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Nonbank Banks: Congressional Options

Davis W. Turner

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I. INTRODUCTION

The Bank Holding Company Act [1] (BHCA) defines a bank as an institution that both accepts demand deposits *and* makes commercial loans.[2] An institution choosing to perform only one of these two activities falls outside the scope of the BHCA and constitutes a "nonbank bank."[3] The creators of a nonbank bank re-

1. 12 U.S.C. §§ 1841-1850 (1982).
2. *Id.* § 1841(c). The statute defines a bank as "any institution . . . which (1) accepts deposits that the depositor has a legal right to withdraw on demand, and (2) engages in the business of making commercial loans." *Id.*
3. Although nonbank banks escape the regulations imposed by the BHCA, they are not necessarily free from regulation. The Comptroller of the Currency ("Comptroller") stressed this point at recent congressional hearings:

> Nonbank banks suffer from a name that does not describe them accurately. Except for purposes of the Bank Holding Company Act, nonbank banks are in fact banking institutions. Unlike many other forms of limited purpose banks, OCC-chartered nonbank banks are subject to the full scope of regulatory, supervisory, and enforcement authority exercised by this Office. Nonbank banks receive regular national bank charters. They are subject to the same laws and regulations as other national banks, including FDIC insurance requirements if they are taking deposits; laws requiring nondiscrimina-

ceive two principal benefits from the institution's status as a nonbank bank.[4] First, a bank holding company acquiring a nonbank bank can avoid the geographical restrictions imposed by the Douglas Amendment[5] to the BHCA. Second, a company outside of the banking industry may acquire a nonbank bank without becoming a bank holding company and, therefore, may operate free from the BHCA's product[6] and geographic restraints.

The discovery of this avenue for expansion in the financial services industry has led to an "avalanche" of applications to establish nonbank banks.[7] While the Comptroller of the Currency ("Comptroller") has been willing to grant charters to nonbank banks,[8] the Board of Governors of the Federal Reserve System ("Board") has been very reluctant to approve these institutions[9] and has opposed the widespread establishment of nonbank banks. The Board's resistance has resulted in litigation leaving the future of nonbank banks in doubt and has prompted forecasts of the demise of nonbank banks.[10]

Recent United States Supreme Court decisions, however, have

> tory lending and other consumer laws; and safety and soundness regulations, including capital requirements. Nonbank banks also receive regular on-site examinations and must get regulatory approval for changes in their corporate structure.

Nonbank Banks: Hearings on H.R. 20 Before the Subcomm. on Financial Institutions Supervision, Regulation and Insurance of the House Comm. on Banking, Finance and Urban Affairs, 99th Cong., 1st Sess. 179 (1985) (statement of C. T. Conover, Comptroller of the Currency) [hereinafter *Hearings*].

4. *See generally* Felsenfeld, *Nonbank Banks—An Issue in Need of a Policy*, 41 Bus. Law. 99, 100 (1985) (discussing the consequences of creating a nonbank bank).

5. 12 U.S.C. § 1842(d) (1982); *see infra* text accompanying notes 39-47.

6. 12 U.S.C. § 1843 (1982).

7. As of June 28, 1985, the Comptroller had received 368 applications to charter interstate nonbank banks. U.S. Trust Petition for Certiorari at A35, U.S. Trust Corp. v. Board of Governors, 760 F.2d 1135 (11th Cir. 1985), *cert. granted, vacated, and remanded*, 106 S.Ct. 875, *rev'd*, 800 F.2d 1534 (1986).

8. As of June 5, 1985, the Comptroller had granted preliminary approval for 279 nonbank bank charter applications. *Nonbank Bank Sweepstakes—OCC Version*, Banking Expansion Rep., Feb. 3, 1986, at 8, 9.

9. The Board has authorized only 23 nonbank banks. *See, e.g., Mellon National Corp.*, 71 Fed. Res. Bull. 256 (1985); *Maryland National Corp.*, 71 Fed. Res. Bull. 253 (1985); *Chase Manhattan Corp.*, 71 Fed. Res. Bull. 249 (1985); *Irving Bank Corp.*, 71 Fed. Res. Bull. 173 (1985); *First National State Bancorp.*, 71 Fed. Res. Bull. 115 (1985); *Suburban Bancorp.*, 71 Fed. Res. Bull. 61 (1985); *Bank of Boston Corp.*, 71 Fed. Res. Bull. 55 (1985); *Bankers Trust Corp.*, 71 Fed. Res. Bull. 51 (1985); *First Interstate Bancorp.*, 70 Fed. Res. Bull. 660 (1984). In addition, the Board has approved no applications since March 15, 1985. *See Suspension of Processing of Applications to Acquire Nonbank Banks*, 71 Fed. Res. Bull. 323 (1985).

10. *See The Nonbank Bank May Be History*, Banking Expansion Rep., June 3, 1985, at 2, 3.

revitalized the nonbank bank controversy and have legitimized the existence of nonbank banks. In *Board of Governors v. Dimension Financial Corporation*[11] the Supreme Court held that the Board exceeded its authority when it expanded the definition of demand deposits and commercial loans in order to include some nonbank banks under the Board's regulatory umbrella.[12] The Court viewed the question of whether to regulate nonbank banks as a matter for Congress to address, not the Board or the courts.[13] Subsequently, the Court remanded *U.S. Trust Corporation v. Board of Governors*[14] to the United States Court of Appeals for the Eleventh Circuit for action consistent with *Dimension Financial.* In *U.S. Trust Corporation* the Eleventh Circuit had interpreted the Douglas Amendment as prohibiting the establishment of an interstate network of depository nonbank banks.[15] However, because the Supreme Court's interpretation of the BHCA in *Dimension Financial* directly conflicted with the Eleventh Circuit's original holding, the Eleventh Circuit was forced to reverse its earlier decision and affirm the Board's approval of U.S. Trust's application for a nonbank bank. Thus, the Supreme Court's actions leave little room for the Board or the courts to prevent the proliferation of nonbank banks. The nonbank bank issue is now squarely in the hands of Congress, but so far Congress has been reluctant to address the controversy.

This Note examines the status of nonbank banks in light of these recent Supreme Court decisions and discusses concerns that Congress should address through legislation. Part II examines the legislative history behind both the BHCA's definition of a bank and the Douglas Amendment to the BHCA. Part III discusses regulatory and judicial responses to the creation of nonbank banks and analyzes the impact of the Supreme Court's *Dimension Financial* decision. Finally, Part IV looks at nonbank banks' influence on the financial services industry, examines proposed congressional solutions, and suggests the need for comprehensive banking reform legislation rather than piecemeal legislative action.

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11. 106 S. Ct. 681 (1986).

12. *Id.* at 689.

13. *Id.*

14. 106 S.Ct. 875 (1986).

15. Florida Dep't of Banking v. Board of Governors, 760 F.2d 1135, 1141 (11th Cir. 1985), *cert. granted, vacated, and remanded sub nom.* U.S. Trust Corp. v. Board of Governors, 106 S. Ct. 875, *rev'd,* 800 F.2d 1534 (1986).

II. Legislative History

A. *The Changing Definition of a "Bank"*

Congress enacted the BHCA in response to the increasing number of bank holding companies and the perceived need for comprehensive federal regulation of these institutions to protect the public.[16] The changing definition of a BHCA "bank" has prompted the current nonbank bank controversy. Three different definitions of "bank" have evolved since the BHCA's inception in 1956—the original version and the 1966 and 1970 amended versions. With each amendment, Congress debated and narrowed the scope of the BHCA's application to certain financial institutions. Despite these changes, the overall policy behind the BHCA has remained the same.[17] The BHCA seeks to avoid an undue concentration of banking resources and to maintain a separation between banking and commerce.[18] Underlying both objectives is the policy of preventing a monopoly over commercial credit.[19]

The original 1956 definition of a bank was broad, encompassing all state and federally chartered banks.[20] The 1966 amendment

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16. S. Rep. No. 1095, 84th Cong., 2d Sess., *reprinted in* 1956 U.S. Code Cong. & Admin. News 2482, 2483.

17. In 1956 the Board chairman noted the two principal problems arising from the bank holding company structure:

> (1) The unrestricted ability of a bank holding company group to add to the number of its banking units, making possible the concentration of commercial bank facilities in a particular area under a single control and management; and
>
> (2) The combination under single control of both banking and nonbanking enterprises, permitting departure from the principle that banking institutions should not engage in business wholly unrelated to banking . . . .

S. Rep. No. 1095, 84th Cong., 2d Sess., *reprinted in* 1956 U.S. Code Cong. & Admin. News, 2482, 2483. The 1970 Senate Report stated that "it is desirable to continue our long-standing policy of separating banking from commerce". S. Rep. No. 1084, 91st Cong., 2d. Sess., *reprinted in* 1970 U.S. Code Cong. & Admin. News 5520, 5522. The report noted that the concern over the concentration of banking resources was also a primary reason for the 1970 amendment, stating that because of "the large growth of the assets held by the one-bank holding company industry . . . it is necessary to amend the Bank Holding Company Act to bring one-bank holding companies under the regulation provided by that act." *Id.*

18. *See supra* note 17.

19. *See* Lewis v. BT Investment Managers, Inc., 447 U.S. 27, 46 (1980). The Senate Report in 1966 noted this concern over commercial credit, stating that "[t]he purpose of the [BHCA] was to restrain undue concentration of control of commercial bank credit, and to prevent abuse by a holding company of its control over this type of credit for the benefit of its nonbanking subsidiaries." S. Rep. No. 1179, 89th Cong., 2d Sess. 7, *reprinted in* 1966 U.S. Code Cong. & Admin. News 2385, 2391.

20. The 1956 definition of a bank was "any national banking association or any State bank, savings bank, or trust company." Act of May 9, 1956, Pub. L. No. 84-511, § 2(c), 70 Stat. 133 (1956).

narrowed the definition of a bank to "any institution that accepts deposits that the depositor has a legal right to withdraw on demand."[21] Congress' objective in narrowing the definition was to limit the scope of the BHCA to commercial banks.[22] Congress specifically sought to exclude savings banks and industrial banks from the BHCA's authority.[23] Congress chose to exempt these institutions by using the demand-deposit test because savings and industrial banks commonly did not accept demand deposits.[24] Critics saw this definition as overly broad, encompassing institutions that were not commercial banks. They deemed a commercial loan test as more appropriate.[25]

Congress added the commercial loan test with the 1970 amendments,[26] which required that a BHCA bank "engage[] in the

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21. Act of July 1, 1966, Pub. L. No. 89-485, § 3, 80 Stat. 236 (1966).

22. Senator Robertson, Chairman of the Senate Banking Committee, spoke in favor of the bill, stating that the bill "was intended to apply to commercial banks of a sort which might have relationships with businesses and business firms which should be avoided." 112 CONG. REC. 12,385 (1966).

23. The 1966 Senate Report stated:

> This objective can be achieved without applying the act to savings banks, and there are at least a few instances in which the reference to "savings bank" in the present definition may result in covering companies that control two or more industrial banks. To avoid this result, the bill redefines "hank" as an institution that accepts deposits payable on demand (checking accounts), the commonly accepted test of whether an institution is a commercial bank so as to exclude institutions like industrial banks and nondeposit trust companies.

S. REP. No. 1179, 89th Cong., 2d Sess. 7, *reprinted in* 1966 U.S. CODE CONG. & ADMIN. NEWS 2385, 2391; *see also* 102 CONG. REC. 6957 (1956) (statement of Sen. Rohertson).

24. *See id.*

25. A Boston holding company president wrote:

> We believe that the proposed amendment to Section 2(c) needs modification to accomplish its objective of limiting the application of the act to commercial banks. The amendment fails because it emphasizes the source of funds rather than the use to which the funds are put. We suggest that the use of funds is the relevant factor since if a bank does not engage in commercial lending, it cannot commit any of the hypothetical abuses which bank holding company legislation is designed to prevent.

Letter from William W. Wolbach, President, The Boston Co., Inc., to Sen. A. Willis Robertson, Chairman, Senate Comm. on Banking and Currency (April 28, 1966), *reprinted in Amend the Bank Holding Company Act of 1956: Hearings Before a Subcomm. on Banking and Currency*, 89th Cong., 1st Sess. 732-33 (1966).

The Federal Reserve Board also supported the addition of a commercial loan test to the definition. The Chairman of the Board stated tbat he was "impressed by the argument that a bank that does not make commercial loans is not apt to be involved in the kind of abuses the Act is designed to prevent." Letter from Chairman of the Board of Governors of the Federal Reserve System to Sen. Robertson (May 11, 1966), *reprinted in* 112 CONG. REC. 12,386 (1966).

26. The 1970 amendments to the BHCA came in response to the growth of one-bank holding companies (both in number and size). Prior to these amendments, the Act's regulations exempted one-bank holding companies. *See* S. REP. No. 1084, 91st Cong., 2d Sess.,

business of making commercial loans."[27] The amendments resulted in the present conjunctive definition, making the BHCA applicable only to institutions that both accept demand deposits *and* make commercial loans. The Board supported the commercial loan test in 1966[28] and again in 1970. The Senate Report cited the Board's support as a contributing factor to the 1970 change, noting that the Board had argued that the 1966 definition was too broad because it could include institutions that do not make commercial loans and, therefore, do not constitute commercial banks.[29] The House Conference Report also accepted the need for the new definition, stating that the commercial loan test was a specific congressional "exemption from coverage of the Act for any company which is chartered as a bank but which does not make commercial loans."[30]

Despite the Senate and House Reports' language noting the exemption's general applicability to "institutions" and "any company," critics argue that the 1970 amendments were designed to benefit only one company—Boston Safe Deposit and Trust Company ("Boston Safe").[31] The Board accepted this argument in 1982 despite its earlier support of the commercial loan test.[32] Proponents of this view rely on statements made during the debate on the amendment indicating that Boston Safe was virtually the only bank at the time that did not make commercial loans.[33] This con-

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reprinted in 1970 U.S. CODE CONG. & ADMIN. NEWS 5519, 5520-22.

27. Act of Dec. 31, 1970, Pub. L. No. 91-607, § 101(c), 84 Stat. 1760, 1762 (codified at 12 U.S.C. § 1841(d)).

28. *See supra* note 25.

29. S. REP. No. 1084, 91st Cong., 2d Sess., *reprinted in* 1970 U.S. CODE CONG. & ADMIN. NEWS 5519, 5541.

30. H. R. CONF. REP. No. 1747, 91st Cong., 2d Sess. 22, *reprinted in* 1970 U.S. CODE CONG. & ADMIN. NEWS 5561, 5573.

31. *See* Florida Dep't of Banking v. Board of Governors, 760 F.2d 1135, 1140 n.10 (11th Cir. 1985), *cert. granted, vacated, and remanded sub nom.* U.S. Trust Co. v. Board of Governors, 106 S.Ct. 875, *rev'd,* 800 F.2d 1534 (1986). Boston Safe's parent company bad supported the commercial loan definition in 1966 along with the Board. *See supra* note 25.

32. Felsenfeld, *supra* note 4, at 110 (quoting letter from the Board of Governors of the Federal Reserve System to William M. Issac (Dec. 10, 1982) concerning Dreyfeus Corporation's proposed acquisition of Lincoln State Bank). The Board also bad advised Congress at the time of the amendment that it "would have very limited application at present, possibly affecting only one institution." *One-Bank Holding Company Legislation of 1970—Hearings on S. 1052, et al., before the Senate Comm. on Banking and Currency,* 91st Cong., 2d Sess. 136-37 (1970) (letter from Governor Robertson of the Board) [hereinafter *One-Bank Holding Company*].

33. Representative Gonzalez, a member of the House Banking and Currency Committee, stated that "[t]he effect of the amendment is to exempt the Boston Co. from the bill" because it is "[v]irtually tbe only bank which does no commercial lending." 116 CONG. REC.

tention also is supported by the House Conferees' instruction to the Board to construe the exemption very narrowly and to continue to bring within the Act all bank holding companies that should be covered because the new exemption was intended for only "a very small number of cases."[34]

Although the 1970 amendments limited the BHCA's coverage of banks that did not make commercial loans, the amendments expanded the Board's authority to permit a greater number of nonbanking activities for bank holding companies.[35] Permitted nonbanking activities include those that the Board deems "so closely related to banking or managing or controlling banks as to be a proper incident thereto."[36] These activities are exempt from BHCA regulations promoting the separation of banking and commerce. Congress intended this provision to provide bank holding companies with the flexibility to engage in innovative nonbanking activities in reaction to unforeseen changes in the financial services industry.[37] Congress believed this flexibility was necessary to ensure that bank holding companies will continue to provide the public with essential financial services in the future.[38] Pursuant to this exemption, bank holding companies are able to acquire nonbank banks as an activity closely related to banking.

25,848 (1970) (quoting from the National Journal of July 18, 1970).

34. H. R. CONF. REP. No. 1747, 91st Cong., 2d Sess. 22, *reprinted in* 1970 U.S. CODE CONG. & ADMIN. NEWS 5561, 5573-74.

35. Act of Dec. 31, 1970, Pub. L. No. 91-607, § 103(4), 84 Stat. 1760, 1763 (codified at 12 U.S.C. § 1843(c)(8) (1982)).

36. 12 U.S.C. § 1843(c)(8) (1982) [hereinafter § 4(c)(8)].

37. The Senate Report agreed with the Federal Deposit Insurance Corporation's ("FDIC") statement concerning the reasoning behind these BHCA § 4(c)(8) exemptions:

> Inasmuch as the economy and its financial requirements are constantly changing, the Corporation considers it essential that banks and bank holding companies have the flexibility to engage in new types of bank-related activities that may be needed now and in the future if the financial needs of the people are to be met efficiently, competitively, and at reasonable cost. Likely changes in technology, the nature of financial competition and the economic and legal functions of commercial hanking all lead to a conclusion that retaining such flexibility is the wise course for the future.

S. REP. No. 1084, 91st Cong., 2d Sess., *reprinted in* 1970 U.S. CODE CONG. & ADMIN. NEWS 5519, 5531 (quoting *One-Bank Holding Company*, *supra* note 32). *See also* 116 CONG. REC. 31,823 (1970) (statement of Sen. Sparkman, Chairman, Senate Comm. on Banking and Currency).

38. S. REP. No. 1084, 91st Cong., 2d Sess., *reprinted in* 1970 U.S. CODE CONG. & ADMIN. NEWS 5519, 5531 (quoting *One-Bank Holding Company*, *supra* note 32).

B. *The Douglas Amendment*

The Douglas Amendment to the BHCA contains the geographic restrictions that bank holding companies can avoid by creating a nonbank bank. The Douglas Amendment prohibits the Board from approving an acquisition of a bank in one state by a bank holding company in another state unless the laws of the state in which the acquired bank is located specifically authorize the acquisition.[39] Senator Douglas, the chief sponsor of the Amendment,[40] explained that the Amendment sought "to prevent an undue concentration of banking and financial power, and instead keep the private control of credit diffused as much as possible."[41] He was concerned that a concentration of credit resources also would lead to a concentration of industry and trade.[42] Senator Douglas cited examples from Britain and Germany where a monopoly over credit resources created unfair competitive advantages for a bank's nonbanking affiliates because of their freer access to commercial credit.[43]

Senator Douglas also expressed concern over the rapid expansion of bank holding companies and their control of more than twenty percent of the bank deposits in nine states.[44] The Amendment attempted to prevent the continued acquisition of banks across state lines without the state's permission. At the time of its adoption the Amendment amounted to a complete prohibition on interstate banking because no state explicitly permitted out-of-state banks or their holding companies to enter the state for the purpose of conducting banking operations.[45] The Amendment,

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39. 12 U.S.C. § 1842(d) (1982).

40. The Douglas Amendment was added to the BHCA on the floor of the Senate after the Amendment had already been reported out of the House and Senate banking committees. Because the Amendment's legislative history is limited to the Senate debate, "the comments of individual legislators carry substantial weight, especially when they reflect a consensus as to the meaning and objectives of the proposed legislation though not necessarily the wisdom of that legislation." Northeast Bancorp., Inc. v. Board of Governors, 105 S.Ct. 2545, 2551 (1985).

41. 102 CONG. REC. 6857 (1956). Senator Douglas also stated that this purpose extended to the entire BHCA. *See supra* notes 18-19 and accompanying text.

42. 102 CONG. REC. 6857 (1956).

43. *Id. But see infra* note 195.

44. 102 CONG. REC. at 6858-60.

45. *Id.* at 6860. Today many states have passed legislation permitting out-of-state bank bolding companies to enter their states. Some limit this invitation to companies domiciled in states in their geographic region with reciprocal statutes. Maine was the first state to pass regional interstate banking legislation. *See* ME. REV. STAT. ANN. tit. 9-B, § 1013 (1980 & Supp. 1985).

however, permitted individual states to decide whether to allow interstate acquisitions as the financial services industry developed in the future.[46] Despite the geographic restrictions, none of Senator Douglas' statements supports the idea that the Amendment prohibits the ownership of institutions engaging in what the BHCA itself defines as nonbanking activities.[47] The Douglas Amendment's reach, therefore, is limited by the BHCA's definition of a "bank."

III. Regulatory and Judicial Response

The history of regulatory and judicial responses to the establishment of nonbank banks is marked by the Board's opposition, the Comptroller's permission, the circuit courts' confusion, the Supreme Court's allowance, and Congress' inaction. The Board, although backing the 1970 change in the definition of "bank," has opposed the expanded use of nonbank banks at every opportunity—in drafting regulations and orders, in litigating its denial of nonbank bank applications and the issues arising from its expansive definitions of "bank," and in lobbying for a change in the definition of "bank" under the BHCA.[48] While supporting the nonbank bank concept, on two occasions the Comptroller voluntarily has imposed moratoriums on the processing of nonbank bank charters[49] and an injunction currently prevents the Comptroller from granting final approval of additional charters.[50] Congress has been very slow to consider any nonbank banking legislation, with the full House never considering the matter and with a Senate-passed bill dying of House inaction in 1984.[51] In 1985 the House Banking Committee approved a bill for consideration by the full House, but the Senate Banking Committee took no such similar action.[52] Meanwhile, the United States Court of Appeals for the Tenth Circuit interpreted the BHCA as permitting nonbank bank prolifera-

46. 102 Cong. Rec. 6857 (1956).

47. The Supreme Court has noted that the Douglas Amendment places no limitation on bank holding companies' ownership of nonbanking entities. *See* Lewis v. BT Inv. Managers, Inc., 447 U.S. 27, 47-48 & n.13 (1980). *But see* Florida Dep't of Banking v. Board of Governors, 760 F.2d 1135, 1141 (11th Cir. 1985) (holding that the Douglas Amendment prohibits the establishment of nonbank banks unless expressly permitted by state law), *cert. granted, vacated, and remanded sub. nom.* U.S. Trust Co. v. Board of Governors, 106 S.Ct. 875, *rev'd,* 800 F.2d 1534 (1986).

48. *See infra* notes 70-92 and accompanying text.

49. *See infra* notes 55-63 and accompanying text.

50. *See infra* notes 64-68 and accompanying text.

51. *See infra* notes 247-48 and accompanying text.

52. *See infra* notes 249-52 and accompanying text.

tion; the Eleventh Circuit, however, interpreted the same Act as prohibiting depository nonbank banks.[53] The latest chapter in the nonbank bank odyssey occurred when the Supreme Court cleared a major hurdle from the path obstructing the establishment and development of nonbank banks by upholding the Tenth Circuit's interpretation of the BHCA and by vacating and remanding the Eleventh Circuit decision.[54] This part of the Note explores regulatory and judicial responses to the nonbank bank controversy and examines the status of nonbank banks in light of the Supreme Court's recent *Dimension Financial* decision.

A. *The Comptroller of the Currency*

The Comptroller approved the first nonbank bank when Gulf & Western Industries applied to acquire a California bank and proposed to cease the bank's commercial loan activity.[55] As the growth of nonbank banks accelerated and the nonbank bank debate intensified, the Comptroller used his power as the grantor of national banking charters to delay significantly the nonbank hank proliferation. Unlike the Board, the Comptroller favored establishing these institutions and delayed granting charters only to allow Congress time to act on the matter. In recent congressional hearings the Comptroller stated that nonbank banks have a "clearly positive" impact on interstate banking[56] and that interindustry ownership of nonbank banks benefits both consumers and the financial services industry.[57] Despite these optimistic views on nonbank banks, the Comptroller twice has imposed moratoriums on the granting of charters to nonbank banks and presently is prevented from granting final approval of additional nonbank bank charters by an injunction issued by the United States District Court for the Middle District of Florida.[58]

On April 6, 1983, the Comptroller imposed his first moratorium to allow Congress to consider fully the impact of nonbank banks.[59] The Comptroller originally set the moratorium to expire

53. *See infra* notes 98-132 and accompanying text.

54. *See infra* notes 133-57 and accompanying text.

55. *See* Felsenfeld, *supra* note 4, at 111.

56. *Hearings*, *supra* note 3, at 174 (statement of C. T. Conover, Comptroller of the Currency).

57. *Id.*

58. Independent Bankers Ass'n of Am. v. Conover, No. 84-1403 (M.D. Fla. Feh. 15, 1985) (preliminary injunction).

59. Policy Statement Regarding Non-Bank Bank Approvals, 48 Fed. Reg. 15,993 (1983).

at the end of 1983, but extended the moratotium until March 31, 1984, at the request of the Chairman of the Senate Banking Committee. At the moratorium's expiration nonbank bank charter applications flooded the Comptroller's office.[60] On May 18, 1984, the Comptroller announced that any applications filed after March 31, 1984, would not be considered until the end of the 1984 legislative session.[61] Congress, however, adjourned without any new legislation on the matter; subsequently, on October 30, 1984, the Comptroller approved 29 of the 315 new applications and announced his intention to act on the remaining applications.[62] Asserting that the BHCA clearly permitted nonbank banks, the Comptroller noted that twice he had imposed moratoria to allow Congress to consider the issue, but Congress had not acted. As a result, the Comptroller "felt compelled" to begin considering the outstanding applications.[63]

Despite the Comptroller's intention to begin the wholesale chartering of these institutions, a Florida district court's injunction issued on February 15, 1985, prevented the Comptroller from granting final approval to nonbank bank charters.[64] The injunction's basis is the belief that the Comptroller does not have the power under the National Bank Act to charter nonbank banks.[65] The Comptroller has not actively challenged the district court's position even though the Comptroller already has granted preliminary approval to 279 charter applications.[66] Bolstered by the Supreme Court's ruling in *Dimension Financial*,[67] the Comptroller now likely will challenge the Florida court's position.[68]

60. The Comptroller received over 200 charter applications for nonbank banks between March 31, 1984, and May 18, 1984. Renewal of Policy Statement Regarding Non-Bank Bank Approvals, 49 Fed. Reg. 21,137 (1984).

61. *Id.*

62. *Id.*

63. *Id.*

64. Independent Bankers Ass'n of Am. v. Conover, No. 84-1403 (M.D. Fla. Feb. 15, 1985) (preliminary injunction).

65. *See* Holland, *Supreme Court Rescues Nonbank Banks*, BANKING EXPANSION REP., Feb. 3, 1986, at 1, 7.

66. *See id.*

67. Board of Governors v. Dimension Fin. Corp., 106 S. Ct. 681 (1986); *see infra* notes 133-57 and accompanying text.

68. *See* Wermeil & Langley, *Limited Service Banks Cleared By Supreme Court in 8-0 Decision*, Wall St. J., Jan. 23, 1986, at 3, col. 4 (statement by general counsel to the Comptroller).

B. *The Federal Reserve Board*

While the Comptroller possesses the power to grant national bank charters, the Board must grant permission, under section 4(c)(8) of the BHCA,[69] for any bank holding company's acquisition of a nonbank bank, regardless of whether the nonbank bank will operate under a national or state charter. The Board consistently has opposed the widespread establishment of nonbank banks and has lobbied heavily for a change in the definition of "bank".[70] The Board's opposition stems from the belief that nonbank banks are created to avoid the interstate banking prohibitions[71] and tend to erode the separation of banking and commerce.[72] A more subtle reason for the Board's opposition is the effect of nonbank banks on the Board's ability to institute monetary policy. Circumventing the Board's regulations allegedly contributes to the instability of the money supply and an inability to meet money supply targets.[73] The Board's direct opposition to nonbank banks is illustrated by its unfavorable rulings on nonbank bank applications and its use of Regulation Y.[74] In both orders and regulations, the Board has attempted to expand the definition of "demand deposit" and "commercial loan," leading invariably to court challenges.

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69. *See supra* text accompanying notes 35-38.

70. *See, e.g.*, Naylor, *Volcker Urges Congress to Give Top Priority to Nonbank Bank*, AM. BANKER, Feb. 20, 1986, at 1.

71. *Hearings, supra* note 3, at 14 (statement of Paul Volcker, Chairman of Board of Governors of the Federal Reserve System).

72. *Id.* at 23.

73. Paul Volcker, Chairman of the Federal Reserve Board, alluded to this factor when he stated that commercial banks "are the critical link between monetary policy and the economy." *Id.* at 19. The nonbank banks' effect on monetary policy was noted later in the hearings with the comment that it "must complicate the Federal Reserve's task in managing our nation's monetary policy and money supply goals." *Id.* at 126-27 (statement of William Nodine on behalf of the U.S. League of Savings Institutions).

One commentator has noted:

> [S]ome economists have concluded that [financial] innovation has in fact reduced the predictability of the money-GNP relationship to such an extent that targeting money supply growth is no longer appropriate, at least as long as significant innovation and deregulation are occurring.
>
> Others, however, favor retention of the present strategy at least for the present. They point out that the instability that has been observed in recent years has resulted from (1) concerted efforts . . . to circumvent regulations . . . and (2) the disruptions caused by subsequent deregulation.

Broaddus, *Financial Innovation in the United States—Background, Current Status and Prospects*, ECON. REV., Federal Reserve Bank of Richmond, Jan./Feb. 1985, at 2, 20.

74. Regulation Y is the Board's regulation implementing the Bank Holding Company Act of 1956, as amended, and the Change in Bank Control Act of 1978. 12 C.F.R. § 225 (1986).

The Board first attempted to slow the growth of nonbank banks when it denied nonbank bank status to a subsidiary of Wilshire Oil Company.[75] The subsidiary attempted to convert to a nonbank bank by eliminating demand deposits. It reserved the right to demand fourteen days notice prior to allowing withdrawals from a customer's checking account. Although the subsidiary informed its customers of this change in bank policy, the subsidiary also assured customers that it never intended to enforce this right. The Board declared that such action did not transform the account from its classification as a demand deposit.[76] On appeal, the United States Court of Appeals for the Third Circuit affirmed the Board's order, finding that denial of the charter fell fully within the Board's authority under the BHCA.[77]

A more significant action took place when the Board attempted to redefine demand deposits and commercial loans. The Board expanded "demand deposits" by including in its definition negotiable order of withdrawal (NOW) accounts.[78] The Board believed that NOW accounts, in practice, were equivalent to demand deposits because the provisions requiring notice prior to withdrawal were rarely, if ever, invoked.[79] The Board relied on its order in *Wilshire* and the subsequent Third Circuit decision affirming that order to support emphasizing the substance of the deposit rather than its form.[80] An additional factor the Board believed demonstrated the actual character of NOW accounts was the "transaction accounts" label that Congress attached to NOW accounts in other legislation.[81]

The Board fully redefined demand deposits and commercial loans when adopting new definitions in Regulation Y.[82] The Board justified these revisions as "bring[ing] the regulation into conformity with previous orders of the Board interpreting the Act and . . . carry[ing] out the purposes and prevent[ing] evasion[s] of the

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75. *See* Wilshire Oil Co. v. Board of Governors, 668 F.2d 732 (3rd Cir. 1981), *cert. denied*, 457 U.S. 1132 (1982).

76. *Id.*

77. *Id.* For a discussion of the Third Circuit's opinion, see *infra* text accompanying notes 92-96.

78. *First Bancorp.*, 68 Fed. Res. Bull. 253 (1982).

79. *Id.*

80. *Id.* at 253-54.

81. *Id.* at 254.

82. *See* Bank Holding Companies and Change in Bank Control; Revision of Regulation Y, 49 Fed. Reg. 794, 818 (1984).

Act."[83] The Board believed nonbank banks threatened the national banking system because they damaged Congress' efforts to maintain a separation between banking and commerce, undermined prohibitions on interstate banking, and provided a competitive advantage for nonbank banks over regulated banks offering equivalent services.[84] The Board expanded "demand deposits" to include NOW accounts and other instruments that "as a matter of practice" were payable on demand.[85] The Board expanded "commercial loans" to include money market and interbank transactions.[86]

Even with the expanded definitions, nonbank banks could have continued to develop if bank holding companies avoided the prohibited activities in Regulation Y. U.S. Trust demonstrated that the avenue for expansion was still open when it converted a Florida subsidiary into a nonbank bank. U.S Trust applied for approval under section 4(c)(8) of the BHCA to expand the subsidiary's activities to include accepting time and demand deposits as well as making consumer loans, but specifically avoided making commercial loans even under the revised definitions.[87] Although the Board believed approval of the application undermined the policies of the BHCA, the Board found itself bound by the definition of a bank to approve the application.[88] The Board's order contained an urgent plea for congressional action to protect the policies of the BHCA.[89] The Board also included several conditions in its order to ensure that U.S. Trust would not engage in commercial

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83. *Id.* at 798-99.

84. *Id.* at 835-36.

85. Deposits that a depositor has a legal right to withdraw on demand were defined as "any deposit with transactional capability that, as a matter of practice, is payable on demand and that is withdrawable by check, draft, negotiable order of withdrawal, or other similar instrument." *Id.* at 818.

86. Commercial loans were defined as "any loan other than a loan to an individual for personal, family, household, or charitable purposes, and includes the purchase of retail installment loans or commercial paper, certificates of deposit, bankers' acceptances, and similar money market instruments, the extension of broker call loans, the sale of federal funds, and the deposit of interest-bearing funds." *Id.*

87. *U.S. Trust Corp.*, 70 Fed. Res. Bull. 371 (1984).

88. *Id.* at 372.

89. The Board stated:

> The requirement of Board approval of this application under the provisions of existing law is one of a number of recent developments that underscore the critical need for Congressional action on legislation to apply the policies of the Bank Holding Company Act to institutions that are chartered as hanks and that offer transaction accounts to the public.

Id. at 373.

lending either directly or indirectly.[90] Applying the statutory tests, the Board concluded that the subsidiary would be engaging in proper nonbanking activities and that these activities would not "result in any conflicts of interest, unsound banking practices, or other adverse effects."[91] Thus, even with Regulation Y's expanded definitions and the Board's best efforts, the Board could not bring nonbank banks to an end. The Board, however, announced subsequently that it was suspending further processing of applications to acquire nonbank banks in recognition of the injunction imposed on the Comptroller.[92]

C. *Federal Circuit Court Decisions*

Each of the Board's actions discussed above was appealed and the resulting decisions eventually created a split among the circuit courts over the correct interpretation of the BHCA. The first case to address directly the growing nonbank bank trend came before the United States Court of Appeals for the Third Circuit. In *Wilshire Oil Company v. Board of Governors*[93] the Third Circuit upheld the Board's finding that Wilshire's mythical fourteen-day notice requirement prior to withdrawal did not alter the checking account's character as demand deposits.[94] The court, therefore, held that the Board operated within its power to prevent evasions of the BHCA's purpose[95] by issuing a cease and desist order.[96] The court endorsed the Board's action of looking beyond the form of the deposit to the substance of the account.[97]

A more substantive challenge to the legality of nonbank banks occurred when the United States Court of Appeals for the Tenth

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90. The Board imposed three conditions:

> (1) Applicant will not operate Trust Company's demand deposit taking activities in tandem with any other subsidiary or other financial institutions;
>
> (2) Applicant will not link in any way the demand deposit and commercial lending services that define a bank under the Act; and
>
> (3) Trust Company will not engage in any transaction with affiliates . . . without the Board's approval.

Id.

91. *Id.*

92. *See Suspension of Processing of Applications to Acquire Nonbank Banks*, 71 Fed. Res. Bull. 323 (1985).

93. 668 F.2d 732 (3rd Cir. 1981), *cert. denied*, 457 U.S. 1132 (1982).

94. 668 F.2d at 739. *See supra* notes 75-76 and accompanying text.

95. Section 5(b) of the BHCA authorizes the Board "to issue such regulations and orders as may be necessary to enable it to administer and carry out the purposes of this chapter and prevent evasions thereof." 12 U.S.C. § 1844(b) (1982).

96. 668 F.2d at 738-39.

97. *Id.*

Circuit addressed the issue in *First Bancorporation v. Board of Governors*.[98] First Bancorporation applied to the Board to acquire a subsidiary and operate it as an industrial loan company. First Bancorporation planned to offer NOW accounts and make commercial loans through the subsidiary. The Board, however, determined that NOW accounts were demand deposits in substance.[99] Accordingly, the Board approved the acquisition of the subsidiary only on the condition that the subsidiary choose between offering NOW accounts and making commercial loans.[100]

On appeal, the Tenth Circuit overturned the Board's order.[101] The court noted that Utah regulations required industrial loan companies to reserve the right to require thirty days notice prior to permitting withdrawals from NOW accounts.[102] The court distinguished *Wilshire* because *Wilshire* concerned a blatant attempt to evade the BHCA with a mythical notice requirement.[103] In *First Bancorporation* no "legal right to withdrawal on demand" existed because the thirty day notice was a legal requirement, not a sham.[104] The Board argued that the court should not interpret literally the statutory language of the BHCA, but examine the legislative intent behind the definition. The court, however, found the legislative intent unequivocally expressed in the words of the statute and found that NOW accounts, as restricted by the Utah regulation, did not constitute demand deposits under the BHCA.[105]

The Board's attempt to redefine demand deposits and commercial loans did not end with *First Bancorporation*. The United States Court of Appeals for the Tenth Circuit again faced the nonbank bank issue in *Dimension Financial Corporation v. Board of Governors*.[106] Dimension Financial Corporation[107] challenged the

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98. 728 F.2d 434 (10th Cir. 1984).

99. *First Bancorp.*, 68 Fed. Res. Bull. 253 (1982); *see supra* notes 76-80 and accompanying text.

100. 68 Fed. Res. Bull. at 254. The Board also informed First Bancorporation that it would have to make the same decision with another industrial loan company subsidiary that was presently performing both functions. 728 F.2d at 435. If the subsidiary chose to offer NOW accounts, it would "be subject to the same interest rate limitations and reserve requirements that would apply to a federally insured depository institution." *Id.* at 255.

101. 728 F.2d at 438.

102. *Id.* at 435; *see* UTAH DEPT. OF FIN. INST. REG. No. 2, Vol. 1 at 162.

103. 728 F.2d at 436. The NOW accounts in *First Bancorporation* differed from demand deposits in substance as well as form.

104. *Id.*

105. *Id.* at 436-37.

106. 744 F.2d 1402 (10th Cir. 1984), *aff'd*, 106 S. Ct. 681 (1986).

107. Dimension sought approval to open 31 nonbank banks in 25 states. Wermeil & Langley, *supra* note 68, at 3, col. 2.

Board's revision of Regulation Y,[108] which broadened the definition of "bank" and curbed the number of nonbank banks. Adhering to its demand deposit holding in *First Bancorporation*,[109] the court confined its discussion in *Dimension Financial* to Regulation Y's expanded definition of commercial loans. The Tenth Circuit found that the Board's inclusion of money market and interbank transactions in its definition of commercial loan had no relation to the actual meaning of commercial loan but "was adopted purely to carry out a new Board policy—to *stop changes* in the business of providing financial services."[110] The court traced prior Board rulings that had held money market activities were not commercial loans[111] and, after examining the BHCA's legislative history, stated that Congress expressly permitted the creation of nonbank banks.[112] Accordingly, the Tenth Circuit overturned the Board's order, finding that the Board lacked statutory authority under section 5(b)[113] of the BHCA to redefine the elements of a "bank" for the purpose of bringing certain nonbank banks under the Act's scope.[114]

The opposite view was expressed in the Eleventh Circuit's decision in *Florida Department of Banking v. Board of Governors*.[115] The case arose out of a challenge to the Board's approval of U.S. Trust Company's application to expand the activities of its nonbanking Florida subsidiary.[116] The Eleventh Circuit took an approach different from the Tenth Circuit in interpreting the BHCA's definition of "bank." The Eleventh Circuit refused to interpret literally the statute and instead examined the BHCA's underlying policy. The court found that Congress designed the Act to prevent an undue concentration of banking resources and to prevent abusive credit practices between a bank holding company

108. *See Revision of Regulation Y*, 70 Fed. Res. Bull. 121 (1984); *supra* notes 82-86 and accompanying text.

109. 744 F.2d at 1404.

110. *Id.* at 1405 (emphasis in original).

111. *Id.* at 1404-06. "The change was from white to black, from no to yes." *Id.* at 1406.

112. *Id.* at 1407.

113. *See supra* note 95.

114. *See* 744 F.2d at 1410-11.

115. 760 F.2d 1135 (11th Cir. 1985), *cert. granted, vacated, and remanded sub nom.* U.S. Trust v. Board of Governors, 106 S. Ct. 875, *rev'd*, 800 F.2d 1534 (1986).

116. *See U.S. Trust Corp.*, 70 Fed. Res. Bull. 371 (1984); *see also supra* notes 86-90 and accompanying text. The Florida Bankers Association, the Florida Department of Banking and Finance, the Conference of State Bank Supervisors, and the Sun Bank/Palm Beach all had appealed the Board's order. 760 F.2d at 1138.

and its subsidiaries.[117] In the court's view, the Douglas Amendment also embodied a third policy of prohibiting "interstate deposit-taking networks by bank holding companies without specific state authorization."[118] The court then interpreted the 1970 addition of the commercial loan test as a "technical amendment," intended to benefit a single institution[119] and not to destroy the Douglas Amendment's policy.[120] The court concluded that a literal interpretation of the BHCA would deny Florida the right to prohibit out-of-state bank holding companies from establishing deposit-taking institutions in Florida.[121] The Eleventh Circuit overturned the Board's order granting approval to U.S. Trust's application and held that the Board should have exercised its power under section 5(b) to deny the application.[122]

Following the Eleventh Circuit's *Florida Department of Banking* decision, the United States Court of Appeals for the Tenth Circuit reiterated its BHCA interpretation in *Oklahoma Bankers Association v. Federal Reserve Board*.[123] Citicorp had applied to the Board under section 4(c)(8) of the BHCA for permission to purchase an inactive Oklahoma trust company's charter.[124] Citicorp planned to operate a subsidiary that would engage in commercial lending and issue thrift certificates, but would not accept demand deposits or offer NOW accounts. The Oklahoma Bankers Association contended that the subsidiary was a bank because, under Oklahoma law, a trust company had the authority to accept demand deposits and make commercial loans. Therefore, the Association argued, the Douglas Amendment prohibited Citicorp's acquisition regardless of whether the trust company planned to exercise this power.[125] The Board rejected this contention and approved the acquisition, noting that because Citicorp did not plan to accept demand deposits through its subsidiary, the acquisition did not present the same "concerns previously expressed

117. 760 F.2d at 1141; *see supra* note 18 and accompanying text.

118. 760 F.2d at 1141.

119. *Id.* at 1142; *see supra* notes 31-34 and accompanying text.

120. 760 F.2d at 1142.

121. *Id.* at 1143.

122. *Id.* at 1143-44; *see supra* note 95.

123. 766 F.2d 1446 (10th Cir. 1985).

124. *See Citicorp*, 69 Fed. Res. Bull. 921 (1983). Oklahoma law did not permit the chartering of industrial banks. Citicorp, however, planned to engage in activities similar to an industrial bank through its trust company. *Id.*

125. *Id.*

by the Board regarding the permissibility of nonbank banks."[126]

On appeal, the Tenth Circuit upheld the Board's order.[127] The Tenth Circuit followed its previous decisions and, without mentioning the *Florida Department of Banking* decision, contradicted the Eleventh Circuit's reasoning. The court rejected the Association's arguments that (1) the thrift deposit accounts were demand deposits and (2) the trust company was a bank because the company would have the power to accept demand deposits.[128] The court found that the thrift deposit accounts were not demand deposits because the accounts were governed by legally enforceable contracts establishing a right to notice prior to withdrawal.[129] In rejecting the second argument, the court commented that Congress intentionally had abandoned the argument that an institution should be classified as a bank merely because the institution had the power, under state law, to accept demand deposits.[130] The court found that the proper analysis in determining whether an institution is a bank is whether the institution actually performs the services that constitute the two-part statutory test.[131] In upholding the Board's order, the Tenth Circuit reiterated that the BHCA's definition of a "bank" clearly allowed the creation of nonbank banks.[132]

D. Board of Governors v. Dimension Financial Corporation

The Supreme Court accepted the opportunity to settle the confusion surrounding the legal status of nonbank banks by granting certiorari to *Board of Governors v. Dimension Financial Corporation,*[133] but declined the opportunity to hear *U.S. Trust Corporation v. Board of Governors*[134] in tandem. In *Dimension*

126. *Id.* at 922. The Board also found no evidence that this acquisition "would result in any undue concentration of resources, conflicts of interest, unsound banking practices, or other adverse effects." *Id.*

127. 766 F.2d at 1452.

128. *Id.* at 1449-50.

129. *Id.* The court also rejected the notion that the actual practice should be taken into account rather than the statute. *Id.* at 1450, *citing First Bancorp.,* 728 F.2d at 436.

130. 766 F.2d at 1450.

131. *Id.*

132. *Id.* at 1449 (citing *Dimension Financial Corp.,* 744 F.2d at 1408).

133. 106 S. Ct. 681 (1986).

134. 106 S. Ct. 875 (1986) (cert. granted, vacated, and remanded). U.S. Trust argued that *Dimension Financial* could not resolve the issues of *U.S. Trust* because: (1) U.S. Trust's subsidiary did not make commercial loans, even as defined by Regulation Y; (2) *Dimension Financial* concerned activities more significant to nonbank banks owned by firms, whereas *U.S. Trust* concerned activities significant to nonbank banks owned by bank

Financial a unanimous Court[135] held that the Board had exceeded its statutory authority by redefining "demand deposits" and "commercial loans" as it had.[136] The Court recognized that the BHCA grants the Board broad regulatory power over bank holding companies,[137] but held that the BHCA's definition of a "bank" limits the Board's regulatory authority.[138]

The Court first examined the BHCA statutory language to determine Congress' intent regarding the Board's power to change the definition of a "bank."[139] The Court found that Congress limited the BHCA's scope to institutions that accepted deposits with a "legal right to withdrawal on demand."[140] The Court determined that the Board's attempt to include deposits that, "as a matter of practice," are payable on demand within BHCA coverage was not a reasonable interpretation of the statutory language.[141] Because

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holding companies; (3) *Dimension Financial* did not address the applicability of the Douglas Amendment to the ownership of depository nonbank banks; and (4) *Dimension Financial* did not interpret the BHCA's full definition of "bank" as applied to a depository nonbank bank making no commercial loans. U.S. Trust Petition for Certiorari at 20-21, U.S. Trust Corp. v. Board of Governors, 760 F.2d 1135 (11th Cir. 1985), *cert. granted, vacated, and remanded,* 106 S. Ct. 875, *rev'd,* 800 F.2d 1534 (1986). U.S. Trust agreed, however, with the Florida respondents that if *U.S. Trust* was not denied outright, it should be argued in tandem with *Dimension Financial.* "The Court will be better able to resolve the broad, underlying issues of *U.S. Trust* and the related, specific issue of *Dimension* if both cases are considered together." U.S. Trust Reply and Supplemental Brief at 4, U.S. Trust Corp. v. Board of Governors, 760 F.2d 1135 (11th Cir. 1985), *cert. granted, vacated, and remanded,* 106 S. Ct. 875, *rev'd,* 800 F.2d 1534 (1986).

135. The vote was 8-0. Justice White did not take part in the decision. 106 S. Ct. at 682.

136. *Id.* at 689.

137. *Id.* at 684. The Board has the power "to restrain the undue concentration of commercial banking resources and to prevent possible abuses related to the control of commercial credit." *Id.* (quoting S. REP. No. 1084, 91st Cong., 2d Sess., at 24, 1970 U.S. CODE CONG. & ADMIN. NEWS 5519, 5541).

138. 106 S. Ct. at 684.

139. *Id.* at 686. "First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 842-43 (1984). *Accord* American Tobacco Co. v. Patterson, 456 U.S. 63, 68 (1982); Central Trust Co. v. Official Creditors' Comm., 545 U.S. 354, 359-60 (1982); Consumer Prod. Safety Comm'n v. GTE Sylvania, Inc., 447 U.S. 102, 108 (1980). The Supreme Court, however, has held that the literal meaning of a statute should not be followed to a conclusion "plainly at variance with the policy of the legislation as a whole." United States v. American Trucking Ass'ns, 310 U.S. 534, 543 (1940) (quoting Ozawa v. United Statres, 260 U.S. 178, 194 (1922)). *Accord* Train v. Colorado Pub. Inerest Research Group, 426 U.S. 1, 9-10 (1976); Perry v. Commerce Loan Co., 383 U.S. 392, 399-400 (1966).

140. 106 S. Ct. at 686.

141. The Court stated: "[N]o amount of agency expertise—however sound may be the result—can make the words 'legal right' mean a right to do something 'as a matter of prac-

NOW account depositors do not retain a legal right to withdrawal on demand, the Court held that NOW accounts cannot be demand deposits regardless of actual practice.[142]

Turning to the commercial loan provision of the bank definition, the Court found that the Board's inclusion of "commercial loan substitutes"[143] exceeded the common interpretation of commercial loans in the financial services industry.[144] Including these loan substitutes, the Court noted, contradicted even the Board's previous interpretations of commercial loans.[145] On prior occasions the Board had excluded money market transactions from the commercial loan definition.[146] The Court also rejected the argument that the 1970 addition of the commercial loan test was a "technical amendment" prompted by the concerns of only one institution.[147] The Court reasoned that the statute's plain language and legislative history point to the statute's general applicability.[148] In 1970 Boston Safe had conducted some money market activities that the Board sought to classify as commercial loans.[149] The Court, however, found no support for the contention that the definition of commercial loans was intended to mean anything other than its normally accepted usage.[150]

After holding the Board's definitions to be unreasonable interpretations of the statute's plain language, the Court then consid-

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tice.' " *Id.* Furthermore, the Court noted: "A *legal* right to withdraw on demand means just that: a right to withdraw deposits without prior notice or limitation." *Id.* (emphasis in original).

142. *Id.*

143. *Id.* at 686 & n.4. In implementing its order, the Board referred to commercial paper as "an important suhstitute for commercial loans." 49 Fed. Reg. 794, 840 n.34. The Court seized upon this suhstitution language to show that money market activities were not commercial loans. "Substitutes are not the same thing as the items being substituted for." Holland, *Supreme Court Rescues Nonbank Banks*, BANKING EXPANSION REP., Feb. 3, 1986, at 7.

144. 106 S. Ct. at 686-88.

145. *Id.* at 687.

146. *Id.; see D.H. Baldwin Co.*, 63 Fed. Res. Bull. 280 (1977) (participating in the federal funds market and issuing certificate of deposits are not commercial loans).

147. 106 S. Ct. at 687-88; *see supra* notes 31-34, 119-28 and accompanying text.

148. 106 S. Ct. at 687-88.

149. *Id.* at 688. According to the Court, the Board advised Boston Safe in 1972 that it was not a BHCA hank. "The Board understands that Boston Safe purchases 'money market instruments,' such as certificates of deposit, commercial paper, and bank acceptances. In the circumstances of this case, such transactions are not regarded as commercial loans for the purposes of the Act." *Id.* (quoting letter to Lee J. Aubrey, Vice-President, Federal Reserve Bank of Boston, from Michael A. Greenspan, Assistant Secretary, Board of Governors, p. 2 (May 18, 1972)).

150. 106 S. Ct. at 688.

ered the argument that the new definitions fell within the overall purpose of the BHCA.[151] The Board contended that the purpose behind the BHCA was to regulate institutions functionally equivalent to banks.[152] The Court, however, found the purpose of the statute evident in its plain language.[153] The Court reasoned that to ignore the plain language of the statute would amount to ignoring the compromise embodied in the amendments and worked out in Congress as Congress sought a definition that would best fit its purpose.[154] Although noting a possible need to regulate nonbank banks, the Court determined that Congress intended to regulate only banks as Congress had defined them in the statute and not institutions that were functionally equivalent.[155] The Court noted the possibility of an imperfect statute, but stated that Congress, rather than the courts or the Board, should address any statutory shortcomings.[156]

E. Legal Uncertainties

The Supreme Court's *Dimension Financial* decision leaves little doubt that the BHCA permits the creation of nonbank banks. The Board has failed in its efforts to include transactions and accounts that are close substitutes for commercial loans and demand deposits in their definitions. Nothing in the legislative history indicates that the definition of a "bank" should be interpreted in any way other than as literally stated in the statute. The statutory language is the product of compromise between competing policy concerns. When viewed from the Board's or a court's limited perspec-

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151. *Id.*

152. *Id.*

153. *Id.* at 688-89. "The 'plain purpose' of legislation, however, is determined in the first instance with reference to the plain language of the statute itself." *Id.* (citing Richards v. United States, 369 U.S. 1, 9 (1962)). *But see supra* note 139.

154. The Court further noted:

> Application of "broad purposes" of legislation at the expense of specific provisions ignores the complexity of the problems Congress is called upon to address and the dynamics of legislative action. Congress may be unanimous in its intent to stamp out some vague social or economic evil; however, because its Members may differ sharply on the means for effectuating that intent, the final language of tbe legislation may reflect hard fought compromises. Invocation of the "plain purpose" of legislation at the terms of the statute itself takes no account of the processes of compromise and, in the end, prevents the effectuation of congressional intent.

106 S. Ct. at 689.

155. *Id.*

156. *Id.; accord* Morrison-Knudsen Constr. Co. v. Office of Workers Comp. Prog., 461 U.S. 624, 635-36 (1983); Potomac Elec. Power Co. v. Office of Workers Comp. Prog., 449 U.S. 268, 279-80 (1980).

tive, which may fail to consider the full array of policy objectives sought to be attained by Congress, the line drawn by Congress may seem arbitrary. Congress, however, is the appropriate body to weigh the competing policies and reach a definition that best resolves these policies. Both the courts and the Board must respect the legislative balancing of policies and any resulting compromise. The Board improperly relied on its own notion of banking policy and its desire to regulate these financial institutions, thereby invading Congress' legislative sphere.

The Supreme Court granted certiorari in *U.S. Trust* five days after announcing its *Dimension Financial* decision; the Court vacated *U.S. Trust* and remanded the decision to the Eleventh Circuit for further consideration in light of *Dimension Financial.* The Eleventh Circuit reversed its original decision and held that U.S. Trust's application for a nonbank bank, which was approved by the Board, could not be prohibited judicially.[157] The Supreme Court's holding in *Dimension Financial* left little room for any decision other than a reversal of *U.S. Trust.* The error in *U.S.Trust* was manifest. The Eleventh Circuit iguored one half of a two part test, finding that the 1970 addition of the commercial loan test was merely a "technical amendment." The Supreme Court's interpretation of the BHCA was diametrically opposed to the Eleventh Circuit's. The crucial distinctions were the Supreme Court's statements that the 1970 addition was not a technical amendment and that only Congress, not the courts or the Board, could amend the statute.

Despite the Supreme Court's ruling in *Dimension Financial,* legal uncertainties still exist and require clarification before a wide scale proliferation of nonbank banks can take place. First, the Florida district court's injunction in *Independent Bankers,* presently prohibiting the Comptroller from issuing any final nonbank bank approvals,[158] will delay nonbank bank proliferation. The

157. 760 F.2d 1135 (11th Cir. 1985), *cert. granted, vacated, and remanded sub nom.* U.S. Trust v. Board of Governors, 106 S. Ct. 875, *rev'd,* 800 F.2d 1534 (1986).

158. Independent Bankers Ass'n of Am. v. Conover, No. 84-1403 (M.D. Fla. Feh. 15, 1985) (preliminary injunction). One commentator has noted that, despite the district court injunction, a number of methods still exist for establishing nonbank banks. These methods include: having an existing national or state bank refrain either from taking demand deposits or making commercial loans; petitioning a state banking authority to charter a State bank as a nonbank bank; or converting a state bank to a national one and having the new bank refrain either from taking demand deposits or making commercial loans. Natter, *Dimension Case Ruling Could Lead to More Nonbank Banks,* AM. BANKER, April 11, 1986, at 6.

Comptroller has not actively sought an appeal in this case, but likely will do so in light of *Dimension Financial*.[159] A change in personnel at the Comptroller's office and the FDIC also may impede future nonbank bank proliferation.[160] The new Comptroller already has stated his opposition to regulation by loophole.[161] Thus, even if the injunction is overturned, the new Comptroller may scrutinize nonbank bank applications more closely than the prior, prononbank bank Comptroller.

A second legal obstacle is new state legislation barring nonbank banks. In light of the growth in nonbank banks, some states have adopted statutes prohibiting the operation of any type of limited-service bank.[162] Most states, however, have not enacted such legislation, and the validity of this legislation has yet to be tested in the courts.

An obvious question in light of *Dimension Financial* is what effect this decision will have on the plans of bank holding companies and other firms now that such a major hurdle to nonbank banking has been cleared. Some industry observers predict that the number of nonbank bank applications will increase well beyond the number now on file with the Comptroller;[163] others expect

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159. The general counsel to the Comptroller stated that, because of the Court's ruling in *Dimension Financial*, the appeal was being taken off "hold." There are still uncertainties as to when an appeal will be filed. Wermeil & Langley, *supra* note 68, at 3, col. 4.

160. Robert L. Clarke replaced C. T. Conover as Comptroller of the Currency and L. William Seidman replaced Bill Isaac at the FDIC.

161. *See* Naylor, *Comptroller Nominee Robert Clarke Unveils His Views on Banking Policy*, AM. BANKER, Nov. 13, 1985, at 22.

However, Comptroller Clarke admitted that he would have no choice other than to approve nonbank-bank applications once the injunction is lifted. The Comptroller also stated that he does not favor legislation aimed simply at the nonbank bank loophole. Ringer, *Uniting Industry to Attack Nonbank Loophole Heads Agenda of Independent Bankers' Incoming President*, AM. BANKER, March 11, 1986, at 30, 40.

162. States passing laws banning nonbank banks include North Carolina, Connecticut, Colorado, Florida, Virginia, and New Jersey. *See Hearings*, *supra* note 3, at 146 (testimony of Charles Hardwick, Vice-Chairman, National Conference of State Legislatures). One commentator has questioned the applicability of state regional interstate banking laws to nonbank banks, noting that the states' authority to pass these laws comes from the BHCA, which allows states to regulate interstate bank acquisitions. Because nonbank banks technically are not "banks" within the meaning of the BHCA, it is argued that applying this legislation to nonbank banks could constitute an "impermissible interference with interstate commerce" and, as such, violate the commerce clause of the United States Constitution. Natter, *supra* note 158, at 4, 6.

163. *See* Naylor, *High Court Throws Out U.S. Trust Ruling*, AM. BANKER, Jan. 28, 1986, at 1, 38 (statement of Charles F. Long, executive vice-president, Citicorp). Representative Jim Cooper, (D) Tennessee, a member of the House Banking Committee, stated: "The Fed had its finger in the dike for a long time. Now that it's been told it can't, the flood of non-bank banks is coming." Wermeil & Langley, *supra* note 68, at 3, col. 2.

interested companies to proceed with caution because,[164] as one industry executive stated, "[t]here are still a lot of clouds hanging over us."[165] Although some legal uncertainties await clarification in the courts, the major threat to the continued escalation of nonbank banks is congressional action.

IV. CONGRESSIONAL OPTIONS

A. *Policy Concerns*

Because the Court's *Dimension Financial* ruling leaves little room for the Board or the courts to halt the expansion of nonbank banks, those opposing the establishment of these institutions must turn to Congress for assistance. As Congress examines the issues and concerns surrounding the nonbank bank controversy, it should not respond instinctively to what has been inappropriately labeled a "loophole."[166] Calling the nonbank bank development a loophole simply misrepresents the legislative history. Nonbank banks did not arise from an unforeseen omission in the definition of a bank.[167] In 1970 Congress specifically sought to exclude from the BHCA's scope those institutions, such as Boston Safe, that did not make commercial loans. The existence of Boston Safe demonstrates that Congress was aware that similar institutions would accept the invitation to avoid the BHCA and its accompanying product and geographical restrictions.[168] The current definition is

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164. William E. Gibson, senior vice-president and chief economist at RepublicBank Corp. in Dallas stated: "We still need to talk to the lawyers before deciding anything." Naylor, *supra* note 163, at 38.

165. *Id.* at 1 (statement of Julius Loeser, attorney with First Interstate Bancorp).

166. Congress and the public in general abhor anything resembling a "loophole" and sentiment will favor closing such unintended openings. With this knowledge, opponents have been quick to label the development of nonbank banks as "regulation by loophole" and its supporters "an army of loophole pushers." *Hearings, supra* note 3, at 121 (statement of William E. Nodine on behalf of U.S. League of Savings Institutions).

George D. Gould, undersecretary for domestic finance at the Treasury Department, commented tbat the name nonbank bank, "with its accessory 'loophole,' is desigued to evoke opposition. One wonders what would have been the future of discount brokers if some public affairs genius for securities firms had tarred them effectively with the term 'nonbroker broker.'" *Regulatory Reform Needed in Nonbank-Bank and Thrift Dilemmas,* AM. BANKER, March 18, 1986, at 21-22.

167. *See supra* notes 16-38 and accompanying text.

168. As the Supreme Court noted:

> The statute by its terms . . . exempts from regulation *all* institutions that do not engage in the business of making commercial loans. The choice of this general language demonstrates that, although the legislation may have been prompted by the needs of one institution, Congress intended to exempt the class of institutions not making commercial loans.

not a "loophole," but rather a deliberate attempt to exclude institutions that Congress believed did not pose the same dangers as full-service commercial banks.[169] The only unforseen development was perhaps the number of institutions that would choose this route.[170]

Congress again has the opportunity to examine the situation and determine which institutions to include under the scope of the BHCA. Congress' examination should consider carefully the overall state of the financial services industry and disregard the negative implications of the "loophole" tag hung on nonbank banks. In determining the future of nonbank banks, Congress should evaluate the principal concerns of nonbank banks' opponents. Critics' reasons for their opposition to the spread of nonbank banks are many and varied, but their arguments usually fall into one of four categories. First, nonbank banks violate the spirit of the Douglas Amendment by permitting de facto interstate banking without a state's consent.[171] Second, nonbank banks violate the separation between banking and commerce.[172] Third, the ability to acquire nonbank banks has decreased greatly any interest in acquiring failing thrifts.[173] Last, the growth of nonbank banks results in inefficiencies and misallocations of capital and other resources.[174] This section addresses the validity of these concerns and their impact on congressional deliberations concerning the continued existence of nonbank banks.

The emergence of nonbank banks has led commentators to question whether the two broad policies governing bank regulation in the past—prohibiting interstate banking and limiting bank activities to those closely related to banking—remain viable goals. The ability of nonbank banks to avoid interstate banking prohibitions has prompted some of the harshest criticisms of nonbank banks. Opponents charge that nonbank banks contravene a state's right to decide policy regarding interstate banking and force inter-

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Dimension Financial, 106 S. Ct. at 687 (emphasis original).

169. *See supra* notes 29-30 and accompanying text.

170. "No legislature can be expected to catalog all the anticipated effects of a statute . . . ." Town of Hallie v. City of Eau Claire, 105 S. Ct. 1713, 1719 (1985).

171. *See Hearings, supra* note 3, at 14 (statement of Paul Volcker, Chairman, Federal Reserve Board).

172. *See id.*

173. *See id.* at 198-99 (testimony of Edwin S. Gray, Chairman, Federal Home Loan Bank Board).

174. *See id.* at 89-90 (testimony of James G. Cairns, Jr., President, American Bankers Association).

state banking upon states.[175] Opponents also charge that if interstate banking is desired, it should be accomplished through a legislative plan rather than haphazardly through nonbank banks.

Although nonbank banks are a means of escaping the BHCA's geographical restrictions, interstate banking is already effectively in existence and is becoming increasingly more prevalent. Many states have passed statutes permitting out-of-state bank holding companies to enter either on a reciprocal or nonreciprocal basis.[176] Even without explicit statutory permission, bank holding companies have broken interstate barriers and presently conduct a variety of activities across state lines through grandfathered banks,[177] Edge Act banks,[178] loan production offices,[179] nonbank subsidiaries,[180] special purpose banks,[181] shared automatic teller machines,[182] credit cards, national advertisements, and toll-free

175. *See id.* at 147 (testimony of Charles Hardwick).

176. *See supra* note 45. Twenty-two states have adopted reciprocal or nonreciprocal interstate banking laws. *See* Whitehead, *Interstate Banking: Probability or Reality*, ECON. REV., Federal Reserve Bank of Atlanta, March 1985, at 6, 9.

177. Nine grandfathered U.S. bank holding companies control 139 banks and 1,137 branch offices in 21 states. Seven grandfathered international banking organizations control 138 interstate offices. *Whitehead, supra* note 176, at 7-8.

178. "Edge corporations have been established under section 25(a) of the Federal Reserve Act to provide international banking services. There are no geographic restrictions on Edge corporations . . . . There are approximately 150 interstate offices of Edge corporations, the great majority of which are owned by the largest banking organizations." Cohen, *Interstate Banking: Myth and Reality*, 18 LOY. L.A.L. REV. 965, 972 (1985).

179. Loan production offices are permitted on an interstate basis as long as these facilities only originate, but not approve or make, loans. 12 C.F.R. § 7.7380 (1979). Estimates indicate that approximately 375 interstate loan production offices now exist. Cohen, *supra* note 178, at 972.

180. The most popular method of conducting interstate banking operations is the maintenance of interstate offices by nonbank subsidiaries controlled by bank holding companies, permitted under section 4(c)(8) as activities closely related to banking. There are approximately 6,000 interstate finance company subsidiaries and 700 mortgage banks as well as various other offices active in leasing, trust services, insurance, and industrial banks. Cohen, *supra* note 178, at 970-71.

181. State legislation may create special purpose banks, thereby enabling out-of-state institutions to establish a bank thereby limited to certain operations. "For example, an out-of-state bank holding company may set up a single office to engage in wholesale banking or credit card operations. To date, South Dakota, Delaware, Virginia, Maryland, Nebraska, and Nevada have adopted such special-purpose provisions." Whitehead, *supra* note 176, at 17.

182. There are eight national shared automatic teller systems and over two hundred regional systems. *See Status of ATM's under State Branching Laws: Hearings on S. 2898 Before the Comm. on Banking, Housing, and Urban Affairs*, 98th Cong., 2d Sess. 59 (1984) (statement of Roland E. Brandel, member, Consumer Bankers Ass'n). National ATM networks include: Plus (47 states), Cirrus (43 states), The Exchange (33 states), Express Cash (27 states), Citishare (15 states), Nationet (10 states), Visa (9 states), and Master Teller (5 states). *See No Shakeout Yet for ATM Systems*, BANKING EXPANSION REP., Sept. 17, 1984, at 2-3. *See generally* Note, *The Future of Shared Automatic Teller Networks in the Wake*

telephone numbers. Some bank holding companies effectively have established nationwide banking systems using these devices.[183] The argument that prohibiting nonbank banks preserves the prohibitions on interstate banking ignores the fact that these prohibitions are breaking down through a variety of other means. Eliminating nonbank banks alone would do little to stop the haphazard deterioration of interstate barriers to banking.

Another argument in support of preserving prohibitions on interstate banking is that these prohibitions ensure a diverse and competitive financial services industry.[184] Opponents see nonbank banks as a destabilizing force in this highly competitive market.[185] In fact, the reverse is true. Rather than a negative impact, nonbank banks have a positive effect on the marketplace. Nonbank banks allow a bank holding company to diversify across state lines and, therefore, lessen the holding company's risk. Nonbank banks reach new customers who possess loan needs different from a bank holding company's ordinary customers. Nonbank banks spread loans to different industries and to different segments of the economy, creating a diversity that otherwise would not exist in a bank holding company's loan portfolio. Thus, the loan loss risk is lessened because a bank holding company "avoid[s] putting too many of its loans 'in the same basket.' "[186] Furthermore, as a bank holding company attracts new customers, it diversifies its deposit base as well.[187] Yet another benefit to bank holding companies is the addition of new customer relationships in states that may allow the future establishment of "banks" in their state by out-of-state bank holding companies.[188] The impact on the customer also is positive: rather than destabilizing a competitive market, new entrants lead to more choices, lower prices, and greater flexibility for customers.[189]

The second major category of criticism stems from an histori-

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of Marine Midland Bank: A Call for Federal Legislation, 38 VAND. L. REV. 1621 (1985).

183. "Given all the avenues open to banks or holding companies for providing banking-type financial services across state lines, it is hard to deny that interstate banking is a reality today." Whitehead, *supra* note 176, at 17.

184. *See Hearings, supra* note 3, at 111 (statement of Charles T. Doyle, President-Elect, Independent Bankers Association of America).

185. *See id.* at 125 (statement of William E. Nodine, U.S. League of Savings Institutions).

186. Moulton, *Nonbank Banks: Catalyst for Interstate Banking*, BUS. REV., Federal Reserve Bank of Philadelphia, Nov./Dec. 1985, at 3, 6.

187. *Id.* at 6-7.

188. *Id.* at 7.

189. *See Hearings, supra* note 3, at 174-75 (statement of C. T. Conover).

cal conviction that banking and commerce should remain separate. The original reason for this separation was the belief that the banking business was a low risk, prudent enterprise; commerce, on the other hand, encompassed inherently greater risk. Nonbank banks allegedly violate this principle because nonbank holding companies can acquire nonbank banks. If the separation between banking and commerce is not maintained, critics argue, "[a]nyone, from securities firms to fast food outlets, could go into the banking business."[190] Critics advance three primary reasons for the necessity of the banking/commerce separation. The first reason relates to the original purpose of the BHCA—the prevention of a concentration of resources.[191] Second, unless banking and commerce remain separate, a concern exists that credit extension decisions will not be made at arm's length.[192] Last, bank safety and soundness concerns arise if the separation between banking and commerce is relaxed.[193]

In reality, the demarcation between banking and commerce has become blurred in recent years[194] and eliminating nonbank banks will do little to restore the separation. A nonbank bank proliferation is allegedly the first stage in a movement toward concentrating banking resources in the hands of a few firms. This concentration, however, is unlikely ever to materialize.[195] Critics

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190. *Id.* at 111 (statement of Charles T. Doyle).

191. *Id.* at 14 (statement of Paul Volcker).

192. *Id.* at 111 (statement of Charles T. Doyle).

193. *Id.* at 85 (statement of Paul Volcker).

194. "When you get to the lines that you want to draw, for instance, between the activities of investment banking and commercial banking, between insurance and commercial banking, between real estate development and commercial banking, then, I think, the lines have gotten more hlurred . . . ." *Id.* at 37 (statement of Paul Volcker).

195. Two commentators have written:

> In thinking about the liheralization of branching and product line restrictions on commercial banks, Americans should not ignore the banking history of other countries. Many observers bave relied on casual appraisals of those experiences to conclude that the adoption of unrestricted interstate banking would lead us to duplicate the concentrated hanking structures of other countries.
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> . . . .
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> . . .[T]he facts that were uncovered suggest that fears of excessive concentration resulting from nationwide branching are exaggerated. In several countries the apparent high levels of concentration are illusory . . . . And in those countries where banking really is concentrated, this appears to result from the existence of barriers to entry which do not and would not exist in the United States.

Baer & Mote, *The Effects of Nationwide Banking on Concentration: Evidence From Abroad*, ECON. PERSP., The Federal Reserve Bank of Chicago, Jan./Feb. 1985, at 3. The article concludes by contemplating a situation of complete geographic and product deregulation, predicting that the "net effect should be a reduction in concentration at the national expressed this same fear about grandfathered banks, but history shows no evidence of a concentration ever occurring.[196] Even without nonbank banks, nonbank holding companies still can own thrift companies without restrictions on diversification into other lines of business.[197] The Chairman of the Federal Reserve Board, Paul Volcker, even has analogized these institutions to nonbank banks, labeling them "nonthrift thrifts."[198] Nonbank holding companies also own both federal and state chartered trust companies and some of the more than 1,200 industrial banks.[199] In addition, nondepository companies own finance and mortgage loan companies.[200] The breakdown between commerce and banking also is occurring on the bank side, with bank holding companies operating discount brokerage firms and engaging in many other permitted nonbanking activities.[201] Furthermore, the Glass-Stegall Act permits state chartered nonmember banks to affiliate with securities firms.[202]

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level. This effect should be even more unambiguous and pronounced at the local market level." *Id.* at 16.

A comparison between states with varying branching laws reveals negligible differences in concentration levels. Interstate banking would not result in increased concentration in local markets, but rather more competitive pricing due to a breakdown in barriers to entry. Rhoades, *Interstate Banking and Product Line Expansion: Implications From Available Evidence*, 18 LOY. L.A.L. REV. 1115, 1121-22 (1985).

196. Approximately 34,000 insured depository institutions exist in the United States, and the number of national banks increased by 500 between 1980 and 1985. *Hearings, supra* note 3, at 187 (statement of C. T. Conover). The concentration of resources in the banking industry is small compared to other businesses, with the top 10 banks' (in size) share of the deposit base decreasing two percentage points since 1980. *Id.* at 188. The Board has the power under the 1970 amendments to the BHCA to review grandfathered banks and require divestiture "to prevent undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices." *Id.* at 221. In over 100 reviews the Board had not been able to find this kind of worrisome abuse and, consequently, has yet to order divestiture in any of its reviews. *Id.*

197. One commentator has stated:

> If a holding company owns only one thrift (a unitary thrift holding company) and its federally insured institution meets the qualified institution standards, the parent company and its non-insured affiliates may undertake a virtually unlimited array of activities. Examples of unitary thrift holding companies include Household International, ITT, National Steel, and Sears . . . . Unlike commercial banks, which must receive approval from the Federal Reserve on 4(c)(8) activities, unitary thrift holding companies require no approval process.

Johnson, *The Thrift Charter: A Valuable Alternative for Commercial Banks?*, ECON. REV., Federal Reserve Bank of Atlanta, Oct. 1985, at 26, 30.

198. *Hearings, supra* note 3, at 15.

199. *See id.* at 174 (statement of C. T. Conover).

200. *See id.*

201. *See id.* at 33-34 (statement of Paul Volcker).

202. Four major sections in the Glass-Stegall Act consider the relationship between

Nonbank holding companies, however, do not require the actual ownership of a nonbank bank or other close bank substitute in order to provide depository accounts for customers. These companies already can provide money market or cash management accounts from which third party payments can be made and a nonbank holding company may become a deposit broker and sell deposits of banks or thrifts.[203] Thus, despite the emergence of nonbank banks, the separation between banking and commerce has deteriorated and will deteriorate further because of competition and innovation. The probability of an undue concentration of resources resulting from a breakdown is remote, but could be addressed through regulation or legislation.[204]

Another concern supporting the separation of banking and commerce arises from the belief that nonbank holding companies will use their nonbank banks' credit to grant preferential treatment to the holding company's customers or to its other subsidiaries. Former Comptroller C. T. Conover argued that this threat is minimal and can be addressed through regulatory safeguards.[205] The former Comptroller also favored prohibiting nonbank holding companies' nonbank banks from making commercial loans. This would prevent possible conflicts of interest and ease concerns over the use of insider information.[206] Other regulators also may place restraints and conditions upon their approval of nonbank bank applications in order to limit the possibility of unfair competition.[207]

According to some observers, an influx of nonbank holding companies in the banking area is clearly a positive development rather than a threat to the safety and soundness of the banking system.[208] Consumers and the financial system as a whole benefit from the infusion of outside capital and talent.[209] Any threat to existing banks is minimal in light of the historical adaptability of

banking and securities firms. They are 12 U.S.C. §§ 24(7), 78, 377, and 378 (1982). Only one, § 378, applies to state chartered nonmember banks. This section makes it unlawful for any organization engaged in the securities business to engage in the business of receiving deposits at tbe same time. "However, nonmember banks only were required to choose between engaging in deposit banking or investment banking, and were not affirmatively required to separate themselves from tbeir security affiliates." SYMONS & WHITE, BANKING LAW, at 435 (2d ed. 1984).

203. *See Hearings*, *supra* note 3, at 99 (statement of James G. Cairns).

204. *See id.* at 175 (statement of C. T. Conover).

205. *Id.* at 175 (statement of C. T. Conover).

206. *Id.*

207. *See id.*

208. *See id.* at 174-75.

209. *Id.* at 175.

banks and their ability to react to changes in the industry.[210] Banks, however, have been hurt by their inability to respond to nonbank competition with the present geographical and product restrictions in place.[211] Nonbank banks allow bank holding companies to avoid geographic restrictions. Meanwhile, the Board voluntarily has increased the number of permitted nonbanking activities, thus easing the pressure resulting from product restrictions. Critics still maintain that nonbank banks allow organizations outside the banking sphere to skim off the most profitable pieces of the banking business and, consequently, to erode the health and competitive position of existing banks.[212]

The third major category of criticism originates primarily from the Federal Home Loan Bank Board (FHLBB). The FHLBB charges that the availability of nonbank banks has led to a decrease in the number of purchasers of failing thrifts.[213] When a

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210. Pavel & Rosenblum, *Banks and Nonbanks: The Horse Race Continues*, ECON. PERSP., Federal Reserve Bank of Chicago, May/June 1985, 15.

211. Two commentators have stated:

> Bank activities have long been heavily regulated, not only because of concern over potential conflicts of interest, unfair competition, and undue concentration of resources, but more important, for safety and soundness reasons. . . .
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> . . .Proponents of deregulation argue that continued regulation of activities adds nothing to the system protecting bank safety and soundness. They further contend that regulation places banks at a competitive disadvantage and will allow less-regulated nonbank competitors to assume banks' role in our financial system. Advocates of continued regulation argue that deregulation would strain the rest of the safety and soundness system and could even undermine the banking system. . . .
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> . . .Our conclusion is that deregulation poses no threat to the stability of the financial system but that failure to deregulate does pose such a threat.

Wall & Eisenbeis, *Risk Considerations in Deregulating Bank Activities*, ECON. REV., Federal Reserve Bank of Atlanta, May 1984, 6.

212. *See Hearings, supra* note 3, at 84-85 (statement of Paul Volcker). Robert Clarke, however, takes the opposite view:

> Banking is trapped in a catch-22. It cannot adapt now because 50 years ago men who wore spats and carried walking sticks believed commercial banking, if strictly regulated, carried less risk than other types of financial services. As a result, restrictions on allowable activities have prevented U.S. banks from effectively serving changing customer needs, while other financial competitors have made siguificant inroads into some of the best banking market segments. . . .
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> . . . [T]hey also have made it difficult for banks to seek alternative sources of income as their traditional activities have become less profitable. As a result, banks too often have taken on more risky lending or concentrations of credits as they have sought to maintain an acceptable level of profitability. The consequences of long-standing restrictions have become more severe in recent years as the competitive and economic conditions have evolved. Bank performance, clearly, has suffered.

Clarke's Historical Perspective Argues for Greater Bank Powers, AM. BANKER, April 29, 1986, at 4.

213. *See Hearings, supra* note 3, at 198-99 (statement of Edwin J. Gray).

bank holding company can move interstate by acquiring a nonbank bank in good financial condition, the FHLBB argues, the holding company will not acquire a failing thrift and its attendant problems to accomplish the identical purpose. Extending this logic, however, would require eliminating regional interstate banking because this also decreases interest in acquiring failing thrifts.[214] Furthermore, because failing thrifts are available for purchase, eliminating nonbank banks would not protect the prohibitions on interestate banking. Eliminating nonbank banks would only make riskier a bank holding company's move interstate because bank holding companies desiring to move interstate are prohibited from acquiring nonbank banks in good financial condition. Therefore, prohibiting nonbank banks merely would force those bank holding companies that desire to move interstate to purchase less financially attractive thrifts, thus posing an inherently greater risk for the holding company. One commentator has suggested that to assist the FHLBB, rather than eliminating nonbank banks, a better solution would be to merge the FHLBB's insurance fund with that of the FDIC.[215]

The American Bankers Association ("Association") has expressed the final major category of criticism, charging that nonbank banks are inefficient and result in a misallocation of capital and other resources.[216] Nonbank banks are inefficient, the Association argues, because they are costly to establish and provide only limited services.[217] Capital is misallocated when used to create limited service facilities rather than "supporting a wider scale, more efficient economic growth that is possible under a more traditional bank."[218] The costs of inefficiencies and misallocation are supposedly borne by the consumer.[219]

The former Comptroller disagreed vehemently with this argument.[220] Bank holding companies are capable of making invest-

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214. *Id.* at 252 (statement of C. T. Conover).

215. "If the existence of market forces means that the franchise value of thrifts goes down, I don't think the Government ought to step in to limit the numher of institutions because we want to supply some money to the FSLIC. If the FSLIC needs some more funds, we ought to merge it with the FDIC." *Id.* at 241-42 (statement of William M. Isaac, Chairman, Federal Deposit Insurance Corporation).

216. *See id.* at 89 (statement of James G. Cairns).

217. *Id.* at 90.

218. *Id.*

219. *Id.*

220. "I think that's an incredible argument; I don't think it makes any sense at all." *Id.* at 240 (statement of C. T. Conover).

ment decisions based on projected returns. A nonbank bank would not open unless a fair return was feasible.[221] The flow of capital into limited service facilities will continue so long as geographic restraints exist on full-service banks. Competitive pressures will force this result. The number of loan production offices and special purpose banks is increasing despite their ability to offer only limited services. A nonbank bank, however, which offers NOW accounts and makes commercial loans, is more equivalent to "traditional banking" than these limited service facilities. Even with a prohibition on nonbank banks, limited service institutions will increase as long as bank holding companies are prohibited from competing on a full scale basis with other financial institutions.

The various policy concerns surrounding the proliferation of nonbank banks ultimately narrow to the question of whether the historical concerns of separating banking and commerce and prohibiting interstate banking remain valid. The primary criticisms behind opposition to interstate banking and product deregulation are that a concentration of banking services will result and bank safety and soundness will be compromised.[222]

At present banking is relatively free of market concentration. With regard to domestic deposits, the largest bank has a 3.7 percent share of the national market and the ten largest banks together have only a 14.8 percent collective national market share.[223] These statistics, however, overstate the market concentration of banking services because a variety of other financial and nonfinancial companies are now performing traditional banking functions.[224] Of all the consumer installment and revolving credit lenders in the United States, General Motors is the largest and seven of the top ten are nonbank competitors.[225] General Motors has a 26 percent share of the automobile lending market; the largest bank in the market, Bank America, has only a 1.3 percent share.[226] Of institutions issuing credit cards, Sears has 66.6 million cards outstanding while the nearest bank, Citicorp, only has 11.7 million

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221. *Id.* at 240-41.

222. *See* Cohen, *supra* note 178, at 965; Note, *The Demise of the Bank/Nonbank Distinction: An Argument for Deregulating the Activities of Bank Holding Companies*, 98 HARV. L. REV. 650-56 (1985).

223. Cohen, *supra* note 178, at 974.

224. *See id.* at 974-76.

225. Lecture by Silas Keehn, President, Federal Reserve Bank of Chicago, Owen Graduate School of Management, Vanderbilt University (March 15, 1986) [hereinafter *Keehn Lecture*].

226. *Id.*

cards outstanding.[227] The banking industry, therefore, appears free from market concentration when nonbanking competitors are taken into consideration.[228] Congress first imposed the limitations on interstate banking when nonbank competition did not exist. Thus, the current presence of these nonbank competitors should allay fears of market concentration.

The fear of market concentration in the banking industry stems from the banking history of other countries.[229] A study conducted by the Federal Reserve Bank of Chicago, however, found that such fears were unfounded.[230] In those countries with relatively high levels of market concentration in the banking industry, barriers to entry into the banking industry existed that do not exist in the United States.[231] The study concluded that complete geographic and product deregulation would lead to a reduction in market concentration at the national level, with an even more unambiguous and pronounced effect at the local market level.[232]

The removal of barriers to interstate banking may prompt an increase in the acquisition of small and medium sized banks by larger money-center banks. The removal of regional interstate barriers already has resulted in the consolidation of smaller banks with larger regional banks. In 1984 there were only eight interstate bank acquisition proposals, but after the Supreme Court's ruling in *Northeast Bancorp* the number of proposals increased to fifty-two in 1985.[233] Although some bank acquisitions will take place if the barriers to interstate banking are removed, opportunities will remain for smaller, more efficient banks to enter specific market niches. In states like California, where state-wide branching is permitted and the banking industry is dominated by institutions such as Bank America and First Interstate, the number of new banks entering the market has been increasing each year,[234] demonstrating the unlikelihood of increased market concentration.

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227. *Id.*

228. Sears also has recently introduced its new Discovery credit card, which will compete further with other national credit cards. "If banking organizations have been able to retain 50% of the market for bank services, a percentage which appears high, then the largest banking organization would have only a 1.85% national market share and the ten largest only a collective 7.4% share." Cohen, *supra* note 178, at 975.

229. Baer & Mote, *supra* note 195, at 3.

230. *Id.*

231. *Id.*; *see supra* note 195.

232. Baer & Mote, *supra* note 195, at 16.

233. *Keehn Lecture, supra* note 225.

234. *Id.*

Interstate banking is a positive force and is needed for the continued strength of our financial system. To a large extent, interstate banking already exists. A recent study showed that up to 19 percent of consumers presently deal with an out-of-state financial service provider.[235] This same study also revealed that 41 percent of the consumers that did not use an out-of-state provider would feel comfortable using one with local offices.[236] The consumer would be one of the first to benefit from increased competition and the more efficient pricing of banking services.[237] The variety and quality of services will increase in this competitive atmosphere while profits should fall.[238] The result will be a more efficient banking system.[239]

Just as the concerns over excessive market concentration lack contemporary validity, the concerns over bank safety and soundness arising from interstate banking and product deregulation also are exaggerated. Just as nonbank banks will provide a positive effect on bank safety and soundness,[240] an end to interstate banking prohibitions also will further this goal. A greater number of existing institutions will diversify across state lines and thereby lessen the risk associated with doing business in a specific state or region. "The basic concept here is simple and universally accepted. Diversification reduces risk."[241]

Concerns over a breakdown in barriers between banking and commerce focus on bank safety and soundness. Critics have argued that in a bank holding company structure, the serious financial problems of a nonbanking subsidiary might threaten the soundness of a banking subsidiary[242] and that even if the banking subsidiary's safety and soundness were not actually threatened, the public's perception of the banking subsidiary's well being might be associ-

235. *Id.*

236. *Id.*

237. *Id.*

238. *Id.*

239. "Although raising the specter of excessive concentration remains a potent tool in political debate, recent studies suggest that neither excessive concentration nor anticompetitive abuses are likely to ensue if activities regulation is eliminated." Note, *supra* note 221, at 656-57 (footnotes ommitted).

240. *See infra* text accompanying note 255.

241. Cohen, *supra* note 178, at 987. Because banks are limited geographically, a bank is a captive of its state economy. A bank in a one industry state will have its loan portfolio and profits tied to that industry. Examples of this today are the oil industry in Texas and agriculture in states like Kansas and Iowa. *Id.*

242. Note, *supra* note 222, at 657.

ated with the financial condition of the nonbanking affiliate.[243] That a banking subsidiary would be liable for the debts of its parent bank holding company or its nonbanking affiliates, however, is unlikely.[244] Modification of current laws and regulations also could address any fears that the subsidiary bank's resources would be misappropriated by its parent or affiliates.[245] Finally, regulations less intrusive than product regulation could be employed to curb any problems associated with the public's perception of the stability of the subsidiary.[246]

The regulations prohibiting interstate banking and separating banking and commerce no longer address contemporary concerns. Instead, the regulations tend to have a negative impact on bank safety and soundness. If, however, Congress chooses to maintain the prohibition on interstate banking and the separation between banking and commerce, the elimination of nonbank banks will do little to prevent the circumvention of these policies.

B. Legislative Proposals

Congress has moved slowly in addressing the nonbank bank controversy as well as many other controversial topics in the financial services area. Both the House and Senate have held committee hearings on the nonbank bank issue.[247] The House of Representatives, however, has been unable to produce a bill addressing this controversy. The Senate, on the other hand, passed "The Financial Services Competitive Equity Act" in 1984 by an overwhelming margin.[248] The Senate bill, however, expired at the end of the legislative session because the House failed to pass comparable legislation. In 1985 the Senate failed to act on the issue other than to hold committee hearings on nonbank banks and other issues of concern in the financial services industry.[249] The Senate Banking

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243. *Id.* at 657-58.

244. *Id.* at 658.

245. *Id.*

246. *Id.*

247. *See, e.g., Hearings, supra* note 3; *Moratorium Legislation and Financial Institutions Deregulation: Hearings on S. 1532, S. 1609, and S. 1682 Before the Senate Comm. on Banking, Housing and Urban Affairs,* 98th Cong., 1st Sess. (1983); *Comprehensive Reform in the Financial Services Industry: Hearings Before the Senate Comm. on Banking, Housing, and Urban Affairs,* 99th Cong., 1st Sess., Part I (1985) [hereinafter *Comprehensive Reform*].

248. *See Comprehensive Reform, supra* note 247, at 1 (statement of Senator Jake Garn). S. 2851 passed the Senate on Sept. 13, 1984 by an 89 to 5 margin. 30 CONG. REC. S11162 (daily ed. Sept. 13, 1984).

249. *See Comprehensive Reform, supra* note 247.

Committee preferred not to expend its time and resources passing more legislation only to have it expire because of House inaction. The Senate's concern was justified as the House again failed to pass any legislation addressing the nonbank bank issue during 1985. The House, however, did hold hearings on tbe nonbank bank issue and reported H.R. 20,[250] "The Financial Institutions Equity Act," out of the banking committee. The problem in 1985 arose in the House Rules Committee, where debate over the bill prevented it from being placed on the legislative calendar. In 1986 the House Banking Committee again was unable to win the Rules Committee's approval because of a "mammoth lobbying effort led by Sears, Roebuck & Co."[251] Similarly, the Senate failed to produce any banking legislation during 1986, thus making the 99th Congress the fourth consecutive congressional session to pass no significant banking legislative.[252]

With both chambers of Congress now controlled by the Democratic party, the likelihood of passing banking legislation in 1987 is enhanced.[253] Previously, the House and Senate had taken different approaches to the nonbank bank issues. H.R. 20 "had a single fundamental purpose: to close loopholes in existing laws relating to depository institutions."[254] Senator Garn, however, had pledged that the "Senate will do more than just close loopholes."[255] The Senate leadership, however, has now changed. The new chairman of the Senate Banking Committee, Senator Proxmire, is an outspoken critic of nonbank banks and pushed for a one year moratorium on nonbank banks at the end of the 99th Congress.[256] Thus, the chances of producing legislation banning nonbank banks, similar to the House committee's proposed legislation, are now greatly increased.

The House bill will accomplish what it proposes to

250. H. R. REP. No. 175, 99th Cong., 1st Sess. 2 (1985).

251. Naylor, *Volcker Urges Congress to Give Top Priority to Nonbank Bank*, AM. BANKER, Feb. 20, 1986, at 1. Rep. Claude Pepper, Chairman of the House Rules Committee, bottled up the bill because bis home state of Florida "fear[ed] invasion by New York banks." Naylor & Kutler, *Comptroller Makes New Friends Even Among His Foes*, AM. BANKER, April 18, 1986, at 16-17.

252. *See* Naylor & Easton, *Another Year with no Bills for Banking*, AM. BANKER, Oct. 21, 1986, at 1.

253. *See* Naylor, *Banks Face New Lineup in Democratic Senate*, AM. BANKER, Nov. 6, 1986, at 1, 14.

254. H. R. REP. No. 175, 99th Cong., 1st Sess., 2, 10.

255. *Comprehensive Reform*, *supra* note 247, at 2.

256. *See* Naylor, *Proxmire Stands His Ground on Nonbank-Bank Amendment*, AM. BANKER, Oct. 17, 1986, at 1.

do—eliminate nonbank banks and nonthrift thrifts.[257] This proposal, however, is inappropriate and misguided for several reasons. First, eliminating nonbank banks is a simplistic response to what has been inappropriately labeled a loophole. The proposal does not address the competitive, financial, and technological pressures that gave rise to nonbank banks. Second, no evidence indicates that nonbank banks hurt the consumer or the financial services industry. In fact, the opposite is true. As discussed earlier, nonbank banks allow bank holding companies and other firms to diversify and, therefore, to reduce their risk exposure. Nonbank banks also offer the consumer lower interest costs and greater convenience. Finally, the proposal does not address any of the policy questions arising from the nonbank bank controversy, such as whether the interstate restrictions serve a useful purpose when interstate banking effectively exists, or whether nonbank banks owned by nonbank holding companies fill a needed role in today's economy.

The challenge the House Banking Committee and Senator Proxmire are attempting to avoid is the drafting of comprehensive banking legislation. A bill such as H.R. 20 only will delay the need to address the broader issues; it will not make them go away. The problems in the banking industry only will intensify as competition in the financial services industry increases and banks are placed at a competitive disadvantage because of geographic and product limitations. These issues cannot be resolved through piecemeal legislation. As Senator Garn stated, "[w]e could simply close loopholes, but if we did, new loopholes would develop overnight."[258] The House proposal is an inadequate response to the crucial issue of what form the financial services industry should take in the United States to best meet the needs of the future. Current banking law is outmoded and does not "take into account all of the technological, economic, demographic, and competitive changes that have occurred in the past several years."[259]

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257. "Beyond redefining what is a bank, and tbereby stopping the 'non-bank' bank situation, the Committee has also found it necessary to amend tbe National Housing Act provisions relating to savings and loan holding companies. Absent these cbanges, new loopholes would be created by whicb conglomerate enterprises could use thrift institutions to circumvent existing law." H. R. REP. No. 175, 99th Cong., 1st Sess., 2, 8. *See supra* note 197.

258. *Comprehensive Reform, supra* note 247, at 2. George D. Gould reached a similar conclusion, stating that "the prohibition approach runs the sizable risk of failing to hold back market change and thus misses an opportunity to develop the right regulation from the start." *Regulatory Reform Needed in Nonbank-Bank and Thrift Dilemmas*, AM. BANKER, March 18, 1986, at 21-22.

259. Collins, *Congressional Update and Outlook on Interstate Banking*, ECON. REV.,

Only comprehensive legislation can address these changes adequately.[260] As demonstrated in this Note, removal of the barriers to interstate banking and the restrictions on services provided by banks or their affiliates will result in neither a concentration of banking resources nor a compromise in the safety and soundness of banks. Rather, these changes are needed in order to allow banks to remain competitive in the rapidly changing financial services industry. Failure to enact reformatory legislation, therefore, will result in declining bank safety and soundness as banks are prohibited from diversifying while their competition continues to expand into traditional areas of banking. Nonbank banks are a way for banks to react to the pressures found in a regulated environment. If Congress were to address the issues of interstate banking and the separation of banking and commerce by significantly relaxing these regulations, nonbank banks would not be necessary. However, nonbank banks serve as the next best alternative until comprehensive banking reform legislation is enacted to ease the regulatory, competitive, and financial pressures in the financial services industry.

Federal Reserve Bank of Atlanta, March 1985, 23, 27.

260. Even the new Comptroller, a critic of nonhank banks, states: "[I]nstead of continuing to argue over the nonbank bank, it would be preferable to move ahead at the federal level with comprehensive legislation that grants banks in all states the ability to adapt, directly and efficiently, to a changing market." *Clarke's Historical Perspective Argues for Greater Bank Powers*, AM. BANKER, April 29, 1986, at 4, 12. Comptroller Clarke favors expanding the number of permissible banking activities. *Id.*; *see also* Note, *supra* note 222, at 650 (discussing the implications of activities deregulation).

Similarly, many also are calling for full fledged interstate banking. President Reagan asked Congress in his annual Economic Report of the President to dismantle interstate banking barriers because "'it is time to move toward true interstate banking.'" Naylor, *Reagan Urges Action on Interstate Banking*, AM. BANKER, Feb. 7, 1986, at 1. In a very detailed study of the existing banking structure, the Administration's Task Force found the existing system "perpetuates the existing discrimination against the retail customer, deprives the public of the benefits of increased competition, impedes the efficient allocation of resources, retards the development and application of new technologies, and restricts the ability of bank management to compete with other, nonbank financial institutions." Report of the President, Dep't of the Treasury, Geographic Restrictions on Commercial Banking in the United States 2 (Jan. 1981). Paul Volcker, Chairman of the Federal Reserve Board, also favors interstate banking as a way to handle the number of ailing banks. Naylor, *Volcker Urges Congress to Give Top Priority to Nonbank Bank*, AM. BANKER, Feb. 20, 1986, at 1. Issues other than product and geographic restrictions also need to be addressed because of the outdated nature of the nation's banking laws. *See also* Note, *supra* note 181, at 1621 (describing the necessity of federal legislation to ensure the development of electronic banking technology).

V. Conclusion

The Supreme Court's recent *Dimension Financial* decision has placed added pressure on Congress to address the nonbank bank controversy. Congress no longer can delay action while waiting for the courts to settle the issue. The financial services industry is currently in disarray, with interstate banking existing despite the BHCA's geographic restrictions. Companies outside the banking sphere have established services that compete directly with banks, but operate without the geographic or product restrictions that burden banks. In an effort to compete, bank holding companies have found various means to avoid the BHCA's product and geographic restrictions. Nonbank banks have emerged from the desire of both bank holding companies and various other multi-dimensional financial companies to compete with one another. Eliminating nonbank banks will not ease this competitive pressure but will serve only to restrict the ability of "banks" to compete with those not subject to the BHCA. Comprehensive banking legislation is needed to resolve the broader issue of bank regulation, and only through legislative reform will the nonbank bank controversy be resolved.

Davis W. Turner