bank affiliated REITs accounted for 1/3 of total industry assets of $20 billion. The shares of the bank-sponsored REITs were sold to the public on the strength of the bank image of conservatism, solidity and expertise. However, the bank-sponsored REITs were riddled with abuses and conflicts that bear an uncanny resemblance to bank securities abuses of the late 1920s.

When the real estate boom of the early 1970s inevitably burst, the REITs lost approximately 80% of the value of their assets. But the dramatic losses were not confined to investors in the REITs. The Supreme Court proved prescient in its warning in the case of the Investment Company Institute v. Camp,* that sponsoring banks, fearing for their public reputations, would find themselves forced to take extreme and imprudent measures to attempt to shore up investment affiliates for this is exactly what they did in the case of their pooled real estate funds. Thus, Chase Manhattan Bank, the nation's third largest bank, committed in one form or another approximately half of a billion dollars in an unsuccessful effort to prevent its REIT from going into bankruptcy. Many other banking institutions entered into similar

* 401 U. S. 617 (1971).

rescue operations with similarly unhappy results. Substantial banks were damaged and there was diversion of bank resources which could have gone to provide needed credit to other areas of the economy.

Senator Proxmire recently stated:

> "When a bank has a stake in economic enterprise its credit judgments tend to be skewed. The most recent example is the involvement of banks in the real estate investment trust business where bank losses ran to the hundreds of millions of dollars. Congress, in fact, had to adopt special legislation just this year to bail out large banks holding real estate in connection with REIT defaulted loans, so that those banks would not have to charge off large losses to their already depleted capital base."*

Unfortunately, the federal banking regulators apparently have not learned from the lessons taught by the REIT experience. Banks are currently mass-merchandising interests in bank-sponsored pooled investment funds to unsophisticated small retirement plans. When the Institute testified before this Committee on S. 72, we presented evidence regarding this mass-merchandising, stating that in our view this activity constitutes a clear violation of the Glass-Steagall Act. It is apparent from the advertisements (copies attached) that pooled investment funds have not been operated by banks for the investment of existing trust assets. At the conclusion of our statement, Senator Proxmire and David Silver, President of the Institute had the following exchange:

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* Sen. Rept. 96-735, 96th Cong. 2d Sess., p. 31 (1980).

The Chairman: "I haven't had a chance to think about this very carefully, but you may well be correct that this constitutes a violation of Glass-Steagall. At any rate, it certainly doesn't seem to be banking in the usual sense by any means.

Mr. Silver: It is not the offer of fiduciary services, Mr. Chairman.

The Chairman: That's right."*

Despite clear rebuffs from the courts,** the banking industry continues to ignore the Congressional mandate for separation of banking from the securities business. Even more disturbing, the bank regulatory agencies themselves contribute to that defiance. The REIT debacle and the current merchandising of pooled pension funds demonstrate the unwillingness of the bank regulatory agencies to withstand industry pressures to undercut the fundamental policies of the Glass-Steagall Act. It confirms that effective enforcement of the prohibitions against bank involvement in the securities industry requires legislative action to remove discretion from the bank regulatory agencies.

Conclusion

For over a century, Congress has sought to prevent commercial banks and their affiliates from engaging in the general securities business out of concern that such activities inevitably will result in economic disaster for the banks and the nation as a whole. Congress' concerns have been amply justified by events, most recently by the crises which resulted from bank sponsorship of REITs in the early

* Hearings on S. 72, Senate Committee on Banking, Housing and Urban Affairs, 95th Cong., 2d Sess., 348 (1978).

** See the Investment Company Institute v. Camp, supra., and Investment Company Institute v. Board of Governors of the Federal Reserve, supra.

1970s. Yet, the banks and the bank regulatory authorities have repeatedly sought to subvert Congress' intent, for example: by banks forming securities affiliates in the early 1900s in order to circumvent The National Banking Act; by the Comptroller's successful lobbying in the 1920s to permit banks to underwrite securities; by the Comptroller's efforts in the 1960s to authorize banks to sponsor mutual funds; by bank sponsorship of REITs in the early 1970s; by the present mass-merchandising of interests in bank collective pension funds; and by the current efforts of major banking institutions to repeal the Glass-Steagall Act and return to the dangerous pattern of the 1920s.

We believe that S. 39 affords Congress the opportunity to categorically reaffirm the historic national policy that prohibits commercial banks and their affiliates from engaging in the general securities business. Over 100 years of experience indicates that this matter is far too important to be left to the business judgment of the banks or to the administrative discretion of the bank regulatory authorities.

Attachments

PENSIONS AND INVESTMENTS, APRIL 24, 1978

PENSIONS & INVESTMENTS, APRIL 25, 1977

IT'S ABOUT TIME INVESTMENT MANAGERS WERE JUDGED ON THEIR SUCCESSES INSTEAD OF THEIR ADDRESSES.

In other words, it's about time that managers of employee benefit plans realized that you don't have to be located in one of the great investment centers to have a great investment record.

Take us, for example. The First National Bank of Birmingham. We're certainly not at the hub of the investment industry, yet our Trust Division has been outperforming the industry standards for years.

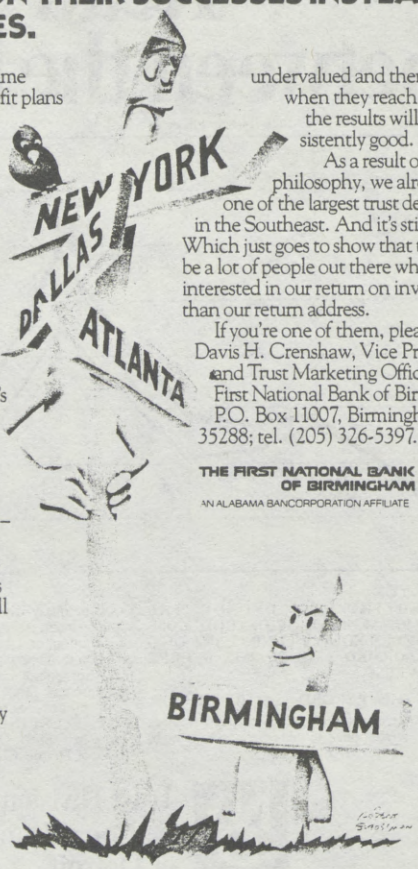
1972-76 is a good example. During that time, our Corporate commingled equity fund's rate of return was 7.9 percent versus only 4.9 percent for the Standard & Poor's 500. And for 1976 itself, our overall return was more than 14 points higher than the S&P– a hefty 38.5 percent.

How can a bank from Birmingham get this kind of results for its clients? Because despite all the myths and misunderstandings, it's still philosophy that determines investment success. Not geography.

And we have a philosophy that would be just as sound no matter where we had our office. Which is simply that if you consistently buy stocks that are undervalued and then sell them when they reach full value, the results will be consistently good.

As a result of this philosophy, we already have one of the largest trust departments in the Southeast. And it's still growing. Which just goes to show that there must be a lot of people out there who are more interested in our return on investment than our return address.

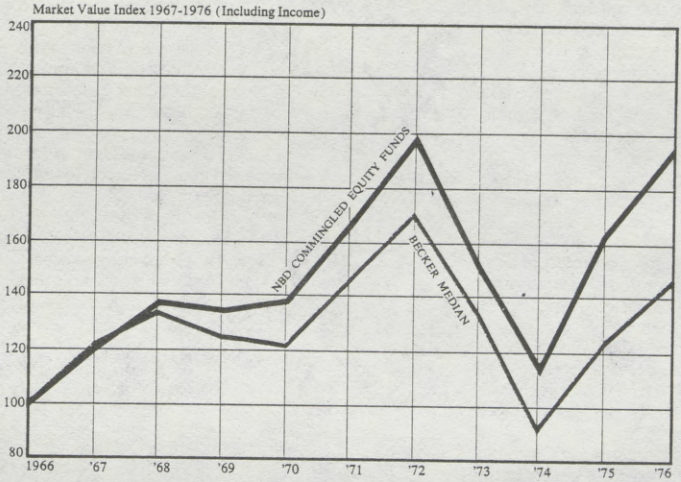
If you're one of them, please contact Davis H. Crenshaw, Vice President and Trust Marketing Officer, The First National Bank of Birmingham, P.O. Box 11007, Birmingham, Ala. 35288; tel. (205) 326-5397.



THE FIRST NATIONAL BANK OF BIRMINGHAM

AN ALABAMA BANCORPORATION AFFILIATE MEMBER FDIC

Read between the lines.



OVER THE LAST DECADE, THE NATIONAL BANK OF DETROIT COMMINGLED EQUITY FUNDS HAVE OUTPERFORMED 97% OF THE BECKER UNIVERSE.

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- Consistently superior performance from peak to peak, trough to trough, and over full market cycles.
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This is no guarantee of future success. It's an indicator that sound investment strategies and decisions can deliver outstanding results.

We specialize in fine tuning fixed-income employee benefit accounts for consistent performance, with low volatility through market cycles, to produce the superior results you're looking for.

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We're specialists in stocks, bonds, oil, real estate, and the complexities of ERISA. And regardless of the size of your trust, we analyze your particular requirements, then tailor an investment and administrative program to meet the performance goals of your plan.

This flexibility has enabled First of Tulsa's investment record to rank in the top 12% of those money managers surveyed nationwide by the Becker Securities Corporation *

For more information about how our administrative and investment capabilities can help your company (and you), call collect for John Heard at (918) 586-5384. Or write First of Tulsa today.

*Pooled equity fund for employee benefit accounts, equities only, 1-1-70 thru 12-31-76.

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MORTGAGE INSURANCE COMPANIES OF AMERICA
1725 K STREET, N. W., SUITE 1402 - WASHINGTON, D. C. 20006 - (202) 785-0767

JOHN C. WILLIAMSON
EXECUTIVE DIRECTOR

STEVEN P. COEHLER
DIRECTOR OF RESEARCH AND ECONOMICS

June 26, 1980

The Honorable William Proxmire, Chairman
Banking Housing and Urban Affairs Committee
Room 5300 Dirkson Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

The Mortgage Insurance Companies of America submits the enclosed testimony in support of H.R. 2255 and respectfully requests that it be included in the record of the Committee's hearings on this legislation.

Because of the time constraints the Committee is under, we will not present our views during the hearing but stand ready to respond to any questions any Committee member may have.

Sincerely,

John C. Williamson

Enclosure
SPD/JCW/cd

Statement of Robert L. Waldo, President, Mortgage Insurance Companies of America*, to be presented to the Senate Committee on Banking, Housing and Urban Affairs, in support of H.R. 2255, a bill to limit the insurance activities of bank holding companies and their subsidiaries.

July 1, 1980

Mr. Chairman and Members of the Committee:

The Mortgage Insurance Companies of America strongly supports H.R. 2255 and recommends that the Committee recommend Senate approval of the bill as soon as practicable. The House has given its overwhelming support to this legislation by a vote of 333 to 25 on June 12, 1980; and the Senate in the 95th Congress approved a similar measure. The time is opportune for having this bill become law.

This Association has testified on previous occassions in support of legislation to curb the insurance activities of bank holding companies so we summarize, as concisely as possible, our rationale for supporting H.R. 2255.

In 1974 the Federal Reserve Board ruled that mortgage guaranty insurance was a permissible activity of bank holding companies although it did not approve the applications as of that time**. While we appreciate that the Federal Reserve Board has not received any further applications, the

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*The Mortgage Insurance Companies of America is a trade association consisting of thirteen domestic private mortgage insurance companies whose insurance-in-force on May 31, 1980 was $98.5 billion. The national officers of the Association are Robert L. Waldo (President of Verex Assurance, Inc.), Madison, Wisconsin, President; Leon T. Kendall, President of Mortgage Guaranty Insurance Corporation), Milwaukee, Wisconsin, Vice-President; William A. Simpson, (President of Republic Mortgage Insurance Company) Winston-Salem, North Carolina, Secretary; Jackson W. Goss, (President Tiger Investors Mortgage Insurance Company) Boston, Massachusetts; and John C. Williamson, Washington, D.C., Executive Vice President.

** In 1973 three bank holding companies submitted applications to the Federal Reserve Board for approval of entry in the mortgage insurance business.

possibility that the Board may at some future date approve an application of a bank holding company to engage in the mortgage insurance business makes the most compelling reason why we urge favorable action by the Congress on this legislation.

Bank holding companies cannot enter the mortgage insurance business without creating a potential conflict of interest. Banks as providers of mortgage credit should not be allowed to have a financial interest in the sale of an insurance that could be required as part of the transaction. It is essential from the standpoint of the public that the lender and mortgage insurer deal at arm's length. Let me explain why this is necessary.

Mortgage insurers write insurance at the request of a lender who is originating a low downpayment loan. The lender wants this insurance to protect him against loss resulting from the default of a borrower.

The mortgage insurer must look at the nature and the quality of a lender's assets, his appraisal, underwriting, and servicing abilities, and his methodology for handling delinquent loans. We question seriously whether a mortgage insurer would be able to objectively evaluate a sister affiliate of the same bank holding company system. In no way would they be dealing at arm's length.

This can be illustrated in at least four situations.

First, a mortgage insurer must objectively evaluate a lender before he can issue a master policy. This is not only dictated by sound underwriting principles, but required by the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, both of which purchase conventionally financed mortgages on the strength of private mortgage insurance

Second, the decision by the lender as to whether to apply for mortgage

insurance for certain loans must be based on objective evaluation of risk. A lender considering mortgage insurance offered by a company within the same bank holding company family introduces a biased element in the decision process. This may result in unnecessary mortgage insurance and in unnecessary cost to the home-buyer.

Third, the decision of the insurer to approve the application from the lender for loan default coverage must also be based upon objective evaluation. Here again such evaluation would be compromised through a self-dealing arrangement if the insured and insurer were members of the same bank holding company system.

Fourth, the insurer's evaluation of a claim by a lender must be objective. The decision, for example, whether to pay 20% to 25% of the claim, according to the coverage of the policy, or to pay the entire claim and take title to the property must be determined on the basis of what is in the best interest of the insurance company. Here again, objective evaluation is tainted if the insurer and the lender are both members of the same financial family. The conflict of interest permeating such a decision is self-evident.

It has been suggested that entry of bank holding companies in the mortgage insurance business may be in the public interest by increasing competition in the industry. Actually, the mortgage insurance business is very competitive. There are presently fourteen private mortgage insurance companies most of whom are writing insurance on a national basis. No state is served by less than four companies, and more than twenty states are served by at least ten companies.

A fifteenth domestic mortgage insurance company is about to enter the industry. It will have an initial capitalization of 25 million.

The industry has a clear record in being able to attract new capital. This maintains its competitiveness and ability to serve the homebuying public. No public advantages can be shown from entry by BHCs.

Finally, I want to bring to the Subcommittee's attention the fact that the Federal Home Loan Bank Board has recognized the inherent conflict of interest between an insurer and its lender-customer; and has moved by regulation to minimize such conflicts. Insurers are prohibited from maintaining deposits with lender-customers; and insured institutions may not own more than 1% of the equity securities in an MIC and have its mortgages insured by such MIC. The Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association have adopted comparable requirements underscoring the need for more arm's length dealing between insurer and insured.

It would be most unfortunate if in some future year the Federal Reserve Board would reverse this regulatory trend toward arm's length dealing. To avert such an eventuality, the Congress by enacting this legislation will make it clear and unmistakable that mortgage guaranty insurance is not a permissible activity of bank holding companies.

I thank you for this opportunity to comment on this legislation on behalf of the industry and commit the association to be ready to answer any questions from members of the Committee.

NACSA
NATIONAL ASSOCIATION of CASUALTY & SURETY AGENTS

Government Affairs Office
600 Pennsylvania Avenue, S.E.
Suite 202
Washington, D.C. 20003
(202) 547-6616

July 1, 1980

The Honorable William Proxmire
Chairman, Senate Banking, Housing and
Urban Affairs Committee
United States Senate
Washington, D.C. 20510

Re: S. 2874 and H.R. 2255, Bank Holding Company Act Amendments

Dear Mr. Chairman:

As President of the National Association of Casualty and Surety Agents (NACSA), an association representing medium to large size property and casualty insurance agencies and brokerage firms, it is my pleasure to submit for the hearing record of the Senate Banking, Housing and Urban Affairs Committee NACSA's comments on S. 2874 and H.R. 2255, the Bank Holding Company Act Amendments of 1979. NACSA appreciates the opportunity to publicly express its views on this important legislative matter and strongly supports you in your continued efforts to pass this legislation in a timely fashion.

I cannot overemphasize the urgent need for passage of this legislation. Bank holding company activities in the field of insurance, with few exceptions, are a real threat to a consumer's choice of insurance as well as to the viability of a competitive marketplace in the sale of insurance, a non-banking related activity.

Sincerely yours,

Philip L. Cochran

Philip L. Cochran
President
National Association of Casualty
and Surety Agents

PLC:jab
Enclosure
CC to: NACSA Officers
Members of the Senate Banking, Housing and Urban Affairs Committee

BEFORE THE

SENATE COMMITTEE ON BANKING, HOUSING & URBAN AFFAIRS

BILL NOS. S. 2874 AND H.R. 2255

STATEMENT OF

NATIONAL ASSOCIATION OF CASUALTY & SURETY AGENTS

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NATIONAL ASSOCIATION OF CASUALTY AND SURETY AGENTS

The National Association of Casualty and Surety Agents (NACSA) is an organization comprising over three hundred of the larger property and casualty insurance agencies and brokerage firms in the United States accounting for approximately 20 percent of the total property/casualty insurance industry's premiums. NACSA appreciates the opportunity to provide for the record these written comments concerning impermissible insurance activities of bank holding companies.

There is currently an urgent need for legislation prohibiting bank holding companies from engaging in all but a few specifically identified forms of insurance activities.

In the 95th Congress, the House overwhelmingly voted for such legislation as an amendment to Title XIII of the Financial Institution Regulatory Act of 1978. However, in spite of this strong mandate, a last minute legislative compromise prevented this legislation from being included in the final bill which was enacted into law.

On June 12 of this year, the House overwhlemingly passed H.R. 2255, the Bank Holding Company Act Amendments, by a vote of 333 to 25. Clearly, such a vote indicates again the urgent need for speedy passage of this important piece of legislation.

This Committee has now before it two bills, S. 2874 and H.R. 2255, each containing the language as passed by the House on June 12. NACSA strongly supports the insurance language of these bills and urges this Committee to work expeditiously on this legislation which, if enacted, will prohibit bank holding companies from

engaging in insurance activities other than those specifically exempted.

The increasing insurance activities of bank holding companies are resulting in unfair competitive practices on the part of such companies who are using their inordinate economic power in the banking market to foreclose competition in the insurance area. For the past eight years, the Federal Reserve Board has consciously ignored this anticompetitive effect of bank holding company insurance activities, in spite of the clear congressional mandate, contained in the "public interest" test of § 4(c)(8) of the Bank Holding Company Act, that the Board consider anticompetitive effects. All indications are that the Board will continue in this direction. Consequently, there is a particularly urgent need for corrective legislation such as S. 2874 and H.R. 2255. Absent such legislation, insurance agents will be forced to spend more time and money challenging improper Board actions.

I. LEFT TO OPERATE UNDER A GENERAL STANDARD, THE FEDERAL RESERVE BOARD WILL NOT EFFECTIVELY LIMIT INSURANCE ACTIVITIES OF BANK HOLDING COMPANIES

In 1970, Section 4(c)(8) of the Bank Holding Company Act was amended to its current form which prohibits bank holding companies from engaging in insurance activities unless the Federal Reserve Board finds such activities to be so closely related to

banking as to be a proper incident thereto, and further finds that public benefits outweighing possible adverse effects can reasonably be expected to result. For the past eight years the Federal Reserve Board has interpreted this "general standard" in the most expansive sense, and while expending a great amount of time and resources, has allowed bank holding companies to engage in almost all forms of property and casualty insurance.

In 1971, citing Section 4(c)(8) of the Bank Holding Company Act as authority, the Federal Reserve Board promulgated 12 CFR Section 225.4(a)(9). This regulation allowed bank holding companies to engage in, among others, the following broad categories of insurance:

1.) Any insurance directly related to an extension of credit by a bank or bank related firm to the provision of other financial services by a bank or bank related firm; and

2.) Any insurance sold as a matter of convenience to the purchaser so long as this portion of the insurance activity of the bank holding company is insignificant.1/

1/ This provision of the regulation allowing "convenience insurance" was struck down in Alabama Association of Insurance Agents, Inc. vs. Board of Governors of The Federal Reserve, 533 F.2d 224 (5th Cir. 1976); re-hearing denied, 558 F.2d 729 (5th Cir. 1977); cert. denied 46 U.S.L.W. 3539, No. 770668, February 27, 1978. On April 10, 1978, the Board proposed an amendment to 12 CFR §225.4(a)(9) in order to conform the regulation to this decision of the Alabama Association case. The proposal is still pending.

Under this extremely broad standard, the Federal Reserve Board has allowed numerous forms of insurance activities. These activities include the following forms of insurance where such insurance has been issued to protect property in which the bank has a security interest or to protect the bank holding company's ability to obtain repayment of loans:

1.) Fire, theft, and other perils
2.) Comprehensive insurance
3.) Collision insurance
4.) Marine insurance
5.) Liability insurance
6.) Property floater insurance
7.) Homeowner's insurance
8.) Boiler and machinery insurance
9.) Surety bonds
10.) Credit life, credit accident, and credit health insurance issued to cover the debtor.[2/]

Furthermore, the Board has also allowed bank holding companies to engage in the sale of numerous forms of insurance, such as automobile insurance, when sold as a matter of convenience to the purchaser.[3/]

2/ Alabama Financial Group, Inc., 39 Fed. reg. 25548 (1974); First National Holding Corporation, 39 Fed. Reg. 33411 (1974).

3/ Id.

In summary, over the past eight years, *the Federal Reserve Board* in its application of the general "closely related" standard of §4(c)(8) of the Bank Holding Company Act has expended a great amount of time and administrative resources, yet *has failed to effectively limit the expanding scope of insurance activities engaged* in by bank holding companies.

II. FEDERAL RESERVE BOARD HAS CONSISTENTLY FAILED TO SHOW CONCERN OVER ANTICOMPETITIVE EFFECTS OF BANK HOLDING COMPANY INSURANCE ACTIVITIES

In determining whether the conduct of a proposed insurance activity by a bank holding company will produce public benefits which will outweigh adverse effects such as undue concentration of resources and unfair competition, the Federal Reserve Board has continually turned its back upon facts which clearly demonstrate actual or potential tying of the sale of insurance to granting of credit by bank holding companies.

This shortcoming of the Board was amply demonstrated in the Board proceedings leading up to both the Alabama Association of Insurance Agents[4/] case and the recent case of Florida Association of Insurance Agents vs. Board of Governors of the Federal Reserve System.[5/] In addition the recent study[6/] conducted by the Board on the subject of tie-ins between granting of credit and sales of insurance by

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4/ Supra at note 1

5/ 591 F.2d 334 (5th Cir. 1979)

6/ "A study of Tie-Ins Between the Granting of Credit and Sales of Insurance by Bank Holding Companies and other Lenders"

bank holding companies, is yet another clear example of the Board's refusal to recognize the anticompetitive results of bank holding company insurance activities.

In both proceedings leading up to the Alabama Association, case, the administrative law judge had made a finding that the economic concentration of the applicant bank holding companies threatened insurance agents, and that a substantial possibility of tying of insurance sales to loans existed.7/

In the Alabama Financial Group proceeding, the Administrative Law Judge, finding the Applicant to have as high as 46.7 percent of deposits in some markets, concluded that the Applicant "...would have a dominant position in terms of captive clientele which could be influenced to divert from local existing independent insurance agencies. While coercive tying of insurance sales to lending is illegal under Section 106 of the Act, 'voluntary' tying through subtle influencing particularly in times of tight money is a distinct possibility despite protestations of TAFG witnesses to the contrary".8/

7/ January 14, 1974 Recommended Decision of the Administrative Law Judge, F.R.B. Docket IA-8 (First National Holding Company) and February 7, 1974 Recommended Decision of the Administrative Law Judge, F.R.B. Docket IA-10 (Alabama Financial Group).

8/ February 7, 1974 Recommended Decision of the Administrative Law Judge, F.R.B. Docket IA-10 (Alabama Financial Group).

In the First National Holding Company proceeding, the Administrative Law Judge, finding the applicant and another bank holding company to control 52.8 percent of the Atlanta market, concluded that "...their combined economic power would represent a formidable threat to the independent agencies by reason of the banks' advantage in terms of a very large built-in clientele of borrowers and that consequently...the independent commission agents would have difficulty surviving".9/

The Federal Reserve Board, having reviewed these findings of the Administrative Law Judge, nevertheless in large part rejected the Recommended Decision of the Administrative Law Judge and allowed the Applicant bank holding companies to engage in many types of insurance which the Administrative Law Judge had found to be contrary to the public interest. In so acting, the Board merely stated that it had found no actual evidence of the bank holding companies using their economic power to coerce.

This insistence by the Board that there be a showing of actual abuse of economic power ignored the clear intent of Congress that the Board consider not only actual abuse of economic power, but also the potential for such abuse. This intent of Congress was clearly manifested in the Conference Report to accompany the 1970 amendments to Section 4(c)(8) of the Bank

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9/ January 14, 1974 Recommended Decision of the Administrative Law Judge, F.R.B. Docket IA-8 (First National Holding Company).

Holding Company Act of 1956:

> "But the dangers of 'voluntary' tie-ins and reciprocity are basically structural and must be dealt with by the Board in determining the competitive effects of bank holding company expansion into fields closely related to banking when considering applications under Section 4(c)(8). These will be difficult questions, for assurances of good faith and the intention not to engage in tie-ins and reciprocity by the Applicant bank holding companies will largely be irrelevant to the just as serious dangers of 'voluntary' tie-ins and reciprocity. The Board must, in any case, consider these problems in carrying out its responsibilities under the Act." (emphasis supplied) 10/

In the Florida Association of Insurance Agents 11/ case the Fifth Circuit felt compelled to strongly chastise the Board for again ignoring an Administrative Law Judge's findings that proposed insurance activities of a bank holding company would have anti-competitive effects in the insurance industry.

In the Florida Association of Insurance Agents case the administrative law judge had found that approval of the applications would produce "large concentrations" of market power which would "decrease competition within the insurance industry" by driving smaller competitors out of business or into mergers.12/ The Board, while explicitly approving the administrative law judge's conclusion that increased service competition would result from approval of the applications, refused to mention the administrative law judge's specific finding that such approval would have an

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10/ H.R. Report No. 91-1747, p. 18, December 16, 1970.

11/ Supra at note 5

12/ Supra at note 5, pp. 340, 341

anticompetitive effect on the insurance industry.[13] Noting that this act of the Board was alone sufficient to merit reversal, the Fifth Circuit felt compelled to instruct the Board on remand to address this important issue.[14]

Nothing could underscore more clearly the inclination of the Board to ignore the serious threat of undue concentration of bank holding company resources in the insurance area than the fact that the Fifth Circuit, in Florida Association of Insurance Agents, was compelled to remand a decision of the Board and instruct the Board to consider and discuss an administrative law judge's findings of anticompetitive effect.

Yet another example of the Board's continued refusal to give serious and objective analysis to the problem of anti-competitive actions by bank holding companies in the insurance area is the recent Board study entitled "A Study of Tie-Ins Between the Granting of Credit and Sales of Insurance by Bank Holding Companies". This study has been severely criticized by both the Federal Trade Commission[15] and the staff of the Comptroller of the Currency[16] for both its conclusion that tying of insurance to extension of credit is not significant and for its underlying methodology.

13/ Id.

14/ Id.

15/ Feb. 5, 1979 letter from Lewis H. Goldfarb, Asst. Director for Credit Practices, FTC to Senator Proxmire.

16/ Dec. 6, 1978 Memorandum of David H. Pyle, Visiting Scholar; endorsed as position of Comptroller's staff in February 9, 1979 letter from Asst. Chief Counsel, Fred Barrett to FTC.

In this study, the Board concluded that explicit tying between the granting of credit and the sale of credit-related insurance was "practically non-existent" and that implicit pressures brought by lenders upon borrowers were "neither very strong nor widespread in the industry". In reaching this conclusion the Board ignored the evidence produced by its own survey. For the Board's own survey showed that at least 16.4% and perhaps as much as 25% of consumers felt required to purchase insurance in conjunction with extension of credit. In its criticism of the Board study the Federal Trade Commission noted that this 25% violation rate was not only significant but unacceptable.

Furthermore, the FTC correctly pointed out that had the Board not conducted its survey so as to elicit evidence favorable to bank holding companies, the evidence of bank holding company tying activities would have been even stronger. For example, in order to determine the penetration rate of bank holding companies in the insurance market, the Board provided bank holding companies with voluntary questionnaires. The FTC pointed out that such a procedure most likely resulted in those bank holding companies with low penetration rates reporting such favorable information to the Board, and those bank holding companies with high penetration rates refusing to volunteer such information.

The FTC also noted in its letter to Senator Proxmire that the method by which the Board study sought to determine the degree of coercion imposed upon consumers by bank holding companies was also biased in favor of the bank holding companies.

The Board based its findings in this area partly upon the answers of bank holding companies to questions as to bank procedures in selling insurance. Obviously, no bank holding company is going to describe its practices as coercive. The Board finding of lack of coercion was also based upon its assumption that no coercion had been placed upon any consumer who reported that he had not purchased insurance. The FTC pointed out that a recent consumer study demonstrated that up to 40% of consumers who purchase insurance in connection with an extension of credit do not realize that they have done so. Therefore, a significant number of consumers who the Board assumed were not coerced, in fact had insurance tied to the extension of credit so effectively that they did not even see the tie.

In its letter to Senator Proxmire, the FTC also expressed deep concern over the fact that the Board study indicated that no consumer complaints had been filed alleging tying of sale of insurance to extension of credit. The FTC pointed out that such indication was contrary to the fact that the FTC had in the past reported such consumer problems to the Board.17/

In summary, the Board study of the tying of sale of insurance to extension of credit demonstrates two facts. The evidence produced by the Board study demonstrates that a significant degree

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17/ One of these consumer complaints resulted in a FTC consent order against Guardian Loan and a refund of over $40,000 in unearned credit insurance premiums to the company's customers. the sale of Guardian Loan to a bank holding company was subsequently approved by the Board in spite of the fact that the FTC had reported the consent order and the customer refund to the Board.

of coercion is imposed upon consumers by bank holding companies. Secondly, the actions taken by the Board in the conduct of the study, first in structuring the survey so as to elicit information most favorable to bank holding companies and then in reaching conclusions contrary to the information elicited, demonstrated that the Board is predisposed toward allowing bank holding companies to engage in insurance activities without regard to the anticompetitive effect resulting therefrom.

The Federal Trade Commission and the Comptroller of the Currency are not the only organizations which have noted this shortcoming of the Board. The Fifth Circuit in the Florida Association of Insurance Agents[18/] case also noted the refusal of the Board to concern itself with anticompetitive effects resulting from insurance activities of bank holding companies. Legislation such as that contained in HR 2255, HR 2747 and HR 2856 is necessary to limit the insurance activites of the bank holding companies. The Federal Reserve Board has proven itself unwilling to take the necessary steps in this area.

18/ Supra at note 4

III. CONCLUSION

For the past eight years the Federal Reserve Board has refused to properly apply the general "closely related" standard of §4(c)(8) of the Bank Holding Company Act so as to effectively limit insurance sales activities of bank holding companies and thereby protect against anticompetitive effects resulting from such activities. The bank holding companies have been allowed to engage in an increasing number of insurance activities.

The Courts have overturned the Board in many instances, and both the Courts and other agencies have been compelled to chastise the Board for turning its back upon obvious showings of anticompetitive effects resulting from insurance activities of bank holding companies. The insurance agents have been forced to spend considerable time and money in having improper Board action overturned; but the agents cannot match the resources of the bank holding companies or the Federal Reserve Board. Applications of bank holding companies for permission to engage in insurance activities continue to be filed.

All indications are that in processing these applications the Board will continue to ignore the anticompetitive effect of increased bank holding company activities in the insurance area. The insurance agents and the Courts should not be forced to expend further time and money in order to rectify improper Board action.

Legislative relief is urgently needed. Such relief would be afforded by passage of S. 2874 and H.R. 2255. Each go beyond the current general "closely related" standard to prohibit large bank holding companies from engaging in the sale of all but a few specifically identified forms of insurance. NACSA asks this Committee to adopt such legislation.

Respectfully submitted,

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STATEMENT BY

RUSSELL A. HOWARD, FMS

PRESIDENT

OF THE

PROFESSIONAL INSURANCE AGENTS

This statement of position by the National Association of Professional Insurance Agents (PIA) is submitted in support of legislation before the Senate Committee on Banking, Housing and Urban Affairs that would amend Section 4(c)(8) of the Bank Holding Company Act of 1956 to prohibit bank holding companies from engaging in insurance agency activities except under certain prescribed conditions. Such a prohibition is contained in H.R. 2255 and S. 2874.

The Professional Insurance Agents is a national association with membership of more than 33,000 independent property and casualty insurance agents from each of the fifty states, the District of Columbia, Puerto Rico, Canada and the Virgin Islands.

PIA has long been concerned with the continued expansion of bank holding companies into the business of insurance and the lack of interest on the part of the Federal Reserve Board in stopping this expansion.

The Federal Reserve Board, under a "general standard" approach, allows bank holding companies, among other activities, to provide any insurance that is directly related to an extension of credit by a bank or to the provision of other financial services by a bank. To date, the Federal Reserve Board has proven itself unwilling to effectively regulate the activity of bank holding companies in the area of insurance and has

shown an extreme indifference to the potential of bank holding companies to exert undue economic coercion upon insurance agents and consumers alike.

Therefore, PIA urges this Committee to adopt legislation to specifically prohibit bank holding companies from engaging in any insurance activities except for a few specified types of insurance which have proven to be proper activities for bank holding companies and with which we do not take issue.[1]

The approach taken by H.R. 2255 and S. 2874 would provide the Federal Reserve Board and the bank holding companies with explicit insturctions as to what is and what is not a permissible insurance activity for a bank holding company. We think this is the best approach since it would eliminate the ill effects of the confusing and inconsistent rulings which have been promulgated by the Federal Reserve Board in this area. As a result, for the past eight years, the Federal Reserve Board, as well as the courts, have expanded a great deal of time and energy in this area. However, in large part due to

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1/ Such permissible insurance activities would be those in H.R. 2255 as approved by the House of Representatives on June 12, 1980, i.e.: (1) credit life and A & H sold to insure repayment of a loan; (2) credit property insurance sold by a BHC finance company subsidiary to protect collateral on loans of less than $10,000; (3) insurance sold in a town with a population of 5,000 or less or where insurance agency facilities are otherwise inadequate; (4) by bank holding companies engaged in the sale of insurance on or before June 6, 1978; (5) by bank holding companies with total assets of $50 million or less; and (6) by bank holding companies acting as supervisor for property-casualty insurance on the BHC's own property or group insurance on its employees.

its lack of concern for the potential of bank holding companies to exert undue economic coercion upon the insurance business, the Board has failed to caary out Congress' clear intent that insurance activities of bank holding companies be limited. To allow the Federal Reserve Board to continue with this "general standard" approach would be to sanction bureaucratic inefficiency and unbridled growth of bank holding companies at a time when the American public has clearly called for a more effective use of the administrative process and a check upon concentration of economic power.

I. THE FEDERAL RESERVE BOARD HAS ALLOWED AN EXTREMELY BROAD RANGE OF INSURANCE ACTIVITIES UNDER ITS "GENERAL STANDARD"

In 1970 Section 4(c)(8) of the Bank Holding Company Act was amended to prohibit bank holding companies from engaging in insurance activities unless the Federal Reserve Board determined that the insurance activities were "so closely related to banking" as to be a "proper incident thereto," and that the performance of the insurance activity by a bank holding company could reasonably be expected to produce benefits to the public which outweigh possible adverse effects. In 1971, the Federal Reserve Board, citing the 1970 amendments to Section 4(c)(8) of the Bank Holding Company Act as authority, promulgated 12 C.F.R. Section 225.4(a)(9). This regulation essentially allowed bank holding companies to engage in the following insurance activities:

1.) Any insurance for the holding company and its subsidiaries;

2.) Any insurance directly related to an extension of credit by a bank or to the provision of other financial services by a bank;

3.) Any insurance sold as a matter of convenience to the purchaser so long as this portion of the insurance activity of the bank holding company was insignificant; and

4.) Any insurance sold in a community which the bank holding company demonstrated had inadequate insurance agency facilities or had a population of 5,000 inhabitants or less.

The Federal Reserve Board, whose members have a strong banking background, has been barraged with a great number of applications from bank holding companies seeking permission to engage in nearly every conceivable form of insurance activity. The reaction of the Board to this barrage of applications has been confusing, illogical, and inconsistent. Prior to the 1977 decision of the Fifth Circuit in Alabama Association of Insurance Agents, Inc. v. Board of Governors of the Federal Reserve System[2] the Board allowed a broad range of insurance activities. These activities included

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2/ 533 F.2d 244 (5th Cir. 1976); re-hearing denied, 558 F.2d 729 (5th Cir. 1977); cert. denied 46 U.S.L.W. 3539, No. 77-668, February 27, 1978

the following forms of insurance where such insurance was issued to protect assets financed by the bank holding company or to protect the bank holding company's ability to obtain payment of loans:

1.) fire, theft, and other perils;

2.) comprehensive insurance;

3.) collision insurance;

4.) marine insurance;

5.) liability insurance;

6.) property floater insurance;

7.) homeowners' insurance;

8.) boiler and machinery insurance;

9.) surety bonds; and

10.) performance bonds.[3]

Prior to the Fifth Circuit opinion in Alabama Association, the Board also allowed banks to engage in credit life, credit accident, and health insurance issued for the purpose of assuring the ability of the debtor to repay a debt, and the Board also allowed numerous forms of convenience insurance such as automobile insurance.[4]

In addition to the numerous forms of insurance listed above, bank holding companies made application, albeit unsuccessfully, for still additional forms of insurance.

3/ Alabama Financial Group, Inc., 39 Fed. Reg. 25, 548 (1974); First National Holding Corporation, 39 Fed. Reg. 33411 (1974).

4/ Id.

These forms of insurance include:

1.) business interruption insurance;

2.) fidelity insurance;

3.) level term life insurance;

4.) loss of rent insurance; and

5.) mortgage guarantee insurance.[5]

The numerous forms of insurance listed above demonstrate the need to replace the ineffective general standard with a specific prohibition upon all but a few specific forms of insurance.

II. PROPERTY AND CASUALTY INSURANCE IS NOT CLOSELY RELATED TO BANKING

By allowing bank holding companies to engage in numerous forms of property and casualty insurance in connection with an extension of credit or other financial services by the bank holding company, the Board has given an extremely pro-banking interpretation to the words "closely related to banking." When one fully understands the intricacies of property and casualty insurance, it becomes clear that the sale of such insurance is not "closely related" to banking within the fair meaning of those words.

5/ Alabama Financial Group, Inc., 39 Fed. Reg. 25548 at 25550 (1974); First National Holding Corporation, 39 Fed. Reg. 33411 at 33421, 33413 (1974); Barnett Banks of Florida and Chase Manhattan of New York, 40 Fed. Reg. 44260 at 44622, 44624 (1975); Pan American Bankshares, Inc., Miami, Florida, 40 Fed. Reg. 44630 at 44632 (1975).

The three factors which are most commonly used to determine whether an activity is "closely related" are:

1.) The functional equivalence of the activity to banking;

2.) The ability of the activity to be operationally integrated into the bank's lending process; and

3.) The need of the bank to conduct the activity.

All three of these factors are absent in the case of property and casualty insurance.

There is no functional equivalence between the lending process and the sale of property and casualty insurance. Procedural steps taken in reviewing a loan application and drafting a loan contract are simply different from the procedures inherent in selecting, selling, and servicing property and casualty insurance.

Further, it cannot be argued that the sale of property and casualty insurance can be operationally integrated into the lending process. Property and casualty insurance is categorically different from credit life, credit health, and the limited form of credit accident insurance. These latter forms of insurance are generally written under a blanket policy issued to the lender without underwriting of individual applicants. There are no underwriting decisions to be made by the bank and no consumer decisions with respect to form or scope of coverage.

By comparison, the sale of property and casualty insurance necessitates an analysis of numerous factors, none of which are related to the lending process. The property and casualty insurance agent must assess all of the risks with which his client is faced and attempt to allocate the limited resources of his client to cover the most significant risks in an economic manner. He must be able to reassess his client's coverage needs as his client's business or personal situation changes. In the case of personal property, the agent must design his client's policy to include coverages for special costly items such as jewelry, furs, and art objects, not included in the "standard form" coverage. Also the property and casualty agent must be familiar with the literally hundreds of different policy forms which he must choose from and often combine in order to give his client the most appropriate coverage. In addition to this extensive knowledge which the property and casualty agent must have of both his client's situation and the form of insurance available which will most properly fit that situation, the agent must also be prepared to service the policy which he sells. In some instances this may entail the authority to settle small claims in the range of a hundred to a thousand dollars depending upon the company and type of loss. Furthermore, the agent must handle claims for his client so that the client obtains the most speedy, efficient, and fair coverage from the insurance company. All of these skills are beyond the expertise of the normal loan officer.

There is simply no parallel between the information and skills needed by the loan officer for the loan transaction and the information and skills required by the property and casualty insurance agent for the issuance of insurance. Consequently, the sale of property and casualty insurance may not be operationally integrated into a loan transaction.

Nor can it be shown that bank holding companies need to engage in the sale of casualty and property insurance. Of course, a bank needs to make sure that the property in which it has a security interest is insured, but there is no need for the bank to sell such insurance. A bank needs buildings and telephones to conduct business, but this need does not make the construction of buildings or the provision of telephone service "closely related" to banking. As was explained above, insurance agents are better trained than a loan officer to see that the property in which a bank has a security interest is adequately insured. Consequently, a bank holding company has no need to engage in the sale of property and casualty insurance.

The fact that property and casualty insurance has nevertheless been treated by the Federal Reserve Board under a "general" standard as "closely related" to banking demonstrates the need for Congress to specifically prohibit bank holding companies from engaging in all but a few specific forms of insurance.

III. THE FEDERAL RESERVE BOARD HAS SHOWN LITTLE CONCERN OVER THE POTENTIAL OF BANK HOLDING COMPANIES TO EXERT ECONOMIC COERCION UPON THE INSURANCE BUSINESS

Not only has the Federal Reserve Board found the sale of property and casualty insurance to be closely related to banking, but it has also found the conduct of those activities by bank holding companies to be in the public interest. In making this finding, the Board has evidenced a noticeable lack of concern over the potential of bank holding companies to exert undue economic coercion upon the insurance business.

The history of the Alabama Association case demonstrates this failure of the Federal Reserve Board to objectively regulate the activities of the bank holding companies in the insurance area. The Fifth Circuit in that case was reviewing two decisions of the Federal Reserve Board, which in turn had reviewed the Recommended Decisions of an Administrative Law Judge. The Administrative Law Judge, who was not from the Federal Reserve System, but was "on loan" from another federal agency, recommended that the major holding companies, First National Holding Company and Alabama Financial Group, Inc., be denied the right to engage in all forms of insurance except for proprietary and employee insurance and for credit life, credit health, credit accident, and mortgage redemption insurance.[6]

6/ January 14, 1974 Recommended Decision of the Administrative Law Judge, F.R.B. Docket Ia-8 (First National Holding Company) and February 7, 1974 Recommended Decision of the Administrative Law Judge, F.R.B. Docket Ia-10 Southern Bankcorporation).

The bases for both decisions of the Administrative Law Judge were essentially identical. Citing "destructive competition through the possibility of voluntary tying (insurance with lending) particularly in periods of tight money,"[7] the Administrative Law Judge found that reasonable expectation of public benefits was outweighed by the possibility of the adverse effects represented by destruction of competition.

In the Southern Bankcorporation proceeding, two bank holding companies controlled over two billion dollars of deposits in Atlanta representing over 50 percent of the market. One of the applicants in that case forecast earnings from marketing insurance in the amount of $4,812,500 annual premiums. The Administrative Law Judge found that the adverse impact upon the Atlanta insurance agents would probably be substantial.[8] Furthermore, in that case there was testimony that a bank holding company would be "more receptive" to a borrower's last offer if insurance premiums were part of the total package. The Administrative Law Judge concluded that "voluntary tying" of insurance to lending was quite possible, and noted that Section 4(c)(8) of the Bank Holding Company Act focused upon "possible" adverse effects and not "probable" adverse effects.[9]

In reaching this decision, the Administrative Law Judge also made the following observation, which although apparently

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7/ February 7, 1974 Recommended Decision of the Administrative Law Judge, F.R.B. Docket IA-10 (Southern Bankcorporation).
8/ Id.
9/ Id.

ignored by the Federal Reserve Board, is in our view, the very reason why your Committee must specifically prohibit bank holding companies from engaging in insurance activities:

> "The proposition reduced to its simplest terms comes down to this: If a bank, large in its community, using predominantly depositors' funds as capital, is authorized to compete against mostly small insurance enterprises by soliciting its debtor-clientele, it is possible, even probable that the Mom and Pop agency will be driven into merger or out of business entirely; and, to this extent, the American dream of a land of opportunity where every man and woman, with some skill and good luck, can become a proprietor or a partner, rather than merely a clerical employee or an insignificant stockholder, will fade further."10

In spite of these alarming findings by the Administrative Law Judge, the Federal Reserve Board rejected in large part the decision of the Administrative Law Judge, and allowed many types of insurance activities which the Administrative Law Judge had found to have presented unacceptable risks of anticompetitive results. In doing so, the Board repeatedly stated that it had found no evidence of attempts by the bank to tie, either voluntarily or involuntarily, the sale of insurance to its provision of banking services. This inclination of the Board to require a showing of actual use of monopoly power by the banks demonstrates the lack of concern of the Board over the potential of bank holding companies to

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10/ Id.

use their extraordinary economic power in an unfair manner. Monopoly power has long been held to be an evil in itself, regardless of whether that power is in fact exercised by its holder.[11]

Further, it should be noted that in Florida Association of Insurance Agents v. Board of Governors of the Federal Reserve System,[12] the Fifth Circuit remanded three cases back to the Federal Reserve Board with instructions to require the applicants to introduce evidence with respect to the effect of state law (in this case Florida and Texas) on the public benefits criteria enumerated in Sec. 4(c)(8) and to consider and review the revised applications in accordance with the statutory criteria outlined in its earlier Alabama decision.

IV. BANK HOLDING COMPANIES CONTINUE TO PRESSURE FOR EXPANDED SCOPE OF PERMISSIBLE INSURANCE ACTIVITIES

Sensing this pro-banking attitude of the Federal Reserve Board System, bank holding companies have continued to pressure the Board to expand the scope of permissible insurance activities.

Recently, a bank holding company, NCNB Corporation, applied to the Federal Reserve Board for approval to retain

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11/ "So it is that monopoly power, whether lawfully or unlawfully acquired, may itself constitute an evil and stand condemned under S2 [Sherman Act] even though it remains unexercised." (brackets added). U.S. v. Griffith 334 U.S. 100 (1948).

12/ CA. #'s 75-3151 to 75-3153, 75-3342, 75-3343 and 75-3358 5th Cir., March 19, 1979) 591 F. 2d 334 (5th Cir. 1979)

its indirect subsidiaries which were engaged in the actual underwriting (i.e., ultimate risk bearing) of property and casualty insurance related to extensions of credit by NCNB Corporation's affiliates. On May 12, 1978, the Federal Reserve Board denied the application finding that the activities of the subsidiaries were not closely related to banking. However, the fact that one Governor on the Board voted against rejecting the application and the very fact that the bank holding company even made the application are indicative of bank holding companies' belief that the Federal Reserve Board will allow them to engage in almost any type of insurance activity.

Further evidence of this attitude on the part of the bank holding companies may be found in the comments which were filed on May 1, 1978 by the American Bankers Association upon the Federal Reserve Board's proposed amendment to 12 C.F.R. Section 225.4(a)(9), that regulation which defines the scope of insurance activities which may be engaged in by bank holding companies. In these comments, the American Bankers Association argued that bank holding companies should be allowed to issue extensions or renewals upon credit related insurance even though the loan which is related to the insurance has been paid in full. It is hard to conceive how the issuance of such renewal insurance by banks can be seen to be "closely related to banking" when such renewals are issued after the period when the loan which was the basis for the issuance of the insurance has been paid. Nonetheless, this position of the American Bankers Association

indicates that the bank holding companies feel that the Federal Reserve Board might apply the general "closely related" test in such a manner as to allow renewal insurance.

V. FEDERAL RESERVE BOARD CONTINUES TO APPROVE APPLICATIONS DESPITE THE SENSE OF CONGRESS TO THE CONTRARY

The non-banking activities of bank holding companies received intense scrutiny during the 95th Congress. Accordingly, on October 5, 1978, the U.S. House of Representatives voted 252 to 72 to amend Se. 4(c)(8) to restrict bank holding company involvement in non-banking activities. On October 15, 1978, the Senate approved by voice vote identical language. Unfortunately, notwithstanding the separate but equal actions of both houses of Congress, the legislation did not pass because of parliamentary circumstances and the enormous crush of end-of-session business.

In spite of this rather clear expression of intent by the 95th Congress and without regard to a specific request by several House and Senate banking committee members to Federal Reserve Board Chairman G. William Miller that a "moratorium on new or expanded insurance agency activities by bank holding companies be established by the Federal Reserve Board in all but the most urgent cases of public need," the Federal Reserve Board has approved some 200 bank holding company applications to enter the property and casualty insurance business since October of 1978.

VI. CONCLUSION

In light of the above comments, the Professional Insurance Agents strongly urges the Senate Banking, Housing and Urban Affairs Committee to act favorably on legislation as approved by the U.S. House of Representatives on June 12, 1980 by a vote of 333-25, which would specifically prohibit bank holding companies from engaging in the sale of insurance except for a few specific types of insurance activities. Such legislation is necessary to effectively limit the insurance activities of bank holding companies and to put an end to the unproductive administrative proceedings which have been going on at great expense for the past eight years using a general standard. The need is urgent. PIA is hopeful that the committee will move swiftly to complete the work you so ably began in the 95th Congress.

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July 11, 1980

By Hand

The Honorable William Proxmire
Chairman
Senate Committee on Banking,
Housing and Urban Affairs
Room 5300
Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

We respectfully request that this letter be included in the record of your Committee's hearings on H.R. 2255 and related bills to restrict the insurance activities of bank holding companies and their subsidiaries. This submission is made on behalf jointly of our following clients:

CONNECTICUT MUTUAL LIFE INSURANCE COMPANY,
Hartford Connecticut

MASSACHUSETTS MUTUAL LIFE INSURANCE COMPANY,
Springfield, Massachusetts

THE MUTUAL BENEFIT LIFE INSURANCE COMPANY,
Newark, New Jersey

THE MUTUAL LIFE INSURANCE COMPANY OF NEW YORK,
New York, New York

NEW ENGLAND MUTUAL LIFE INSURANCE COMPANY,
Boston, Massachusetts

NORTHWESTERN MUTUAL LIFE INSURANCE COMPANY,
Milwaukee, Wisconsin

By way of brief background, our firm was employed first in 1974 by one company and then successively by the five other companies. Each had become concerned by complaints from respon-

sible members of their respective agency forces that existing life and accident and health insurance of established policyholders was being replaced or curtailed by the explicit or implicit demand of bank subsidiaries of bank holding companies that such insurance be purchased through bank-affiliated insurance agencies. Opportunities to compete for the sale of new insurance also were being stifled. The complaining agents protested the elimination of normal competitive opportunities by the exercise of economic pressures by bank officers and employees, sometimes exerted on mutual customers of the banks and the insurance agents in connection with a new loan or other banking transaction and sometimes unrelated to any new banking transaction.

Our firm was authorized to investigate independently the factual basis for complaints of this nature and to advise our clients whether we perceived a current or potentially serious threat to the traditional highly competitive marketing operations in the insurance industry through the entry of bank holding companies and their affiliates into the business of selling insurance. We knew that to businessmen and consumers generally in need of normal banking services, even the suggestion of placing insurance through a bank affiliate can be the full equivalent of economic coercion of the worst kind.

Our firm's investigation verified, as our clients had strongly suggested, that a blanket condemnation of bank holding companies and their banks and other subsidiaries clearly would be unwarranted. Some bankers continued the policy of not offering bank sponsored insurance, leaving to the individual bank customer the selection of his own agent and insurance company to provide any insurance required in support of a banking transaction. Other banks adhered to the traditional role of providing (normally through a group insurance contract or contracts) credit insurance coverage in amounts and for durations directly related to the loan or other banking transaction. We became satisfied, however, that a growing number of banks and bank holding company organizations seized upon the 1970 Amendments to the Bank Holding Company Act and expansive Federal Reserve Board interpretations to market insurance under circumstances which point strongly to unfair and improper use of the economic power of the banks in conducting those controlled and affiliated insurance operations.

Our clients are in accord that such activities, particularly if they continue to increase unchecked, are inimical to the orderly, normally competitive marketing of insurance by

highly trained professional agents. They are destructive of the public's right to free choice of an insurance agency and the right to secure the best insurance at the most competitive price to meet the individual's insurance needs. As I have stated in testimony before this Committee and before the House Banking Financial Institutions Subcommittee on several occasions during the past four years, we believe these practices can only be effectively dealt with by restoring the traditional wall separating banking from commerce.

As passed by the House, H.R. 2255 would effectively accomplish this result, while recognizing the legitimate and historic role of banking institutions in certain limited insurance areas such as credit insurance. Since our clients and their agents are in the life insurance business, their particular interests relate to H.R. 2255's provision concerning life insurance and annuities. These provisions, which we strongly support, would prohibit bank holding companies and their subsidiaries from providing life insurance or annuities as a principal, agent or broker except where the insurance is limited to assuring the repayment of the outstanding balance due on a specific extension of credit by a bank holding company or its subsidiary in the event of the death or disability of the debtor, or with respect to any insurance agency activity in a place that either has a population not exceeding 5,000 or that the bank holding company, after notice and opportunity for a hearing, demonstrates has inadequate insurance agency facilities.

We strongly urge the immediate adoption of H.R. 2255 with these appropriate restrictive provisions. Prompt Committee and floor action is essential so that this legislation, which already has been passed overwhelmingly by the House, can be enacted during this Congress. Please be assured that we will welcome any questions which you may have.

Respectfully submitted,

Edward J. Schmuck

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