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ESSAY

Fenceposts Without a Fence

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Banking organizations in the United States have long been subject to two broad categories of regulatory requirements. The first is permissive: a "positive" grant of rights and privileges, typically via a charter for a corporate entity, to engage in the business of banking. The second is restrictive: a "negative" set of conditions on those rights and privileges, limiting conduct and imposing a program of oversight and enforcement, by which the holder of that charter must abide. Together, these requirements form a legal cordon, or "regulatory perimeter," around the U.S. banking sector.

The regulatory perimeter figures prominently in several ongoing policy debates, from the treatment of stablecoins and other crypto assets to the role of Big Tech in finance. The perimeter itself, however, is ill-defined and often misunderstood. To clarify it, this Article situates the regulatory perimeter in the longer historical arc of U.S. banking from the colonial era to the present. This

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Article identifies a new pattern behind changes to the nature, shape, and position of the perimeter—outside-in pressure, inside-out pressure, and reform and expansion. The Article also pinpoints a shift, decades old but previously neglected, in the design of regulatory categories and the distribution of responsibility between Congress and the executive branch. Put together, these trends have created a regulatory perimeter that is broader, more complex, and arguably more permeable than at any point in its history—a line of fenceposts without a fence.

INTRODUCTION

The United States and countries around the world have seen the recent proliferation of "FinTech" competitors to banking organizations, which traditionally engage in three core bundled activities: taking deposits, making loans, and facilitating payments.[1]

Consider the following competitors: Stablecoins like Tether or USD Coin act as a deposit substitute that also can be used for payments.[2] Plaid operates closer to the payments dimension by providing the technological infrastructure for financial apps like Venmo. Along the lending dimension, LendingTree is an online platform that matches potential borrowers with loan providers, and Rocket Mortgage uses online applications rather than brick-and-mortar branches to provide mortgages. (Figure A1 in the Appendix provides a visual illustration of this disaggregation and, in some cases, reaggregation of the core business of banking.)

These new entrants can often grow and compete against existing banks because they have newer or better technology[3]—hence, many are

1. *See* Michael J. Hsu, Acting Comptroller, Office of the Comptroller of the Currency, Remarks Before the Federal Reserve Bank of Philadelphia Fifth Annual Fintech Conference: Modernizing the Financial Regulatory Perimeter (Nov. 16, 2021):

> Banking consists of three bundled activities: taking deposits, making loans, and facilitating payments. In the early 2010s, fintechs began to unbundle the payments leg, offering goods and services aimed at improving customers' payments experiences . . . . The largest payments fintechs have not stopped there, however. Many have augmented their platforms and expanded into adjacent areas, such as extending various forms of credit and offering interest on cash held. Today, a range of fintechs provide seemingly the full suite of banking and investment services—including in cryptocurrencies—with the convenience of tech;

see also Dan Awrey, *Unbundling Banking, Money, and Payments*, 110 GEO. L.J. 715, 739 (2022) [hereinafter Awrey, *Unbundling Banking*] (explaining why "banking, money, and payments have remained so deeply intertwined for so long").

2. Stablecoins have been in the news recently, given the spectacular collapse of the algorithmic stablecoin TerraUSD. *See, e.g.*, David Yaffe-Bellany & Erin Griffith, *How a Trash-Talking Crypto Founder Caused a $40 Billion Crash*, N.Y. TIMES (May 18, 2022), https://www.nytimes.com/2022/05/18/technology/terra-luna-cryptocurrency-do-kwon.html [https://perma.cc/783A-KY8V] (discussing TerraUSD's collapse); Alexander Osipovich & Caitlin Ostroff, *Crash of TerraUSD Shakes Crypto. 'There Was a Run on the Bank.',* WALL ST. J. (May 12, 2022, 12:10 PM), https://www.wsj.com/articles/crash-of-terrausd-shakes-crypto-there-was-a-run-on-the-bank-11652371839 [https://perma.cc/TG92-FCEJ] (describing billions of dollars of loss resulting from TerraUSD's collapse).

3. *See* Howell E. Jackson, *The Nature of the Fintech Firm*, 61 WASH. U. J.L. & POL'Y 9, 10–11 (2020) [hereinafter Jackson, *Fintech Firm*] (noting that fintech firms benefit from "a wide range of private and regulatory innovations that have become possible through the rapid decline in the cost of computing, accompanied by the widespread availability of reliable, high-speed connectivity (typically over the internet)"); *see also* Chris Brummer & Yesha Yadav, *Fintech and the Innovation Trilemma*, 107 GEO. L.J. 235, 240 (2019) ("[B]anking regulators . . . have . . . grappled with how to

categorized as "financial technology" or "FinTech" companies. In addition, they are not subject to the same regulatory and supervisory requirements as existing banks.[4] These new entrants often operate and thrive in a regulatory gray area, outside of the well-established "regulatory perimeter."

In November 2021, the President's Working Group on Financial Markets—including the Treasury Department and the federal banking and securities regulatory agencies—released a report on stablecoins, noting that these financial instruments "currently fall . . . outside of the regulatory perimeter altogether."[5] That same month, Acting Comptroller of the Currency Michael Hsu gave remarks on "modernizing the financial regulatory perimeter" to propose a framework for regulating synthetic banking.[6] Lawmakers, regulators, and supervisors now frequently mention the regulatory perimeter in public speeches. But what exactly is the regulatory perimeter, and why is it so crucial for the growth and stability of the financial system? This piece sets out a brief response to this question and a provisional theory of how the perimeter emerges, changes, and grows.

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Banking organizations in the United States have long been subject to two broad categories of regulatory requirements. The first is

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oversee and regulate new technologically savvy entrants into the lending and payments industries.").

4. *See* Dan Awrey & Kathryn Judge, *Why Financial Regulation Keeps Falling Short*, 61 B.C. L. REV. 2295, 2304 (2020) ("Given the myriad costs associated with operating a bank, from complying with activity restrictions to ongoing supervisory oversight and deposit insurance premiums, regulatory arbitrage was likely among the forces driving the rapid growth of this shadow banking system in the years leading up to the crisis.").

5. PRESIDENT'S WORKING GRP. ON FIN. MKTS., FED. DEPOSIT INS. CORP. & OFF. OF THE COMPTROLLER OF THE CURRENCY, REPORT ON STABLECOINS 15 (2021), https://home.treasury.gov/system/files/136/StableCoinReport_Nov1_508.pdf [https://perma.cc/QD5F-ZSX7]. The report was the result of a collaborative effort by the Department of the Treasury, the Board of Governors of the Federal Reserve System, the Securities and Exchange Commission ("SEC"), the Commodity Futures Trading Commission ("CFTC"), the Federal Deposit Insurance Corporation ("FDIC"), and the Office of the Comptroller of the Currency ("OCC"). *Id.* at 2 n.3.

6. Hsu, *supra* note 1; *see also* Christopher J. Waller, Governor, Fed. Rsrv. Sys., Speech at the SNB-CIF Conference on Cryptoassets and Financial Innovation, Zürich, Switzerland: Risk in the Crypto Markets (June 3, 2022):

> By law or by practice, many crypto-related products and activities fall between the cracks of traditional legal and regulatory structures, outside the so-called "regulatory perimeter." In that environment, the normal backstops and safety nets of traditional finance do not necessarily or reliably apply. High volatility is the rule, not the exception; fraud and theft occur regularly, often at large scale. Your whole pot is always on the table; you take part at your own risk.

permissive: a "positive" grant of rights and privileges, typically via a charter for a corporate entity, to engage in the business of banking.[7] The second is restrictive: a "negative" set of conditions on those rights and privileges, limiting conduct and imposing a program of oversight and enforcement, by which the holder of that charter must abide.[8]

Together, these requirements form a legal cordon, or "regulatory perimeter," around the U.S. banking sector. Inside that perimeter are firms that can legally conduct a set of banking activities, subject to various forms of regulation and supervision. Outside that perimeter are firms conducting other financial and nonfinancial activity under the broad heading of "commerce"—subject to other laws and restrictions, but not to the specific combination of positive grants and negative restrictions of the perimeter. A range of firms lie close to the boundary, blurring the distinctions between commerce and banking.[9]

Today's regulatory perimeter faces a variety of challenges and pressures—from the "unbundling" and "rebundling" of the traditional banking business; to the growth of stablecoins, stored-value platforms, and other new technologies; to the entry of commercial firms into the financial services space; to the advent of new financial services charters, with new uses for old ones. These developments are the topic of substantial current scholarship.[10] For instance, Professor Dan Awrey

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7. Positive requirements in this context also fall under the umbrella of "entry restrictions." *See, e.g.*, Morgan Ricks, *Entry Restriction, Shadow Banking, and the Structure of Monetary Institutions*, 2 J. FIN. REGUL. 291, 291–95 (2016) (explaining the origins of banking entry restrictions).

8. *See* Francesco Parisi, Norbert Schulz & Jonathan Klick, *Two Dimensions of Regulatory Competition*, 26 INT'L REV. L. & ECON. 56, 56–66 (2006) (providing a model of regulatory competition in multibody administrative settings); *see also* Dan Awrey, *Bad Money*, 106 CORNELL L. REV. 1, 4–5, 7 (2020) [hereinafter Awrey, *Bad Money*] (noting that banks issue money from within an intricate public regulatory framework designed to help enhance bank credibility while upstarts such as PayPal desire to act outside of this framework).

9. *See, e.g.*, Saule T. Omarova, *The Merchants of Wall Street: Bank, Commerce, and Commodities*, 98 MINN. L. REV. 265, 268–69 (2013) ("[I]n the last decade, large U.S. FHCs—including Goldman, Morgan Stanley, and JPMC—emerged as major merchants of physical commodities and energy, notwithstanding the legal wall designed to keep them out of any non-financial business."); Reid B. Stevens & Jeffery Y. Zhang, *The Costs of Banks Engaging in Non-Banking Activities: A Case Study*, 39 YALE J. ON REGUL. 375, 377 (2022) ("Since the passage of the Glass-Steagall Act . . . significant cracks have emerged in the wall that separates banking and commerce, and those cracks are only growing."); *see also* Jackson, *Fintech Firm*, *supra* note 3, at 12–13:

> If a firm engages in some core financial function—like banking, insurance, or the securities business—then the firm itself (often along with all affiliated entities) is subject to strict regulation . . . . Once subject to entity-based regulation, a financial firm also enjoys certain benefits not available to other firms.

10. *See, e.g.*, Ryan Clements, *Defining the Regulatory Perimeter for Stablecoins in Canada*, 66 CANADIAN BUS. L.J. 201 (2022) (discussing stablecoins); Agustín Carstens, Stijn Claessens, Fernando Restoy & Hyun Song Shin, *BIS Bulletin No. 45: Regulating Big Techs in Finance*, BIS 1–9 (Aug. 2, 2021), https://www.bis.org/publ/bisbull45.pdf [https://perma.cc/W26D-HYEN]

has examined the way in which the regulatory perimeter entrenches banks' ability to bundle deposit taking, loan extensions, and payments.[11] Professors Gary Gorton and Jeffery Zhang have discussed the systemic dangers of stablecoins proliferating outside of the regulatory perimeter.[12] Professors Howell Jackson and Morgan Ricks have proposed fitting stablecoins within the existing regulatory perimeter, analyzing whether stablecoins may already be subject to some established system of financial regulation.[13]

Scholars have yet to focus on lessons from the centuries' worth of legal changes to the regulatory perimeter itself. These lessons are worth learning because, as constituted, the perimeter is often quite easily breached. In normal times, when markets are functioning smoothly, this arbitrage goes unaddressed, and the resulting efficiency gains deliver benefits. In times of economic stress, however, a rapid deterioration in conditions can lead to financial ruin for many, particularly for the most vulnerable. Previous generations have also had to address this same tension. Lawmakers now face the task of crafting the next iteration of the regulatory perimeter; as they work to do so, it is helpful to understand how we got here in the first place.[14]

* * *

In Parts I and II of this Article, we first explain the creation and evolution of the U.S. regulatory perimeter. In Part III, we present several lessons for today's regulators who are attempting to revise the

(reviewing policy challenges for banks and regulators regarding oversight of big tech firms); Markus K. Brunnermeier, Harold James & Jean-Pierre Landau, *The Digitalization of Money* 2–29 (Nat'l Bureau of Econ. Rsch., Working Paper No. 26300, 2019) (examining the "economic implication of digital currencies").

11. *See* Awrey, *Unbundling Banking*, *supra* note 1, at 721 (noting the reluctance of policymakers "to fundamentally rethink the legal frameworks that support and entrench our current bundled system of banking, money, and payments").

12. *See* Gary B. Gorton & Jeffery Y. Zhang, *Taming Wildcat Stablecoins*, 90 U. CHI. L. REV. (forthcoming 2023) (arguing that issuers of stablecoins are essentially unregulated banks that are susceptible to destabilizing runs).

13. *See* Howell E. Jackson & Morgan Ricks, *Locating Stablecoins Within the Regulatory Perimeter*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 5, 2021), https://corpgov.law.harvard.edu/2021/08/05/locating-stablecoins-within-the-regulatory-perimeter/ [https://perma.cc/F2J7-JTP2] (arguing that stablecoins may be "covered by one of the surviving provisions of the Glass-Steagall Act: Section 21(a)(2)").

14. To be clear, our Article is focused on the bank regulatory perimeter in the United States. Many other sectors within the financial industry—and many industries in general—have an accompanying regulatory perimeter. *See* Howell E. Jackson, *Regulation in a Multisectored Financial Services Industry: An Exploration Essay*, 77 WASH. U. L.Q. 319 (1999) [hereinafter Jackson, *Multisectored Financial Services*] (describing the regulatory structures of private contract, securities regulation, futures contracts, investment companies, depository institutions, insurance companies, and employee benefit plans).

perimeter. These lessons include, inter alia, a discussion of the patterns in the perimeter's nature, shape, and position.[15] As a preview, we see these patterns from three different perspectives.

Outside-in pressure. Firms outside the regulatory perimeter—sometimes, but not always, with a commercial presence—enter into more direct competition with firms inside it, offering the services of a regulated bank while avoiding most or all of its requirements. Engaging in this regulatory arbitrage permits firms to traverse the perimeter, often increasing the ties between banking and commerce and eroding the value of a bank charter.

Inside-out pressure. Firms inside the regulatory perimeter respond to this pressure by advocating regulation of their nonbank competitors. Regulated firms also form new partnerships, create new products, convert to new charters, or lobby for changes to disadvantageous regulatory requirements. They find allies in commercial firms, as well as in competing regulators and jurisdictions. They argue either that restrictions are arbitrary, restraining innovation and unnecessarily marking certain acceptable activities as unsafe, or pushing conduct beyond the reach of regulation. In either case, they argue these restrictions place regulated firms at a disadvantage, imperiling their safety and soundness, the integrity of the financial system, and overall economic growth.

Reform and expansion—by devil or disaster. Pressure on the perimeter can culminate in action, either by scandal or crisis, or both. In response to this pressure, regulators, legislators, and industry act to patch or expand the perimeter—often while letting existing institutions operate under legacy treatment—or increase permissible activities in exchange for increased regulation. With few exceptions, the effect is to push the perimeter outward, extending it to at least some set of firms and activities not previously within regulators' jurisdiction.

This Article concludes by explaining that the U.S. regulatory perimeter is broader, more complex, and arguably more permeable than at any point in its history. In short: If the regulatory perimeter remains in its current form or continues to weaken along its recent historical trend, we will see the continued proliferation of financial innovations in the regulatory gray area. Lawmakers and regulators interested in

15. Importantly, we do not view this pattern as systemic, deterministic, or necessary, nor as a rigid account of the instances of perimeter change we describe; instead, we intend it as a *Gedankenbild*, a "unified analytical concept" derived from "concrete individual phenomena." *See* Max Weber, *"Objectivity" in Social Science and Social Policy*, *in* THE METHODOLOGY OF THE SOCIAL SCIENCES 90 (Edward A. Shils & Henry A. Finch eds., trans., 2011); *see also* Jon Hendricks & C. Breckinridge Peters, *The Ideal Type and Sociological Theory*, 16 ACTA SOCIOLOGICA 31, 32 (1973) (referencing Weber's *Gedankenbild* concept).

improving the stability of our financial system should consider modifying the perimeter based on the lessons provided herein.

I. THE EARLY HISTORY OF THE REGULATORY PERIMETER

Our historical analysis of the U.S. regulatory perimeter begins in the early republic.[16] We examine the origins of bank chartering and proceed onto the evolution of the perimeter that occurred through the Civil War, past the founding of the Federal Reserve, and beyond the New Deal.

A. Creating the Perimeter

1. The Early Separation of Banks and Corporates

In the beginning, no perimeter separated banking from other kinds of corporate activity. During the late colonial era and the early republic, almost all corporate entities were subject to positive and negative regulatory requirements, regardless of their business or activities. Incorporation was largely an exercise of state control over local civic institutions; the Crown, and then colonies and states, issued corporate charters that conferred limited liability and perpetual personality but which also came with a host of restrictive conditions.[17]

For most corporations, these conditions began to ease in the mid-nineteenth century. State governments began issuing charters without the specific approval of the legislature, and courts began to distinguish

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16. The historical analysis presented herein is based on our working paper: Nicholas K. Tabor, Katherine E. Di Lucido & Jeffery Y. Zhang, *A Brief History of the U.S. Regulatory Perimeter* 2–49 (Fin. & Econ. Discussion Series, Working Paper No. 2021-051, 2021). All diagrams reflect categorizations of financial institutions by year of introduction in statute, subject to some form of finance-specific federal oversight (i.e., not merely antitrust or general criminal liability). They exclude definitions of financial products or customers, except to the extent such products or customers define the scope of a regulated entity; include functional categories in securities and consumer protection laws but exclude Farm Credit Administration, Federal Land Bank, and Small Business Administration–related entities; and exclude Internal Revenue Code items unless explicitly incorporated by reference within a financial regulatory statute. *Id.*

17. This power derived from the English law concept of visitation, which endures today in the law of national banks. *See* Judge Glock, *The Forgotten Visitorial Power: The Origins of Administrative Subpoenas and Modern Regulation*, 37 REV. BANKING & FIN. L. 205, 207–08 (2017–2018) (discussing the development of visitation powers); 12 C.F.R. § 7.4000 ("Visitorial powers with respect to national banks . . . ."); Jason Kaufman, *Corporate Law and the Sovereignty of States*, 73 AM. SOCIO. REV. 402, 409 (2008) (exploring the development of corporations in the United States, including development based on English law). In fact, private banking—and specifically, the establishment of a private land bank in Massachusetts that used real estate to collateralize circulating notes—was the site of a heated debate over British colonial control, spurring the British government to extend the 1720 "Bubble Act" (and its regulation of unincorporated joint-stock companies) to the Americas in 1841. F. Ward McCarthy Jr., *The Evolution of the Bank Regulatory Structure: A Reappraisal*, FED. RSRV. BANK RICH. ECON. REV., Mar./Apr. 1984, at 3, 5.

the (narrower) rights of public corporations from the (broader) protections of private ones.[18] For banks, though—which remained the lynchpin of state public finance—the conditions not only remained but tightened.[19] States began charging fees for issuing bank charters; they taxed banks' capital, dividends, deposits, and profits; acquired shares in the banks themselves; and required banks to purchase shares in (or issue "bonuses" to) state entities.[20]

These early charters also reflected a distinction older than the corporate form itself: between permissible "banking" activities and impermissible "commercial" ones.[21] Initially, U.S. charter restrictions

18. *See, e.g.*, Trs. of Dartmouth Coll. v. Woodward, 17 U.S. 518, 600 (1819) ("The only rules for the government of these private corporations are the laws and constitutions assigned by the founder."); Kaufman, *supra* note 17, at 420 ("Beginning in the 1810s and '20s, American courts began to differentiate the rights and powers of public corporations from those of privately-held corporations."); Ronald E. Seavoy, *The Public Service Origins of the American Business Corporation,* 52 BUS. HIST. REV. 30, 58–60 (1978) [hereinafter Seavoy, *Public Service Origins*] (discussing the evolution of public versus private corporations in the United States); Ronald E. Seavoy, *Laws to Encourage Manufacturing: New York Policy and the 1811 General Incorporation Statute*, 46 BUS. HIST. REV. 85, 90–91 (1972) [hereinafter Seavoy, *Laws to Encourage Manufacturing*] (examining the impact of New York's 1811 general incorporation statute on the expansion of corporations).

19. The extent of this fiscal dependency is hard to overstate. From 1836 to 1840, for example, Massachusetts received more than eighty-two percent of its tax revenues from the banking sector. *See* Richard Sylla, John B. Legler & John J. Wallis, *Banks and State Public Finance in the New Republic: The United States*, *1790-1860*, 47 J. ECON. HIST. 391, 401 (1987); *see also* Bernard Shull, *Separation of Banking and Commerce in the United States*, 18 J. BANKING & FIN. 255, 259 n.6 (1994):

> General incorporation altered the character of the charter granted by the state from "a right to a defined enterprise" to "any lawful business" . . . . For banking, however, . . . the charter retained the older form that defined and limited the business, and retained a governmental body to regulate and supervise.

20. John Joseph Wallis, Richard E. Sylla & John B. Legler, *The Interaction of Taxation and Regulation in Nineteenth-Century U.S. Banking*, *in* THE REGULATED ECONOMY: A HISTORICAL APPROACH TO POLITICAL ECONOMY 136 (Claudia Goldin & Gary D. Libecap eds., 1994):

> The most famous example occurred in 1835, when a chastened Nicholas Biddle desperately sought a Pennsylvania charter for the Bank of the United States, whose federal charter was about to expire. The bank's lobbyist spent $128,000 on legislative pressure, and in the end the bank, by the terms of the state charter, had to pay Pennsylvania a bonus of $2 million and grant the state a "temporary" loan of $1 million annually as well as a "permanent" loan of $6 million.

21. Restrictions on commercial activity date to at least the thirteenth century, during which banks in Italian city-states were barred from participating in import-export or commodity activities. *See* John Krainer, *The Separation of Banking and Commerce*, 2000 FED. RSRV. BANK S.F. ECON. REV. 15, 16. As in the early republic, however, the reality was more complicated. Genoese, Venetian, and Florentine banks were originally established to facilitate compulsory lending to the state and, later, to manage more complicated forms of public debt. *See* Michele Frantianni & Franco Spinelli, *Italian City-States and Financial Evolution*, 10 EUR. REV. ECON. HIST. 257, 262 (2006) (discussing early banking in Italy). Once involved in trade finance, these institutions could often secure dominant positions in the markets they were financing. The rents associated with such activity were substantial. *See, e.g.*, Richard A. Goldthwaite, *The Medici Bank and the World of Florentine Capitalism*, 114 PAST & PRESENT 3, 3–22 (1987).

on banking activity were general, often limiting the bank only to its "usual banking powers."[22] As banks began to exercise the discretion these charters allowed, however, states imposed narrower, more tailored conditions. In New York, banks were generally prohibited from transacting in goods or commodities, except those received as collateral on a defaulted loan (e.g., in connection with debt previously contracted); in Massachusetts, banks were limited to real estate holdings worth twelve percent of capital; and in Maine, limits existed on holdings of property in fee simple but not on any other form of ownership.[23] At least in part, these restrictions reflected concerns that banks with unconstrained powers would favor the merchant class.[24]

These restrictions became more uniform with the spread of "restraining acts," which clarified that only those with the affirmative permission of the state could engage in the "business of banking."[25]

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22. In 1839, for example, only sixty-six of ninety-seven New York State bank charters had specified limits on permissible business or a specific definition of the business of banking. DAVIS DEWEY, STATE BANKING BEFORE THE CIVIL WAR, S. DOC. NO. 581, at 44 (2d Sess. 1910). Commercial actors also remained deeply involved in early banking activities; more than two-thirds of the directors and officers of the banks of New York, Philadelphia, and Baltimore in 1840, 1850, and 1860 were or had been merchants. Harold C. Livesay & Glenn Porter, *The Financial Role of Merchants in the Development of U.S. Manufacturing, 1815-1860*, 9 EXPLS. ECON. HIST. 63, 67 (1971–1972).

23. S. DOC. NO. 581, at 44–45 (citing S. 62-87, 1st Sess. (N.Y. 1839)). These motley restrictions were not limited to the United States and were sometimes visible within a single institution. For example, the 1694 charter of the Bank of England prohibited the Bank from trading in "goods, wares, or merchandise"—while simultaneously requiring the bank to lend its capital stock only and exclusively to the government. *See* Halley Goodman, *The Formation of the Bank of England: A Response to Changing Political and Economic Climate, 1694*, 17 PENN HIST. REV. 10, 21 (2009) (discussing the Bank of England's formation); Shull, *supra* note 19, at 257 (examining the language in the Bank of England's charter).

24. The Bank of North America is an instructive example. In 1781, the bank was chartered principally to help finance the expenses of the Army of the Potomac. LAWRENCE LEWIS JR., A HISTORY OF THE BANK OF NORTH AMERICA: THE FIRST BANK CHARTERED IN THE UNITED STATES 16–17 (1882). Three years later, its Pennsylvania charter was repealed after sustained protests by agrarian interests, who claimed that the bank unduly benefited merchants; the charter had not restricted the bank's commercial activities. *Id.* at 55–66. Shortly after, in 1787, Pennsylvania granted the bank another charter with several new limitations: the bank's corporate existence was limited to fourteen years, the bank was forbidden to hold real estate not necessary for its existence, and the bank was prohibited from "trading in any merchandise, save bullions and bills of exchange." *Id.* at 73 (citing Act of Mar. 17, 1787, 2 Dallas' Laws, 499); *see also* BRAY HAMMOND, BANKS AND POLITICS IN AMERICA: FROM THE REVOLUTION TO THE CIVIL WAR (1957). The First and Second Banks of the United States had similar restrictions in their charters, limiting land ownership and "deal[ing] or trad[ing] in any thing, except bills of exchange, gold or silver bullion, or in the sale of goods really and truly pledged for money lent and not redeemed in due time." An Act to Incorporate the Subscribers to the Bank of the United States, ch. 10, 1 Stat. 191 (1791); An Act to Incorporate the Subscribers to the Bank of the United States, ch. 44, 3 Stat. 266 (1816).

25. This affirmative permission also increased the rents that states could demand for charters, corruptly or otherwise. *See* McCarthy, *supra* note 17, at 7 ("Since they were bargaining from a position of strength, state legislatures were able to insist on a variety of favorable financial arrangements in exchange for the profit opportunities conferred by charters."); Bray Hammond, *Free Banks and Corporations: The New York Free Banking Act of 1838*, 44 J. POL. ECON. 184, 187

Consistency came at the cost of specificity, however: restraining acts rarely said what the "business of banking" actually was.[26] The boundaries of these acts were quickly tested and often surmounted.[27] A notable example involved the Manhattan Company, a corporation chartered in 1799 to lay water pipes for the City of New York.[28] The company's charter included a provision that let it invest surplus capital in any legal "monied transactions or operations" (a variant of the more common "business of banking" language).[29] Then–New York assemblyman Aaron Burr drafted the charter, voted to approve it, and then joined the board of the new company, which became the forerunner of Chase Manhattan Bank.[30] Its infrastructure activity remained meager, and New York lacked an adequate supply of clean drinking water for the next forty years.[31]

2. The Federal Perimeter and the Early Dual Banking System

Before the Civil War, federally chartered banks (i.e., mainly, the First and Second Banks of the United States) generally faced more explicit restrictions on commercial activity than previously.[32] Postwar

(1936) (quoting N.Y. Fireman Ins. Co. v. Ely, 2 Cow. 678, 678–712 (N.Y. Sup. Ct. 1824)) ("The object of [New York's 1804] restraining act was to guarantee to these banks 'a monopoly of the rights and privileges granted to them, which had been encroached upon or infringed by private associations.' ").

26. *See* Roger S. White, *Evolution of the Legal Framework for Government Regulation of Commercial Banking*, 1 PROC. BUS. HIST. CONF. 83 (1973) (detailing thirty-five restraining statutes in twenty-six states).

27. Shull, *supra* note 19, at 258 ("Banking powers were obtained by 'internal improvement' companies to build canals, railroads, and turnpikes . . . . When the Second Bank of the U.S. was rechartered by Pennsylvania . . . [it] invested heavily in securities, attempted to support the market for cotton, and failed in 1841.").

28. EDWIN G. BURROWS & MIKE WALLACE, GOTHAM: A HISTORY OF NEW YORK CITY TO 1898, at 361 (1998); *The Chase Manhattan Corporation*, BRITANNICA, https://www.britannica.com/topic/The-Chase-Manhattan-Corporation (last visited Mar. 17, 2023) [https://perma.cc/HEY5-L76Y].

29. BURROWS & WALLACE, *supra* note 28, at 361.

30. *Id.*

31. *Id.* at 361–62. The company would also play a substantial role in financing the Democratic-Republican candidates in the contested election of 1800. *See* Brian Phillips Murphy, *"A Very Convenient Instrument": The Manhattan Company, Aaron Burr, and the Election of 1800*, 65 WM. & MARY Q. 233, 234 (2008) (discussing the Manhattan Company's involvement in the 1800 election).

32. Even these restrictions were often illusory. For example, despite charter limitations on dealing in commodities, the Second Bank of the United States (and its then president, Nicholas Biddle) orchestrated a plan to support cotton prices by cornering the market in London. HAMMOND, *supra* note 24, at 467–68. To evade the restrictions, Biddle and other officers of the bank contracted with agents in the South to purchase cotton, ship it to other agents in Liverpool, and hold the purchases back to inflate the price. *Id.* at 468. The contracts were financed by the sale of securities, including those of the bank, in London to British financiers. *Id.* As was customary at the time, the

federal restrictions evolved from state "free banking" laws, which replaced the restraining acts and removed artificial caps on the number of bank charters.[33] The new laws, however, often contained their own lists of specific activities that a bank could pursue.[34] Under New York's Free Banking Act of 1838, for example, anyone with sufficient capital could establish a bank—subject to the nation's first-ever requirement of "safety and soundness."[35] Once established, the Act held that banks would "carry on the business of banking" by discounting debt, receiving deposits, buying and selling bullion, making loans "on real and personal security," and "exercising such incidental powers as shall be necessary to carry on such business."[36]

The National Bank Act of 1863 embraced language similar to the New York law, authorizing holders of national banking charters to engage only in the "business of banking" and exercise powers "incidental" thereto.[37] Early case law shows that this limitation was far-

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directors retained first recourse to the bank's facilities—meaning they enjoyed the support of the bank's resources without bearing unlimited liability for its actions. *Id.*

33. U.S. DEP'T OF THE TREASURY, REPORT OF THE SECRETARY OF THE TREASURY ON THE STATE OF THE FINANCES FOR THE YEAR ENDING JUNE 30, 1861, at 17 (1861) (justifying currency plan "[t]o enable the government to obtain the necessary means for prosecuting the war to a successful issue, without unnecessary cost").

34. Edward L. Symons, Jr., *The "Business of Banking" in Historical Perspective*, 51 GEO. WASH. L. REV. 676, 690 (1983) (describing language of various bank charters); *see also* HAMMOND, *supra* note 24, at 186–90 (same).

35. HAMMOND, *supra* note 24, at 595–97. The Act was eventually challenged on the basis that the New York legislature could not pass such an Act without a two-thirds vote of all legislators, which the Act had not received, and that a law authorizing "an indefinite number of corporations would be unconstitutional." Hammond, *supra* note 25, at 193–94. After a decades-long controversy over whether a bank was a "corporation" for purposes of state law, New York's Court for the Correction of Errors—then the highest court of New York, composed of state senators, the president of the New York Senate, the chancellor of the Court of Chancery, and three justices of the (lower) Supreme Court—ruled that banks were not corporations and upheld the Act. *Id.* at 200–01.

36. Symons, *supra* note 34, at 690 (quoting Ch. 260, § 18, 1838 N.Y. Laws 245, 249).

37. *Id.* at 698–99 (quoting Act of Feb. 25, 1863, ch. 58, § 11, 12 Stat. 665, 668). The Act also provides what appears to be the first federal statutory definition of banking. Associations formed thereunder had

> [the] power to carry on the business of banking by obtaining and issuing circulating notes in accordance with the provisions of this act; by discounting bills, notes, and other evidences of debt; by receiving deposits; by buying and selling gold and silver bullion, foreign coins, and bills of exchange; by loaning money on real and personal security, in the manner specified in their articles of association, for the purposes authorized by this act, and by exercising such incidental powers as shall be necessary to carry on such business[.]

National Bank Act of 1863, ch. 58, 12 Stat. 665. The activities permissible for national banks have evolved over time by both statutory amendment and interpretation. *See* 12 U.S.C. § 24 (corporate powers of associations); Shull, *supra* note 19, at 263–66 (discussing recent developments in banking).

reaching but porous.[38] National banks could not originate mortgages (since Congress specified their power to lend "on personal security," not real property) but could host apartments and unrelated businesses alongside their headquarters.[39] National banks could acquire, own, or dispose of stock in satisfaction of a debt (an "incidental" power) but not "deal in" stock or own stock in a "speculative" enterprise (not an "incidental" power).[40] National banks could not "engage directly in a manufacturing or business enterprise under any circumstances" but could buy seed, hire plowmen, and operate a farm, if the goal was to preserve the value of the farm as collateral.[41]

Figure 1 presents the first of several snapshots of the U.S. regulatory perimeter, here, circa 1864. Along the vertical axis, we map regulated entities roughly to their respective regulators. Along the horizontal axis, we allocate regulated activities into various zones of regulation, on a spectrum from "banking" to "commerce." In 1864, both the new Office of the Comptroller of the Currency and a new federal definition of the "business of banking" emerged.[42] The relevant regulations at that time were focused on the safety and soundness of banks (in the far corner of the "prudential zone"); the rights and responsibilities envisioned in the new federal banking law applied specifically to banks voluntarily chartered as such. As the void in most of Figure 1 demonstrates, the early regulatory perimeter was still far from encompassing activities beyond the core "business of banking."

Even with these patchwork exceptions, national banking rules were more stringent than state-level regulation, and state banks maintained significant market share until 1865, when Congress levied a ten percent tax on all state bank notes.[43] The tax caused a sharp decline among state banks, but they experienced a steady resurgence.[44]

38. At the same time, this jurisprudence suggests that contemporary ideas about the contents of "banking" had been elaborated at the state level and went far beyond mere deposit taking. *See* Oulton v. Sav. Inst., 84 U.S. 109, 118–19 (1872) (noting, in dicta, that "[b]anks in the commercial sense are of three kinds, to-wit: 1, of deposit; 2, of discount; 3, of circulation," and "an institution prohibited from exercising any more than one of those functions is a bank in the strictest commercial sense . . . ."); *cf.* Hinckley v. Belleville, 43 Ill. 183, 184 (1867) (holding "the business of a money-changer," defined as "a broker who deals in money or exchanges," to "constitute[ ] . . . the greater part" of "the business of a banker").

39. *Powers of National Banks to Acquire Various Kinds of Property*, 33 HARV. L. REV. 718, 719 & n.2 (1920) (first citing U.S.R.S. § 5137; and then citing Brown v. Schleier, 194 U.S. 18 (1904)).

40. *Id.* at 719, 720 n.11 (first citing U.S.R.S. § 5201; and then citing First Nat'l Bank of Ottawa v. Converse, 200 U.S. 425 (1906)).

41. *Id.* at 720–21 n.15 (first citing Cockrill v. Abeles, 86 F. 505 (8th Cir. 1898); and then citing First Nat'l Bank of Great Bend v. Bannister, 54 P. 20 (Kan. Ct. App. 1898)).

42. *See* National Bank Act of 1863, ch. 58, §§ 1, 9, 12 Stat. at 665–68.

43. McCarthy, *supra* note 17, at 12.

44. *Id.*

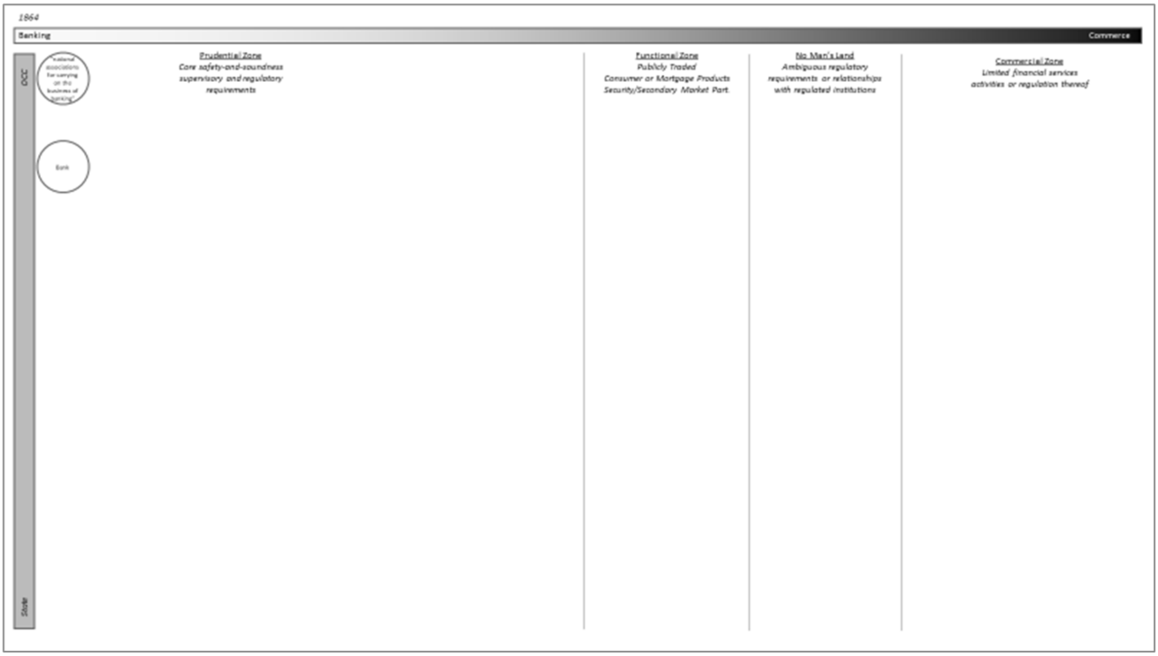
States eased chartering requirements and enforcement of existing banking laws, and state banks avoided the note tax by abandoning note issuance altogether, letting customers instead use checks to transfer money on deposit.[45] State trust companies also emerged as competitors; as their state-law monopoly over land-title guarantee and trust insurance began to erode, trusts pivoted to their long-standing ancillary authority to "receive deposits of money in trust."[46] The combination of deposit taking, custody, and relatively lax regulation gave the trusts a potent competitive advantage over both state and federal banks.[47]

45. *Id.*; *1866-1913: The System in Operation*, OFF. OF THE COMPTROLLER OF THE CURRENCY, https://www.occ.treas.gov/about/who-we-are/history/1866-1913/index-occ-history-1866-1913.html (last visited Feb. 25, 2023) [https://perma.cc/786C-UA75] (show "Resurgence of State Banks").

46. GEORGE ERNEST BARNETT, NAT'L MONETARY COMM'N, STATE BANKS AND TRUST COMPANIES SINCE THE PASSAGE OF THE NATIONAL-BANK ACT, S. DOC. NO. 61-659, at 14 (3d Sess. 1911). At the turn of the twentieth century, trust companies were paying two to five percent interest on their deposits while banks were paying none, at least to individual depositors. Alexander D. Noyes, *The Trust Companies: Is There Danger in the System?*, 16 POL. SCI. Q. 248, 255 (1901). Under the contemporary New York law, a trust company could "receive deposits of trust moneys . . . from any person or corporation . . . ." *Id.* at 250. Although this authorization appears narrower than that applying to banks ("receiving deposits"), a catch-all provision was read to allow general deposit taking (a trust company may accept "any and all such trusts and powers . . . as may be conferred upon . . . it by any person"). *Id.* at 252.

47. BARNETT, *supra* note 46, at 18 ("[A]t the present time the trust company, as it appears in the corporation laws of most of the States, may be fairly well defined as a bank which has power to act in the capacity of trustee, administrator, guardian, or executor.").

FIGURE 1: THE FEDERAL FINANCIAL REGULATORY PERIMETER, CIRCA 1864



A familiar cycle followed.[48] Some states resisted the trusts' expansion into providing virtually all banking services, but most states came to endorse it via a mix of favorable court decisions and new laws.[49] Banks responded by seeking the right to offer trust services, and in

48. A somewhat similar cycle emerged during the 1880s and 1890s around building and loan associations, cooperative entities that at their peak served over 11 million customers. David A. Price & John R. Walter, *It's a Wonderful Loan: A Short History of Building and Loan Associations*, FED. RSRV. BANK RICH. ECON. BRIEF, Jan. 2019, at 1. Larger-scale national associations emerged from the more than five thousand local associations, avoiding the interstate banking restrictions that applied to banks. *Id.* at 3–4. These new entrants charged higher fees and lacked robust local loan diligence, but they promised dividend yields "several times those available from banks, local associations, or government bonds." *Id.* at 4. Downturns in 1893 and 1897 would shutter most national associations, though building and loan associations arose again in the 1920s before ebbing again in the 1930s. *Id.* at 4–5.

49. Stutter steps on this issue were common. In Pennsylvania, for example, an 1874 general incorporation statute allowed for title-insurance companies, but not trust companies; an 1881 act gave certain title-insurance companies trust powers but prohibited them from offering banking services; an 1885 act gave such companies the right to accept deposits; an 1895 act gave them the right to issue notes and loans; and a 1900 federal court decision gave them the right to take both demand and time deposits. BARNETT, *supra* note 46, at 17; *see also* State *ex rel.* Crow v. Lincoln Tr. Co., 144 Mo. 562 (1898) (holding that trusts cannot accept interest-free demand deposits but can accept time deposits with nominal interest payable on demand by check).

many cases, they succeeded.[50] Gradually, the two sets of institutions (banks and trusts) began to resemble one another, and regulators began to express alarm about the lighter regulation the trusts received.[51] A mix of half measures followed: including holding company–like structures in California, New Hampshire, and Michigan, which let trusts take deposits but required those deposits to remain separate from other sources of funding.[52] By 1907, trust companies were active money market participants, essential to both overnight securities lending and short-term, cross-border (sterling) trade finance.[53] The trusts controlled roughly as many assets as all national banks combined, without the national banks' reserve requirements, investment restrictions, or (in many cases) clearinghouse membership costs.[54]

On October 16, 1907, a failed takeover of a large copper firm spread insolvency rumors through the New York markets.[55] When those rumors hit the sizable Knickerbocker Trust Company, a run ensued; bank deposits and loans remained steady, but those at the largely unregulated trusts collapsed.[56] Call money interest rates spiked and

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50. *See* BARNETT, *supra* note 46, at 19 (listing examples of state legislation allowing banks to engage in "trust-company powers"). Banks were not the only institutions to do so. *See* STATE OF N.Y. BANKING DEP'T, ANNUAL REPORT OF THE SUPERINTENDENT OF BANKS, at xxxii (1907) ("A like evil exists in the case of certain business corporations such as department stores, which, through a merely technical compliance with law, receive deposits and pay therefor high rates of interest.").

51. BARNETT, *supra* note 46, at 20 ("An injustice would be done were we to deal with all financial institutions in accordance with the names under which they operate rather than with reference to the character of business in which they are actually engaged.").

52. *Id.* at 22. New Jersey passed one of the nation's first holding company laws in 1889, and while its scope was broader than financial services, its development was intimately connected to trust-related issues. *See* Charles M. Yablon, *The Historical Race Competition for Corporate Charters and the Rise and Decline of New Jersey: 1880-1910*, 32 J. CORP. L. 323, 340 (2007) (discussing New Jersey's passage of a broad holding company law drafted by New York trust lawyers in response to trust interest concerns).

53. Jon Moen & Ellis W. Tallman, *The Bank Panic of 1907: The Role of Trust Companies*, 52 J. ECON. HIST. 611, 615–17 (1992); Jon R. Moen & Ellis W. Tallman, *The Panic of 1907*, FED. RSRV. HIST. (Dec. 4, 2015), https://www.federalreservehistory.org/essays/panic-of-1907 [https://perma.cc/RZ9U-JA9M] [hereinafter FED. RSRV. HIST.].

54. Moen & Tallman, *supra* note 53, at 612, 616 (estimating that precrisis capital levels were approximately 4.8 percent at New York trusts, versus 5.8 percent at state banks and 7.5 percent at national banks).

55. FED. RSRV. HIST., *supra* note 53.

56. *Id.* at 611. The run occurred after the Knickerbocker Trust announced that its clearing agent, the National Bank of Commerce—a member of the New York Clearing House—would no longer act on behalf of the Knickerbocker Trust. Carola Frydman, Eric Hilt & Lily Y. Zhou, *Economic Effects of Runs on Early "Shadow Banks": Trust Companies and the Impact of the Panic of 1907*, 123 J. POL. ECON. 902, 909 (2015). Without a clearing agent, the Knickerbocker Trust lacked even indirect access to clearinghouse funding. *Id.* Rumors involving interlocking directorates helped propagate the spread. *See* ROGER LOWENSTEIN, AMERICA'S BANK: THE EPIC STRUGGLE TO CREATE THE FEDERAL RESERVE 62 (2015) (explaining how vulnerable trusts "were linked by a chain of interlocking boards").

stocks plummeted until a backstop for the other failing trusts emerged.[57] The consequences of the panic were dire, sparking a recession that reached far beyond the financial sector into the real economy.[58]

B. Uniting the Perimeter

1. Post-1907 Reforms

The congressional and industry debate that followed the Panic of 1907 focused on reserves, not regulation; on the inability of banks to marshal liquid resources; and on the decreasing probability that J.P. Morgan would live to stem the next crisis, as he did the last.[59] For the first time, however, the public debate was dominated by questions of monopoly power in both banking and commerce, in keeping with the broader reform efforts of the Progressive Era.[60] Hearings in the U.S. House Banking and Currency Committee focused on the near-collusive relationship between large banks in the issuance of railroad securities.[61] These hearings documented interlocking directorates between banks and their clients and proposed a (failed) measure to prohibit such interlocks.[62] Discussions of a potential new reserve system centered on where power could or should be concentrated—in the East or the West, in large banks or small ones, and in government or the banking industry.[63]

The Federal Reserve Act that stemmed from this debate narrowed the regulatory gap between national banks, state banks, and trusts. The Act made Federal Reserve membership—and the requirements that went with it—mandatory only for national banks.[64] All other banks and trust companies could apply for membership if they

57. This backstop was, famously, the personal intervention of J. P. Morgan. *See* FED. RSRV. HIST., *supra* note 53 (describing the "legendary" actions of Morgan and his role in dealing with the crisis).

58. *Id.*

59. For a review of this debate, see generally LOWENSTEIN, *supra* note 56.

60. *See, e.g.*, *id.* at 138 (describing the Aldrich Plan as "a plot to siphon 'the people's money' to monopolies and trusts" and quoting Robert La Follette); *id.* at 143 (quoting Woodrow Wilson, "the greatest monopoly in this country is the money monopoly"); *id.* at 151 (quoting Alfred Owen Crozier, decrying the Aldrich Plan as "a huge private money trust to monopolize and forever control the entire public currency . . . of the United States"). Significant concern also existed about the extent to which this money monopoly determined which enterprises received capital. Vincent P. Carosso, *The Wall Street Money Trust from Pujo Through Medina*, 47 BUS. HIST. REV. 421, 426 (1973).

61. LOWENSTEIN, *supra* note 56, at 175–76.

62. *Id.* at 192, 222, 228.

63. *E.g.*, *id.* at 228–29.

64. V. GILMORE IDEN, THE FEDERAL RESERVE ACT OF 1913, at 48 (1914).

met the same capital, reserve, reporting, liability, and other regulatory requirements as a national bank—including, after the Act's passage, potential supervision by the Board of Governors of the Federal Reserve System ("Board").[65] This offer of Federal Reserve services (and access to emergency lending) as a conditional benefit preserved the dual banking system while applying federal bank regulation to consenting state banks. It also gave the banking industry leverage in the legislative debate.[66] Money-center banks used this leverage to extract concessions on perimeter issues—for example, earning national banks the right to make farm mortgages and open foreign branches and narrowly avoiding a deposit insurance requirement.[67]

Figure 2 depicts the regulatory perimeter shortly after the Federal Reserve Act was passed. Although regulated categories in this diagram are still limited to the "prudential zone," more prudential regulators and more categories have emerged. The OCC has jurisdiction over "national banks," "national currency associations," and "foreign branches" of national banks. The Federal Reserve has jurisdiction over its "member banks." State regulators have jurisdiction over, among other entities defined in federal law, "state banks," "nonmember banks," "state banking associations," and "state trust companies."[68]

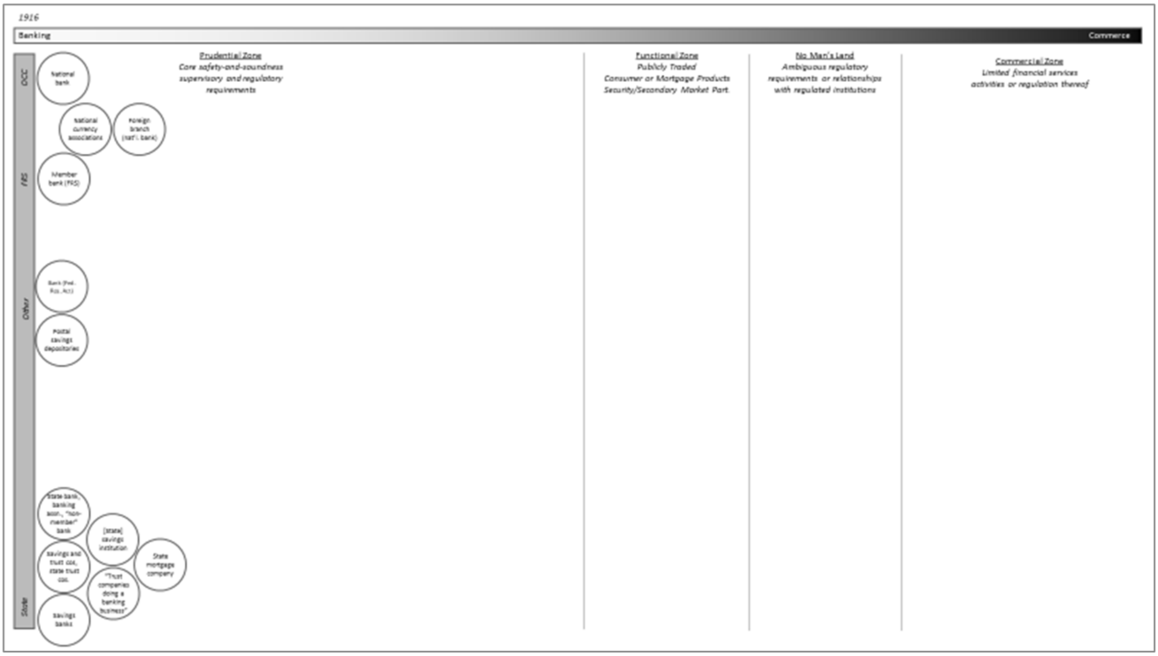
65. *Id.* at 49–51.

66. At one point, the head of National City Bank publicly threatened that, if the Federal Reserve remained under federal (instead of private) control, banks would abandon both the new institution and their old national charters. LOWENSTEIN, *supra* note 56, at 220–21. The threat did not materialize. *Id.*

67. *Id.* at 245, 249; IDEN, *supra* note 64, at 91–92. The Federal Reserve Act also eliminated the competitive advantage trust companies relied on by permitting national banks to engage in trust activities. Federal Reserve Act, Pub. L. No. 63-43, § 11(k), 38 Stat. 251, 262 (1913) (codified as amended at 12 U.S.C. § 92a(a)) (granting the Board discretion to permit national banks to engage in trust activities); *see also* Act of Sept. 28, 1962, Pub. L. No. 87-722, 76 Stat. 668 (1962) (codified as amended at 12 U.S.C. § 92a) (transferring authority to grant permission to the OCC). Attempts by the trust companies to overturn this provision failed, see First Nat'l Bank of Bay City v. Fellows *ex rel* Union Tr. Co., 244 U.S. 416 (1917), and in 1918, Congress authorized national banks to act "in . . . any other fiduciary capacity that state banks or trust companies did in the state where the national bank was located." Eugene N. White, *Banking Innovation in the 1920s: The Growth of National Banks' Financial Services*, 13 BUS. & ECON. HIST. 92, 96 (1984).

68. *See* Tabor, Di Lucido & Zhang, *supra* note 16 (manuscript at 36).

FIGURE 2: THE FEDERAL FINANCIAL REGULATORY PERIMETER, CIRCA 1916



2. The Inter-crisis Period

The state/federal regulatory gap narrowed, but did not close, after the passage of the Federal Reserve Act.[69] Federal war and agricultural finance efforts sparked a dramatic expansion of U.S. capital markets.[70] By the end of World War I, New York sat at the center of a global system of private, cross-border, and increasingly short-term credit.[71] Over the 1920s, this system also came to dominate domestic

69. New gaps also emerged. *See* ELIZABETH F. BROWN, THE VOLCKER ALLIANCE, PRIOR PROPOSALS TO CONSOLIDATE FEDERAL FINANCIAL REGULATORS 14–19 (2015) (discussing how state banks rejected for Federal Reserve membership were accepted when they converted their charters to national bank charters); *see also* McCarthy, *supra* note 17, at 17 (explaining how state banks, not constrained by federal regulations unlike national banks, were able to take greater action in investment banking).

70. *See* Parinitha Sastry, *The Political Origins of Section 13(3) of the Federal Reserve Act*, ECON. POL'Y REV., Sept. 2018, at 7–13 (describing eligibility of Treasury, Treasury-secured member, Farm Loan Bank, War Finance Corporation, Federal Intermediate Credit Bank, and Reconstruction Finance Corporation debt for Federal Reserve Bank discounts).

71. *See* TOBIAS STRAUMANN, 1931: DEBT, CRISIS, AND THE RISE OF HITLER 3–4 (2019) (describing postwar short-term loans to Germany); ADAM TOOZE, THE DELUGE: THE GREAT WAR, AMERICA AND THE REMAKING OF THE GLOBAL ORDER, 1916-1931, at 495–96 (2014) (stating that Wall Street investors had loaned Germany $2 billion after World War I); LIAQUAT AHAMED, LORDS

financing activity, and as more companies tapped capital markets for financing needs, commercial bank loans shrank to a fraction of total business credit.[72] State banks, trust organizations, and commercial finance companies could respond to this shift by underwriting or dealing in securities, a practice that remained largely unregulated; national banks (with some exceptions) could not.[73] To remain competitive—and to avoid other measures, like higher reserve requirements and real estate restrictions[74]—national banks began shedding their charters by merging with state banks, acquiring trust companies, or launching securities affiliates under "holding company" structures.[75] Banks also pushed to loosen activity constraints, finding a receptive audience both in Congress and among other regulators.[76] Finally, in 1927, the McFadden Act (mostly known for easing restrictions on intrastate branching) removed the bar on national banks dealing in "investment securities" altogether.[77]

OF FINANCE: THE BANKERS WHO BROKE THE WORLD 282–84 (2009) ("American bankers, assured under the plan of being repaid first ahead of reparations owed to France and Britain, had fallen over one another in their enthusiasm to lend to Germany.").

72. *See* Lauchlin Currie, *The Decline of the Commercial Loan*, 45 Q.J. ECON. 698 (1931) (discussing different explanations for the decline in the usage of commercial loans, including the expansion of finance companies).

73. Notably, the Federal Reserve did not treat national banks and state member banks equally in this regard. Legislation passed in 1917 provided that a state member bank or trust company "shall retain its full charter and statutory rights as a State bank or trust company, and may continue to exercise all corporate powers granted it by the State in which it was created, and shall be entitled to all privileges of member banks." Raymond P. Kent, *Dual Banking Between the Two World Wars*, *in* BANKING AND MONETARY STUDIES 47 (Deane Carson ed., 1963).

74. These restrictions included a measure barring national banks (but not state member banks) from "lend[ing] to any individual, partnership, or corporation . . . in excess of 10 percent of their capital stock and surplus." *Id.* at 50. The McFadden Act later raised this limit to twenty-five percent with respect to securities transactions and fifteen percent with respect to safe-deposit box subsidiaries. *Id.* at 52.

75. *Id.* at 46 ("According to the 1924 report of the Comptroller, 206 national banks having capital stock of $100,000 or more had converted to or been absorbed by state institutions in the period since January 1, 1918; these banks had taken $2,234 million of assets out of the national banking system."). It is worth noting, however, that many large national banks were more than competitive with their state counterparts during this period and, in fact, remained dominant in international finance. *See* AHAMED, *supra* note 71, at 210 (listing three large national American banks that "had come to dominate the sovereign loan market").

76. As with Citigroup in the 1990s, the Comptroller's rulings on securities dealing reflected practices that national banks had already adopted. Arthur E. Wilmarth, Jr., *Citigroup: A Case Study in Managerial and Regulatory Failures*, 47 IND. L. REV. 69, 72–77 (2013); *see, e.g.*, OFF. COMPTROLLER OF THE CURRENCY, ANNUAL REPORT 12 (1924):

> Section 24 of the Federal reserve act should be further amended to enable a national bank to buy and sell investment securities . . . . This provision would make very little change in existing practice, since a great number of national banks now buy and sell investment securities, and the office of the comptroller has raised no objection because this has become a recognized service which a bank must render.

77. The McFadden Act was only the second amendment to the statutory powers of national banks since the National Bank Act itself. *See* National Bank Act, ch. 106, § 8, 13 Stat. 101 (1864)

For a time, these reforms served their intended purpose; regulatory differences shrank, the exodus from the national system slowed, and some large state member banks converted back to the national charter.[78] By 1929, however, approximately a half-dozen of the largest national banks had again returned to a state charter.[79] The following three years revealed the shortcomings of this arrangement.

In November 1930, the banking subsidiary of Caldwell and Company—a Nashville, Tennessee holding company—marked significant losses from "depreciation in the value of securities" and shut its doors.[80] Caldwell's announcement triggered a cascade of bank runs—not through the Federal Reserve's clearing systems but through parallel correspondent-banking networks, which still connected state-chartered institutions.[81] The result was an inability to access reserves, very similar to what banks experienced in 1907 and the first domestic banking crisis of the Great Depression. When paired with higher leverage, years of accommodative reserve policy, and restrictive discounting policies at Federal Reserve Banks, stress that began

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(codified as amended at 12 U.S.C. § 24); Tabor, Di Lucido & Zhang, *supra* note 16 (manuscript at 31–49). The first was a 1922 change giving national bank charters succession of ninety-nine years, in lieu of twenty, thus removing an impediment to avenues of participation in trust activities. McFadden Act, Pub. L. No. 69-639, § 2, 44 Stat. 1224, 1226 (1927) (codified as amended at 12 U.S.C. § 24); Act of July 1, 1922, Pub. L. No. 67-262, 42 Stat. 767 (codified as amended at 12 U.S.C. § 24); Gary Richardson, Daniel Park, Alejandro Komai & Michael Gou, *McFadden Act of 1927*, FED. RSRV. HIST. (Nov. 22, 2013), https://www.federalreservehistory.org/essays/mcfadden-act [https://perma.cc/5UNY-A77N]. The Act also enumerated a number of "incidental powers . . . necessary to carry on the business of banking," including "discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes" subject to certain limits. § 2(b), 44 Stat. at 1226, 1227 (codified as amended at 12 U.S.C. § 24).

78. Kent, *supra* note 73, at 53–54.

79. *Id.* at 54.

80. Gary Richardson, *The Check Is in the Mail: Correspondent Clearing and the Collapse of the Banking System, 1930 to 1933*, 67 J. ECON. HIST. 643, 659 (2007).

81. *Id.* at 660–65. The Federal Reserve served as an alternative to the private interbank clearing system before the Depression, making the private system more resilient to solvency shocks but less resilient to liquidity shocks. Mark Carlson & David C. Wheelock, *Did the Founding of the Federal Reserve Affect the Vulnerability of the Interbank System to Contagion Risk?*, 50 J. MONEY CREDIT & BANKING 1711, 1711–12 (2018). After the onset of the Depression, the private interbank network became more concentrated in cities with Federal Reserve offices. *See id.* at 1711; Matthew Jaremski & David C. Wheelock, *The Founding of the Federal Reserve, the Great Depression, and the Evolution of the U.S. Interbank Network*, 80 J. ECON. HIST. 69, 72 (2020) (discussing the shift in bank relationships to cities with Federal Reserve offices); *see also* Erik Heitfield, Gary Richardson & Shirley Wang, *Contagion During the Initial Banking Panic of the Great Depression* 1–2, 9–10 (Nat'l Bureau of Econ. Rsch., Working Paper No. 23629, 2017), https://www.nber.org/papers/w23629 [https://perma.cc/J46N-F34E] (demonstrating spatial and interbank contagion in initial banking crisis of the Great Depression, with fewer bank suspensions among more liquid, less highly leveraged banks and in Federal Reserve districts that pursued more accommodative liquidity policy).

outside the regulatory perimeter was fatal to thousands of U.S. banking organizations within it.[82]

C. Expanding the Perimeter

1. The New Deal

The Great Depression prompted efforts to address the regulatory perimeter gaps that made the banking crisis possible. Congress's ultimate approach was to make the federal financial regulatory perimeter both broader and stronger—adding positive rights, particularly in the securities space, while imposing new negative restrictions.

To broaden the perimeter, Congress first took steps to expand nonmember banks' access to Federal Reserve emergency credit—for only one year.[83] Later, the Banking Acts of 1933 and 1935 clarified which firms qualified as holding companies or affiliates of state or national banks and subjected them to a limited set of disclosure, examination, and even some quantitative prudential requirements.[84] Those Acts took a similar approach to the new Federal Deposit

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82. *See* FED. DEPOSIT INS. CORP., THE FIRST FIFTY YEARS 3 (1984) (enumerating more than 9,000 banking failures between 1930 and 1933); Ben S. Bernanke, *Nonmonetary Effects of the Financial Crisis in the Propagation of the Great Depression*, 73 AM. ECON. REV. 257, 259–60, 265–66, 272–73 (1983).

83. This expansion proceeded in several halting stages. Congress first established the Reconstruction Finance Corporation ("RFC") on the express condition that RFC debt would not be eligible for rediscount by Federal Reserve Banks, but allowed Federal Reserve Banks to rediscount member bank loans collateralized by RFC funds. Sastry, *supra* note 70, at 15. The RFC, however, shared its senior leadership and office space with the Board of Governors. Michael Gou, Gary Richardson, Alejandro Komai & Daniel Park, *Reconstruction Finance Corporation Act*, FED. RSRV. HIST. (Nov. 22, 2013), https://www.federalreservehistory.org/essays/reconstruction-finance-corporation [https://perma.cc/LY4X-H938]. Under the new section 13(3) of the Federal Reserve Act, Congress expanded access to "any individual, partnership, or corporation," but only for "real bills," i.e., short-term, "self-liquidating" instruments tied to the conversion of raw materials to finished goods. Sastry, *supra* note 70, at 5, 21. In its implementing regulations, the Board explicitly excluded nonmember banks from the definition of an eligible "corporation." *Id.* at 25. Only after the passage of section 13(13) in the Emergency Banking Act of March 9, 1933—and over the objection of the Board—did nonmember banks and trusts gain access to Federal Reserve Bank "advances," at the discretion of the lending Federal Reserve Bank and subject to a sunset date. *Id.* at 25–26.

84. *See* Banking Act of 1933, Pub. L. No. 73-66, § 2(c), 48 Stat. 162, 163 (1933) (codified as amended at 12 U.S.C. § 221a) (defining "holding company affiliate" as control over majority of shares or directors); *id.* § 5(c) (describing, among other matters, examination and disclosure requirements for affiliates); *id.* § 19 (describing conditions for approval of holding company affiliate application for bank voting share, including holdings and early liquidity requirement); *see also* Mark B. Greenlee, *Historical Review of "Umbrella Supervision" by the Board of Governors of the Federal Reserve System*, 27 REV. BANKING & FIN. L. 407, 410–11 (2008) (outlining voting permit requirements and concurrent bank examination). *But see* Banking Act of 1935, Pub. L. No. 74-305, § 301, 49 Stat. 684, 707 (codified as amended at 12 U.S.C. § 228) (generally exempting one-bank holding companies from voting permit requirements).

Insurance Corporation ("FDIC")—a significant step that Congress contemplated but rejected in 1914—extending eligibility for deposit insurance to virtually all banks, trusts, and "mutual savings banks" (and requiring it of all national banks and member banks) but ensuring that either the FDIC, OCC, or Federal Reserve would supervise every subscriber to the insurance fund.[85] Congress also required the largest state banks to become Federal Reserve members by 1941, and it eased restrictions on intrastate branching and real estate loans to align them more closely with state rules.[86]

To strengthen the perimeter, the New Deal laws (particularly the Glass-Steagall Act) created broad new federal statutory definitions of "banking" and "securities" activities, making it unlawful for new categories of legal entities engaged in one to also engage in the other.[87] Notably, the jurisdiction provided to banking law was defined in formalistic terms, not functional terms—thereby significantly limiting

85. § 8, 48 Stat. at 168; § 101, 49 Stat. at 684. In addition, and over time, most states also required FDIC insurance for state commercial banks "as a condition of receiving a charter, either by statute, regulation, or as a matter of administrative policy or practice." John C. Dugan, Mark E. Plotkin, Keith A. Noreika & Michael Nonaka, *FDIC Insurance and Regulation of U.S. Branches of Foreign Banks*, *in* REGULATION OF FOREIGN BANKS AND AFFILIATES IN THE UNITED STATES 605, 606 n.2 (Randall D. Guynn ed., 8th ed. 2014).

86. Banking Act of 1935, ch. 614, sec. 101, § 12B(y)(1), 49 Stat. at 703.

87. Part of this statutory definition was circular—defining, in essence, a bank as an organization that was legally a bank. The Banking Act of 1933 (including the Glass-Steagall Act) defined "banks" by reference to section 1 of the Federal Reserve Act, which itself defined "bank" as "to include State bank, banking association, and trust company, except where national banks or Federal reserve banks are specifically referred to." Banking Act of 1933, ch. 89, § 2(a), 48 Stat. at 162; Federal Reserve Act, ch. 6, § 1, 38 Stat. 251, 251 (1913). The Banking Act of 1935 defined national banks and national banking associations by reference to their charter, and the National Bank Act of 1863 defined such associations by their purpose for "carrying on the business of banking." *See* Banking Act of 1935, sec. 101, § 12B(c), 49 Stat. at 684–85; National Bank Act of 1863, ch. 58, § 5, 12 Stat. 665, 666. Other contemporary statutes offered a more functional definition. The Banking Act of 1935 defined a state bank as "any bank, banking association, trust company, savings bank, or other banking institution which is engaged in the business of receiving deposits," and it also defined deposits in detail. Banking Act of 1935, sec. 101, § 12B(c)(1), (c)(12)–(14), 49 Stat at 684–85. The Securities Exchange Act of 1934 adopted a slightly different definition, also anchored in charter status, but including firms "a substantial portion of the business of which consists of receiving deposits or exercising fiduciary powers . . . ." Securities Exchange Act of 1934, ch. 404, § 3(a)(6), 48 Stat. 881, 883; *see also* Securities Act of 1933, ch. 38, §§ 2(a)(1), 3(a)(2), 48 Stat. 74, 74, 76.

its reach.[88] In comparison, the jurisdiction provided to securities law was functional, which has led to its long reach.[89]

In addition, the New Deal laws imposed new restrictions on board composition and interaffiliate transactions to prevent firms from circumventing these new definitions and required prior consent from regulators for certain bank acquisitions.[90] These laws created a mandatory deposit-insurance backstop, with governance that included all the federal regulatory agencies and supervisory requirements that applied to all its subscribers.[91] Finally, these laws gave the President near-plenary authority to exercise emergency powers over banking and other financial institutions—state, federal, or unincorporated—if the new prudential safeguards failed.[92]

Figure 3 shows the full effect of these transformative changes to the regulatory perimeter, occurring from 1916 to 1940. Figure 1 (circa 1864) and Figure 2 (circa 1916) show a perimeter limited to the first column—the "prudential zone"—indicating a focus on the safety and soundness of individual institutions. By the start of World War II, the perimeter had expanded into new areas. In the "functional zone," the perimeter now reaches firms engaged in a panoply of securities activities, including issuance and brokerage. The perimeter, however, also reaches a new set of institutions less clearly defined by their charter status or activities, like the affiliates of banks and holding companies. On the vertical axis, the perimeter also reflects the arrival of two new regulatory agencies: the Federal Deposit Insurance Corporation and the Federal Home Loan Bank Board ("FHLBB").

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88. For an explanation of the differences between formal and functional definitions of banking used in financial regulation, see MICHAEL S. BARR, HOWELL E. JACKSON & MARGARET TAHYAR, FINANCIAL REGULATION: LAW AND POLICY 123–25 (2021), noting that functional definitions can track more closely with original policy objectives. Some commentators, like Professor Morgan Ricks, have thus remarked that "failure to specify a functional legal definition of what constitutes a monetary instrument is the *original sin* of banking law, and it is the main source of our current regulatory troubles." MORGAN RICKS, THE MONEY PROBLEM: RETHINKING FINANCIAL REGULATION 237 (2016) (emphasis added).

89. *See* BARR ET AL. , *supra* note 88, at 124 (observing that securities law has expanded to "embrace a wide variety of multi-party investment relationships").

90. *See, e.g.*, Banking Act of 1933, ch. 89, § 8, 48 Stat. 162, 168 (1933) (requiring federal regulators' consent for emergency bank acquisitions); *id.* at § 13, 48 Stat. at 183 (imposing restrictions on member bank transactions with affiliates); *id.* at § 32, 48 Stat. at 194 (prohibiting officer and director interlocks between member banks and securities firms).

91. Specifically, the Banking Act of 1935 seated the Comptroller on the board of the FDIC, required OCC- and Federal Reserve-regulated banks to subscribe to FDIC insurance, required the OCC and the Federal Reserve to share reports of examination with the FDIC, and allowed the FDIC to examine national and member banks only with those other agencies' permission. § 101, 49 Stat. at 684.

92. Emergency Banking Relief Act, ch. 1, sec. 2, § 5(b), 48 Stat. 1, 1–2 (1933).

Together, these measures effectively divided the perimeter into two parts: an inner part of insured banking organizations, with access to emergency lending, and an outer part, dividing securities-based financial activity from commercial endeavors. Compared to 1913, the reforms focused less on the dangers of monopoly than on avarice and the possibility of national ruin.[93] They were also incomplete—for example, extending visibility into banks' nonbank affiliates as a condition of voting permits and other benefits but without creating formal regulatory authority over them.[94] Both points changed in the early postwar period with the increasing popularity of holding companies—new firms (or converted banks) that acquired and controlled banking organizations in multiple states.[95] The principal effect of these large holding company structures was to evade interstate bank-branching restrictions.[96]

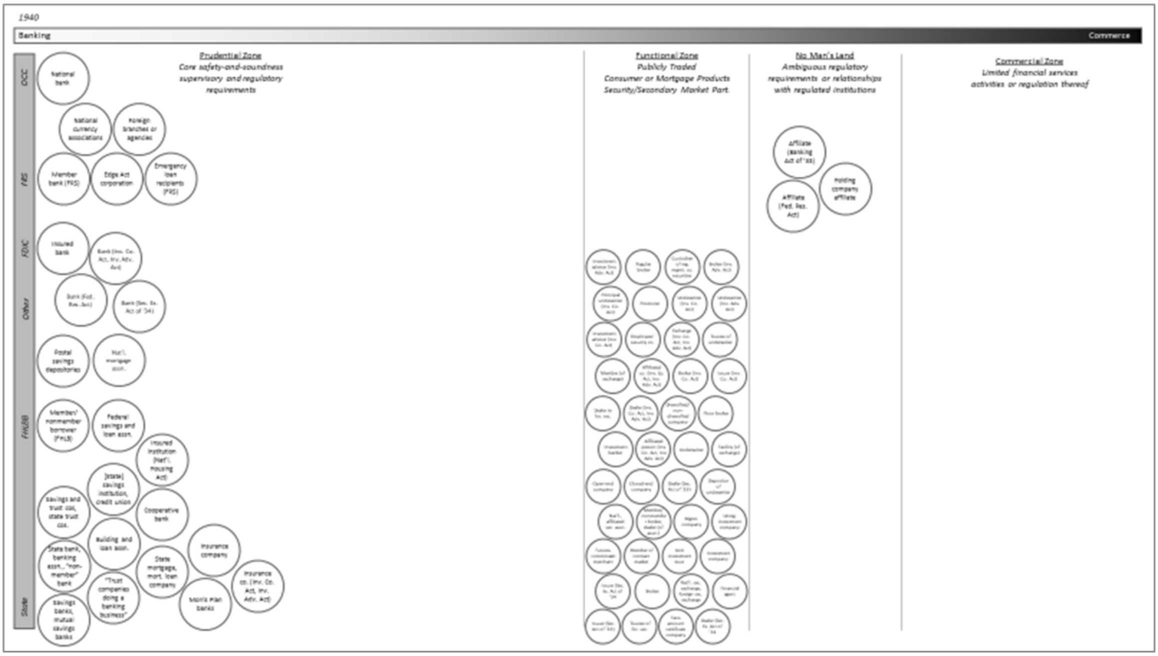
93. *See, e.g.*, President Franklin D. Roosevelt, First Inaugural Address of Franklin D. Roosevelt (Mar. 4, 1933), https://avalon.law.yale.edu/20th_century/froos1.asp [https://perma.cc/8E2D-ZJU2] ("[T]here must be an end to a conduct in banking and in business which too often has given to a sacred trust the likeness of callous and selfish wrongdoing . . . ."). But even early discussions of monopoly issues around bank holding companies focused on the power of banks in credit markets, not on the power of financial firms in commercial markets. More modern debates, like the dominance of conglomerates over commercial activity or the risk of commercial activity to insured banks, did not figure prominently in the early holding company discourse. *See generally Branch, Chain, & Group Banking: Hearings Before the H. Comm. on Banking and Currency*, 71st Cong., 2d Sess., Vol. 1, Part 8, at 787–1012 (1930).

94. Comment, *The Bank Holding Company Act of 1956*, 7 DUKE L.J. 1, 7–8 (1957).

95. Despite the increasing prominence of nonbank/bank relationships, both total deposits and the number of branches controlled by nonbank holding companies declined from 1933 to 1954. *Id.* at 2 n.16. Many of these relationships, however, emerged through loopholes the New Deal legislation created, like exempting nonbanks that did not hold a majority stake or vote its shares in a member bank. Saule T. Omarova & Margaret E. Tahyar, *That Which We Call a Bank: Revisiting the History of Bank Holding Company Regulation in the United States*, 31 REV. BANKING & FIN. L. 113, 121–22 (2011).

96. In addition, as the Board of Governors pointed out in its 1943 report to Congress, firms were using holding company structures to avoid falling within the scope of the Investment Company Act of 1940. *See* BD. GOVS. FED. RSRV. SYS., THIRTIETH ANNUAL REPORT 34–37 (1943), https://fraser.stlouisfed.org/files/docs/publications/arfr/1940s/arfr_1943.pdf?utm_source=direct_download [https://perma.cc/8PMA-GUYF]. *Compare id.*, *with* Bd. Governors Fed. Rsrv. Sys. v. Agnew, 329 U.S. 441, 446–49 (1947) (finding that national bank petitioners were engaged "substantially" and thus "primarily" in the business of securities underwriting and, therefore, were within Federal Reserve jurisdiction under the Banking Act of 1933).

FIGURE 3: THE FEDERAL FINANCIAL REGULATORY PERIMETER, CIRCA 1940



2. The Holding Company Debate

The Board began to voice concerns over this holding company trend in the early 1940s—arguing publicly that the laws of holding company relationships were rigid, formalistic, incomplete, and impotent, as well as a danger to sound banking, fair competition, and the principles of fair play.[97] Soon, however, the focus of the holding company debate narrowed to the Transamerica Corporation, a conglomerate with minority interests in three of the country's largest banks, majority interests in forty-seven others, and other holdings in oil, insurance, real estate, heavy manufacturing, lumber, and frozen vegetable companies.[98] Starting in 1948, the Board pursued a bitter and

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97. Only two lines in the Federal Reserve's three-page argument refer to concerns about broader commercial concentration. *See* BD. GOVS. FED. RSRV. SYS., *supra* note 96, at 36 ("It is axiomatic that the lender and borrower or potential borrower should not be dominated or controlled by the same management."); *id.* at 37 ("Moreover, the [holding company] lends itself readily to the amassing of vast resources obtained largely from the public which can be controlled and used by a few people and which give to them . . . an unfair and overwhelming advantage in . . . carrying out an unlimited program of expansion.").

98. The three banks in question were Bank of America N.T. & S.A, National City Bank of New York, and Citizens National Trust & Savings Bank of Los Angeles. TRANSAMERICA CORP.,

ultimately unsuccessful five-year antitrust action against Transamerica, claiming the firm's actions substantially lessened competition between the banks it acquired and tended to create a monopoly in the banking business.[99]

The Board's loss (and substantial lobbying from small and independent banks), however, sparked congressional action, culminating in the Bank Holding Company Act of 1956.[100] This legislation created a broader, more flexible standard for finding nonbank control of a bank, and it gave the Federal Reserve regulatory and supervisory authority over the new category of "bank holding companies" ("BHCs") that met that standard.[101] It also gave the Board control over BHC acquisitions and approvals, created a blanket prohibition on BHC acquisition of voting shares in "any company which is not a bank," and established a two-year sunset period for BHC ownership or control of firms engaged in "any business other than that of banking."[102]

ANNUAL REPORT 6, 14, 18 (1948), https://fraser.stlouisfed.org/files/docs/historical/eccles/019_06_0001.pdf?utm_source=direct_download [https://perma.cc/W2P9-WYUT]. Together, these financial holdings were worth more than $93 million and represented more than sixty percent of Transamerica's assets. *Id.*

99. Broader discussion of the Transamerica case included three separate arguments: the claim that large interstate banks would tend toward monopoly within banking; the claim that banks would favor their commercial affiliates over other firms in the same industry; and the claim that effective consolidated supervision of a financial conglomerate is impossible. *See, e.g.*, Note, *Transamerica—The Bank Holding Company Problem*, 1 STAN. L. REV. 658, 660–69 (1949). The general focus on monopoly concerns is also visible in the Bank Merger Act, Pub. L. No. 86-463, 74 Stat. 129 (1960), which required approval from the federal financial regulatory agencies for any merger of insured depositories, and which harmonized the review standards of those agencies with the Department of Justice. The contentious Transamerica proceedings also included an unsuccessful motion to disqualify Marriner Eccles for using "his position of public trust and power to promote further his selfish personal interests" and advance a personal "grudge" against the firms' executives. Motion to Disqualify Marriner S. Eccles & Lawrence Clayton at ¶ 3, In re Transamerica Corp. (1948), https://fraser.stlouisfed.org/archival/1343/item/461356 [https://perma.cc/837L-JXDR]. In those proceedings, the circuit court also grappled with banking separation—claiming that "more than 100 years ago the Supreme Court had held that banking was not commerce"—but did so via an apparent misreading of dicta in an 1850 case to which no bank was a party. *See* Transamerica Corp. v. Bd. of Govs. of Fed. Rsrv. Sys., 206 F.2d 163, 166 (3d Cir. 1953) (citing Nathan v. Louisiana, 49 U.S. 73 (1850)).

100. Omarova & Tahyar, *supra* note 95, at 121–22.

101. Specifically, a bank holding company under the Act "(1) directly or indirectly owns, controls, or holds with power to vote" at least twenty-five percent of the voting shares to two or more banks (or bank holding companies), (2) controls "in any manner" the election of the majority of directors of such banks, or (3) has at least twenty-five percent of the shares of such banks voted for its shareholders' benefit by a trustee. Bank Holding Company Act of 1956, ch. 240, § 2(a), 70 Stat. 133, 133.

102. Specifically, the Act required prior Board approval for a company to become a bank holding company, for a company to own or control more than five percent of a bank's voting shares, or for two or more bank holding companies to merge. *Id.* §§ 3(a)–(c), 4(a). The factors for gaining that approval were broad, including the companies' "prospects," the "character of their

The BHC Act expanded the regulatory perimeter but also introduced significant gaps to it. One gap, an exemption for nonbank trust companies, was closed by amendment a decade later.[103] Two other gaps proved more durable and consequential. First, the Act excluded companies that owned or controlled just one bank from the definition of a BHC.[104] Second, the Act defined a "bank" only by its charter status, including national and state banks, uncapitalized savings banks, and trust companies.[105] Congress narrowed this scope further in 1966 by shifting to a functional approach—defining a bank as a firm that accepts demand deposits—while allowing single-bank holding companies to vote their shares in a subsidiary bank without prior approval from the Board.[106]

Put together, these loopholes created a powerful incentive to form a specific type of holding company: one with a single bank and a number of other nonbank affiliates.[107] Banks and commentators attributed the resulting growth in such BHCs to increased competition from nonbanks, which used new technology to offer higher-yield products and a wider range of financial services.[108] Whatever the reason, the rush into these "congeneric" structures was swift. One-bank

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management," and the "convenience, needs, and welfare of the communities and the area concerned." *Id.*

103. Act of July 1, 1966, Pub. L. No. 89-485, sec. 2, § 2(b), 80 Stat. 236, 236. This exemption was targeted mainly at the DuPont Trust, which owned more than thirty Florida banks and nonbank businesses. *See* Omarova & Tahyar, *supra* note 95, at 139–40. The elimination of the exemption, during a contentious strike at one of its railways, was targeted at DuPont as well. *Id.*

104. § 2(a), 70 Stat. at 133.

105. *Id.* § 2(c). The same was true of the Act's definition of a BHC "subsidiary," which lacked the expansive "directly or indirectly" and "holds with power" language of the Act's definition of a BHC. *Id.* § 2(a), (d).

106. § 2(c), 80 Stat. at 236 (" 'Bank' means any institution that accepts deposits that the depositor has a legal right to withdraw on demand.").

107. Avoiding registration as a BHC required a company to derive at least forty percent of adjusted gross income from sources other than bank dividends, a bar most commonly met by insurance holdings. *See* Omarova & Tahyar, *supra* note 95, at 145 n.126 (citing *One-Bank Holding Company Legislation of 1970: Hearing on S. 1052, S. 1211, S. 1664, S. 3823, and H.R. 6778 Before the S. Comm. on Banking and Currency*, 91st Cong. 461 (1970)); *see also* Franklin R. Edwards, *The One-Bank Holding Company Conglomerate*, 22 VAND. L. REV. 1275, 1278 (1969).

108. Omarova & Tahyar, *supra* note 95, at 143 (citing Carl A. Sax & Marcus H. Sloan III, *The Bank Holding Company Amendments of 1970*, 39 GEO. WASH. L. REV. 1200 (1970)); *see also* Edwards, *supra* note 107, at 1282 (describing the role of credit cards, higher-yield savings deposits, and the regulatory bar on paying interest on demand accounts, as well as other factors); *Recent Changes in the Structure of Commercial Banking*, 56 FED. RSRV. BULL. 195, 200 (1970) [hereinafter *Recent Changes*]:

> One-bank holding companies may legally enter almost any industry in any geographic area. Large banks have thus been motivated to form such companies in order to enter product and geographic markets that they had formerly been barred or discouraged from entering by either law or regulation. Some observers have viewed the recent movement as a response to competitive pressures and to customer demands for a wider variety of services.

holding companies multiplied from 117 in 1955, to 550 in 1965, to 800 in 1968.[109] Thirty-four of the one hundred largest U.S. banks formed or announced plans to form one-bank holding companies in the two years after the 1966 BHC Amendments passed, including Bank of America, Chase Manhattan, First National City, Continental Illinois, Wells Fargo, and Morgan Guaranty Trust.[110] From 1965 to 1968, bank deposits under one-bank holding company control increased from $15.1 billion to $108.2 billion, accounting for a quarter of all deposits.[111]

Independent banks sought refuge from this trend in the Comptroller's office.[112] Directly and through subsidiaries, national banks competed with the congenerics by expanding their activities into life insurance, travel services, data processing, armored cars, credit reporting, warehousing, and a range of other pursuits.[113] Then-Comptroller James Saxon sanctioned this expansion under the "incidental powers" clause of the National Bank Act.[114] After the courts declined to endorse Saxon's interpretation of this clause, attention turned to Congress and to another round of BHC Act amendments.[115]

The 1970 Amendments followed the broad model of the 1966 bill: expanding the scope of BHC designation authority while narrowing the scope of the term "bank."[116] The Federal Reserve could now designate a firm as a BHC if the Board found direct or indirect exercise of a "controlling influence over the management and policies of a bank," regardless of ownership or control of the bank's voting shares.[117] The Board could also define the nonbanking activities that BHCs could undertake, so long as those activities were still "closely related" to banking and would produce a net public benefit.[118] To qualify as a bank

109. Edwards, *supra* note 107, at 1275 (citing H. COMM. ON BANKING & CURRENCY, 91ST CONG., THE GROWTH OF UNREGISTERED BANK HOLDING COMPANIES: PROBLEMS AND PROSPECTS 1 (Comm. Print 1969)).

110. H. COMM. ON BANKING & CURRENCY, 91ST CONG., THE GROWTH OF UNREGISTERED BANK HOLDING COMPANIES: PROBLEMS AND PROSPECTS 6 (Comm. Print 1969).

111. *Id.* at 1. Branch banking—with "chain banking," an alternative to holding company–driven expansion—also increased in this period, but less sharply, by roughly a fifth from 1961 to 1969. *See Recent Changes*, *supra* note 108, at 198.

112. Other legislative efforts came at the state level. Edwards, *supra* note 107, at 1286.

113. *Id.* at 1279.

114. Saxon's definition of banking, in congressional correspondence, was similarly broad. *See* Edwards, *supra* note 107, at 1279 (citing Letter from James M. Saxon, Comptroller of the Currency, to Edward J. Gurney, U.S. House of Reps. (Oct. 26, 1964) (on file with authors)).

115. *See id.* at 1280–81.

116. *See* Omarova & Tahyar, *supra* note 95, at 146–48.

117. Bank Holding Company Act Amendments of 1970, Pub. L. No. 91-607, sec. 101(a), § 2(a)(2), 84 Stat. 1760, 1761.

118. This provision—which the Board supported, and which replaced a "laundry-list" approach in House legislation—was intended to be broader than the "business of banking" language in the BHC Act itself, which the Board had interpreted as limiting a BHC's permissible holdings to

under the BHC Act, however, an institution now had to fit an even narrower definition—it needed to both accept demand deposits and make commercial loans.[119]

II. THE MODERN REGULATORY PERIMETER

The U.S. regulatory perimeter experienced new pressures with the rise of financial innovations in the mid-twentieth century. The historical analysis in Part II examines the changes that occurred to the perimeter in the 1980s, through the deregulatory era of the 1990s and 2000s, and since the 2008 Global Financial Crisis.

A. Revising the Perimeter

1. Nonbank Banks

The consequences of the 1970 Bank Holding Company Amendments took a decade to become clear, thanks to generous legacy provisions and an accommodative regulatory stance toward BHC activities.[120] In the 1980s, however, rising interest rates created sharp pressure on both sides of the regulatory perimeter. Banks and BHCs, still subject to interest rate caps, sought other nondeposit sources of revenue; thrifts and other nonbank financial firms, recently relieved of such restrictions, competed aggressively for both commercial and consumer clients; and commercial firms sought cheaper sources of

affiliates that supported the activities of the bank itself. *See id.* sec. 103(4), § 4(c)(8), 84 Stat. at 1764; Alfred Hayes, President, Fed. Rsrv. Bank of N.Y., The 1970 Amendments to the Bank Holding Company Act: Opportunities to Diversify, Remarks Before the 43rd Annual Mid-Winter Meeting of the New York State Bankers Association (Jan. 25, 1971), *in* 53 FED. RSRV. MONTHLY REV. 23, 24 (1971), https://www.newyorkfed.org/medialibrary/media/research/monthly_review/1971_pdf/02_1_71.pdf [https://perma.cc/ATY9-HL72].

119. Bank Holding Company Act Amendments of 1970, sec. 101(c), § 2(c), 84 Stat. at 1762 (defining a bank as a U.S. 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"). Fatefully, the Act introduced a new statutory definition of "thrift institution," covering not just the mutual savings banks and cooperatives (with no capital stock) exempted from earlier iterations of the BHC Act but also "domestic building and loan or savings and loan associations." *Id.* sec. 101(e), § 2(i), 84 Stat. at 1763.

120. The grandfather clause allowed any activities lawfully conducted by a BHC as of June 30, 1968 to continue for a decade. Sec. 103(1), § 4(a)(2), 84 Stat. at 1764; Omarova & Tahyar, *supra* note 95, at 151 (citing Arthur E. Wilmarth, Jr., *Wal-Mart and the Separation of Banking and Commerce*, 39 CONN. L. REV. 1539, 1569 (2007)). The lone exception to the relative stability of the 1970s perimeter was the International Banking Act, which brought foreign banking organizations under Federal Reserve supervision and allowed them to secure national charters and deposit insurance. *See* Frank Anthony Misuraca, *Foreign Banking in the United States: An Objective Study of the International Banking Act of 1978*, 4 J. INT'L L. & PRAC. 539, 541–43 (1995).

financing without triggering federal regulation.[121] The 1970 amendments created a common way to meet all of these goals: the use of so-called "nonbank banks," which either accepted demand deposits or made commercial loans—or (technically, at least) did neither.[122]

The first major attempts to use this loophole came from outside the regulatory perimeter.[123] In August 1980, the OCC allowed the Gulf and Western Corporation, a Fortune 500 firm with offerings from auto parts and sugar to oil and gas, to acquire Fidelity National Bank, which had recently divested itself from commercial loans and promised to make no others.[124] By March 1981, the Board ruled that Fidelity was not a bank and that Gulf and Western was not a bank holding company; two years later, a similar pattern followed when the OCC and the Board conditionally allowed a New York BHC to take demand deposits and make commercial loans via its Florida trust company.[125] A wave of applications from both BHCs and other holding companies followed—most focused on card, consumer lending, and money market services—and the ranks and size of nonbank banks increased sharply.[126] Congress also pared back the activity restrictions these institutions faced, both

121. The Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132, established a six-year process for the phaseout of interest rate caps (under the auspices of a U.S. Treasury–led "Deregulatory Committee"). It also standardized reserve requirements for both member and nonmember banks. Omarova & Tahyar, *supra* note 95, at 151–52; *see also* Kenneth J. Robinson, *Savings and Loan Crisis*, FED. RSRV. HIST. (Nov. 22, 2013), https://www.federalreservehistory.org/essays/savings-and-loan-crisis [https://perma.cc/SH43-MQ8X]; Paul R. Allen & William T. Wilhelm, *The Impact of the 1980 Depository Institutions Deregulation and Monetary Control Act on Market Value and Risk: Evidence from the Capital Markets*, 20 J. MONEY CREDIT & BANKING 364, 366–67 (1988).

122. U.S. GOV'T ACCOUNTABILITY OFF., GAO-86-46FS, FINANCIAL SERVICES: INFORMATION ON NONBANK BANKS 3 (1986), https://www.gao.gov/assets/ggd-86-46fs.pdf [https://perma.cc/H4X6-ACNU] [hereinafter GAO, FINANCIAL SERVICES].

123. *But see* Joe Mahon, *Financial Services Modernization Act of 1999, Commonly Called Gramm-Leach-Bliley*, FED. RSRV. HIST. (Nov. 22, 2013), https://www.federalreservehistory.org/essays/gramm-leach-bliley-act [https://perma.cc/2R9C-8MEW] (detailing Board approvals of "Sec. 20 subsidiaries" beginning in 1987).

124. The approval came shortly after Gulf and Western's then-CEO Charles Bluhdorn settled charges of accounting fraud with the SEC. GAO, FINANCIAL SERVICES, *supra* note 122, at 3–4; William G. Blair, *Charles G. Bluhdorn, The Head of Gulf and Western, Dies at 56*, N.Y. TIMES (Feb. 20, 1983), https://www.nytimes.com/1983/02/20/obituaries/charles-g-bluhdorn-the-head-of-gulf-and-western-dies-at-56.html [https://perma.cc/MAJ9-GHXA].

125. GAO, FINANCIAL SERVICES, *supra* note 122, at 4–5.

126. Before April 1, 1984, only 53 such applications had been filed with the OCC; from April 1, 1984 to May 20, 1985, 388 were filed. *Id.* at 5. By 1987, 200 applications had been granted, and another 200 were pending. Omarova & Tahyar, *supra* note 95, at 152. The fastest growing of these was Greenwood Trust Company of Delaware, affiliated with Sears, which increased its deposits from $27 million to $1.05 billion in less than a year. *Id.* at 152 n.147 (citing ROBERT E. LITAN, WHAT SHOULD BANKS DO? 49 (1987)). Among thrifts specifically, assets grew 56 percent from 1982 to 1985. Robinson, *supra* note 121.

by easing federal regulatory requirements and by preempting state ones.[127]

The Board, as well as a growing number of small banks, began working to close these loopholes on competitive, prudential, and economic development grounds.[128] In January 1984, the Board reinterpreted the relevant terms in the BHC Act, defining a demand deposit as a deposit that "as a matter of practice is payable on demand" and a commercial loan as including a number of common "commercial loan substitutes."[129] As in the 1960s, litigation, public debate,[130] circumvention by the Comptroller's office,[131] and defeat at the Supreme Court followed.[132] Congress responded by passing the Competitive Equality Banking Act ("CEBA") of 1987, placing all FDIC-insured institutions under the BHC Act's definition of a "bank" but formally excluding a range of institutions, including every nonbank bank that

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127. These measures allowed the use of checking-like nondemand deposit accounts (such as NOW, Super NOW, and money market deposit accounts), lifted certain limits on thrift activities, and relaxed bank single-counterparty credit limits. *See* F. JEAN WELLS, CONG. RSCH. SERV., REP. NO. 82-177 E, PUB. L. NO. 97-320, GARN-ST. GERMAIN DEPOSITORY INSTITUTIONS ACT OF 1982: A BRIEF EXPLANATION 6–7 (1983), https://www.everycrsreport.com/files/19821101_82-177E_c1001abbf79653976a45bc9bd0fc46e8e128c52b.pdf [https://perma.cc/6R2H-5TT3] [hereinafter WELLS, GARN-ST. GERMAIN]. Effective capital requirements at thrift institutions, in particular, fell sharply from 1980 to 1982. *See* NAT'L COMM. ON FIN. INST. REFORM, RECOVERY & ENF'T, ORIGINS AND CAUSES OF THE S&L DEBACLE: A BLUEPRINT FOR REFORM: A REPORT TO THE PRESIDENT AND CONGRESS OF THE UNITED STATES 35–36 (1993), https://heinonline.org/HOL/P?h=hein.tera/ocsldeb0001&i=47 [https://perma.cc/Y8CP-49EJ]. Policymakers justified these measures by citing increased competition among banks, changing technology, and high interest rate pressures on thrift institutions. *See id;* WELLS, GARN-ST. GERMAIN, *supra*.

128. GAO, FINANCIAL SERVICES, *supra* note 122, at 5.

129. Bd. of Governors v. Dimension Fin., 474 U.S. 361, 364, 367–69 (1986) (citing 49 Fed. Reg. 794, 835–36 (1984)).

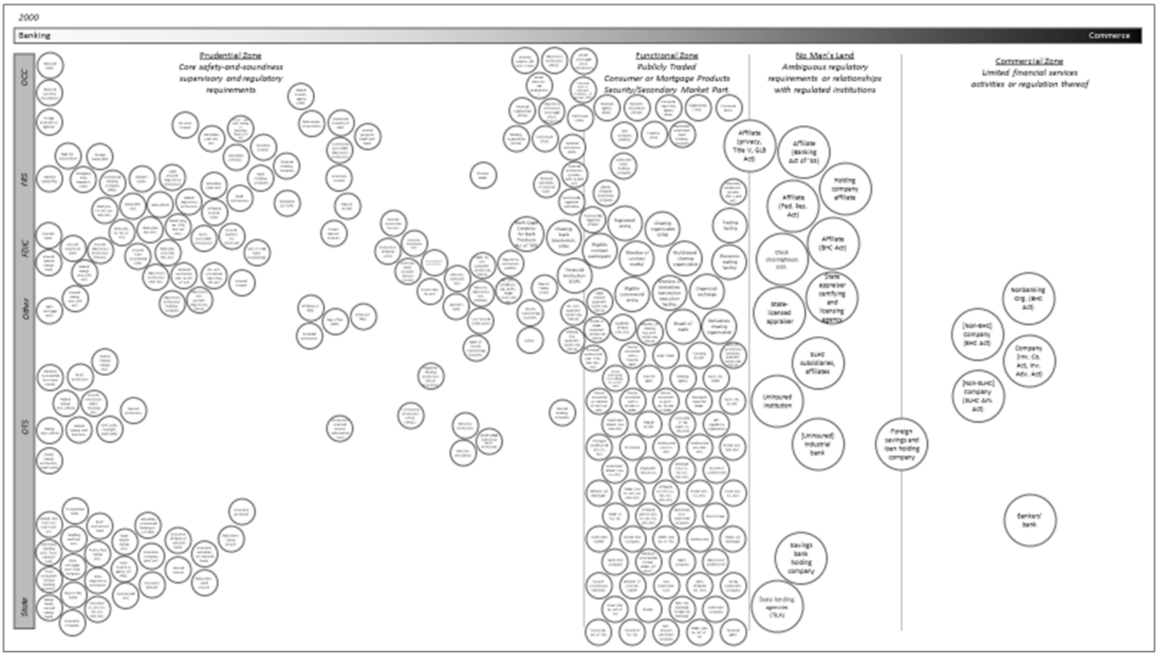
130. *See, e.g.*, FED. RSRV. BANK OF MINNEAPOLIS, ANNUAL REPORT 1982: ARE BANKS SPECIAL? (1982), https://fraser.stlouisfed.org/files/docs/historical/frbminn/1982_frb_minneapolis.pdf?utm_source=direct_download [https://perma.cc/682W-KARR]; *Board of Governors v. Dimension Financial*, OYEZ, https://www.oyez.org/cases/1985/84-1274 (last visited Jan 28, 2023) [https://perma.cc/A2GR-RTLQ] (featuring the oral argument of Michael Bradfield, for petitioner, who argued that the 1970 amendments' definition of banking included a "combination" of commercial lending with the production of "instruments that are money"); LITAN, *supra* note 126.

131. The OCC introduced a limited moratorium on the chartering of *new* nonbank banks in April 1983, four months before approving the Florida application (from U.S. Trust Corporation) referenced above. GAO, FINANCIAL SERVICES, *supra* note 122, at 7. The Board finalized its revision to Regulation Y in January 1984. *See supra* note 129 and accompanying text. In October, the Comptroller said he could wait no longer for congressional action and ended the moratorium. GAO, FINANCIAL SERVICES, *supra* note 122, at 5–7.

132. The Court struck down the new "demand deposit" definition on "step zero" *Chevron* grounds. *See Dimension*, 474 U.S. at 368, 374; Cass R. Sunstein, Chevron *Step Zero*, 92 VA. L. REV. 187 (2006). In striking down the commercial loan definition, however, it held that a commercial loan must "entail the face-to-face negotiation of credit between borrower and lender"; any "extensions of credit in the open market that do not involve close borrower-lender relationships" are not commercial loans. *Dimension*, 474 U.S. at 369–70.

existed when the Act passed.[133] The result was to sanction the prior financial regulatory regime, rather than fundamentally reform it, just as a wave of thrift institution failures began to crest.[134] Figure 4 depicts the scope of the federal financial regulatory perimeter including the 1970 Amendment, CEBA, and the relevant loopholes.

FIGURE 4: THE FEDERAL FINANCIAL REGULATORY PERIMETER, CIRCA 2000



2. The Rise of the Categorization Approach

Unlike in previous crises, reforms passed after the savings and loan ("S&L") crisis focused less on the conduct of financial institutions than the conduct of regulators.[135] Nevertheless, the late 1980s and early

133. Omarova & Tahyar, *supra* note 95, at 157; Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, § 101, 101 Stat. 552, 554–64.

134. Robinson, *supra* note 121 (discussing the "thrift industry meltdown").

135. These include the new standards for setting and enforcing thrift accounting and capital requirements, changes to financial institution supervisory ratings, and the Prompt Corrective Action framework. For example, the FDIC Improvement Act of 1991, Pub. L. No. 102-242, § 142(b), 105 Stat. 2236, 2279–81, made the Federal Reserve liable to the FDIC for certain excess losses on discount window lending to critically undercapitalized institutions. This approach also sharply increased the salience of quantitative capital and liquidity requirements in federal prudential regulation. *See* Anthony C. Providenti Jr., *Playing with FIRREA, Not Getting Burned: Statutory*

1990s saw several perimeter changes beyond those in CEBA. The Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA") restored thrift activity restrictions, created a consolidated regulator for state and federal thrifts, and moved thrift deposit insurance (and the power to issue enforcement actions) to the FDIC.[136] It created a new enforcement regime for persons "who participate in the conduct of the affairs" of a financial institution (i.e., institution-affiliated persons), including consultants, independent contractors, attorneys, and others prescribed by regulation.[137] The FDIC Improvement Act of 1991 guaranteed the deposit insurer a veto over any financial institution seeking insurance, including all national banks and member banks.[138] It also narrowed the gap between insured state and national banks, by prohibiting the former from engaging in activities and investments not permissible for the latter.[139]

Many regulatory measures in the 1990s, however, served to push the perimeter outwards and to make it more porous; they increased the permissible activities of banks and other regulated financial institutions while restricting federal oversight of those same activities.[140] In 1994, citing the benefits of diversification after a series of regional economic downturns, Congress lifted most restrictions on

Overview of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, 59 FORDHAM L. REV. S323, S326, S330 (1991); George J. Benston & George G. Kaufman, *FDICIA After Five Years*, 11 J. ECON. PERSPS. 139, 144 (1997) ("Congress instead sought to stiffen the backbone and reduce the discretion of regulators through a policy that became known as 'structured early intervention and resolution,' or SEIR. . . . SEIR appealed to both Congress and the administration in the early 1990s as a politically feasible, quickly implementable and effective solution.").

136. Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183 [hereinafter "FIRREA"]. The Act also increased some oversight of foreign bank offices in the United States, and it took steps to increase coverage of state banks under federal deposit insurance, without requiring such coverage. *See id.* § 204(c)(1)-(5), 103 Stat. at 191; Providenti, *supra* note 135, at S336–S337. A predecessor study from the U.S. Treasury recommended more sweeping changes, including a much broader range of permissible affiliate activities for both well-capitalized banks and "financial services holding companies," which Congress declined to pass. *See* Michael P. Malloy, *Double, Double Toil and Trouble: Bank Regulatory Policy at Mid-Decade*, 63 FORDHAM L. REV. 2031, 2047–51 (1995).

137. FIRREA, §§ 204(f)(6), 901, 103 Stat. at 193, 446–50.

138. Federal Deposit Insurance Corporation Improvement Act of 1991, Pub. L. No. 102-242, § 115, 105 Stat. 2236, 2249 [hereinafter "FDICIA"]; *see* FDIC, *The Banking Crises of the 1980s and Early 1990s: Summary and Implications*, *in* 1 HISTORY OF THE 90S: AN EXAMINATION OF THE BANKING CRISES OF THE 1980S AND EARLY 1990S 12 (1997).

139. FDICIA, Pub. L. No. 102-242, § 303, 105 Stat. at 2349; *see also* Activities of Insured State Banks and Insured Savings Associations, 63 Fed. Reg. 66276, 66315 (Dec. 1, 1998).

140. This paragraph does not address significant rollbacks in the scope of consumer protection statutes and derivatives oversight. *See* FIN. CRISIS INQUIRY COMM., THE FINANCIAL CRISIS INQUIRY REPORT: FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES 45–48, 76–78 (2011), https://www.govinfo.gov/content/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf [https://perma.cc/EXH8-ECC5].

interstate branching and bank mergers.[141] At the same time, it eased "operational and managerial" requirements on certain bank holding companies, and it significantly increased banks' ability to acquire nonbank companies, use interlocking managers or directors, engage in new nonbank activities, and outsource bank services to nonbank third parties, even over regulators' objections.[142] Meanwhile, the OCC extended banks' ability to offer insurance, annuities, and index fund–like products.[143] It also pushed for the end of structural requirements and activity restrictions that "depriv[ed] individual institutions of the freedom to choose how to provide financial services."[144] In Figure 4, for the first time, regulated entities span these zones, reflecting the

141. *See* Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, Pub. L. No. 103-328, 108 Stat. 2338. The Act's main perimeter-relevant change was to foreign bank regulation, allowing the Board and FDIC to condition approval of a foreign banking organization ("FBO") branch or agency application on the FBO carrying out all U.S. banking activities in a "domestic banking subsidiary." *Id.* § 104(a), 108 Stat. at 2355–56.

142. With regard to outsourcing, the Riegle Community Development and Regulatory Improvement Act of 1994 amended the Bank Service Company (*née* Corporation) Act, Pub. L. No. 87-856, § 5, 76 Stat. 1132, 1133 (1962) (as amended by the Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, § 709, 96 Stat. 1469, 1540–44) to require notice to its primary federal regulator of an insured bank investment in a bank service corporation, rather than prior approval from such regulator. Pub. L. No. 103-325, §§ 318(c), 323, 108 Stat. 2160, 2224, 2227 (1994) (excluding holding companies from safety and soundness standards). For other provisions, see Economic Growth and Regulatory Paperwork Reduction Act of 1995, Pub. L. No. 104-208, §§ 2208, 2210, 2612, 110 Stat. 3009, 3406–10, 3476 (1996). The Board also gained substantial discretion to approve foreign bank branches within the United States. *Id.* § 2214, 110 Stat. at 3411–13.

143. Several of these extensions rested on a 1916 provision (originally 12 U.S.C. § 92), thought to have been repealed in 1918, that allowed any national bank located and doing business in a place with a population of 5,000 or less to act as an agent for any insurance company. U.S. Nat'l Bank of Ohio v. Indep. Ins. Agents of Am., 508 U.S. 439, 439 (1993). In a 1993 decision, the Supreme Court held that section 92 remained in effect and that it did not constrain where such a bank could offer or perform such agency services. *Id.* at 439–40, 463; *see also* Barnett Bank of Marion Cnty. v. Nelson, 517 U.S. 25 (1996) (holding that section 92 preempts Florida insurance law); Nationsbank of N.C. v. Variable Annuity Life Ins. Co., 513 U.S. 251 (1995) (upholding OCC determination that sale of fixed, variable, and hybrid annuities is incidental necessary power to business of banking authorized under 12 U.S.C. § 24); Inv. Co. Inst. v. Ludwig, 884 F. Supp. 4 (1995) (upholding OCC finding of stock index futures within scope of 12 U.S.C. § 24). Other cases also established near-exclusive OCC authority over national bank conduct, even as to state laws. *See, e.g.*, First Union Nat'l Bank v. Burke, 48 F. Supp. 2d 132 (1999). Separately, the Court upheld looser restrictions on credit union eligibility. *See* Nat'l Credit Union Admin. v. First Nat'l Bank & Tr. Co., 522 U.S. 479 (1998).

144. Reasons cited include changing consumer preferences in "an age of rapidly changing communications and computer technology," overall efficiency, a lack of evidence of a bank funding advantage over other financial services firms, and "the needs of consumers, poor people, and small businesses." Press Release, Eugene A. Ludwig, Comptroller of the Currency, Off. of the Comptroller of the Currency, Statement Before the Subcommittee on Capital Markets, Securities and Government Sponsored Enterprises Committee on Banking and Financial Services U.S. House of Representatives (Mar. 5, 1997), https://www.occ.gov/news-issuances/news-releases/1997/nr-occ-1997-21.html [https://perma.cc/2LLV-H8RH]. The OCC also introduced a special-purpose charter program, on which it would later elaborate. *See* Rules, Policies, and Procedures for Corporate Activities, 61 Fed. Reg. 60342 (Nov. 27, 1996).

creation of categories and regimes affecting both prudentially and functionally regulated institutions.

The apex of this trend was the Gramm-Leach-Bliley Act.[145] The legislation repealed the required separation of securities and banking activities that had been in place since the Depression.[146] In part, this action paved the way for a simpler system of broad, segmented, and Board-supervised "financial holding companies" ("FHCs")—whose nonbank affiliates could undertake almost any activity "financial in nature," but whose banking subsidiaries were limited to more traditional functions.[147] The Act, however, also ratified recent expansions in agency and judicial interpretations of the "business of banking"; gave the OCC and FDIC expanded powers to limit or approve bank activities, while restricting the Board's supervision of BHC and FHC subsidiaries; and created new regulatory categories that narrowly prescribed oversight of certain financial products.[148] It also expanded the scope of permissible activities that national banks themselves could undertake via "financial subsidiaries."[149] The resulting legislation not only sanctioned several elements of then current industry practice but

145. Gramm-Leach-Bliley Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999). This paragraph omits a concurrent debate over derivatives regulation, beginning with a 1997 SEC proposal to create a new status of "OTC derivatives dealer" subject to a form of limited broker-dealer regulations. OTC Derivatives Dealers, 62 Fed. Reg. 67940 (Dec. 30, 1997). The CFTC responded with a "concept release" considering whether OTC derivatives were covered under the Commodity Exchange Act. Over-the-Counter Derivatives, 63 Fed. Reg. 26114 (May 12, 1998). Congress enjoined and eventually overruled this possibility in the Commodity Futures Modernization Act of 2000, Pub. L. No. 106-554, 114 Stat. 2763.

146. § 101, 113 Stat. at 1341–42.

147. The Act permits firms to engage in any activity that is "financial in nature or incidental to such activity; or is complementary to a financial activity and does not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally," as defined in regulation. *Id.* § 103, 113 Stat. at 1342–51. Merchant banking activities were, for a time, excluded. *Id.* § 122, 113 Stat. at 1381. The Act also includes a long and expansive list of such activities, including "[l]ending, exchanging, transferring, investing for others, or safeguarding money or securities," providing advisory services, making a market in securities, and generally doing anything "usual" in connection with the activities of BHCs anywhere abroad. *Id.* § 103, 113 Stat. at 1342–51. The Board had authority to determine the scope of such activities for FHCs, subject to a veto by the Secretary of the Treasury. *Id.* In determining the scope of such activities for national banks, however, the roles were reversed, with the Secretary of the Treasury making the determination subject to a Board veto. *Id.* § 121, 113 Stat. at 1375–81.

148. *See, e.g.*, *id.* §§ 104, 113–15, 121, 201, 205, 113 Stat. at 1352–59, 1368–81, 1385–93. Other examples abound. Though the authors have not taken a full tally, new categories introduced include FHCs, investment bank holding companies, financial subsidiaries, hybrid products, identified banking products, insurance subsidiaries and affiliates, mutual redomesticated and redomesticating insurers, licensed insurance producers, and ATM fund operators.

149. *Id.* § 121, 113 Stat. at 1375–81. While treating said subsidiaries as affiliates for purposes of interaffiliate transaction limits, the Act nonetheless exempts certain covered transactions between the bank and any financial subsidiary. *Id.*

also deepened the permissible ties between banking, commerce, and other financial services.[150]

This trend continued for the following decade, as firms continued to consolidate and diversify within the larger and more permeable regulatory perimeter.[151] In the meantime, external pressure on the perimeter also mounted.[152] One well-catalogued source was the "shadow banking system," a disaggregated network of market-based financial intermediaries, distanced but not divorced from public sector support, that accumulated trillions more in liabilities by 2007 than the formal banking system itself.[153] Another source was the Industrial Loan Corporation ("ILC"), a consumer-lending charter status that dated to the early twentieth century, which the original BHC Act and Federal Deposit Insurance ("FDI") Act excluded from their definitions of "bank."[154]

Until the late 1980s, ILCs primarily made small loans to industrial workers and were not generally permitted to accept deposits.[155] In 1987, however, CEBA exempted the parent companies of

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150. Few provisions of the Act addressed commercial activities directly, even in light of the new "incidental" and "complementary" activity provisions, *supra* note 147. *But see* § 103, 113 Stat. at 1342–51 (imposing restrictions on grandfathered commercial activities and requiring report with "analysis and discussion of the risks posed by commercial activities of financial holding companies to the safety and soundness of affiliate depository institutions"); *id.* § 401, 113 Stat. at 1434–36 (preventing the "creation of new S&L holding companies with commercial affiliates").

151. Significant exceptions remain in the expansion of public company audit and anti–money laundering/countering the financing of terrorism ("AML/CFT") requirements. *See* Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745; USA PATRIOT Act of 2001, Pub. L. No. 107-56, 115 Stat. 272.

152. *See also* Rules, Policies, and Procedures for Corporate Activities; Bank Activities and Operations; Real Estate Lending and Appraisals, 68 Fed. Reg. 6363, 6370–71 (Feb. 7, 2003) (proposing a "special purpose national bank that limits its activities to fiduciary activities or to any other activities within the business of banking"); Rules, Policies, and Procedures for Corporate Activities; Bank Activities and Operations; Real Estate Lending and Appraisals, 68 Fed. Reg. 70122, 70126 (Dec. 17, 2003) (narrowing proposal to firms that "conduct at least one of the following core banking functions: (1) [r]eceiving deposits; (2) paying checks; or (3) lending money").

153. This trend includes significant growth in secondary market activity, largely outside the regulatory perimeter, including growth in the total notional derivatives volume from roughly $70 trillion in 2001 to $445 trillion in 2007. ALAN S. BLINDER, AFTER THE MUSIC STOPPED 63–64 (2013). As this history has been the subject of recent and extensive scholarship, it is not covered in detail here. *See, e.g.*, Zoltan Poszar, Tobias Adrian, Adam Ashcraft & Hayley Boesky, *Shadow Banking*, FED. RSRV. BANK N.Y. ECON. POL'Y REV., Dec. 2013, at 6 (estimating shadow bank liabilities at $22 trillion, versus traditional banking liabilities at $14 trillion).

154. In 1938, thirty-one states offered some type of ILC charter; only sixteen of these states permitted ILCs to accept deposits. *See* RAYMOND J. SAULNIER, INDUSTRIAL BANKING COMPANIES AND THEIR CREDIT PRACTICES 30, 42 (1940); *see generally* Omarova & Tahyar, *supra* note 95, at 158–59.

155. Scott G. Alvarez, Gen. Couns., Bd. of Governors of the Fed. Rsrv. Sys., Industrial Loan Companies, Testimony Before the Senate Committee on Banking, Housing, and Urban Affairs, (Oct. 4, 2007), https://www.federalreserve.gov/newsevents/testimony/alvarez20071004a.htm [https://perma.cc/W3J7-MUAU]; *see also* Martin J. Gruenberg, Chairman, FDIC, Statement on De Novo Banks and Industrial Loan Companies Before the Committee on Oversight and Government

even FDIC-insured ILCs from holding company supervision.[156] As demand for the ILC charter grew, states also expanded ILC powers to be nearly identical to those of a bank.[157] By 2006, ILCs had grown from $4.2 billion in assets to $213 billion, a number of large financial firms had chartered ILCs of their own, and several commercial firms had sought to do the same.[158] When Walmart requested an ILC charter from the FDIC, public opposition emerged from a mix of small banks, grocery stores, labor unions, consumer and community groups, and realtors.[159] The FDIC responded by imposing a moratorium on new ILCs and proposing several legislative changes; a legislative moratorium followed, and the FDIC did not approve another ILC application until March 2020.[160]

Reform (July 13, 2016), https://oversight.house.gov/wp-content/uploads/2016/07/Gruenberg-FDIC-Statement-7-13.pdf [https://perma.cc/XL4N-GCX4].

156. Specifically, CEBA exempts an ILC from the definition of a "bank" if: (1) the ILC is chartered by a state eligible to issue industrial bank charters; (2) the charter is from a state that required FDIC insurance on March 5, 1987; and (3) the ILC meets at least one of three conditions: (i) the ILC does not accept demand deposits; (ii) the ILC has less than $10 million in assets; or (iii) the ILC has not been acquired by another company since August 10, 1987. Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, sec. 101(a), §2(c)(2)(H), 101 Stat. 552, 555; 12 U.S.C. § 1841(c)(2)(H).

157. Omarova & Tahyar, *supra* note 95, at 161–63.

158. Much of the growth was from the transfer of uninsured brokerage customer deposits to corresponding ILCs and, specifically, of American Express's credit card operations to a separate Utah-chartered ILC. Parent Companies of Industrial Banks and Industrial Loan Companies, 86 Fed. Reg. 10703 (Feb. 23, 2021). Other financial institutions with ILCs included Goldman Sachs, Morgan Stanley, Merrill Lynch, and Lehman Brothers. Large commercial firms that obtained ILC charters included General Electric, General Motors, Sears, Target, and Harley-Davidson. James R. Barth, Tong Li, Apanard Angkinand, Yuan-Hsin Chiang & Li Li, *Industrial Loan Companies: Supporting America's Financial System*, MILKEN INST. 4, 6, 26, 31, 45 (2011), https://citeseerx.ist.psu.edu/document?repid=rep1&type=pdf&doi=af4e2442b5117b640fea2c3a6b66d882edd4e596 [https://perma.cc/ET3A-GKQ5].

159. *See* Arthur E. Wilmarth, Jr., *Wal-Mart and the Separation of Banking and Commerce*, 39 CONN. L. REV. 1539, 1545 (citing Bernard Wysocki Jr., *On the Shelf: How Broad Coalition Stymied Wal-Mart's Bid to Own a Bank*, WALL ST. J., (Oct. 23, 2006), https://www.wsj.com/articles/SB116118495912296504 [https://perma.cc/FY54-82RV]).

160. Following the failure or severe distress of a number of these financial firms during the 2008 financial crisis, the Dodd-Frank Act established another, temporary moratorium on ILCs. Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), Pub. L. No. 111-203, § 603, 124 Stat. 1376, 1597–99 (2010); *see also* Parent Companies of Industrial Banks and Industrial Loan Companies, 86 Fed. Reg. at 10708 (citing U.S. GOV'T ACCOUNTABILITY OFF., GAO-12-160, CHARACTERISTICS AND REGULATION OF EXEMPT INSTITUTIONS AND THE IMPLICATIONS OF REMOVING THE EXEMPTIONS (2012), https://www.gao.gov/assets/gao-12-160.pdf [https://perma.cc/H7GH-UMGM]) (describing ILC transformation from a class of "small, limited-purpose institutions" to "a diverse group of insured financial institutions with a variety of business models").

B. Today's Perimeter

The 2008 financial crisis revealed the consequences of diversification and consolidation inside the regulatory perimeter, sharp growth in financial activities outside the perimeter, and deeper ties between the two. Risk that was nominally contained to the nonbanking sector, or to the nonbanking portions of consolidated financial firms, accrued instead to banking organizations, the public purse, and the broader economy.[161] The U.S. legislative response expanded the regulatory perimeter to cover many sources of this risk, from secondary-market activity, to consumer lending, to certain nonbank financial firms, the last of which regulators now had the authority to designate as "systemically important."[162]

In substance, the Dodd-Frank Act deviated materially from the financial reforms of the prior thirty years. In method, it was consistent with the categorization approach embodied in most financial reform efforts since the S&L crisis. The Act incorporated the definitions of "bank," "bank holding company," "depository institution," and more than fifty other categories of regulated entity without amendment.[163] It introduced more than eighty others, increasing the number of such categories in federal law by more than a fifth.[164] Separately, it established new standards for prudential oversight and conduct regulation while limiting the discretion of regulators in implementing those standards.[165] The three major pieces of financial regulatory legislation passed since then have followed a similar approach.[166]

The resulting federal financial regulatory perimeter, shown in Figure 5, is broader, more complex, and arguably more permeable than at any point in its history. It contains several hundred statutory categories, each conferring its own mix of rights and obligations—some

161. For a discussion of several examples and the federal response, see, for example, BEN S. BERNANKE, TIMOTHY F. GEITHNER & HENRY M. PAULSON, JR. WITH J. NELLIE LIANG, FIRST RESPONDERS: INSIDE THE U.S. STRATEGY FOR FIGHTING THE 2007-2009 GLOBAL FINANCIAL CRISIS (2020).

162. *See* 124 Stat. 1376.

163. *Id.* § 2, 124 Stat. at 1386.

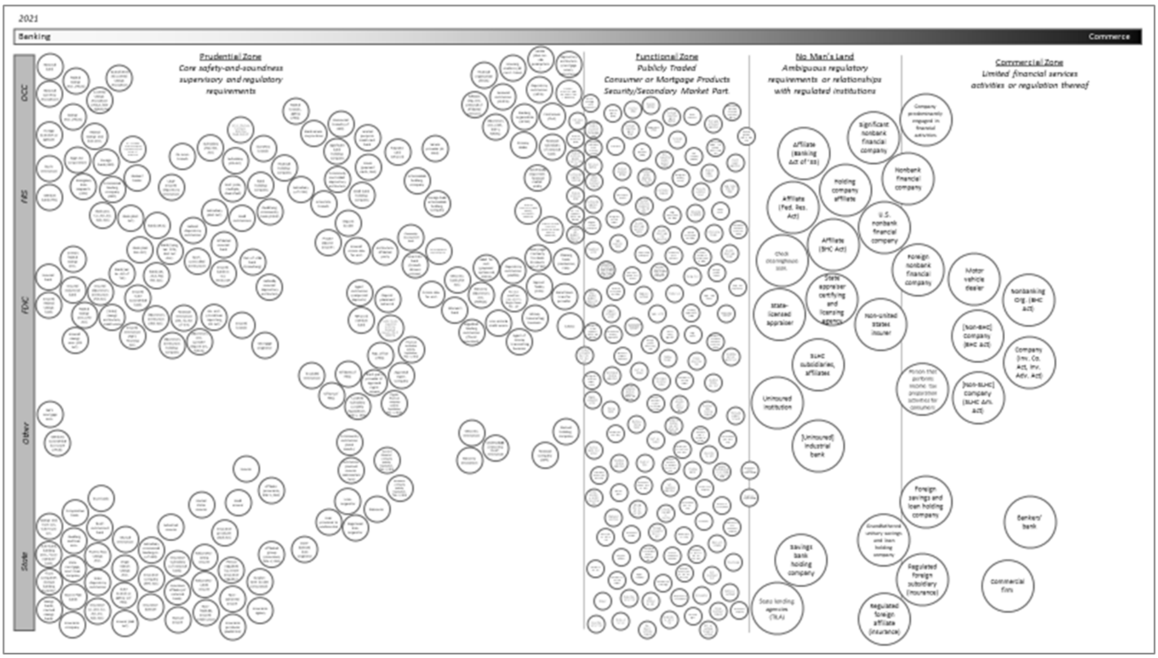
164. This calculation was made by comparing Figure 4, *supra*, and Figure 5, *infra*.

165. This is particularly true of FBOs. The Dodd-Frank Act required certain institutions to form and conduct certain activities via "intermediate holding companies," subject to a broader range of prudential requirements. *Id.* § 626, 124 Stat. at 1638–40. Many FBOs responded by shifting assets and activity to branches, which were preserved under the new statutory measures. *See* Jeremy C. Kress, *Domesticating Foreign Finance*, 73 FLA. L. REV. 951 (2021); *see also* Nicholas K. Tabor, *Trust but Verify: Domestic Politics and International Coordination in U.S. Post-Crisis Financial Regulatory Policy*, 39 U. PA. J. INT'L L. 889 (2018).

166. *See* Economic Growth, Regulatory Relief, and Consumer Protection Act, Pub. L. No. 115-174, 132 Stat. 1296 (2018); Insurance Capital Standards Clarification Act of 2014, Pub. L. No. 113-279, 128 Stat. 3017; Act of Dec. 18, 2014, Pub. L. No. 113-250, 128 Stat. 2886 (2014).

requiring the formation of a specific legal entity; others requiring public registration, disclosure, or supervision; still others requiring some form of chartering with prior government consent. Almost any entity or legal person offering financial services typically falls under one or several of these categories, triggering at least some kind of public oversight. Conversely, however, by tailoring the scope of its activities and its legal form, a careful firm can choose some forms of regulation over others. Critically, regulators have the authority to keep firms inside the perimeter from venturing into commercial territory but lack the authority to police "breaches" from the outside in.

FIGURE 5: THE FEDERAL FINANCIAL REGULATORY PERIMETER, CIRCA 2022



III. LESSONS FOR TODAY'S FINANCIAL REGULATORS

Using the analysis presented in Parts I and II, we now present four lessons that history holds for the perimeter challenges of today.[167]

167. The analysis presented in this Part is based on our previous working paper with several Federal Reserve colleagues: Alexandros Vardoulakis, Asad Kudiya, Byoung Hwa Hwang, Courtney Demartini, Dan McGonegle, Gavin Smith, Jess Cheng, Katherine E. Di Lucido, Kathy Wilson, Jeffery Y. Zhang, Joseph Cox, Mary L. Watkins, Meg Donovan, Nicholas K. Tabor, Nick

These insights may prove useful in crafting the next iteration of the regulatory perimeter.

A. Porous and Dynamic

First, the United States has always had a legal perimeter separating "banking" from "commerce." That perimeter has always been porous, and it has never been static.

The early American perimeter derived from banks' public purpose—not just as legislatively chartered entities but also as a source of economic rents and fiscal support. The goal of this separation was not to protect banking from commerce but to ensure that banking served commerce adequately, providing financing for public infrastructure and other preferred projects. As such, governments placed these early banks on one side of a porous perimeter, with a close relationship to commercial activity.

This direct fiscal role has faded over time, but the permeable, shifting nature of the perimeter has not. The territory between banking and commerce has always been large and contested, with the areas under financial regulators' jurisdiction changing with the politics and law—and technology—of the time.[168] Over time, Congress has also recognized other benefits associated with separating banking and commerce, including protection against concentration of economic power and conflicts of interest. The particulars differ, but the debates seeking to define and capture these benefits are as old as the nation itself. Perimeter changes are natural, and there is helpful, clarifying precedent for even the most novel, idiosyncratic challenges. To understand those challenges, it is important to understand what is old about them, not just what is new.

B. Pressure from All Sides

Second, challenges to the perimeter often follow a common pattern—starting with outside-in pressure, followed by inside-out pressure, and frequently culminating in crisis.

Ehlert & Stacey L. Schreft, *Lessons from the History of the U.S. Regulatory Perimeter*, FEDS NOTES (Oct. 15, 2021), https://www.federalreserve.gov/econres/notes/feds-notes/lessons-from-the-history-of-the-u-s-regulatory-perimeter-20211015.html [https://perma.cc/QY97-WRAY].

168. Some argue that recent technological developments make it particularly feasible to use contractual arrangements to evade the regulatory perimeter. *See, e.g.*, Jackson, *Fintech Firm*, *supra* note 3, at 13 (pointing out that "when Apple wanted to launch Apple Pay, it simply entered into contracts with existing banks and credit card providers to use their payment access and monetized its payments interface through a share of interchange fees").

Disputes about the scope of federal banking regulation are historically specific. A typical pattern of push and pull, however, has emerged between institutions and the agencies and jurisdictions that regulate them. When the perimeter buckles, it typically starts with pressure from less well-regulated firms—that is, from the outside in.

Outside-in pressure. Firms outside the regulatory perimeter—sometimes, but not always, with a commercial presence—enter into more direct competition with firms inside it, offering the services of a regulated bank while avoiding most or all of its requirements. Engaging in this regulatory arbitrage permits firms to traverse the perimeter, often increasing the ties between banking and commerce and eroding the value of a bank charter.

In the early republic and free banking era, this "outside-in pressure" came from merchant banks, utilities, and other firms with the capacity to engage in "monied transactions or operations." In the early dual banking era, it came from state-chartered banks, which shifted to deposit taking and check issuance after the introduction of a federal tax on note issuance. In the late nineteenth- and early twentieth-century, it came from trust companies expanding beyond their traditional custody business; before the Depression, from the widespread and explosive growth in securities lending; after the war, from several stripes of holding companies, conglomerates, and "congenerics"; and later, from "nonbank banks," money market funds, industrial loan companies, and other forms of "shadow banking."[169] Indeed, we see this pressure increasing today in the form of stablecoins that are proliferating in the cryptocurrency ecosystem.[170]

Inside-out pressure. Firms inside the regulatory perimeter typically respond to this pressure by advocating regulation of their nonbank competitors and straining at the fetters on their own conduct. Regulated firms form new partnerships, create new products, convert to new charters, or lobby for changes to disadvantageous regulatory requirements. They find allies in commercial firms, as well as in competing regulators and jurisdictions. They argue that restrictions either are arbitrary, restraining innovation and unnecessarily marking certain acceptable activities as unsafe, or pushing conduct beyond the reach of regulation. In either case, they argue these restrictions place regulated firms at a disadvantage—imperiling their safety and soundness, the integrity of the financial system, and overall economic growth.

169. *See* RICKS, *supra* note 88 (describing the various forms of shadow banking).

170. *See* Gorton & Zhang, *supra* note 12 (arguing that stablecoin issuers are unregulated banks).

These arguments are most familiar from the universal banking debates of the 1990s and shadow banking debates of the 2010s. They date, however, to at least the late nineteenth century, figuring especially prominently into regulatory actions during the late 1920s, late 1960s, and early 1980s. Accounts of changing technology have figured in much of this discourse.

Reform and expansion—by devil or disaster. Pressure on the perimeter can culminate in action, either by crisis, scandal, or both. In response to this pressure, regulators, legislators, and industry act to patch or expand the perimeter—often while letting existing institutions operate under legacy treatment—or increase permissible activities in exchange for increased regulation. In turn, this can lead to political action to redefine the perimeter, move it, or patch up its holes. The actors involved can vary and often include Congress, banks, and regulators themselves. With few exceptions, the effect is to push the perimeter outward, extending it to at least some set of firms and activities not previously within regulators' jurisdiction.

Three arguments consistently recur during perimeter expansion: that unregulated or underregulated activities create moral hazard, posing a threat to the core banking sector, financial stability, and the public purse; that uneven regulation is inequitable, capricious, or even corrupt; and that a flimsy perimeter fosters monopoly, giving large commercial firms an unfair economic advantage. They figured in the Pujo Committee's "money trust" investigation, the Pecora Commission hearings, the mid-century Bank Holding Company Act debates, and the recent ILC discussions. Where a crisis is absent, a salient case often suffices—J.P. Morgan in the 1910s, Transamerica in the late 1940s and early 1950s, DuPont in the 1960s, Travelers/Citibank in the 1990s, and Walmart in the early 2000s.

C. Because You Do, You Are; Because You Are, You Do

Third, the core architecture of the U.S. regulatory perimeter is simpler than some current debates suggest.

Contemporary discussions often draw a distinction between "entity-based" and "activity-based" approaches to financial regulation. In an entity-based system, regulators have jurisdiction over certain categories of legal persons. In an activity-based system, regulators have jurisdiction based on what a legal person does, like making loans or dealing in securities. This distinction, however, has long obscured more than it has clarified. In the U.S. context, it is largely a red herring.

Congress often confers regulatory jurisdiction—and defines positive grants and negative restrictions—by creating a set of categories (e.g., "bank," "credit union," "Federal Reserve member," "deposit broker"). Those categories might be based on a mix of entity- and activity-based factors. They can capture a wide range of legal persons and arrangements—both formal and informal—and very often, they can require that an activity take place only within a particular type of organizational structure. For example, an institution might be a "depository institution" because it holds a certain type of "bank" charter.[171] It might hold that charter, in turn, because of the specific business it conducts or hopes to conduct, such as taking deposits.[172] It might conduct that business, in turn, because it is closely related to another aspect of its business, like lending.[173]

A rough and ready rule captures this relationship, which fits much of the last 150 years of federal financial law: *Because you do, you are; and because you are, you do.*

Until quite recently, the bank regulatory perimeter was determined mainly by the second part of this rule: *Because you are, you do*. In other words, only properly chartered banks could engage in the business of banking, and regulators had the power to limit what and how they did that. Technological advances have enabled nonbanks to "do" many parts of the traditional banking bundle—to facilitate payments, hold deposits, and extend credit—thus shifting focus to the first part of the phrase: *Because you do, you are*.[174]

D. Increased Complexity in the Modern Era: The Categorization Approach to Perimeter Design

Fourth, nearly forty years ago, Congress made an important and enduring shift in regulatory design. Over time, this shift has made the perimeter significantly more complex.

The federal perimeter began to take shape in 1791, with the introduction of the term "bank" in the organic statute of the Bank of the

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171. *See, e.g.*, 12 U.S.C. § 461(b)(1)(A)(i) (defining "depository institution" to include "any insured bank as defined in section 3 of the Federal Deposit Insurance Act").

172. *See, e.g.*, 12 U.S.C. § 1813(h) (defining "insured bank" by reference to "bank"); 12 U.S.C. § 1813(a)(1) (defining "bank" to include "State bank"); 12 U.S.C. § 1813(a)(2) (defining "State bank" to include "any bank . . . which is engaged in the business of receiving deposits").

173. *See, e.g.*, 12 U.S.C. § 378(a)(2) (prohibiting receipt of deposits, unless a person is (i) specifically authorized to do so under federal or state law and (ii) subject to examination and regulation).

174. Hsu, *supra* note 1, at 3 ("Today, a range of fintechs provide seemingly the full suite of banking and investment services—including in cryptocurrencies—with the convenience of tech. These fintechs are reassembling the three legs of banking synthetically, outside of the bank regulatory perimeter.").

United States.[175] Over the next 230 years, Congress extended the perimeter by adding new regulatory categories that defined new rights and responsibilities. Each change was typically a response to a specific challenge, like a new product or service, a new legal entity structure, or a new cross-jurisdictional or cross-border issue. Their cumulative effect was to make the perimeter more complex: as agencies formed and dissolved, new categories incorporated or supplanted others, and the boundaries between core prudential supervision and more functional approaches emerged and blurred.

This pattern, however, has not been static. Instead, a significant shift occurred almost forty years ago—a shift toward a new approach to regulatory design and a different allocation of responsibility between Congress and the regulatory agencies. This new approach did not diminish the perimeter's mounting complexity; it accelerated it.

Before the 1980s, debates about the placement and shape of the perimeter typically focused on the meaning and scope of existing regulatory categories—for example, which activities should define the "business of banking," which entities should qualify as "banks" (or "bank holding companies"), or what should qualify as a "deposit." In this earlier era, those broad terms set the rough outer bounds of regulators' jurisdiction, within relatively concise statutes. Inside those bounds, agencies had substantial discretion to oversee the conduct of supervised institutions subject to public input through measures like notice-and-comment rulemaking. This approach made the perimeter more responsive and resilient to changing industry practices.

Over the course of the 1980s, however, Congress's approach to the perimeter changed. By the decade's end, financial regulatory legislation typically maintained the existing statutory definitions of "banking," "deposits," "securities," and other key terms. Instead, reform legislation most often created new, sometimes overlapping sets of regulatory categories—extending federal oversight not just to new institutions but also to new *categories* of institutions, charters, and activities. At the same time, Congress reduced agencies' discretion in the exercise of such oversight.[176] Reform legislation described the

175. An Act to Incorporate the Subscribers to the Bank of the United States, ch. 10, 3 Stat. 191 (1791).

176. This point echoes work on the shifting role of the banking charter, banking supervision, and their relationship to monetary policy. *See* Lev Menand, *Why Supervise Banks? The Foundations of the American Monetary Settlement*, 74 VAND. L. REV. 951 (2021) (arguing that banks depend on banking agencies' supervision, and advocating for a shift in the historical perspective of supervision); David Zaring, *Modernizing the Bank Charter*, 61 WM. & MARY L. REV. 1397 (2020) (arguing that modernizing the banking charter should not be easy and should have more transparent review by agencies and courts).

restrictions each type of institution should and should not face in extensive and unprecedented statutory detail.

This trend arguably began to crest with the Gramm-Leach-Bliley Act in 1999 (which introduced roughly thirty new regulatory categories), but it persisted in both the Dodd-Frank Act (which incorporated more than fifty existing categories without amendment and introduced over eighty new ones) and the Economic Growth, Regulatory Relief and Consumer Protection Act (which introduced eighteen more categories, repealing none).

The United States has embraced this "categorization" approach through several turns of the credit cycle, in periods of both deregulation and reregulation. During that time, it has experienced (arguably) four financial crises attributable to factors both internal and external to the financial system. In each case, important firms, activities, and other sources of the stress were outside the regulatory perimeter, compounding fragility inside it. In each case, regulators lacked clear, well-resourced, plenary authority to oversee those firms and activities. In each case, a period of reform followed, aimed at restoring or improving the perimeter's integrity. And in each case, the reforms followed the same broad approach as the time before.

Today, the resulting federal financial regulatory perimeter is broader, more complex, and arguably more permeable than ever before. It contains several hundred statutory categories, each conferring its own mix of rights and obligations—some require the formation of a specific legal entity; others require public registration, disclosure, or supervision; still others require some form of chartering with prior government consent. Almost any entity or legal person offering financial services typically falls under one or several of these categories, triggering at least some kind of public oversight. By tailoring the scope of its activities and its legal form, however, a careful firm can choose some forms of regulation over others. And critically, while the current regulatory perimeter keeps firms inside it from "venturing outside" to engage in commercial activity, it lacks the same ability to keep firms outside the perimeter from "venturing in" to engage in bank-like activity without bank-like regulation and supervision.

CONCLUSION

Today's financial regulatory perimeter faces a variety of challenges and pressures. As discussed in this Article, we have witnessed the "unbundling" and "rebundling" of the traditional banking business; the growth of stablecoins, stored-value platforms, and other new technologies; the entry of commercial firms into the financial services space; and the advent of new financial services charters, with new uses for old ones.

The proliferation of these new financial products outside of the regulatory perimeter has immense consequences for the stability of our financial system and the economic well-being of regular individuals.[177] Take stablecoins like Tether, for instance. The issuers of most stablecoins claim that their coins are backed by cash and safe assets, pegged to a fiat currency like the U.S. dollar, and redeemable on demand. From the perspective of economic theory, stablecoin issuers are economically equivalent to unregulated banks. Not surprisingly, stablecoin issuers are vulnerable to bank runs. In May 2022, the decline in the price of Bitcoin and the death spiral of the algorithmic stablecoin TerraUSD were enough to knock some stablecoins off their pegs. Tether holders withdrew $7 billion during the panic.[178] A couple of months later, cryptocurrency lending platforms such as Celsius and Voyager—entities that engaged in banking with cryptocurrencies—faced bank runs and declared bankruptcy.[179]

Lawmakers who wish to improve our financial regulatory framework can learn from the lessons presented in this Article. Importantly, strengthening the perimeter also requires understanding and addressing pressures from at least three distinct angles.

Outside-in pressure. First, firms outside the perimeter enter into more direct competition with firms inside it, offering the services of a regulated bank while avoiding most or all of its requirements.

Inside-out pressure. Second, firms inside the perimeter respond to this pressure by advocating regulation of their nonbank competitors. Regulated firms form new partnerships, create new products, convert to new charters, or lobby for changes to disadvantageous regulatory requirements. They find allies in commercial firms, as well as in competing regulators and jurisdictions.

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177. *See, e.g.*, Alexander Osipovich & Caitlin Ostroff, *TerraUSD Crash Led to Vanished Savings, Shattered Dreams*, WALL ST. J. (May 27, 2022, 4:04 PM), https://www.wsj.com/articles/terrausd-crash-led-to-vanished-savings-shattered-dreams-11653649201 [https://perma.cc/C3N4-CKRT] ("A surgeon in Massachusetts can't stop thinking about how he lost his family's nest egg. A young Ukrainian considered suicide after losing 90% of his savings.").

178. Scott Chipolina, *Investors Pull $7bn from Tether as Stablecoin Jitters Intensify*, FIN. TIMES (May 16, 2022), https://www.ft.com/content/db9c3f32-cd91-4149-9788-95b2046bea10 [https://perma.cc/HL8M-79UR].

179. *See* Becky Yerak & Akiko Matsuda, *For Crypto Customers, a Long Battle Ahead in Bankruptcy*, WALL ST. J. (Aug. 1, 2022, 2:47 PM), https://www.wsj.com/articles/for-crypto-customers-a-long-battle-ahead-in-bankruptcy-11659379620 [https://perma.cc/63RB-236R] (describing how people who have invested money into bankrupt crypto firms are likely to face a long legal battle to recover any of their invested money).

Reform and expansion. Third, pressure on the perimeter can culminate in action. In response, regulators, legislators, and industry act to reform the perimeter—often while letting existing institutions operate under legacy treatment—or increase permissible activities in exchange for increased regulation.

Here, in all likelihood, past is prologue. If the regulatory perimeter remains in its current form or continues to expand along its recent historical trend, we will see the continued proliferation and growth of financial institutions in the regulatory gray area. Half a decade ago, the market capitalization of the FinTech industry was substantially lower than that of the traditional banking industry and the total market capitalization of all cryptocurrencies was around $100 billion.[180] Today, the largest FinTech firms rival those of the largest banks and the market capitalization of cryptocurrencies has soared into the trillions.[181]

The 2008 Global Financial Crisis taught us many important lessons, including the need to have large, systemically important financial institutions under regulation and supervision. That cannot happen if the perimeter is little more than a series of fenceposts without a fence.

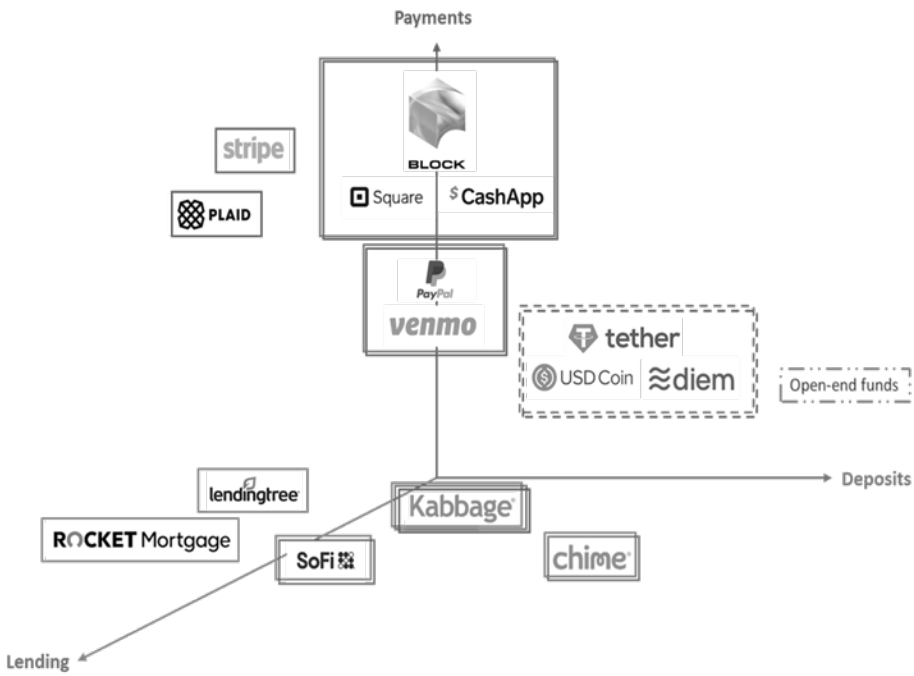
180. *See* Hsu, *supra* note 1, at 1–2.

181. *See id.*

APPENDIX

Figure A1 provides a visual illustration of this disaggregation and, in some cases, reaggregation of the business of banking.[182]

FIGURE A1: THE DISAGGREGATION AND REAGGREGATION OF THE BUSINESS OF BANKING



182. Kabbage, which provides funding directly to small businesses and customers through an automated lending platform, originated at the intersection of deposit taking and lending; SoFi, which transacts in student loan refinancing, mortgages, credit cards, and insurance, was similarly situated. Both Kabbage and SoFi migrated into the financial regulatory perimeter after emerging on its edges: Kabbage was acquired by American Express, a bank holding company, and SoFi became a bank holding company after acquiring a small bank. *See* Ingrid Lunden, *Amex Acquires SoftBank-Backed Kabbage After Tough 2020 for the SMB Lender*, TECHCRUNCH (Aug. 17, 2020, 2:22 PM), https://techcrunch.com/2020/08/17/amex-acquires-softbank-backed-kabbage-after-tough-2020-for-the-smb-lender/ [https://perma.cc/T62L-BRH9]; Press Release, SoFi, SoFi Receives Regulatory Approval to Become a National Bank (Jan. 18, 2022), https://investors.sofi.com/news/news-details/2022/SoFi-Receives-Regulatory-Approval-to-Become-a-National-Bank/default.aspx [https://perma.cc/VE5P-QGU9].