NONBANKS AND NONDEFINITIONS: NEW CHALLENGES IN BANK REGULATORY POLICY*

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Introduction

In studying the corporate existence and powers of banks and bank-like entities, one is unavoidably confronted with the fact that banking is a regulated industry. The significance of this fact manifests itself in varied ways. To a degree otherwise unknown in this modern age of general corporate statutes,[1] banks and bank-like corporate entities are limited and controlled in their corporate activities by relatively specific statutory provisions. Further, these activities are regulated not only by state law but also to a pervasive extent by federal law. Here federal regulation goes well beyond the disclosure-oriented "truth-in-securities"

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[1] *See generally* HURST, THE LEGITIMACY OF THE BUSINESS CORPORATION IN THE LAW OF THE UNITED STATES, 1780-1970 (1970).

approach typical of federal securities regulation,[2] to the substantive supervision of the corporate life of these entities. Indeed, federal regulation includes the possibility of incorporation under federal law itself.[3]

The degree of both state and federal regulation is pervasive and thorough. To establish a corporation intended to enter the banking industry, to expand into other geographic or product markets, to merge with or acquire an existing entity within the industry, to recapitalize or otherwise reorganize the entity and virtually every other action undertaken by an entity within the industry, is subject to regulatory oversight and often express approval of one or more of the regulators, in considerable substantive detail. From birth to death, each step in the corporate life of these entities is subject to regulation.

In a simpler age, the type of banking entity determined the regulator to which the entity was subject.[4] Commercial banks were subject to their chartering authorities, either a state banking official or agency or the U.S. Comptroller of the Currency (the Comptroller). Savings banks and savings and loan associations (S&L's), called "building and loan associations" in some states, were subject to state thrift regulators. Today, however, the broad categories of "commercial banks," "savings banks," "S&L's," and the like can no longer adequately convey an accurate picture of the elements of this regulated industry. For one thing, since the mid-1930's these entities have been subject to a broad range of overlapping lines of regulatory authority, state and federal. For a single corporate transaction, such as an acquisition, any one banking entity may need the regulatory approval of as many as two or more regulators.[5] Proposals to rationalize and realign

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[2] *See* Cohen, *"Truth in Securities" Revisited*, 79 HARV. L. REV. 1340 (1966).

[3] *See, e.g.*, 12 U.S.C. §§ 21-22, 26-27 (1982) (establishment of national banking association).

[4] *See* Golembe, *Our Remarkable Banking System*, 53 VA. L. REV. 1091 (1967). *See also* Symons, *The "Business of Banking" in Historical Perspective*, 51 GEO. WASH. L. REV. 676 (1983). *But see* Hackley, *Our Discriminatory Banking Structure*, 55 VA. L. REV. 1421 (1969); Hackley, *Our Baffling Banking System*, 52 VA. L. REV. 565, 771 (1966).

[5] *See, e.g.*, Report of the Task Group on Regulation of Financial Services 9 (1984) [hereinafter Task Group Report]:

> [T]here is significant overlap and duplication in the responsibilities of the [federal] agencies. For example, five different federal agencies handle each of the antitrust issues and securities matters involving banks

this complex regulatory system[6] have as yet made little progress in the Congress.[7]

A new regulatory vocabulary is emerging nonetheless. These various bank and bank-like entities are now spoken of as types of "depository institutions."[8] In turn, these depository institutions are increasingly viewed by regulatory policymakers as one specific type of "financial intermediary,"[9] a term that also includes credit unions, finance companies, insurance companies, securities firms and the like. Though the new vocabulary is available, changes in the way these entities are regulated have been slow in coming. With respect to depository institutions, the statutory focus is still for the most part on traditional categories like the "commercial bank." The regulated entities have thus been looking more aggressively for ways to overcome the regulatory system's inertia.

Of increasing concern to regulatory policymakers has been the recent trend among these entities to escape some of the strictures of the system through the use of the curious device known

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and thrift institutions. Similarly, two different [federal] agencies regulate state-chartered banks. . . .

In addition to creating areas of duplication among the agencies, the current system also subjects many financial organizations to simultaneous regulation by two or more federal agencies.

6 *See* Task Group Report, *supra* note 5. *See also* Peters & Powers, *Functional Regulation: Looking Ahead*, 18 LOY.-L.A. L. REV. 1075 (1985); Friedman & Friesen, *A New Paradigm for Financial Regulation: Getting from Here to There*, 43 MD. L. REV. 413 (1984); Gorinson, *Depository Institution Regulatory Reform in the 1980's: The Issue of Geographic Restrictions*, 28 Antitrust Bull. 227 (1983); Fein, *Fragmented Depository Institutions Systems: A Case for Unification*, 29 AM. U. L. REV. 633 (1980).

7 *See, e.g., Possibility of Financial Services Reform Legislation in 1985 Doubtful*, 17 SEC. REG. & L. REP. (BNA) 126 (1985).

8 *See* 12 U.S.C. § 461(b)(1)(A) (1982). *See also* text at notes 327-39, *infra*.

9 This generic concept defines a group of entities that share one basic function, "indirect finance." *See* M. STIGUM, THE MONEY MARKET 11 (rev. ed. 1983) (emphasis in original):

> Every financial intermediary solicits and obtains funds from funds-surplus units by offering in exchange for funds "deposited" with it, claims against itself. The latter, which take many forms, . . . are known as *indirect securities*. The funds that financial intermediaries receive in exchange . . . are used by them to invest in stocks, bonds, and other securities issued by ultimate funds-deficit units, that is, in *primary securities*.

The Task Group chaired by Vice President Bush referred to this broad category in its report as "financial service firms." *See, e.g.*, Task Group Report, *supra* note 5, at 16.

as the "nonbank bank."[10] Most nonbank banks *are* banks—because they are chartered under state or federal banking laws and exercise banking powers. But they are *nonbanks*—because they do not exercise all the powers they could. By giving up specified powers, a nonbank bank may escape the technical definition of "bank" under certain federal statutory provisions, and thus is partially freed from the regulatory scheme that other banks must endure. In particular, by avoiding the technical definition of "bank" under the Bank Holding Company Act (BHCA),[11] a holding company may escape regulation by the Federal Reserve Board (the Fed), and thereby avoid restrictions on interstate banking imposed by the Douglas Amendment to the Act.[12]

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10 *See generally* Schellie & Climo, *Nonbank Banks: Current Status and Opportunities*, 102 BANKING L.J. 4 (1985); Felsenfeld, *Nonbank Banks—An Issue in Need of a Policy*, 41 Bus. Law. 99 (1985). The Supreme Court recently gave the following description of nonbank banks:

> institutions that offer services similar to those of banks but which until recently were not under [Federal Reserve] Board regulation because they conducted their business so as to place themselves arguably outside the narrow definition of "bank" found in § 2(c) of the [BHCA, 12 U.S.C. § 1841(c) (1982)]. Many nonbank banks, for example, offer customers NOW (negotiable order of withdrawal) accounts which function like conventional checking accounts but because of prior notice provisions do not technically give the depositor a "legal right to withdraw on demand." 12 U.S.C. § 1841(c)(1). Others offer conventional checking accounts, but avoid classification as "banks" by limiting their extension of commercial credit to the purchase of money market instruments such as certificates of deposit and commercial paper.

Bd. of Governors of the Federal Reserve System v. Dimension Financial Corp., — U.S. —, 54 U.S.L.W. 4101, 4102 (1986).

11 12 U.S.C. § 1841(c) (1982), which states in pertinent part as follows:

> "Bank" means any institution organized under the laws of the United States, any State of the United States, the District of Columbia, any territory of the United States, Puerto Rico, Guam, American Samoa, or the Virgin Islands, . . . 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.

See generally Wilshire Oil Co. v. Bd. of Governors, 668 F.2d 732 (3d Cir. 1981).

12 12 U.S.C. § 1842(d) (1982), which states in pertinent part as follows:

> Notwithstanding any other provision of this section, no application [for acquisition of a bank by a holding company] . . . shall be approved under this section which will permit any bank holding company . . . to acquire, directly or indirectly, any voting shares of . . . any additional bank located outside the State in which the operations of such bank holding company's banking subsidiaries were principally conducted on . . . the date on which such company became a bank holding company,. . . unless the acquisition of such shares . . . of a State bank by an

The nonbank bank device exploits certain statutory "nondefinition definitions" that are supposed to delimit the applicability of bank regulatory laws to banking entities. In response to the rising popularity of this device, a number of states, including New Jersey, have recently enacted legislation to bar the use of the nonbank bank within their jurisdictions. In addition, the Congress and the federal bank regulators have begun to consider the problem, though with few concrete results to date.

This article will seek to explain what a "nonbank bank" is, and why it has become so popular. It will also examine recent legal responses to the rise of the nonbank bank, whether administrative, judicial, or (usually as a last resort) legislative. It will conclude with some suggestions for a more rational response to the new challenge in regulatory policy which the nonbank bank represents.

(Commercial) Banks and "Nonbank Banks"

The "nonbank bank," sometimes euphemistically referred to as the "consumer bank"[13] or the "family bank,"[14] is a mutant version of the commercial bank. Due to the inadequacies and rigidity of current statutory definitions of the term "bank," those seeking to avoid regulatory restrictions that apply to commercial banks have simply decided to limit artificially the scope of their activities, so as to be outside the statutory definition. Yet, they still wish to participate and compete in the banking market, because commercial banks remain, in dollar terms and in terms of the extent of their products and services, the dominant category of depository institutions.

Viewed as a type of financial intermediary, commercial banks held as of December 31, 1983, the largest percentage of financial assets of all intermediaries, 34.5% (or $1,752.6 billion, out of a

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out-of-State bank holding company is specifically authorized by the statute laws of the State in which such bank is located, by language to that effect and not merely by implication.

[13] *See, e.g.*, Carrington, *Just When Is a Bank Not a Bank? When It Is an Abomination*, Wall St. J., Jan. 30, 1984, at 1, col. 4; Hertzberg, *Citibank Unveils New Marketing Strategy In Bid to Become National Consumer Bank*, Wall St. J., Mar. 29, 1984, at 20, col. 1.

[14] *See, e.g.*, Weiner, *Sears Is Proposing A 'Family Bank' Aimed at Consumer*, Wall St. J., Mar. 12, 1985, at 24, col. 3; *Sears Wants to Create Limited 'Family Banks'*, N.Y. Times, Mar. 12, 1985, at D29, col. 1.

total of $5,078.8 billion).[15] (*See* Illustration 1, *infra*.) The next largest percentage, held by S&L's, is less than half of this share (16.2%, or $825.2 billion).[16] By contrast, the money market mutual funds, once feared by depository institutions as causing the "disintermediation" of banks and thrifts from their traditional customers,[17] account for only 3.2% (or $162.5 billion) of financial assets held by intermediaries.[18]

Viewed within the narrower class of depository institutions, the commercial banks' percentage of financial assets held as of year-end 1983 amounts to a 61% share. (*See* Illustration 2, *infra*.) In terms of numbers of institutions, however, the number of commercial banks as compared to S&L's was even greater proportionally than the percentage share of assets. Of the total number of commercial bank and "thrift institutions"[19] (17,939), the commercial banks accounted for 80.6% (or 14,463) and the S&L's for 16.9% (or 3,040).[20] The disproportion between percentage share of assets and percentage of total number of depository institutions that are commercial banks indicates that there is a wide variation in size of commercial banks as a function of financial assets held. Only 1.8% of the total number of commercial banks (256) had assets amounting to more than $1 billion each, and these accounted for 62.5% of assets held by commercial banks (or $1,464 billion).[21] In contrast, 40.2% of the total number of commercial banks (5,812) had assets amounting to less than $25 million each, and these accounted for only 3.6% of assets held by commercial banks (or $84 billion).[22]

In light of the significance of commercial banking as a com-

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15 Task Group Report, *supra* note 5, at 17, Figure 1.

16 *Id.*

17 *See* Malloy & Pitts, *Post-Mortem on Retail Repurchase Agreements: Where were the Regulators?* 3 ANN. REV. BANKING L. 89, 97, 105 (1984).

18 Task Group Report, *supra* note 5, at 17, Figure 1.

19 For purposes of this article, the term "thrift institution" is used to refer generally to S&L's and savings banks. *See generally* J.J. NORTON & S.C. WHITLEY, BANKING LAW § 1.03[3] (1983).

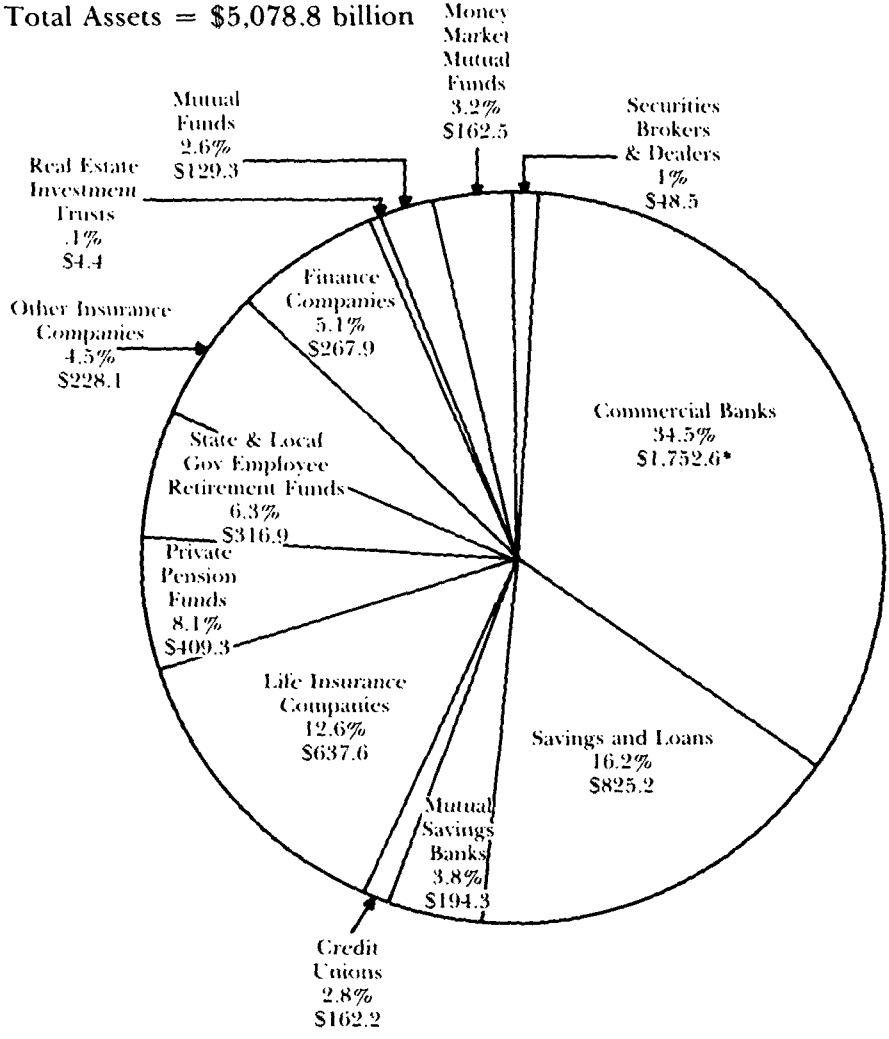
20 *See* Task Group Report, *supra* note 5, at 102, Figure 16. The year-end 1983 figure for number of commercial banks does not differ significantly from the year-end 1980 figure. *See* Report of the President, Geographic Restrictions on Commercial Banking in the United States 1 (Department of the Treasury, January 1981) [hereinafter Geographic Restrictions Report].

21 *See* Task Group Report, *supra* note 5, at 103, Figure 17.

22 *See id.*

Illustration 1

Financial Intermediaries: Share of Total
Private Financial Assets Held
[As of 12-31-83; $ in billions]



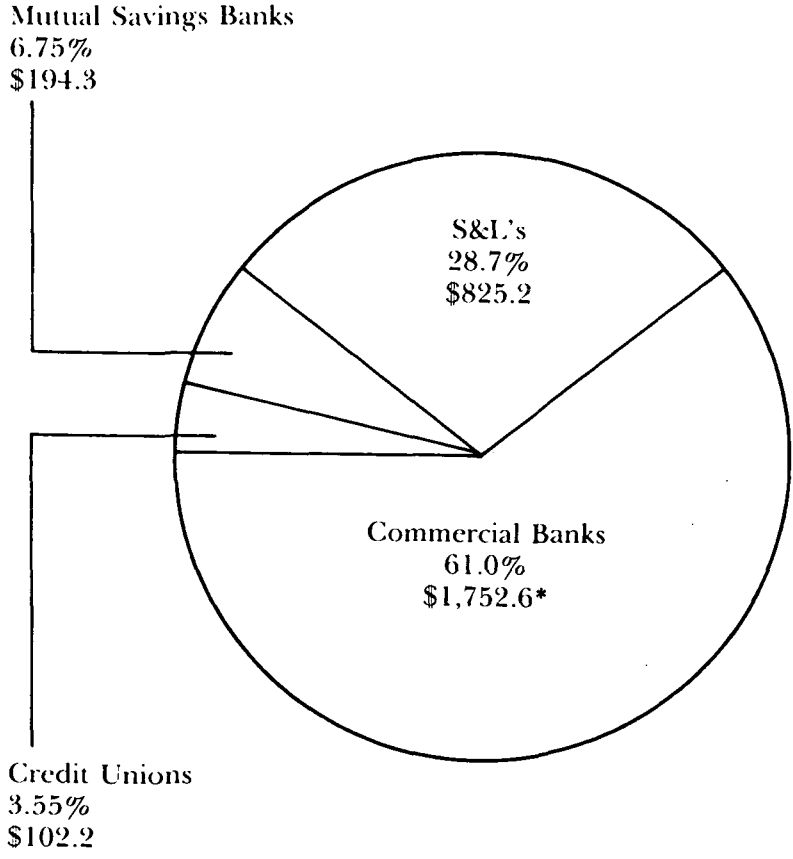
*This figure is net of interbank liabilities. It does not include international banking facilities.

Source: Report of the Task Group on Regulation of Financial Services

Illustration 2

Depository Institutions: Share of Total
Private Financial Assets Held
[As of 12-31-83; $ in billions]

Total Assets = $2,874.3



*This figure is net of interbank liabilities. It does not include international banking facilities.

Source: Report of the Task Group on Regulation of Financial Services

ponent of the financial intermediary market, efforts to enter this sector of the market, or to expand within it on a geographic basis, are quite understandable. The practical reality is that many commercial concerns are beginning to edge their way into that market and are viewed by their consumers as "banks," quite regardless of the technical connotations of the term "commercial bank."

Nevertheless, the technical legal terms of reference remain a factor to be considered. What, then, is a commercial bank in legal terms? In other words, what is "commercial" about a commercial bank? In the first place, these institutions are to be distinguished from thrift institutions.[23] Unlike thrifts, commercial banks are empowered to offer a full range of banking services, including demand deposit accounts (*e.g.*, checking accounts) for business and personal use, savings[24] and time deposits, investment[25] and loan services, and the like. Until recently, thrifts were prohibited from engaging in most of these activities, being limited for the most part to personal savings deposits and personal and home mortgage loans. However, the range of services which thrifts are permitted to offer has expanded dramatically since 1980.[26] As a behavioral matter, however, the traditional distinction between commercial banks and thrift institutions, based on extent of offered services, is still broadly accurate. For the most part, commercial banks remain the undisputed leaders in "full-service" commercial banking.

From a different perspective, "commercial" banks are to be distinguished from investment banks, financial intermediaries

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[23] *Cf.* note 19, *supra*.

[24] *See* Franklin Nat'l Bank v. New York, 347 U.S. 373 (1954) (commercial banks, though not thrift-like "savings" institutions, may offer and advertise "savings accounts").

[25] *See generally* Lybecker, *Bank-Sponsored Investment Management Services: A Legal History and Statutory Interpretative Analysis*, 5 SEC. REG. L.J. 110 (1977). Investment services of commercial banks are limited in certain significant respects by federal and state laws seeking to separate commercial and investment banking activities.

[26] *See, e.g.*, Pub. L. No. 96-221, Title IV, 94 Stat. 151 (1980). *See also* Federal Home Loan Bank Board, Service Corporation Activities, December 15, 1980, 45 Fed. Reg. 82,270 (1980) (discussion of proposed amendments to 24 C.F.R. pt. 545); *id.*, April 23, 1981, 46 Fed. Reg. 23,049 (1981) (to be codified at 24 C.F.R. pts. 545 and 584). *See generally* Roster, *The Modern Role of Thrifts*, 18 LOY.-L.A. L. REV. 1099 (1985). *But cf.* Lapidus, *Commercial Banks and Thrift Institutions: The Differing Portfolio Powers*, 92 BANKING L.J. 450 (1975).

whose business consists primarily of underwriting and distributing securities and acting as brokers and dealers in securities already distributed.[27] At one time, the distinction between these two types of banking concerns was largely a factual one, and it was not impossible for a single financial intermediary enterprise to comprise both commercial and investment banking activities. However, since 1933, federal law has required that such activities be carried on by separate entities and has prohibited most affiliations between commercial and investment banking concerns.[28] While there are several current proposals to realign or remove such prohibitions,[29] the distinction between these two types of "banking" activities will doubtless remain pertinent in any discussion of the regulation of commercial banking as a broad category within the financial intermediary industry.

The preceding discussion tells us two things that "commercial banks" are not. To an extent, the inroads by nonbank banks into the commercial banking sector can be related to these two negatives.

First, the blurring of the line between commercial banks and thrifts have given bank holding companies an opportunity to expand interstate, where they might normally be barred by state and federal geographical restrictions,[30] by acquiring out-of-state thrift institutions rather than commercial banks. Acquisition of a thrift-like, nonbank bank in state *A* by a commercial bank holding company in state *B* might not be subject to geographical restrictions prohibiting acquisition of a bank in state *A* by the bank in state *B*.[31]

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[27] For an excellent historical treatment of the growth of the American investment banking business and the way it functions, see United States v. Morgan, 118 F. Supp. 621, 635-55 (S.D.N.Y. 1953).

[28] The clarity of this line between commercial and investment banking and the precise meaning of the legal prohibitions involved has recently been the subject of vigorous litigation. *See, e.g.*, Securities Industry Ass'n v. Bd. of Govs., FRS, 468 U.S. 137 (1984); Securities Industry Ass'n v. Bd. of Govs., FRS, 468 U.S. 207 (1984).

[29] *Cf.* note 6, *supra*. Current proposals for realignment and reform of the regulatory apparatus in this regard would eliminate or at least considerably narrow such distinctions. *See generally* Task Group Report, *supra* note 5.

[30] *See generally* Cohen, *Interstate Banking: Myth and Reality*, 18 LOY.-L.A. L. REV. 965 (1985); Dunlap, *Interstate Banking Developments in Florida: Pushing Through the Legal Barriers and Toward a Level Playing Field*, 9 NOVA L.J. 1 (1984).

[31] It should be noted, however, that the Fed has traditionally been resistant to proposals by bank holding companies subject to the BHCA to acquire thrift institu-

Second, commercial and investment firms which are barred from holding the stock of a commercial bank[32] are not necessarily barred from holding the stock of a nonbank bank, even though the nonbank bank may look and act very much like a commercial bank.

One major advantage often cited for holding a nonbank bank in either of these two situations is that of "positioning."[33] Should the commercial banking sector become more deregulated, to the point where prohibitions on geographic expansion and holding are eliminated, the holder of a nonbank bank is in a position to convert its operation almost immediately into a full-service commercial bank. Thus, the holder stays a step ahead of its potential competitors in the potential new market.

The regulatory system in effect pays for the benefits of positioning, insofar as it becomes less uniform and predictable in its application. These positioning advantages depend, however, on

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tions as nonbanking subsidiaries under 12 U.S.C. § 1843(c)(8) (1982), which requires, *inter alia*, that the activities of the subsidiary be so "closely related" to banking as to be a "proper incident" thereto. One manifestation of this resistance is apparent in *Order Denying Acquisition of Savings and Loan Association by Memphis Trust Company*, 61 Fed. Res. Bull. 327 (1975), in which the Fed expressed the view that bank holding companies "generally should slow their rate of expansion into new activities." In that same order, the Fed distinguished between the "closely related" and "proper incident" portions of the 1843(c)(8) test.

In fact, the distinction has often served as the basis for denial of similar applications. The policy of the Fed in the 1970's came to be that the activities carried out by the entity to be acquired in such proposals, though closely related, would not be a proper incident to banking. *See, e.g., D.H. Baldwin*, 63 Fed. Res. Bull. 280, 284 (1977); *American Fletcher Corp.*, 60 Fed. Res. Bull. 868, 871 (1974). *See generally* Reitner, *Bank Holding Company and Bank Acquisition of Thrift Institutions, in* BANK COUNSEL 35 *et seq.* (PLI 1982).

This policy began to fray about the edges as the conditions of the thrift industry became progressively more unsettled. By March 1981, the Fed indicated that it was studying the potential effects of thrift institution acquisitions by banks and bank holding companies. *See Federal Reserve Board Release and Notice*, March 16, 1981, (1981-1982 Transfer Binder) FED. BANKING L. REP. (CCH) ¶ 98,649 (March 27, 1981). The Fed has subsequently allowed bank holding company acquisitions, on a selective basis, typically in situations where the target thrift was in danger of failing and had already been subjected to regulatory action by its own regulator. This emerging policy now has specific statutory support. *See* 12 U.S.C. § 1730a(m)(3), (5) (1982) (emergency thrift acquisitions by out-of-state institutions of different types authorized under certain conditions).

32 *See, e.g.*, 12 U.S.C. § 377 (1982).

33 *Cf.* Silver & Norman, *The Trust Company: A Means of Entering the Financial Services Market or Positioning for Interstate Banking*, 101 BANKING L.J. 216 (1984).

the present inadequacies of statutory definitions of the "commercial bank." The nonbank bank exists in the gray area left by the imprecision or rigidity of these definitions.

What, then, do these definitions provide? Looking at the concept of "commercial bank" analytically, various attempts at a definition of its minimum, essential characteristics have been attempted. The traditional, and still the most viable, definition defines a commercial bank as an institution whose business consists of discounting commercial paper,[34] accepting deposits (particularly demand deposits),[35] and making loans (particularly commercial loans).[36] Other, more contemporary formulations stress the demand deposit and commercial loan aspects as the necessary and sufficient conditions for categorizing an institution as a commercial bank.[37] Statutory provisions generally are somewhat vague on this issue, often containing no explicit, substantive definition of "bank" or "commercial bank" and apparently presupposing the common understanding of the term.[38]

One notable exception in this regard is the definitional pro-

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[34] *See generally* Oulton v. German Savings & Loan Soc'y, 84 U.S. (17 Wall.) 109, 118 (1873); In re Wilkins' Will, 131 Misc. 188, 226 N.Y.S. 415 (1928).

[35] *See generally* In re Wilkins' Will, 131 Misc. 188, 226 N.Y.S. 415 (1928); United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 326 (1963).

[36] *See generally* Oulton v. German Savings & Loan Soc'y, 84 U.S. (17 Wall.) 109 (1873); Wilshire Oil Co. v. Bd. of Governors, 668 F.2d 732 (3d Cir. 1981).

[37] Indep. Bankers Ass'n of America v. Conover, No. 84-1403-CIV-J-12 (M.D. Fla., February 15, 1985), FED. BANKING L. REP. (CCH) ¶ 86,178, at 90,535.

[38] *See, e.g.*, 12 U.S.C. § 24 (1982 & Supp. III 1985), Seventh (national [commercial] bank to exercise all powers "incidental to the business of banking"). *See generally* Symons, *supra* note 4; Schweitzer, *Banks and Banking—a Review of the Definition*, 94 BANKING L.J. 6 (1977); Huck, *What is the Banking Business?* 21 BUS. LAW. 537 (1966), *reprinted in* 83 BANKING L.J. 491 (1966).

In federal regulatory statutes, three types of definitional provisions are encountered concerning the term "bank." (*i*) The first, which may be called "circular" or "self-referential," simply defines the term by reference to some other federal enactment. This type is typical in the federal securities laws, where reference is generally made to federal banking law. *See, e.g.*, 15 U.S.C. §§ 78c(a)(6), 80a-2(a)(5), 80b-2(a)(2) (1982). (*ii*) The second, which may be called "jurisdictional," defines "bank" or types of "banks" in terms of the regulatory agency which has jurisdiction over the entity for some relevant purpose. This type is typical in the federal banking laws themselves. *See, e.g.*, 12 U.S.C. §§ 202 ("national bank"); 214 ("state," "national"); 221; 461(b)(1)(B); 1813(a)-(h) (1982). (*iii*) The third, which may be called truly definitional, defines bank in terms of essential factual characteristics. This is a relatively recent statutory development encountered in a very few federal bank regulatory statutes. *See, e.g.*, 12 U.S.C. §§ 461(b)(1)(A) ("depository institution"); 1841(c) (1982) ("bank").

vision in the BHCA which explicitly adopts the traditional definition of "bank" as an institution which accepts demand deposits and makes commercial loans.[39] However, as a technical matter, this definition is only applicable for purposes of determining whether the acquisition of such an institution by a nonbanking entity is subject to the requirements of the BHCA itself.

If an entity is considered a "bank" under the BHCA, then its holding company may have to divest itself of its other commercial subsidiaries,[40] and it may not be able to operate banking subsidiaries across state lines.[41] Concern over escaping these restrictions under the BHCA has led commercial enterprises to consider investment in an entity which operated like a bank, but which was not a "bank" under the technical definition of the BHCA itself. This peculiar kind of "nonbank bank" would thus escape BHCA regulation, but still afford its holding company many of the advantages of participating in the banking industry.

Thus, it is possible that an institution which forbears the exercise of one or the other of the powers of commercial lending or accepting demand deposits might be treated as a "nonbank bank," *i.e.*, not a "bank" under the BHCA, and yet still be considered a "bank" for other purposes.[42] It will receive a bank charter to operate under state or federal banking laws, but it will limit its powers under its charter so as to avoid classification as a "bank" for BHCA purposes. This troublesome definitional question has already been the subject of litigation,[43] culminating in the Supreme Court's recent decision in *Board of Governors of the Federal Reserve System v. Dimension Financial Corp.*,[44] invalidating the Fed's attempt to bring the nonbank banks within the BHCA.[45]

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39 *See* note 11, *supra*.

40 *See generally* Wilshire Oil Co. v. Bd. of Governors, 668 F.2d 732 (3d Cir. 1981).

41 *See* note 12, *supra*.

42 *See* Comptroller of the Currency, *Policy Statement Regarding Non-Bank Bank Approvals*, 48 Fed. Reg. 15,993 (April 13, 1983) [hereinafter *April 1983 Policy Statement*].

43 *See* text at notes 176-87, *infra*.

44 — U.S. —, 54 U.S.L.W. 4101 (1986).

45 *See* text and accompanying notes 144-69, *infra*.

Legal Responses to the "Nonbank Bank" Phenomenon

Administrative Measures

It may be unfortunate but it is nonetheless true that "[c]onflicts between the federal bank regulators are common, if not inevitable. . . ."[46] Nowhere have these conflicts been more apparent than in the positions taken by the federal bank regulators with respect to the emergence of nonbank banks.

The Fed, in some instances abandoning its own prior consistent interpretations of such terms as "commercial loan,"[47] attempted to bring nonbank banks within its jurisdiction to enforce the BHCA. Even while its position was being disputed in two cases before the Tenth Circuit,[48] the Fed only grudgingly began to acknowledge the legitimate status of nonbank banks, wholly outside the regulatory regime of the BHCA.[49]

The Comptroller, on the other hand, appears to have accepted the status of nonbank banks early on. He was reluctant, however, to proceed towards wholesale approval of national bank charters for nonbank banks so long as there still appeared some prospect for timely congressional action which might close the gap in the BHCA.[50] But, when that prospect failed to materialize, one year after he had imposed a moratorium on consideration of such charters, he in effect aggressively threatened

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46 Indep. Bankers of America v. Conover, 603 F. Supp. 948, 958 (D.D.C. 1985) (footnote omitted).

47 *See* Dimension Financial Corp. v. Bd. of Governors, 744 F.2d 1402, 1406 (10th Cir. 1984), *aff'd*, — U.S. —, 54 U.S.L.W. 4101 (1986).

48 *See* text at notes 126-43, *infra*.

49 *See, e.g., Citicorp*, 70 Fed. Res. Bull. 921 (1984); *Mellon National Corp.*, 70 Fed. Res. Bull. 441 (1984); *U.S. Trust Corp.*, 70 Fed. Res. Bull. 371 (1984); *Citizens Fidelity Corp.*, 69 Fed. Res. Bull. 556 (1983).

50 *See, e.g., April 1983 Policy Statement, supra* note 42. It appears that the first occasion on which the Comptroller was confronted with a nonbank bank may have been in the 1980 proposed acquisition of Fidelity National Bank of Concord, California, by Gulf & Western Industries. *See Indep. Bankers Ass'n of America, supra* note 37, at 90,529. *But see* text and accompanying note 151 (earlier Comptroller consideration of proposal for *de novo* nonbank bank limited to trust powers). Gulf & Western's proposal called for the divesting of Fidelity's commercial loan portfolio and the termination of its commercial lending activities, with the intention of avoiding the jurisdiciton of the BHCA. Nevertheless, since Fidelity would remain a national bank, the acquisition required the prior review of the Comptroller under the Change in Bank Control Act, 12 U.S.C. § 1817(j) (1982). In August 1980, the Comptroller issued a notice of his intention not to disapprove the acquisition. *See Indep. Bankers Ass'n of America, supra* note 37, at 90,529.

Congress with possible wholesale approvals of nonbank banks unless legislative action was forthcoming.[51] To date legislative action has still not materialized, and the Comptroller had already begun to make good on this threat[52] when litigation intervened at the initiative of industry opponents of nonbank banks.[53]

Rising above the fray (or sinking below it), the Federal Deposit Insurance Corporation (FDIC) has maintained a view of the merits consistent with that expressed by the Comptroller.[54] Its institutional concern appears to have been limited to the protection of the integrity of the deposit insurance program, and it has conditioned the approval of deposit insurance applications by nonbank banks accordingly.[55]

No case better serves to illustrate the tensions generated at the administrative level by the nonbank bank controversy than

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[51] *See* Statement by C.T. Conover, May 9, 1984, *reprinted in* FED. BANKING L. REP. (CCH) ¶ 99,949, at 87,750:

> Under present law, nonbank banks are definitely legal. Some members of Congress have already expressed to me their displeasure with current law. Some members also support enactment of broad-based legislation to modernize the legal framework for financial services. However, under present law, I will have no choice but to proceed accordingly, unless Congress enacts changes by the end of the current session.

A new, and potentially dramatic, development occurred in March 1986. In testimony before the Senate Banking Committee on March 4, 1986, senior Treasury officials, including Comptroller Clarke, Mr. Conover's successor, announced that the Administration was strongly in favor of encouraging the acquisition of nonbank banks by non-BHC's, including securities firms, merchandisers and insurance companies. *See* Wynter, *White House, in Policy Switch, Urges Acceptance of Limited-Service Banks*, Wall St. J., Mar. 5, 1986, at 64, col. 1. The Administration proposal was specifically intended to encourage such acquisitions of troubled thrift institutions, as a way of easing pressures on the FSLIC insurance fund. *See* Nash, *Plan to Aid F.S.L.I.C. Is Outlined*, N.Y. Times, Mar. 5, 1986, at D5, col. 1.

[52] *See, e.g., Decision of the Comptroller of the Currency on the Applications of Dimension Financial Corporation to Charter 31 National Banks in 25 States*, FED. BANKING L. REP. (CCH) ¶ 99,950 [hereinafter *Dimension Decision*].

[53] *See, e.g., Indep. Bankers Ass'n of America, supra* note 37.

[54] *See, e.g.*, Dimension Financial Corp. v. Bd. of Governors, 744 F.2d 1402, 1406 (10th Cir. 1984), *aff'd*, — U.S. —, 54 U.S.L.W. 4101 (1986) (FDIC position favoring Dreyfus Corporation purchase of nonmember, state-chartered nonbank bank, despite Fed opposition).

[55] *See, e.g., id. See also Nonbank Bank Owned by Securities Firm Must Comply with FDIC Securities Rules*, 16 SEC. REG. & L. REP. 1963 (1984) (FDIC insurance approval for Federated Bank & Trust Co., owned by Federated Investors, Inc.); *FDIC Approves Deposit Insurance for Merrill Lynch, Bear Stearns Banks*, 16 SEC. REG. & L. REP. 1995 (1984).

the applications filed with the Comptroller by the Dimension Financial Corporation (Dimension). In March 1983, the Comptroller had received applications from Dimension, a holding company, to establish 31 national banks,[56] in as many as 25 states,[57] with powers limited in such a way to avoid the two-part definition of "bank" for purposes of the BHCA.[58] The applications contemplated the simultaneous *de novo* creation of the nonbank national banks and the attainment of holding company status for the parent Dimension. The intracorporate relationships were, to say the least, complex. (*See* Illustration 3, *infra*.) The nonbank banks were to be owned by Dimension, a second-tier subsidiary of Valley Federal Savings and Loan. However, it was anticipated that the investment in Dimension would eventually be diluted to less than majority ownership once the banks commenced operations.[59]

The posture of these applications and the complex nature of the intracorporate relationships raised the issue of the overlapping regulatory interests of the Comptroller, as chartering authority, and the Fed, as administrator of the BHCA, in the starkest terms.[60]

In response, Deerbrook State Bank, a potential competitor of the proposed Dimension nonbank banks, petitioned the Fed, requesting that it commence hearings under the BHCA to determine the legality of the proposed banks.[61] In June 1983, the Independent Bankers Association of America (IBAA) filed a letter with the Fed joining in the petition.[62] The petition was primarily based upon the Fed's May 1983 proposal for expansion of the definition of "commercial loan" for BHCA purposes.[63] Dimension countered in August 1983 by submitting a letter to the

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56 *See Dimension Decision, supra* note 52. *See also* Deerbrook State Bank v. Conover, 568 F. Supp. 696, 698 (N.D. Ill. 1983).

57 *See Dimension Decision, supra* note 52, at 87,759.

58 Dimension banks would not offer commercial loans. *Id.* at 87,760. *Cf.* text and accompanying notes 64, 70-71, *infra*.

59 *See Dimension Decision, supra* note 52, at 87,760.

60 *See* Indep. Bankers of America v. Conover, 603 F. Supp. 948, 950 (D.D.C. 1985).

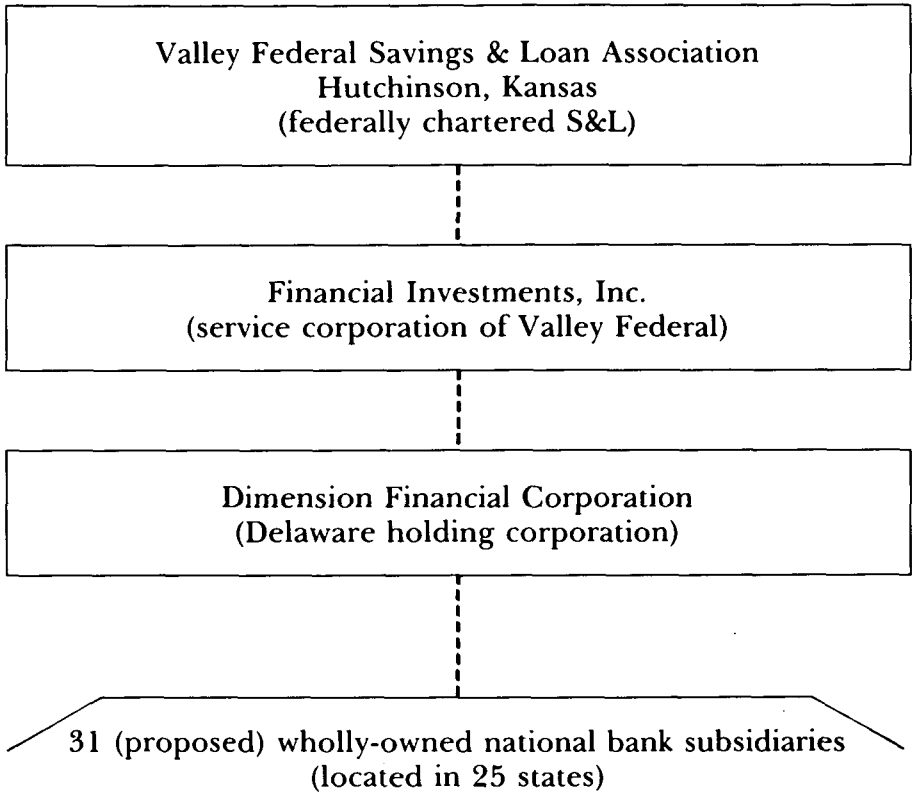
61 *See id.* at 951.

62 *Id.*

63 *See* 48 Fed. Reg. 23,521 (May 1983). The proposal was issued in final form on December 29, 1983, effective February 6, 1984. 49 Fed. Reg. 794 (1984).

Illustration 3

Dimension Financial Corporation:
Intracorporate Relationships



Comptroller which expressed a commitment to avoid engaging in the activities defined as "commercial loans" under the expanded definition, so long as that definition was in effect.[64]

The Comptroller's deliberations over the Dimension applications had continued in the interim. In April 1983, the Comptroller published a notice of public hearings on the applications.[65] The hearings were held on August 8-12, 1983.[66] The 90 parties participating in the hearings and the subsequent comment period were generally opposed to the applications, on the grounds that, *inter alia*, the proposal required the approval of the Fed under the BHCA.[67]

It was not until November 1983 that the Fed, through its General Counsel, made any official comment on the pending Dimension applications. The General Counsel's letter to the Chief Counsel of the Office of the Comptroller was, at best, a mixed blessing to the interested parties. While the General Counsel stated that it did "not appear appropriate for the [Fed] to take any action on the Deerbrook Bank's petition,"[68] he went on to state:

> [T]here is a substantial question whether the Dimension banks would be "banks" for the purpose of the BHC Act. . . . [N]either the [Fed] nor the staff has made any final determination on the status of the Dimension banks under the BHC Act.[69]

In the meantime, the Fed's expanded definition of "commercial loan" was promulgated. While Dimension clearly disputed the validity of the Fed's expanded definition of "commercial loans,"[70] it had already expressed its willingness to limit the activities of its pro-

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64 *See* Indep. Bankers of America v. Conover, 603 F. Supp. 948, 952 (D.D.C. 1985). In January 1984, Dimension made the same commitment directly to the Fed. *See id.*, n.6.

65 48 Fed. Reg. 18,265 (1983).

66 Attempts by Deerbrook State Bank to obtain an injunction against the hearings were unsuccessful. *See* Deerbrook State Bank v. Conover, 568 F. Supp. 696 (N.D. Ill. 1983). *See also* text and accompanying notes 170-75, *infra*.

67 *See* Indep. Bankers of America v. Conover, 603 F. Supp. 948, 951 (D.D.C. 1985).

68 Letter from Michael Bradfield, General Counsel, Board of Governors of the Federal Reserve System (Nov. 15, 1983) *quoted in id.*

69 Indep. Bankers of America v. Conover, 603 F. Supp. 948, 951-52.

70 *See* Dimension Financial Corp. v. Bd. of Governors, 744 F.2d 1402 (10th Cir. 1984), *aff'd*, — U.S. —, 54 U.S.L.W. 4101 (1986).

posed nonbank banks in accordance with the strictures of that expanded definition.[71] In light of the Fed's apparent intention to initiate no action of its own, one may wonder whether in the final analysis the position expressed in the General Counsel's letter represented anything more than a holding action.

Whatever the Fed's intentions, the Comptroller granted preliminary approval for not more than four of the dimension banks, in a thirty-page decision issued on May 9, 1984, reserving judgment on the remainder of the banks.[72] In this regard, the Comptroller specifically noted Dimension's commitment with respect to the Fed's expanded definition of "commercial loan," and concluded as a result that "the application no longer can be said to pose substantial B.H.C.A. questions."[73]

The IBAA responded to this decision by renewing its petition to the Fed.[74] In June 1984, the Fed indicated that it would conduct a thorough inquiry into the operation of the proposed Dimension banks.[75] At this juncture, the campaign was shifted to the judicial arena; the IBAA filed suit in the federal district court for the District of Columbia, challenging the Comptroller's decision.[76]

The Comptroller's decision on the Dimension applications came in the midst of his continuing moratorium on nonbank banks. In April 1983, after having received the Dimension applications, the Comptroller announced what eventually became a one-year moratorium on the processing of nonbank bank applications, in order to give Congress an opportunity to resolve the nonbank bank controversy by legislative action.[77] Characteristically, Congress did not

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71 *See* Indep. Bankers of America v. Conover, 603 F. Supp. 948, 951 (D.D.C. 1985).

72 *See Dimension Decision, supra* note 52, at 87,759.

73 *Id.* at 87,762.

74 *See* Indep. Bankers of America v. Conover, 603 F. Supp. 948, 952 (D.D.C. 1985).

75 Letter from the Secretary of the Board of Governors of the Federal Reserve System (June 19, 1984) *quoted in id.*

76 *See* text and accompanying notes 188-204, *infra.*

77 *See April 1983 Policy Statement, supra* note 42. The moratorium was originally intended to terminate in January 1984. It was twice extended, to continue through March 1984. *See* 48 Fed. Reg. 56,301 (1983). A final extension, imposing a moratorium on the processing of national bank charter applications for nonbank banks accepted for filing after March 31, 1984, expired on October 15, 1984. *See Renewal of Policy Statement Regarding Nonbank Approvals*, 49 Fed. Reg. 21,137 (1984) [hereinafter *Policy Statement Renewal*]. *See also Indep. Bankers Ass'n of America, supra* note 37, at 90,530.

take advantage of the moratorium, and debate on an appropriate resolution of the controversy continued.

By May 1984, the Comptroller had received over 200 applications for nonbank banks, virtually all from established bank holding companies seeking to set up interstate networks.[78] The Comptroller's office believed "that rendering decisions on [nonbank bank] applications during the current session of Congress could have a negative impact on the consideration by Congress of much-needed comprehensive banking legislation."[79] Accordingly, the moratorium was extended through the end of the congressional session.[80] The Comptroller did reach decisions on the applications accepted for filing before the moratorium renewal date of March 31, 1984.[81] By October 1984, the Comptroller had over 300 applications pending for the chartering of nonbank banks,[82] and still Congress had not acted. At that point, the Comptroller lifted the moratorium.[83]

The Comptroller's approach to the nonbank bank problem was to seek a confrontation with Congress, in effect threatening continued nonbank bank charter approvals unless legislative reform was accomplished. The Fed, on the other hand, tried to contain the problem by the exercise of its current regulatory authority. The results have been mixed at best.

The Fed moved against one early nonbank bank through its authority to issue cease and desist orders against violations of the banking laws. In the *Wilshire Oil* case, for example, it sought to require the divestiture by Wilshire Oil of the Trust Company of New Jersey, despite the latter's ostensible elimination of demand deposits.[84] The Fed's administrative order was eventually upheld, on the

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78 *See Policy Statement Renewal, supra* note 77, at 21,137.

79 *Id.*

80 Statement by C.T. Conover, *supra* note 51, at 87,750.

81 *Policy Statement Renewal, supra* note 77, at 21,137. *Cf. Dimension Decision, supra* note 47, at 87,759, n.1.

82 *See* Indep. Bankers of America v. Conover, 603 F. Supp. 948, 953, n.8 (D.D.C. 1985).

83 All but one of the Comptroller's 329 pending applications for nonbank banks were submitted by bank holding companies subject to the BHCA, and therefore subject to approval by the Fed as a "closely related" activity. *See Indep. Bankers Ass'n of America, supra* note 37, at 90,530. *Cf.* text and accompanying note 31, *supra*; text and accompanying note 86, *infra*. Litigation challenging the Comptroller's authority to proceed with the applications quickly intervened once the moratorium was lifted. *See, e.g.*, text and accompanying notes 175-76, *infra*.

84 *See* text and accompanying notes 107-19, *infra*.

grounds that the deposits would in fact continue to be operated as if they were payable on demand.[85]

As the nonbank bank movement continued to develop, however, the Fed began to expand the scope of its administrative response in ways that courts would find difficult to uphold. The Fed first proceeded against nonbank banks to be acquired by existing bank holding companies which were themselves already subject to the BHCA. Under the Act, Fed approval was required before such a company could acquire a non-banking company.[86] So, for example, in its 1981 decision approving the acquisition of an "industrial loan company" by First Bancorporation, the Fed required that the proposed subsidiary not offer both NOW accounts[87] and commercial loans.[88] In addition, the Fed circulated its order in First Bancorporation to other bank holding companies, an action suggesting that the decision embodied in this order represented generally applicable Fed policy.[89] The Fed's order and policy were later challenged before the Tenth Circuit, and rejected by that court.[90]

Similarly, in 1982, the Dreyfus Corporation proposed the acquisition of a nonmember state-chartered bank, insured by the FDIC, in which it would eliminate the bank's commercial loan portfolio while retaining demand deposits, thus freeing the acquisition from BHCA regulation. The Fed responded by asserting that the subsidiary would still be a "bank" for BHCA purposes because purchases of commercial paper, bankers acceptances, certificates of deposit and similar lending vehicles would constitute "commercial loans" within the meaning of the BHCA.[91] The FDIC, which was the primary federal regulator concerned with the acquisition because of the federal insurance of the target bank, refused to accept this inter-

85 *See* Wilshire Oil Co. v. Bd. of Governors, 668 F.2d 732 (3d Cir. 1981). *See also* text at note 116, *infra*.

86 *See, e.g.*, 12 U.S.C. § 1843(c)(8) (1982).

87 "NOW accounts," or negotiable orders of withdrawal, are interest-bearing accounts from which the account holder may withdraw funds by a negotiable order, the functional equivalent of an interest-bearing checking account. NOW accounts are now authorized by 12 U.S.C. § 1832 (1982).

88 *See* First Bancorporation v. Bd. of Governors, 728 F.2d 434, 435 (10th Cir. 1984).

89 *See id.*

90 *See id. See also* text and accompanying notes 126-33, *infra*.

91 *See* Dimension Financial Corp. v. Bd. of Governors, 744 F.2d 1402, 1406 (10th Cir. 1984), *aff'd*, — U.S. —, 54 U.S.L.W. 410 (1986).

pretation by the Fed, and approved the transaction.[92] In a related charter application before the Comptroller, that official also rejected the Fed's new interpretation of the meaning of "commercial loan."[93]

Undaunted by this opposition from the other federal bank regulators, the Fed next acted, in 1984, by promulgation in final form of an amendment to Regulation Y,[94] the Fed regulation implementing the BHCA. In addition to formalizing its new interpretation of "demand deposit,"[95] to include such things as NOW accounts, the amendment also defined "commercial loan" to include:

> the purchase of retail installment loans or commercial paper, certificates of deposit, bankers' acceptances, and similar money market instruments, the extension of broker call loans, the sale of federal funds, and the deposit of interest-bearing funds.[96]

This amendment was generally viewed not as a response to changing business perceptions of what constituted a "commercial loan," but purely as an attempt by the Fed to halt the proliferation of nonbank banks by bringing them within its jurisdiction under the BHCA.[97] This expanded interpretation of the meaning of "commercial loan" was contrary to previous regulatory interpretations both of the Fed and of the other federal regulatory agencies.[98] It was this amendment that was implicated in the Dimension applications discussed previously,[99] and which was later struck down by the Tenth Circuit.[100]

With the judicial repudiation of its attempt to expand the definitions of "demand deposit" and "commercial loan" for BHCA pur-

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92 *See id.*

93 *See id.*

94 *See* 49 Fed. Reg. 794 (1984).

95 *See* 12 C.F.R. § 225.2(a)(1)(A) (1985).

96 *See id.* § 225.2(a)(1)(B) (1985).

97 *See, e.g.*, Dimension Financial Corp. v. Bd. of Governors, 774 F.2d 1402, 1405 (10th Cir. 1984), *aff'd* — U.S. —, 54 U.S.L.W. 4101 (1986). *See also* 49 Fed. Reg. 794, 835-36 (1984).

98 *See Dimension Financial Corp.*, 744 F.2d at 1405-06. *See also* Bd. of Governors of the Fed. Reserve System v. Dimension Financial Corp., — U.S. —, 54 U.S.L.W. 4101, 4104 (1986).

99 *See* text and accompanying notes 63-65, *supra*.

100 *See* Dimension Financial Corp. v. Bd. of Governors, 774 F.2d 1402 (10th Cir. 1984), *aff'd*, — U.S. —, 54 U.S.L.W. 1401 (1986).

poses,[101] the Fed appeared to lapse into relative passivity. While it continued to insist that nonbank bank charter applications required Fed review under the BHCA,[102] the Fed's resistance to nonbank banks was less cogent in practice.[103] Indeed, even before the Comptroller had reached a decision on the Dimension applications, the Fed had already accepted the arguments of U.S. Trust Corporation that its U.S. Trust Company of Florida (USTC-Fla.) was not subject to the BHCA:

> The activities proposed by [USTC-Fla.] have been tested against [the BHCA] definition of bank. . . [USTC-Fla.] will accept demand deposits but not make commercial loans as defined by the [Fed] in Regulation Y. Thus, [USTC-Fla.] will not be a bank within the meaning of the [BHCA].[104]

The Comptroller referred to this Fed decision in support of his eventual approval of the Dimension applications two months later.[105] Characteristically, however, the Fed decision itself was later challenged in litigation.[106]

Judicial Reaction

The earliest judicial reaction to the use of the nonbank bank device was decidedly unpromising for advocates of that device. In *Wilshire Oil Co. v. Bd. of Governors*,[107] the Fed had issued a cease and desist order against Wilshire, the holding company of the Trust Company of New Jersey (TCNJ). The order required that Wilshire comply with the BHCA either by divesting itself of its impermissible non-banking activities (*i.e.*, oil and gas production) or by divesting itself of its interest in TCNJ.[108]

Wilshire eventually responded by sending a notice to TCNJ

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101 *See* text and accompanying notes 126-43, *infra*.

102 *See, e.g.*, text and accompanying note 198, *infra*.

103 *See* Indep. Bankers of America v. Conover, 603 F. Supp. 948, 957 (D.D.C. 1985).

104 *U.S. Trust Corporation*, 70 Fed. Res. Bull. 371, 372 (March 23, 1984).

105 *See Dimension Decision, supra* note 52, at 87,761, n.2.

106 *See* Florida Dept. of Banking v. Bd. of Governors, 760 F.2d 1135 (11th Cir. 1985); *vacated*, U.S. Trust Corp. v. Bd. of Governors, — U.S. —, 34 U.S.L.W. 3493 (1986).

107 668 F.2d 732 (3d Cir. 1981).

108 Wilshire, a one-bank holding company, owned 90% of the shares of TCNJ. It became subject to the BHCA when the act was amended in 1970 to include one-bank holding companies. *See* text at note 227, infra.

depositors indicating that "beginning November 20, 1980 [TCNJ] reserve[d] the right to require 14 days notice prior to withdrawal" from what had previously been demand deposit accounts.[109] Standing alone, this change in account terms would appear to remove TCNJ from the BHCA definition of "bank," since it would no longer be accepting demand deposits. However, the notice to depositors went on to state that TCNJ "ha[d] never exercised its right to require notice and ha[d] no intention of exercising a notice provision on any type of account."[110] For purposes of the BHCA, then, the question was whether these accounts were "deposits that the depositors ha[d] a legal right to withdraw on demand."[111]

Wilshire stressed the statutory language requiring a *legal* right to withdraw on demand, claiming that the notice effectively eliminated that right.[112] The Fed argued to the contrary that the language of the notice indicating that TCNJ had no intention of requiring a 14-day notice created a legal right to withdrawal on demand, since it induced depositors, to their potential detriment, not to terminate their accounts with TCNJ.[113] The Third Circuit refused to resolve the matter based on either technical argument.

The Third Circuit expressed a preference for deciding the case in light of the purposes of the BHCA. It intended to "look beyond the plain language [of the BHCA] . . . to ensure that application of the literal terms does not destroy the practical operation of the statutes."[114] After reviewing the legislative history of the BHCA,[115] the court concluded that

> TCNJ falls within the category of institutions that congress intended to include in its definition of "bank" in the [BHCA]. In practice, TCNJ's "transactional accounts" are "demand deposits," because . . . it has no intention of exercising its right to require advance notice of withdrawals. There is no dispute that TCNJ makes commercial loans. Together, these factors indicate that the possibility of abuse of commercial credit

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109 *See* Wilshire Oil Co. v. Bd. of Governors, 668 F.2d 132, 734 (3d Cir. 1981).

110 *See id.*

111 12 U.S.C. § 1841(c)(1) (1982).

112 Wilshire Oil. Co. v. Bd. of Governors, 668 F.2d 732, 735 (3d Cir. 1981).

113 *Id.*

114 *Id.*

115 *See id.* at 736-37. *See also* text and accompanying notes 219-30, *infra*.

exists. . . .[116]

Taking into account the Fed's statutory authority to issue regulations and orders to "prevent evasions"[117] of the BHCA,[118] the Third Circuit concluded that the Fed acted properly in issuing its cease and desist order against Wilshire.[119] On one level, this decision may seem to be a straightforward triumph of "substance over form." Yet the court was obviously guided by the rather blatant way in which Wilshire sought to "comply" with the BHCA without any material alteration in its dealings with its customers.[120] In addition, Wilshire had become a bank holding company before the act became applicable to one-bank holding companies in 1970.[121] Even after *Wilshire Oil*, therefore, it remained an open question whether complete and literal compliance with the limitations of the BHCA definition of "bank" might free a holding company from the BHCA, particularly if the nonbank was established *de novo* with the approval of a bank chartering authority.

This has been the approach of holding companies to the nonbank bank problem *post Wilshire Oil*. In this they have been encouraged by chartering authorities like the Comptroller, who as recently as May 1984 stated that "[u]nder present law, nonbank banks are definitely legal."[122] Similarly, in reaching his decision to grant four national bank charters to Dimension, the Comptroller emphasized that "Dimension Corp.'s applications . . . represent a sound banking concept. The concept is permissible under applicable federal and state laws."[123] Thus, the practical result of the *Wilshire Oil* decision would appear to have been a greater fidelity on the part of nonbank banks to the literal terms of the BHCA definition of "bank" in light of that decision.[124] The results for consistent regu-

116 Wilshire Oil Co. v. Bd. of Governors, 668 F.2d 732, 737-38 (3d Cir. 1981).

117 12 U.S.C. § 1844(b) (1982).

118 *See Wilshire Oil Co.*, 668 F.2d at 738-39.

119 *Id.* at 740, *citing* First National Bank in Plant City v. Dickinson, 396 U.S. 122, 137 (1969).

120 *See, e.g., Wilshire Oil Co.*, 668 F.2d at 738, n.14.

121 *See* note 108, *supra*.

122 Statement by C.T. Conover, *supra* note 51, at 87,750.

123 *Dimension Decision*, *supra* note 52, at 87,768 (footnote omitted).

124 *See, e.g.*, First Bancorporation v. Bd. of Governors, 728 F.2d 434, 436 (10th Cir. 1984). *See also* Dimension Financial Corp. v. Bd. of Governors, 744 F.2d 1402, 1407 (10th Cir. 1984), *aff'd*, — U.S. —, 54 U.S.L.W. 4101 (1986). "The changes which have come about cannot be characterized as 'evasions' of the [BHCA]. The entities have followed the Act. . . ."

latory policy were nevertheless unfavorable, since this response to *Wilshire Oil* has led to a proliferation of nonbank bank proposals.

As has already been mentioned,[125] the Fed's response to this proliferation was a dramatic change in its interpretation of the meaning of the key statutory terms, "demand deposit" and "commercial loan." This change drew attack from nonbank bank proponents. In *First Bancorporation v. Bd. of Governors*,[126] a holding company challenged the legality of the Fed's interpretation of the term "demand deposit" to include NOW accounts, as embodied in the Fed's orders approving the holding company's proposed acquisition of two Utah industrial loan companies. The Tenth Circuit invalidated the orders on two grounds.

First, on the merits, it did not accept the Fed's expanded interpretation of the statutory term.[127] The court distinguished *Wilshire Oil* as a case involving an attempted evasion of the BHCA, which the Fed had statutory authority to prevent.[128] In contrast, the record in the present case "evince[d] no evidence that [the industrial loan company] had attempted to evade the [BHCA's] provisions."[129] Furthermore, the court viewed the legislative history of certain amendments to the BHCA as indicating a rejection of earlier Fed interpretations which would have included deposits such as NOW accounts within the meaning of the term "demand deposit."[130]

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125 *See* text and accompanying note 47, *supra*.

126 728 F.2d 434 (10th Cir. 1984).

127 *See id.*, at 436:

> We need look no further than the [BHCA] definition of a "bank" to resolve the dispute. . . .Utah law specifically proscribes loan companies from accepting demand deposits, requiring instead that the companies reserve the legal right to demand notice prior to withdrawal. There is therefore no legal right of withdrawal on demand.

128 *Id.*

129 *Id.*

130 *See id.* at 436-37:

> The [Fed] issued two interpretations of the 1956 legislation as including those institutions which accepted deposits subject to check (demand deposits) as well as those which accepted funds from the public that were, in actual practice, repaid on demand. . . . In 1966, . . . Congress amended [the definition of "bank"] to include the "legal right to withdraw" provision. . . Congress rejected the [Fed's] suggested amendment which would have read merely "payable on demand." Congress therefore overturned the [Fed's] interpretation by substituting the "*legal right* to withdraw" language for the [Fed's] right to withdraw on demand *in actual practice* provision. . . .

(Emphasis in original.)

The second ground for invalidating the orders was that the Fed had circulated the orders to other holding companies, with the apparent implication that the interpretation contained therein was intended to establish a generally applicable rule through an adjudicative order.[131] The subsequent use of the orders appeared to the court to indicate that the orders were "merely a vehicle by which a general policy would be changed,"[132] and it concluded that

> This is a broad policy announcement. The [Fed's] order contains no adjudicative facts having any particularized relevance to the petitioner. We must conclude that the [Fed] abused its discretion by improperly attempting to propose legislative policy by an adjudicative order.[133]

The Fed's next move was to promulgate formally its new interpretation of the key statutory terms as generally applicable regulations.[134] This prompted yet another challenge in litigation initiated by Dimension Financial, again before the Tenth Circuit.[135] The court summarily invalidated the "demand deposit" aspect of the new rule on the basis of its previous decision in *First Bancorporation*.[136]

As to the "commercial loan" aspect of the new rule, the court felt compelled to examine prior administrative interpretations of the term,[137] as well as the legislative history of the 1970 amendment to the BHCA which added this last aspect to the definition of "bank."[138] This review led the court to several related conclusions.

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131 *See id.* at 437. While the Tenth Circuit acknowledged that administrative agencies are not "precluded from announcing new principles in an adjudicative proceeding," *id.*, *quoting* N.L.R.B. v. Bell Aerospace Co., 416 U.S. 267, 294 (1974), this use of the adjudicative authority could in certain circumstances amount to an abuse of discretion.

132 First Bancorporation v. Bd. of Governors, 728 F.2d 434, 437 (10th Cir. 1984), *citing* 5 U.S.C. § 551(4) (1982).

133 *Id.* at 438, *citing* N.L.R.B. v. Wyman-Gordon Co., 394 U.S. 759, 764-65 (1969); Ford Motor Co. v. F.T.C., 673 F.2d 1008 (9th Cir. 1981); Patel v. Immigration and Naturalization Service, 638 F.2d 1199 (9th Cir. 1980); United States v. Empey, 406 F.2d 157, 170 (10th Cir. 1969). On the adjudication/rulemaking controversy, *see* B. SCHWARTZ, ADMINISTRATIVE LAW 191-96 (2d ed. 184).

134 *See* text and accompanying notes 94-100, *supra*.

135 Dimension Financial Corp. v. Bd. of Governors, 744 F.2d 1402 (10th Cir. 1984), *aff'd*, — U.S. —, 54 U.S.L.W. 4101 (1986).

136 *See id.* at 1404.

137 *See id.* at 1404-07. *Cf.* text and accompanying notes 91-98, *supra*.

138 *See Dimension Financial Corp.*, 744 F.2d at 1407-08. *Cf.* text and accompanying notes 228-30, *infra*.

First, the views taken by the other interested federal regulatory agencies—as well as by several of the regional Federal Reserve Banks—on the meaning of "commercial loan" was decidedly contrary to that taken by the Fed in its new rule.[139] Second, the new rule was itself an abrupt departure from the Fed's prior "consistent policy or position" on this issue until 1982.[140] Third, the legislative history of the 1970 amendment indicated that the amended definition, by the addition of the "commercial loan" aspect, was intended to exclude entities from the BHCA which did not make "commercial loans" in the ordinary sense of the term.[141] As to that sense of the term, the court had this to say:

> There can be no serious dispute but that the term "commercial loans" as used in the banking business when the [BHCA] was adopted did not include the purchase of money market transactions nor certificates of deposit nor did it include interbank transactions.[142]

The court therefore refused to uphold the Fed in this apparently radical departure from past practice and interpretation. In invalidating this second aspect of the Fed's regulation, the Tenth Circuit underscored the need for a legislative resolution of the nonbank bank problem:

> We cannot hold that the limited authority of the [Fed] permits it to bring about the change here attempted and a change in its own jurisdiction no matter how necessary it perceives the change to be, and no matter how serious it may consider the inaction of Congress to be in face of the growth of financial institutions presently [*sic*] outside the [Fed's] statutory jurisdiction.[143]

In January 1986, the Supreme Court affirmed the Tenth Circuit's decision in *Dimension Financial* in a unanimous opinion delivered by the Chief Justice.[144] In determining whether the Fed had the authority to amend Regulation Y as it had attempted to do, the

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139 *See Dimension Financial Corp.*, 744 F.2d at 1410.

140 *See id.* at 1406.

141 *See id.* at 1408.

142 *Id.*

143 *Id.* at 1410.

144 Bd. of Governors of the Federal Reserve System v. Dimension Financial Corp., — U.S. —, 54 U.S.L.W. 4101 (1986). The vote was 8-0, Justice White taking no part in the consideration or decision of the case. *Id.* at 4105.

Court looked first to the language of the BHCA itself.[145] Application of this analysis to the "demand deposit" portion of the Fed's regulatory amendment required, in the Court's view, no extended discussion. The Court stated:

> By the 1966 amendments to § 2(c) [of the BHCA, 12 U.S.C. § 1841(c)], Congress expressly limited the [BHCA] to regulation of institutions that accept deposits that "the depositor has a legal right to withdraw on demand." . . . The [Fed] would now define "legal right" as meaning the same as "a matter of practice." But no amount of agency expertise—however sound may be the result—can make the words "legal right" mean a right to do something "as a matter of practice." . . . The [Fed's] definition of "demand deposit," therefore, is not an accurate or reasonable interpretation of § 2(c).[146]

The Court then considered the second portion of the Fed's regulatory amendment, the redefinition of "commercial loan." The Fed had characterized the instruments newly included in the definition as "substitute[s] for commercial loans."[147] In noting this, the Court observed that the characterization suggested that these instruments did not fall within the commonly accepted understanding of the term "commercial loan."[148] Seizing upon the Fed's own characterization, therefore, the Court argued:

> The term "commercial loan" is used in the financial community to describe the direct loan from a bank to a business customer for the purpose of providing funds needed by the customer in its business. The term does not apply to, indeed is used to distinguish, extensions of credit in the open market that do not involve close borrower-lender relationships.[149]

The Court went on to observe that the Fed's consistent interpretation of "commercial loan" prior to the amendment of Regulation Y reflected the common understanding of the term in the financial community.[150] Dismissing the Fed's arguments from the

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145 *See id.* at 4103, *quoting* Chevron U.S.A. Inc. v. National Resources Defense Council, Inc., 467 U.S. 837, 842-43 (1984).

146 Bd. of Governors of the Federal Reserve System v. Dimension Financial Corp., — U.S. —, 54 U.S.L.W. 4101, 4103 (1986).

147 49 Fed Reg. 794, 840, n.34 (1984). *See also Citicorp*, 69 Fed. Res. Bull. 921, 923 (1983).

148 Bd. of Governors of the Federal Reserve System v. Dimension Financial Corp., — U.S. —, 54 U.S.L.W. 4101, 4103-04 (1986).

149 *Id.* at 4104.

150 *Id. Cf.* note 98, *supra*.

legislative history of the BHCA, the Court concluded that "[n]othing in the statutory language or the legislative history . . . indicates that the term 'commercial loan' meant anything different from its accepted ordinary commercial usage."[151]

The Court addressed a further argument of the Fed which, in fact, echoes a policy argument endorsed by the Eleventh Circuit in *Florida Dept. of Banking v. Board of Governors*.[152] The argument attempts to measure the authority of the Fed against a broad reading of the policy "purposes" of the BHCA. Following the challenge of its administrative initiative in the Tenth Circuit, the Fed had grudgingly granted approval of the USTC-Fla. application.[153] That approval was challenged by the Florida Department of Banking, on the grounds that the application violated the BHCA policy against interstate banking activities by bank holding companies in the absence of explicit state approval.[154]

In upholding this argument, the Eleventh Circuit adopted a view of implications of the *Wilshire Oil* decision which is more expansive than, and clearly inconsistent with, that adopted by the Tenth Circuit in its *First Bancorporation* decision.[155] While the Eleventh Circuit appears to have acknowledged the fact that the nonbank bank status of UTC-Fla. excluded its from the literal terms of the BHCA,[156] it refused to allow the literal terms of the BHCA definition of "bank" to control the outcome of the case. In effect, the key to its resolution of the problem presented by the case turns upon two issues of characterization. It in effect characterizes such decisions as *First Bancorporation* and *Dimension Financial* as being based upon "[l]iteralism in statutory interpretation."[157] In addition, it

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151 *Bd. of Governors*, — U.S. —, 54 U.S.L.W. at 4104.

152 760 F.2d 1135 (11th Cir. 1985).

153 *Cf.* text and accompanying note 101, *supra*.

154 *Florida Dept. of Banking*, 760 F. 2d at 1143-44, *citing* Wilshire Oil Co. v. Bd. of Governors, 668 F.2d 732 (3d Cir. 1981).

155 *Compare Florida Dept. of Banking*, 760 F. 2d at 1143-44 (Fed statutory authority "to prevent evasions" available to bar nonbank banks) *with* First Bancorporation v. Bd. of Governors, 728 F. 2d 434 (10th Cir. 1984) (*contra*).

156 *See, e.g., Florida Dept. of Banking*, 760 F. 2d at 1137.

157 *Id.* at 1139. *See also id.* at 1141. In addition, however, the Eleventh Circuit did argue that *Dimension Financial* was distinguishable, since it did not "rule specifically on whether nonbank banks could be established without regard to the Douglas Amendment" to the BHCA which prohibits interstate banking by bank holding companies in the absence of explicit state approval. *Id.* at 1142, n.15. *Cf.* note 12, *supra*.

characterized the 1970 amendment to the BHCA definition of the term "bank" as a mere "technical amendment."[158]

In the court's view, a literal reading and application of this "technical amendment" to the status of a nonbank bank would lead to an anomalous result. A fundamental legislative policy embodied in the BHCA would be frustrated, namely, the prohibition against interstate banking by bank holding companies in the absence of explicit approval by the host state of the proposed subsidiary.[159] The application of the statutory definition must therefore be reconciled with this policy in order to prevent evasions of the latter. Accordingly, it was incumbent upon the Fed to utilize its statutory authority to prevent evasions[160] by denying the USTC-Fla. application.[161]

The Eleventh Circuit's characterization of the BHCA definition of "bank" inappropriately skews the legislative history of the act. It is not credible to view the successive amendments of that definition, carefully considered by Congress as representing significant changes in the scope of the BHCA and the jurisdiction of the Fed,[162] as mere "technical" amendments. Nor is it sensible to invoke the BHCA policy concerning interstate banking without regard to the quite conscious jurisdictional limitations imposed by Congress on the Fed's application of the act.[163]

The Fed's policy argument before the Supreme Court in *Dimension Financial* was more broad-based than that found in *Florida Dept. of Banking*. Nonbank banks must be subject to the Fed's BHCA regulations, in light of the policy of the statute as a whole, in order to vindicate the "plain purpose" of the BHCA.[164] In the Fed's view, this would mean treating products which were the "functional equivalents" of demand deposits like demand deposits for purposes of the definition of "bank" in the BHCA.[165] The Court rejected this argument out of hand, noting that "[t]he 'plain purpose' of legisla-

158 *Id.* at 1141. *See also id.* at 1142.

159 *See id.* at 1141.

160 *See* 12 U.S.C. § 1844(b) (1982).

161 *Florida Dept. of Banking*, 760 F. 2d at 1144.

162 *See, e.g.*, Dimension Financial Corp. v. Bd. of Governors, 744 F.2d 1402, 1407-08 (10th Cir. 1984), *aff'd*, — U.S. —, 54 U.S.L.W. 4101 (1986).

163 *See, e.g., id.* at 1408: "The authority of the [Fed] under the [BHCA] is to be exercised in a restricted area."

164 *See* Bd. of Governors of the Federal Reserve System v. Dimension Financial Corp., — U.S. —, 54 U.S.L.W. 4101, 4105 (1986).

165 *Id.*

tion . . . is determined in the first instance with reference to the plain language of the statute itself."[166] The language itself represented an explicit and specific decision with respect to the coverage of the BHCA, and the Fed was without authority to readjust the scope of that coverage.[167] This is not to say that there might not be imperfections in the statutory scheme judged against present regulator needs. However, the Court is clear in leaving the remedy of any such problem to Congress: "If the [BHCA] falls short of providing safeguards desirable or necessary to protect the public interest, that is a problem for Congress, and not the Board or the courts, to address."[168]

In light of its treatment of the "plain purpose" argument, it should not be surprising that the Court within a week went on to vacate the Eleventh Circuit's decision in *Florida Dept. of Banking* in light of its decision in *Dimension Financial*.[169] With these two decisions, then, the Supreme Court has rendered both the courts and the bank regulatory agencies *hors de combat*. It remains for Congress, therefore, to decide whether the jurisdictional limitations implicit in the definition of "bank" need to be readjusted yet again. Whether Congress will respond effectively and responsibly remains to be seen.

From a strategic point of view, judicial consideration of the nonbank bank device has been essentially reactive. If, as the Tenth Circuit believed, resolution of the policy dilemma raised by the device can only be reached legislatively, then at best proponents of the device may expect resort to the courts to impel the regulators to

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166 *Id.*

167 Application of "broad purposes" of legislation at the expense of specific provisions ignores the complexity of the problems Congress is called upon to address and the dynamics of legislative actions. . . . Invocation of the "plain purpose" of legislation at the expense of the terms of the statute itself takes no account of the processes of compromise and, in the end, prevents the effectuation of congressional intent.

. . .Congress defined with specificity certain transactions that constitute banking [*sic*] subject to regulation. The statute may be imperfect, but the [Fed] has no power to correct flaws it perceives in the statute. . . . The Court also rejected the Fed's argument that it had the necessary power under its statutory authority to issue regulations "necessary to . . . prevent evasions" of the BHCA pursuant to 12 U.S.C. § 1844(b) (1982). *Id.*

168 *Id.*

169 U.S. Trust Corp. v. Bd. of Governors, *supra* note 10, at 3493 (1986).

desist from administrative attempts to squeeze out use of the device. By the same token, opponents of the device may expect at most that resort to the courts might provide an impediment to the *pace* of the development of the nonbank bank trend.

One such tactic to slow down the spread of nonbank banks has been to seek injunctive relief against the Comptroller. This tactic attempts to prevent him from taking any steps towards granting a national bank charter to such an entity until the Fed itself has either determined that the BHCA did not apply or approved the acquisition by the holding company.[170] It is clear that issues concerning the applicability of the BHCA are, at the administrative level, within the exclusive jurisdiction of the Fed,[171] and in such a case the Comptroller is required to condition the approval of a charter application on subsequent Fed approval.[172] This is not to say, however, that an injunction against the Comptroller's preliminary consideration of a nonbank bank charter application is appropriate,[173] and at least one court has refused to issue an injunction at such a preliminary stage.[174]

A more straightforward tactic has involved a direct attack on the legality of nonbank banks. This approach is represented by the IBAA's litigation strategy in a number of cases. In *Independent Bankers Assoc. of America v. Conover*,[175] the IBAA was successful in obtaining a preliminary injunction in the Middle District of Florida restraining the Comptroller from granting final approvals for nonbank bank charters, on the grounds that nonbank banks are not en-

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170 This was the approach taken by plaintiffs in opposing the Comptroller's consideration of the Dimension applications. *See* Deerbrook State Bank v. Conover, 568 F. Supp. 696, 698 (N.D. Ill. 1983). *See also* text, *supra* at note 76.

171 *See* Whitney National Bank v. Bank of New Orleans and Trust Company, 379 U.S. 411 (1965). *See also Deerbrook State Bank*, 568 F. Supp. at 698.

172 *See* Gravois Bank v. Bd. of Governors of the Federal Reserve System, 478 F.2d 546 (8th Cir. 1973).

173 *See, e.g.*, Deerbrook State Bank v. Conover, 568 F. Supp. 696, 698-99 (N.D. Ill. 1983):

> In the instant case, no charter has been issued by the Comptroller, nor is there any threat that any charter will issue in the near future or before several procedural steps are taken. . . .
>
> [T]he issue before this Court, plainly stated, is whether the Comptroller can be enjoined from taking any steps whatsoever, including deciding issues which are particularly within his jurisdiction, while substantial BHCA issues remain outstanding.

174 *Id.* at 700.

175 *Supra* note 37.

gaged in the "business of banking" within the meaning of the National Bank Act.[176] If these entities are not in fact engaged in the "business of banking," the argument went, then the Comptroller is not authorized by the act to grant them national charters.

While this argument is not without its attractions, it requires that the language of the act positively granting authority[177] and defining its outward limits[178] must be read as forcing banks chartered under the act to use all of their statutory powers up to those limits. This reading of the statutory language, which itself declines to give *any* definition of "bank" or the "business of banking,"[179] seems tortured.

In supporting this reading, the Middle District of Florida referred to *National State Bank of Elizabeth, N.J. v. Smith*,[180] in which the Comptroller had been enjoined from granting a national bank charter to an entity which would be limited to trust services only. It may be argued to the contrary, however, that this reliance is misplaced. First, the judgment of the District Court was reversed and remanded with directions to dismiss with respect to the Comptroller.[181]Second, the case involved an entity that would refrain from exercising any and all of the traditional powers inherent in the "business of banking."

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176 *See id.* at 90,533. The Comptroller is authorized by the National Bank Act, 12 U.S.C. §§ 1 to 220 (1982), to grant charters to national banks to carry on "the business of banking." *See, e.g., id.* §§ 26, 27. The act also provides that national banks "shall have power [to exercise] . . . all such incidental powers as shall be necessary to carry out the business of banking." *Id.* § 24 (Seventh) (1982 & Supp. III 1985). The act does not define the "business of banking." The court reasoned that

> the core of the business of banking as defined by law and custom is accepting demand deposits and making commercial loans. In fact, most of the litigation has been over whether banks have gone beyond their authorized powers and over whether other types of financial institutions were invading functions which have traditionally been reserved exclusively to banks.
>
> The Comptroller has presented no authority to rebut plaintiffs' argument that the essence of "business of banking," as defined by law and custom, includes taking demand deposits and making business loans.

Indep. Bankers Ass'n of America, supra note 37, at 90,535 (citations omitted).

177 *See, e.g.*, 12 U.S.C. § 27 (1982).

178 *See, e.g., id.* § 24 (Seventh) (1982 & Supp. III 1985).

179 *Cf.* note 38, *supra*.

180 No. 76-1479 (D.N.J. September 16, 1977), *rev'd on other grounds*, 591 F.2d 223 (3d Cir. 1979).

181 *Id.* at 233.

Nevertheless, as the Middle District of Florida pointed out,[182] the dismissal of the complaint as to the Comptroller in *National State Bank* was a result of an amendment of section 27(a) of the National Bank Act which explicitly authorized the chartering of a national bank limited to trust powers.[183] Similarly, a 1982 amendment authorized the chartering of bankers' banks.[184] The court reasoned that "Congress referred to trust companies and bankers' banks as 'limited charter institutions', thus distinguishing them from national banks engaged in the business of banking."[185] From this legislative history, the court concluded:

> It is clear that when Congress has wanted to expand the authority of the Comptroller *to charter national associations that are not to be engaged in the business of banking*, it has done so through specific amendments. If Congress had intended that the Comptroller have broad chartering authority over various types of financial institutions, there would have been no need for the trust company and bankers' bank amendments, and those amendments would not have been narrowly drawn.[186]

The difficulty with this argument is that it still begs the question. What does it mean to charter an entity to engage in the "business of banking"? Does the statutory language mean that such entities are forced to use all available statutory powers? The argument concerning the legislative history of the trust company and bankers' bank amendments is not an independent argument; it depends upon the prior acceptance of a rather strained reading of the pertinent language of the National Bank Act.

In any event, if accepted the argument does no more than bar the Comptroller from conditioning the grant of a charter on the applicant's agreement to limit its activities. It does not, on its own terms, bar the applicant itself from limiting its activities. If the new bank does in fact refrain from commercial lending or accepting demand deposits, then by definition it is not a "bank" for purposes of the BHCA.

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182 *Indep. Bankers Ass'n of America*, *supra* note 37, at 90,536.

183 *See* Financial Institutions Regulatory and Interest Rate Control Act of 1978, Pub. L. No. 95-630, § 1504, 92 Stat. 3641 (1978) (codified at 12 U.S.C. § 27(a) (1982)).

184 *See* 12 U.S.C. § 27(b)(1) (1982).

185 *Indep. Bankers Ass'n of America*, *supra* note 37, at 90,536, *citing* S. REP. No. 97-536, 97th Cong., 2d Sess. 27-28 (1982).

186 *Id.* (emphasis added).

This observation leads to a consideration of another litigation tactic utilized by the IBAA, a direct attack on the status of nonbank banks in light of the BHCA itself. As in the *Deerbrook State Bank* case,[187] the argument of the IBAA before the federal district court for the District of Columbia, in *Indep. Bankers of America v. Conover*,[188] was that the Comptroller lacked authority to consider the legal issues raised by the Dimension applications with regard to the BHCA.[189]

The court noted that the recent decision of the Tenth Circuit in *Dimension Financial*,[190] striking down the Fed's expanded definition of "commercial loan," had an impact on the case before it.[191] However, the court rejected the argument advanced by the defendants that *Dimension Financial* rendered the case moot. The court considered that the straightforward issue of Fed jurisdiction remained:

> This is not a case in which this Court must decide whether the application of [the amended version of] Reg. Y would cause the Dimension subsidiaries to be treated as "banks" under the B.H.C.A. If it were, the invalidation of [the amendments to] Reg. Y might moot this lawsuit. However, the merits of the Reg. Y issue are not being argued here. Instead, the Court must decide whether an injunction should issue to stay the hand of the Comptroller while the [Fed] considers the merits of the Dimension proposal.[192]

Accordingly, the issue raised by this litigation focused on the question of whether or not the Dimension applications raised a "substantial issue" under the BHCA. If so, then the Comptroller was barred from issuing a final charter to the proposed bank, until such time as the Fed had disposed of the issue.[193]

The procedural stance of the case raised some ambiguities in

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187 Deerbrook State Bank v. Conover, 568 F. Supp. 696 (N.D. Ill. 1983).

188 603 F. Supp. 948 (D.D.C. 1985). The suit had originally been filed in the Northern District of Illinois, but the court granted defendant's motion to transfer to the District of Columbia District. *Id.* at 953.

189 *Id.* at 952-53.

190 Dimension Financial Corp. v. Bd. of Governors, 744 F.2d 1402 (10th Cir. 1984), *aff'd*, — U.S. —, 54 U.S.L.W. 4101 (1986).

191 *Indep. Bankers of America*, 603 F. Supp. at 953.

192 *Id.* at 955 (footnote omitted).

193 *See id.* at 955-56, *citing* Whitney National Bank v. Bank of New Orleans and Trust Company, 379 U.S. 411 (1965); Marshall & Ilsley Corp. v. Heimann, 652 F.2d 685, 699-701 (7th Cir. 1981); American Bank of Tulsa v. Smith, 503 F.2d 784, 784-87 (10th Cir. 1974).

the court's view. The IBAA had requested that the court issue an order referring the question of the "substantial" nature of the issues raised in the case to the Fed.[194] However, Fed decisions under the BHCA are subject to appellate review directly before the circuit courts.[195] Granting the relief requested by the IBAA would therefore require the district court to take "action to affect the Court of Appeals' future jurisdictions over the [Fed]; such an order is improper and this Court lacks jurisdiction to enter it."[196] On this ground alone, the court was inclined to deny the plaintiff's request.[197]

Further, on the merits of the "substantial issue" question itself, the court observed that in the Fed's position, *post Dimension Financial*, "[a]ny mention of the [Fed's] belief that a 'substantial' B.H.C.A. question still exists is conspicuously absent. . . ."[198] Even assuming that the Fed had maintained its previous assertion of a "substantial issue" under the BHCA in this case, the court was of the view that it would not be bound by that assertion as a matter of law.[199] In the

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194 *See* Indep. Bankers of America v. Conover, 603 F. Supp. 948, 956, n.13 (D.D.C 1985).

195 *See* 12 U.S.C. § 1848 (1982).

196 *Indep. Bankers of America*, 603 F. Supp. at 956-57, *citing* Telecommunications Research and Action Center v. Federal Communications Commission, 750 F.2d 70, 76-77 (D.C.Cir. 1984); Southwest Bank of Forth Worth v. Heimann, No. 80-1115, *mem. op.* at 4 (D.D.C. March 25, 1981).

197 *See Indep. Bankers of America*, 603 F. Supp., at 957.

198 *Id.* at 957. The court quoted at length from a letter from the Fed General Counsel to the Acting Assistant Attorney General (Civil Division), which stated in pertinent part:

> The [Fed] staff believes that it would be most useful to undertake a review of the lawfulness under the BHC Act of Dimension's acquisition of the proposed national banks after any approval of the Dimension proposal by the [Federal Home Loan] Bank Board [the primary regulator of the Dimension parent, Valley Federal Savings and Loan Association]. . . .
>
> It is of course preferable that matters such as this be resolved by cooperation among the interested agencies with referral to the [Fed] of issues that require resolution under the BHC Act.

Letter from Michael Bradfield, General Counsel, Board of Governors of the Federal Reserve System, January 4, 1985, *quoted in Indep. Bankers of America*, 603 F. Supp. at 957. The absence of reference to any "substantial" issue in the January 1985 letter was, in the court's view, unlikely to be an oversight, particularly when contrasted with the clear reference to the "substantial question" raised by the Dimension applications in the General Counsel's (*ante Dimension Financial*) November 1983 letter. *See* note 68, *supra*. *See also Indep. Bankers of America*, 603 F. Supp. at 957.

199 *Indep. Bankers of America*, 603 F. Supp. at 957-58.

present case, the court found that, particularly in light of the Fed's passivity in the circumstances,[200] no substantial issue under the BHCA was raised by the Dimension applications.[201] While this finding was not meant to imply that BHCA issues might not arise in the operation of the Dimension banks,[202] "the Comptroller [had] correctly decided that the Dimension proposal did not in its present form raise any substantial B.H.C.A. issues."[203] The defendants' motion for summary judgment was therefore granted.[204]

The legal issues surrounding nonbank banks are beginning to resolve themselves. Ironically, at least until March 1986 it seemed that the focus of the debate over the future of interstate banking had already shifted away from nonbank banks. In the wake of the Supreme Court's decision in *Dimension Financial Corp.*,[205] Congress came under increasing pressure to resolve the controversy over nonbank banks.[206] Current congressional proposals would draw nonbank banks, for the most part, within the BHCA scheme of regulation.[207] However, controversy continues between the House and Senate Committees over the precise approach to be taken.[208] In addition, now that Treasury has broken ranks and come out in favor of nonbank banks,[209] the fate of the current congressional proposals is even less clear.

In any event, in the wake of the Supreme Court's decision in *Northeast Bancorp., Inc. v. Board of Governors*,[210] upholding regional interstate banking arrangements, it is clear that the continued formation of regional interstate banking systems will proceed apace. A growing number of states have already adopted statutes permitting out-of-state bank holding companies located in states within a speci-

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200 *See id.* at 958, n.17.

201 *Id.* at 958-59.

202 *Id.* at 959.

203 *Id.*

204 *Id.* at 960.

205 *See* text and accompanying notes 144-69, *supra*.

206 *See, e.g.*, Wynter, *Congress Is Squeezed on 'Nonbank' Issue*, Wall St. J., Mar. 12, 1986, at 6, col. 1.

207 *See, e.g.*, H.R. 20, 99th Cong., 1st Sess. (1985) (the St. Germain bill).

208 *See* Wynter, *White House, in Policy Switch, Urges Acceptance of Limited-Service Banks*, Wall St. J., Mar. 5, 1986, at 64, col. 1.

209 *See* note 51, *supra*.

210 472 U.S. —, 105 S.Ct. 2545 (1985).

fied region to operate a bank within their respective borders.[211]

There were also indications that interest in nonbank banks as the preferred strategy for breaking through interstate banking restrictions was waning, at least for the time being. After the decision in *Dimension Financial Corp.*, one might have expected that chartering authorities would have experienced a heightened interest in the processing of nonbank bank applications, since the BHCA now clearly did not apply to these entities. In fact, the Comptroller reported in mid-February 1986 that his office had received no new requests for nonbank banks since the Court's decision in January.[212] By the first week in March 1986, his office had received only two new applications.[213]

Nevertheless, at least until early March 1986, the Comptroller's office seemed less than enthusiastic about the prospects for the applications already in house. Since November 1, 1984, the office had received 388 applications for nonbank banks, of which 61 were still pending and 280 had received preliminary approval. All these applications were "on hold" because of the injunction against final approval issued in *Independent Bankers Assoc. of America*, in the Middle District of Florida.[214] In testimony before the Senate Banking Committee on March 4, 1986, the Comptroller apparently endorsed the Treasury proposal in favor of nonbank banks, and indicated that he would begin final approvals of the applications once the injunction was lifted.[215]

The issues surrounding nonbank banks may end up being resolved by the force of inertia. If Congress now acts, as it should have some time ago, the problem of the nonbank bank may simply disappear in a haze of "reregulation."[216] However, the prospect for congressional action is now even less clear, if that is possible, for two reasons. First, the House and Senate Committees still do not agree on the approach to be taken in resolving the issue. Second,

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211 *See, e.g.*, Berg, *Banking's Big Merger Spree*, N.Y. Times, Nov. 1, 1985, at D1, col. 3.

212 *See No Nonbank Bank Requests Spurred by High Court Ruling, Comptroller Says*, 18 SEC. REG. & L. REP. (BNA) 224 (Feb. 14, 1986).

213 *See* Nash, *Plan to Aid F.S.L.I.C. Is Outlined*, N.Y. Times, Mar. 5, 1986, at D5, col. 1.

214 *See supra*, note 212.

215 *See* Nash, *supra*, note 213.

216 *But cf.* Note, *The Demise of the Bank/Nonbank Distinction: An Argument for Deregulating the Activities of Bank Holding Companies*, 98 HARV. L. REV. 650 (1985).

Treasury has now taken the position that nonbank banks are not even a problem. To the contrary, Treasury now seems to take the position that, at least in certain situations, nonbank banks might be a very helpful device for infusing needed capital into the thrift industry.[217]

Legislative Actions

As a technical matter, the difficulties that the administrators and the courts have had in responding to the problem of the nonbank bank are essentially definitional. However, these definitional problems are perforce jurisdictional as well.[218] The definition of "bank" for purposes of the BHCA has in fact been amended several times in an effort to adjust the jurisdictional scope of the act.[219] Pending congressional proposals would seek to resolve the current controversy over nonbank banks by adjusting that definition yet again.[220]

The BHCA was originally enacted to prevent undue concentration of commercial banking activities and to separate banking from commerce.[221] The original definition of "bank" for these

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217 *See* Wynter, *supra* note 208.

218 *Cf.* Dimension Financial Corp. v. Bd. of Governors, 744 F.2d 1402, 1405 (10th Cir. 1984), *aff'd*, — U.S. —, 54 U.S.L.W. 4101 (1986); Indep. Bankers of America v. Conover, 603 F. Supp. 948, 958 (D.D.C. 1985).

219 *See generally* Wilshire Oil Co. v. Bd. of Governors, 668 F.2d 732, 733 (3d Cir. 1981).

220 *See* text and accompanying notes 229-31, *infra*.

221 *See* S. REP. No. 1095, 84th Cong., 1st Sess. 2 (1955). The Eleventh Circuit has recently emphasized a third policy purpose which it sees reflected in the BHCA, one which is directly threatened by the use of the nonbank bank device, namely, the congressional desire "to prohibit the creation of interstate deposit-taking networks by bank holding companies without specific state authorization." Florida Dept. of Banking v. Bd. of Governors, 60 F.2d 1135 (11th Cir. 1985), *vacated*, U.S. Trust Corp. v. Bd. of Governors, — U.S. —, 54 U.S.L.W. 3493 (1986). This purpose is reflected in the Douglas Amendment to the BHCA, introduced on the floor of the Senate by Senator Douglas in 1956, and later codified at 12 U.S.C. § 1842(d) (1982). *See* 102 CONG. REC. 6860 (1956) (remarks of Sen. Douglas). *See also* Northeast Bankcorp., Inc. v. Bd. of Governors, 472 U.S. —, 105 S. Ct. 2545, 2551-52 (1985). *Cf.* note 12, *supra*.

While this provision may represent a fundamental policy of the BHCA, the fact remains that the nonbank bank device avoids this policy—as, indeed, it avoids the entire statutory regime of the BHCA—by placing itself outside the definitional framework of the statute entirely. *See* Dimension Financial Corp. v. Bd. of Governors, 744 F.2d 1402, 1407 (10th Cir. 1984), *aff'd*, — U.S. —, 54 U.S.L.W. 4101 (1986)

purposes included all national banks, state-chartered banks and savings banks.[222] This was the so-called "charter test,"[223] that is, if an entity had obtained its corporate charter under a statute granting banking powers, it was covered by the BHCA, regardless of the extent to which the entity utilized the corporate powers available to it.

Ten years later, the BHCA was amended, and the term "bank" was defined to include only those institutions which accepted "deposits that the depositor ha[d] a legal right to withdraw on demand."[224] The legislative history of this amendment appears to indicate that the original definition was considered to be too broad, and the 1966 amendment was intended as a remedy to this problem.[225] Thus, the focus was shifted to the exercise of a corporate power to accept demand deposits, with the explicitly intended result that savings banks, thrift institutions that did not offer demand deposits, were removed from the coverage of the BHCA.[226]

In 1970 Congress amended the BHCA once again, primarily to expand the applicability of it to one-bank holding companies for the first time. Such companies were given ten years either to divest any impermissible non-banking operations or to cease being bank holding companies.[227] However, this expansion in applicability was balanced by a third amendment to the definition of "bank," which currently includes only institutions which both accept demand deposits and make commercial loans.[228] The legislative intention appears to have been to fashion a definition that would serve the policy purposes of the BHCA, but without unnecessarily restricting the activities of institutions that did not engage in *commercial* banking.[229] In achieving this long-sought objective, the focus of the draftsmen of the amended definition was now explicitly upon the commercial loan aspect of the defini-

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222 Act of May 9, 1958, c.240 § 2(c), 70 Stat. 133.

223 *See* Dimension Financial Corp. v. Bd. of Governors, 744 F.2d 1402, 1404 (10th Cir. 1984), *aff'd*, — U.S. —, 54 U.S.L.W. 4101 (1986): "What was a 'bank' in the original Act depended on its charter."

224 Act of July 1, 1966, Pub. L. 89-485, § 3, 80 Stat. 236, 237.

225 *See* S. REP. No. 1179, 89th Cong., 2d Sess. 7 (1966).

226 *See id.*

227 *See* 17 U.S.C. § 1843(a)(2) (1982).

228 *See id* § 1841(c) (1982).

229 *See* S. REP. No. 91-1084, 91st Cong., 2d Sess. 24 (1970).

tion of the term "bank."[230]

The effectiveness of the BHCA in achieving its policy objectives is supported by the authority given to the Fed "to issue such regulations and orders as may be necessary to enable it to . . . prevent evasions [of the act]."[231] In the present context, the question has arisen concerning the extent to which this power to prevent evasions applies to definitional issues. As has already been discussed, this power supports the Fed's attempts to construe or interpret the definition of "bank" in light of the facts of a particular situation.[232] However, there is serious question whether this power would support an attempt by the Fed, in effect, to refine or amend the statutory definition of "bank" itself.[233]

It was with little effort that interested congressional leaders, as well as the federal regulators, came to the view that there was a need for a legislative solution to the nonbank bank problem. Unfortunately, that was one of the few issues on which there was any consensus.[234]

One of the basic disagreements in principle among them was whether the legislative solution should be limited to a mere "loophole-closing" bill or should attempt a comprehensive realignment of the regulatory system.[235] For example, when Rep. St. Germain, chairman of the House Banking Committee, announced in May 1984 that his bill[236] would endorse the narrower approach, the Comptroller and Sen. Garn, chairman of the Senate Banking Committee, both indicated that they were fundamentally opposed to St. Germain's bill.[237] Despite this opposition, as well as criticism from industry groups, Rep. St.

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230 *See id.*

231 12 U.S.C. § 1844(b) (1982).

232 *See* Wilshire Oil Co. v. Bd. of Governors, 668 F.2d 732 (3d Cir. 1982). *See also* text and accompanying notes 111-113, *supra*.

233 *See* First Bancorporation v. Bd. of Governors, 728 F.2d 434 (10th Cir. 1984); Dimension Financial Corp. v. Bd. of Governors, 744 F.2d 1402 (10th Cir. 1984), *aff'd* — U.S. —, 54 U.S.L.W. 4101 (1986). *See also* text and accompanying notes 124-127, *supra*.

234 *See, e.g., Shad Says SEC 'Strongly Endorses' Pending Bills on Financial Reform*, 16 SEC. REG. & L. REP. (BNA) 539 (Mar. 23, 1984).

235 *See St. Germain Drafts Legislation to Close Nonbank Bank Loopholes*, 16 SEC. REG. & L. REP. (BNA) 802 (May 11, 1984).

236 H.R. 5734, 98th Cong., 2d Sess (1984).

237 *Supra* note 235, at 803.

Germain scheduled hearings on the bill for June 1984.[238] At the outset of the hearings, he threw down the gauntlet to his critics; there would be either a loophole-closing bill, or no legislation at all.[239]

In the meantime, Sen. Garn had also resurrected his own proposal and began moving forward with a broader reform bill.[240] He would close the nonbank bank loophole in the BHCA, but also expand the powers of banks, particularly with respect to securities activities.[241] These activities would include discount brokerage services[242] and the marketing of mortgage-backed securities, municipal revenue bonds and money market mutual funds.[243] Donald Regan, then Treasury Secretary, favored this broader approach to reform legislation, charging that the narrower loophole-closing approach was "really protectionist legislation for the securities and insurance industries."[244] Nevertheless, expansion of banks' securities powers continued to be opposed in the House and among some of the Senate Banking Committee members.[245]

A confrontation between these two approaches to bank regulatory reform seemed almost inevitable. After much internal wrangling, two restrictive bills, H.R. 5881 and 5916, were approved in June 1984 by Rep. Wirth's subcommittee[246] and Rep. St. Germain's committee,[247] respectively. Also in late June, the

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238 *See St. Germain Plans Hearings on Measure to Close Loophole; Wirth Slates Markup*, 16 SEC. REG. & L. REP. (BNA) 969 (June 1, 1984). *See also Wirth Plans to Combine Moratorium, Nonbank Loophole Bills in Markup*, 16 SEC. REG. & L. REP. (BNA) 1009 (June 8, 1984).

239 *St. Germain Offers Nonbank Ban Bill of Nothing during Committee Hearings*, 16 SEC. REG. & L. REP. 1002 (June 8, 1984).

240 S. 2181, 98th Cong., 2d Sess. (1984).

241 *See Congressional Panels Appear Poised to Vote on Financial Reforms*, 16 SEC. REG. & L. REP. (BNA) 1039 (June 15, 1984).

242 *But cf.* Securities Industry Ass'n v. Bd. of Governors, FRS, 468 U.S. 137 (1984), (under current law, national bank authorized to acquire discount brokerage firm).

243 *See supra* note 241, at 1040.

244 *Quoted in* Carrington, *Regan Says Plan to Halt Diversification By Banks Is 'Protectionist Legislation,'* Wall St. J., June 20, 1984, at 5, col. 1.

245 *See supra* note 241, at 1040.

246 *See Wirth Panel Approves Bill to Close Nonbank Bank Loophole*, 16 SEC. REG. & L. REP. (BNA) 1070 (June 22, 1984); Noble, *House Panel Clears Banking-Curb Bill*, N.Y. Times, June 22, 1984, at D11, col. 5.

247 *See* Noble, *House Panel Approves New Limits on Banking*, N.Y. Times, June 27,

Senate Banking Committee had approved S. 2181, based on Sen. Garn's broader proposal, although by mid-July it was already open to question whether that bill would be taken up by the Senate before its recess for the Republican National Convention.[248]

In light of the Comptroller's ultimatum to lift his self-imposed moratorium if Congress did not act by the end of that session,[249] the situation was becoming increasingly urgent. In light of the fundamental lack of consensus among the interested parties on the approach that the reform legislation should take,[250] the prospects for action in either the House or the Senate began to disappear.[251] Speculation increased that Congress might compromise and do no more for the interim than impose a legislative moratorium to replace the Comptroller's.[252]

In fact, Congress did even less than that. When Congress returned in September 1984 for a short session, opposition continued in certain quarters in the Senate against the Garn proposal, though the Senate did pass S. 2851 on September 13, 1984.[253] On the House side, St. Germain announced in late September that he did not plan to move before the end of the session on H.R. 5916, since the Senate would probably insist on including an expansion of bank powers too broad to be acceptable to the House.[254] In a letter to Sen. Garn, Rep. St. Germain suggested that Congress consider adopting a compromise moratorium in the interim, but Garn rejected this compromise in a speech delivered four days later.[255] The session ended without any satisfactory resolution from Congress of the nonbank bank problem. Shortly thereafter, as he had threatened, the Comptroller lifted his moratorium and began approving the backlog of

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1984, at D1, col. 1; *House Banking Panel Approves Loophole Closing Bill With New Grandfather Date*, 16 SEC. REG. & L. REP. (BNA) 1100 (JUNE 29, 1985).

248 *See Senate Banking Bill*, 16 SEC. REG. & L. REP. (BNA) 1213 (July 20, 1984).

249 *See* text and accompanying note 51, *supra*.

250 *See, e.g., Garn Blasts Banking Bill Opponents, Continues Push for Comprehensive Bill*, 16 SEC. REG. & L. REP. (BNA) 1325 (AUG. 10, 1984).

251 *See Action on House, Senate Financial Reform Bills Unlikely Before Recess*, 16 SEC. REG. & L. REP. (BNA) 1288 (Aug. 3, 1984).

252 *See id.*

253 *See* Noble, *New York Senators Block Banking Bill*, N.Y. Times, Sept. 7, 1984, at D5, col. 1.

254 *See St. Germain Says No Action Planned This Year on Financial Reform Bill*, 16 SEC. REG. L. REP. (BNA)1550 (Sept. 28, 1984).

255 *See id.*

nonbank bank charter applications before him.[256]

The new Congress promised a continuation of the controversy that had stymied the previous congressional efforts to resolve the nonbank bank problem. Early in January 1985, both St. Germain and Garn indicated that they would initiate efforts to reintroduce their previous proposals.[257] St. Germain did suggest, however, that he would open up a "second track" later for a broader, more comprehensive proposal.[258] In addition, the federal regulators themselves continued their disagreements over the appropriate legislative resolution of the nonbank bank problems.[259]

The current state of play at this writing may be illustrated by the "Financial Institutions Equity Act of 1985,"[260] a bill reported out of the House Banking Committee. The bill incorporates the approach of St. Germain's earlier proposals. It would close the nonbank bank loophole by amending the BHCA definition of "bank" to include either:

> (A) *an insured bank as defined in section 3(h) of the Federal Deposit Insurance Act*;[261] or
>
> (B) an institution which is organized under the laws of the United States, any State of the United States, the District of Columbia, any territory of the United States, Puerto Rico, Guam, American Samoa, or the Virgin Islands, and which—
>
> (i) accepts demand deposits *or deposits that the depositor may withdraw by check or similar means for payment to third parties or others*; and
>
> (ii) makes commercial loans.[262]

It is obvious that one effect of this amendment would be some modest "fine-tuning" of the demand deposit feature of the current BHCA definition of "bank." It is doubtful whether this change,

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256 *Cf.* text and accompanying note 83, supra.

257 *See St. Germain Plans Fast Track in House for Single-Purpose Nonbank Bank Bill*, 17 SEC. REG. & L. REG. (BNA) 62 (Jan. 11, 1985).

258 *See id.*

259 *See* Wynter, *U.S. Regulators Differ on Handling Non-Bank Banks*, Wall St. J., Apr. 19, 1985, at 12, col. 3.

260 H.R. 20, 99th Cong., 1st Sess. (1985). *See* H.R. REP. No. 99-175, 99th Cong., 1st Sess. (1985).

261 *See* 12 U.S.C. § 1813(h) (1982) (defining "insured bank").

262 H.R. 20, 99th Cong., 1st Sess. § 2(a) (1985) (emphasis added).

standing alone, would make any appreciable difference in the jurisdictional scope of the BHCA.

However, the alternative condition, FDIC insurance, would by its own terms include within the BHCA virtually all commercial banks, industrial banks, certain trust companies, and many of the nonbank banks that had already been created.[263] The bill explicitly excludes from the new definition (*i*) entities engaged primarily in foreign banking; (*ii*) certain entities engaged only in credit card operations; and, (*iii*) certain trust companies that limited their activities to trust and fiduciary services.[264] In addition, since FDIC insurance is the key to this loophole-closing, FSLIC-insured thrift institutions would not be covered by the definition.[265]

Nonbank banks given final approval on or before May 9, 1984, could continue their operations outside the BHCA as "designated restricted purpose banks,"[266] but subject to certain significant limitations. Holding companies of such banks would be subject to the BHCA provisions, except for section 4,[267] concerning the regulation of non-banking activities. These banks would be limited to the activities in which they were engaged on May 24, 1984, and violation of this limitation could result in a Fed order for divestiture of the bank by its holding company.[268]

The bill would also amend the Savings and Loan Holding Company Act[269] to bring uninsured thrift institutions under the act.[270] It would also bring unitary savings and loan holding companies under the act,[271] thus paralleling to an extent the treatment of one-bank holding companies, which have been subject to the BHCA since the

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263 *See* H.R. REP. No. 99-175 (1985) at 11. *Cf.* 12 U.S.C. § 1813(h) (1982).

264 H.R. 20, 99th Cong., 1st Sess. § 2(a) (1985).

265 In addition, the bill exempts (*i*) FDIC-insured state-chartered savings banks; (*ii*) federal savings banks that were formerly state-chartered on or before May 24, 1984; and, (*iii*) state chartered S&L's, savings banks and other thrifts insured under state law or by a corporation created pursuant to state law. *See id* § 5(a). Acquisition of one of these thrift institutions by a holding company which engages in activities other than those authorized for a multiple S&L holding company or which operates interstate would result in the loss of the exemption as to that institution. *Id.*

266 *Id.* §§ 2(b), 3.

267 12 U.S.C. § 1843 (1982).

268 H.R. 20, 99th Cong., 1st Sess. § 3(b) (1985).

269 12 U.S.C. § 1730a (1982).

270 H.R. 20, 99th Cong., 1st Sess. § 4(a) (1985).

271 *Id.* § 4(c).

1970 amendments of that act.[272]

Legislative action at the state level has so far been relatively more productive. Certain trends in state statutory provisions with respect to, or affecting, nonbank banks are readily apparent.[273] For present purposes, the pertinent provisions of three types of state statute will be examined.

The first type, which may be referred to as the unilateral out-of-state prohibition, can be illustrated by the Florida statutory provisions. Florida prohibits a bank, trust company, or bank holding company with operations "principally conducted outside" Florida from controlling any bank or trust company operating within the state.[274] For these purposes, a controlled "bank" is defined as "any person having a subsisting charter . . . to conduct a general commercial banking business."[275] The term "general commercial banking business" is defined to *include* "(a) the business of receiving demand and time deposits; (b) the payment of checks; and (c) the conduct of a trust business when duly authorized."[276] Since the definition appears to be inclusive, rather than exclusive, it is likely that this definition should not be read as narrowly as the BHCA definition of bank. If so, nonbank banks would therefore be banks for purposes of the Florida prohibition.[277]

This statutory prohibition would prevent entry of an out-of-state holding company into the state's banking market. In that sense, it would clearly have the effect of negating the interstate banking advantage which nonbank banks afford to their holding companies. However, similar Florida provisions were struck down by the Supreme Court in *Lewis v. BT Investment Managers, Inc.*,[278] as violative of the Commerce Clause.[279] In *Lewis*, the Florida prohibition on out-of-state control of investment advisory services was at

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272 *See* text and accompanying note 197, *supra*.

273 *See generally Dimension Decision*, *supra* note 52, *Appendix: Analysis of State Law Provisions Pertaining to the Application of Dimension Financial Corporation to Charter 31 National Banks in 25 States*, at 87,768-86.

274 Fla. Stat. Ann. § 658.29(1) (West 1984).

275 *Id.* § 658.12(3).

276 *Id.* § 658.12(12).

277 *Cf. Dimension Decision*, *supra* note 52, *Appendix*, *supra* note 273, at 87,769.

278 447 U.S. 27 (1980).

279 *Id.* at 44 (statute a direct burden on interstate commerce). *See also* Continental Illinois Corp. v. Lewis, No. 81-0944-WS (N.D. Fla., Dec. 13, 1983) (Florida prohibition on out-of-state ownership of industrial savings bank unconstitutional).

issue. It could therefore be argued that, at least in such a traditional area of state regulation as banking,[280] the local interest outweighs any impact on interstate commerce.[281] Nevertheless, it is clear under *Lewis* that even state regulation of banking is subject to the limitations on state action implicit in the Commerce Clause.[282]

Thus, the unilateral out-of-state prohibition may be inadequate as a remedy for the nonbank bank problem, for two reasons. First, it is not primarily intended as a response to that problem, but rather, it may be argued, is crafted as a device of "simple economic protectionism."[283] If it resolves the nonbank bank problem, it does so indirectly in gross terms only. Second, this sort of prohibition may raise constitutional challenges such as occurred in *Lewis*.[284]

The second type of statute of concern here may be referred to as the regional interstate model. A growing number of states have adopted statutes permitting out-of-state bank holding companies located in states within a specified region to operate a bank within their respective borders. (*See* Illustration 4, *infra*.) The New England regional banking arrangement was recently upheld by the Supreme Court, in a unanimous decision, in *Northeast Bancorp, Inc. v. Board of Governors*,[285] as against challenges based upon the Douglas Amendment to the BHCA,[286] as well as, *inter alia*, the Commerce Clause. In this regard, the Court emphasized that the BHCA reflected congressional "policies of community control and local responsiveness of banks."[287]

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280 *See, e.g.*, Noble State Bank v. Haskell, 219 U.S. 104 (1911); Farmers & M. Bank v. Federal Reserve Bank, 262 U.S. 649 (1923); *Lewis*, 447 U.S. at 35-36, 38.

281 *Cf.* Edgar v. MITE Corp., 457 U.S. 624, 640-41 (1982) (applying Commerce Clause test of burden disproportionate to legitimate state interest).

282 *Lewis*, 447 U.S. at 38-39.

283 Philadelphia v. New Jersey, 437 U.S. 617, 624 (1978).

284 *But cf.* Northeast Bancorp, Inc. v. Bd. of Governors, 472 U.S. —, 105 S. Ct. 2545, 2554 (1985) (BHCA authorization of state restrictions on interstate bank holding company acquisitions renders certain state actions "invulnerable to constitutional attack under the Commerce Clause"). *See also Lewis*, 447 U.S. at 47 (state authority under BHCA to regulate banking activities of out-of-state holding companies).

285 472 U.S. —, 105 S. Ct. 2545 (1985).

286 *Cf.* note 12, *supra*.

287 Northeast Bancorp., Inc. v. Bd. of Governors, 472 U.S. —, 105 S. Ct. 2545, 2551 (1985).

Illustration 4

States Adopting the Regional
Interstate Model
(As of May 28, 1985)

No reciprocity:

Oregon	BHC's in Alaska, Arizona, California, Hawaii, Idaho, Nevada, Utah, and Washington. Only Oregon banks in existence for at least 3 years may be acquired. Effective July 1, 1986.

Reciprocity required:

Connecticut	BHC's headquartered in the 5 New England States of Maine, Massachusetts, New Hampshire, Rhode Island, and Vermont. Effective June 8, 1983.
Florida	BHC's in the District of Columbia and the following 11 States: Alabama, Arkansas, Georgia, Louisiana, Maryland, Mississippi, North Carolina, South Carolina, Tennessee, Virginia, and West Virginia. Acquired banks must have been in existence for at least 5 years. Effective July 1, 1985.
Georgia	BHC's in the following 9 States: Alabama, Florida, Kentucky, Louisiana, Mississippi, North Carolina, South Carolina, Tennessee, and Virginia. Acquired banks must have been in existence for at least 5 years. Effective July 1, 1985.
Idaho	BHC's in the following 6 States: Montana, Nevada, Oregon, Utah, Washington, and Wyoming. De novo entry is prohibited. Effective July 1, 1985.

Indiana	BHC's in the following 4 States: Illinois, Kentucky, Michigan, and Ohio. Effective July 1, 1985, although acquisitions will not be allowed until Jan. 1, 1986. Indiana banks can avoid being acquired for 2 years under an "opt out" provision of the legislation authorizing interstate banking.
	MBHC's will be prohibited from further bank acquisitions if their individual share of deposits in Indiana banks exceeds 10 percent in 1985, 11 percent in 1986, or 12 percent in 1987.
Kentucky[1]	BHC's in the following 7 States: Illinois, Indiana, Missouri, Ohio, Tennessee, Virginia, and West Virginia. Effective July 13, 1984.
	Nationwide July 13, 1987.
Maryland	BHC's in the District of Columbia and the following 3 States: Delaware, Virginia, and West Virginia. Maryland banks less than 4 years old may not be acquired. Effective July 1, 1985.
	In addition, after June 30, 1987, BHC's in the following 11 States: Alabama, Arkansas, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, Pennsylvania, South Carolina, and Tennessee.
Massachusetts	Banks and BHC's in the 5 New England States of Connecticut, Maine, New Hampshire, Rhode Island, and Vermont. Effective July 1, 1983.
North Carolina	BHC's in the District of Columbia and the following 12 States: Alabama, Arkansas, Florida, Georgia, Kentucky, Louisiana, Maryland, Mississippi, South Carolina, Tennessee, Virginia, and West Virginia. Effective July 1, 1985.
Rhode Island	BHC's in the 5 New England States. Effective July 1, 1984.
	Nationwide July 1, 1986.

South Carolina	BHC's in the District of Columbia and the following 12 States: Alabama, Arkansas, Florida, Georgia, Kentucky, Louisiana, Maryland, Mississippi, North Carolina, Tennessee, Virginia, and West Virginia. Effective July 1, 1986.
Tennessee	BHC's in the following 13 States: Alabama, Arkansas, Florida, Georgia, Indiana, Kentucky, Louisiana, Mississippi, Missouri, North Carolina, South Carolina, Virginia, and West Virginia. Effective July 1, 1985.
Utah	BHC's in the following 11 States: Alaska, Arizona, Colorado, Hawaii, Idaho, Montana, Nevada, New Mexico, Oregon, Washington, and Wyoming. Entry by acquisition only, de novo entry prohibited. Effective April 17, 1984.
Virginia	BHC's in the District of Columbia and the following 12 Southeastern States: Alabama, Arkansas, Florida, Georgia, Kentucky, Louisiana, Maryland, Mississippi, North Carolina, South Carolina, Tennessee, and West Virginia. Effective July 1, 1985.

[1]A regional banking State with a trigger date for nationwide banking

Source: H.R. Rep. No. 99-174

This approach to interstate banking does not constitute a direct legislative response to the nonbank bank problem. Nevertheless, it is a response to the larger concern over interstate expansion of banking markets, of which the nonbank bank phenomenon is one manifestation. As the Court itself noted, the regional interstate model is a state statutory response to "growing competition from nonbank financial services which are not confined within state lines."[288]

Thus, while it may be only an indirect approach to the problem, the existence of the regional interstate model will doubtless do much to modify, and perhaps blunt the significance of, the nonbank

288 *Id.* at 2553.

bank problem. It therefore shares with the unilateral out-of-state prohibition the feature of regulation by indirection, though it is perhaps less heavy-handed in its approach. In addition, the regional model appears to be on firmer ground than the unilateral approach with respect to its constitutionality.[289]

The third type of state statute of interest in the present context has a direct effect on the nonbank bank. It may be accurately referred to as a nonbank prohibition. One recent example of this direct approach to the problem is the New Jersey Act Regulating Control of Certain Depository Institutions.[290] The legislation put into place a moratorium on the establishment of new "nonbank banks" in New Jersey, at first until January 1986,[291] later extended until January 1987.[292]

The moratorium is applicable to all FDIC-insured institutions except (*i*) savings banks, state or federal, and (*ii*) trust companies, limited to trust business.[293] The prohibitory provisions that implement the moratorium are as follows. First, no BHC shall control a "bank," as defined in the legislation,[294] unless it is also a "bank" under the federal BHCA.[295] Second, if the BHC is not a "BHC" under the federal BHCA, then it cannot control a bank in New Jersey.[296] Third, no out-of-state BHC can control a bank in New Jersey.[297]

The act grandfathers control of banks which existed on or before January 1, 1985.[298] This grandfather provision preserved at least seven nonbank banks which had been created by out-of-state

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289 *But see* note 284, *supra*.

290 1985 N.J. Laws 58. Among other things, c.58 was intended to supersede 1985 N.J. Laws 39, which had a somewhat narrower grandfather clause. (*Cf.* note 298, *infra*.) The latter enactment was repealed at the same time that c. 58 was extended for another year, through 1986. *See* 1985 N.J. Laws 521, Jan. 21, 1986. Other states have adopted similar direct nonbank prohibitions. *See, e.g.*, 1984 Conn. Pub. Act. 84-329, § 3 (to be codified at Conn. Gen. Stat. Ann. § 36-563); Fla. Stat. Ann. Sess. Laws, ch. 84-544 (to be codified at Fla. Stat. Ann. § 658.296); N.C. 1983 (Leg. Sess. 1984), c. 1113, § 1 (to be codified at N.C. Gen. Stat. 353-229).

291 1985 N.J. Laws 58, § 6.

292 1985 N.J. Laws 521, § 1.

293 1985 N.J. Laws 58, § 1(a), as amended.

294 *Id.*

295 *Id.*, § 2(a).

296 *Id.*

297 *Id.*, § 5.

298 *Id.*, § 4(a). In addition, § 4(b) states that, if the acquiring company is a BHC, it is grandfathered if the BHC "on or before January 1, 1985, received approval

securities firms in the two years preceding the enactment.[299] Ironically, while allowing these securities firms to continue in control of nonbank banks, the prohibition immediately affected proposed nonbank banks of six out-of-state commercial banking concerns.[300] It would therefore appear that there is more than a suggestion of local economic protectionism in the timing and practical effect of the New Jersey act.

There may be serious questions raised whether this nonbank prohibition can effectively resolve the policy concerns raised by the nonbank bank phenomenon. First of all, the act can do no more than close off the borders of one state—though, admittedly, a state with a vigorous and desirable banking market—from the interstate trend in commercial banking. The nonbank bank problem is, in all probability, not susceptible to resolution on such a piecemeal basis.

Secondly, in any event, this approach to the nonbank bank problem may be against the trend nationwide. As has already been mentioned, the regional interstate model appears to be a growing trend among the states. (*See* Illustration 4, *supra*.) At least five other states have opted to permit interstate full-service banking, either with or without reciprocity. (*See* Illustration 5, *infra*.) In addition, at least twelve other states have opted to permit interstate "limited-service" banking, either on a nationwide or regional basis. (*See* Illustration 6, *infra*.) The end result of adopting the model of the non-

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from the [Fed] to control the bank." In contrast with the earlier 1985 N.J. Laws 39, c. 58 also provides:

> For the purposes of this section, a bank shall be deemed to be a bank as defined in section 1 of this act and to have received approval for a charter, on or before January 1, 1985, even if a charter approval received on or before that date is contingent upon the bank becoming a member [*sic*] of the federal [*sic*] Deposit Insurance Corporation and final approval for membership [*sic*] in the corporation had not been received on or before that date.

1985 N.J. Laws 58 § 4.

299 The seven grandfathered nonbank banks are: Bear Stearns Trust Co. of Trenton; Drexel Trust Co. of Hoboken; Federal Bank and Trust Co. of Gibbsboro; Jersey Transfer & Trust Co. of Millburn; Merrill Lynch Bank & Trust co. of Plainsboro; Paine Webber Trust Co. of Princeton; and, Thomas McKinnon Bank & Trust Co. of East Hanover. *See generally* Milch, *State Blocking Entry of Nonbank Banks*, (Newark) Star-Ledger, Jan. 27, 1985, § 3, at 5, 7, col. 5.

300 The six proponents of nonbank banks directly affected by the act are: Chase Manhattan; Chemical Bank; Citibank; Irving Trust; Marine Midland, all based in New York City; and, Fidelity Bank, of Philadelphia. *See generally* Milch, *supra* note 299, at 7.

bank prohibition may be to cut a state out of a growing nationwide trend towards less artificial geographical restrictions for its own banking industry.

Illustration 5

States Permitting Interstate
Full-Service Banking
(As of May 28, 1985)

No reciprocity:	
Alaska	Bank holding companies (BHC's). Effective July 1, 1982.
Arizona	BHC's by acquisition only until midyear 1992. Effective Oct. 1, 1986. Banks and savings and loan associations (S&Ls) chartered after May 31, 1984, are protected from takeovers for 5 years. After July 1, 1992, de novo entry into the State would be permitted.
Maine	BHC's. Effective Oct. 1, 1975. Reciprocity requirement ended on Feb. 2, 1984.
Reciprocity required:	
New York	BHC's. Effective June 28, 1982.
Washington	BHC's. Effective July 1, 1987.

Source: H.R. Rep. No. 99-174

Illustration 6

States Permitting "Limited-Service"
Banking (As of May 28, 1985)

Nationwide:	
Delaware	Out-of-State bank holding companies (BHC's) to operate limited purpose, wholesale oriented and single office banks. Effective June 6, 1983.

Maryland	Out-of-State BHC's. Effective July 1, 1983. Amended in May 1985 to permit out-of-State BHC's to establish limited service banks until July 1, 1986, and to apply for a full-service charter after that date. The requirements for an out-of-State BHC to obtain a limited-service charter are that it not compete with Maryland banks, it not apply for a full-service charter until it has operated for 6 months, not acquire Maryland banks, and not establish more than 10 full-service branches in the first year. In addition, it must agree to invest at least $25 million in plant and equipment in the State and hire 1,000 employees over a 3-year period. Effective July 1, 1986.
Nebraska	Out-of-State BHC's to operate a single bank office whose operations are limited to the credit card business. Effective Aug. 26, 1983.
Nevada	Permits out-of-State BHC's to operate limited purpose banks, wholesale oriented and single office banks. Effective Mar. 30, 1984.
South Dakota	Out-of-State BHC's to operate limited purpose, wholesale-oriented and single office banks whose principal business is to be credit card operations (authorized March 1980) or out-of-State insurance sales or underwriting (March 1983).
Virginia	Out-of-State BHC's to operate banks whose operations are limited to the credit card business. Effective July 1, 1983.
Illinois	Out-of-State BHC's of in-State banks with liquidity problems and more than $1 billion in assets. Effective June 28, 1984.
Idaho	Out-of-State BHC's, without restriction. Effective July 1, 1985.

Kentucky	Out-of-State BHC's. BHC's entering the State in this way, however, are restricted to not more than 3 bank acquisitions a year and are subject to the general prohibition from further acquisitions once an organization controls more than 15 percent of all domestic assets in Kentucky banks. Effective July 13, 1984.
Washington	Out-of-State BHC's, without restriction. Effective Apr. 25, 1983.
Regional:	
Oregon	Out-of-State BHC's within Alaska, Arizona, California, Hawaii, Idaho, Nevada, Utah, and Washington may acquire a failing in-State bank with assets of $100 million or more. Effective Mar. 12, 1985. Regional banking begins in July 1986.
Utah	BHC's in the following 11 States: Alaska, Arizona, Colorado, Hawaii, Idaho, Montana, Nevada, New Mexico, Oregon, Washington, and Wyoming, without reciprocity requirements. Effective Apr. 13, 1984.

Source: H.R. Rep. No. 99-174

Finally, on its own terms, the act does not close off all forms of nonbank banks. The overall effect of the legislation is to neutralize, for the time being, the use of the nonbank bank to escape BHCA restrictions on interstate activities. In this sense, the New Jersey legislation clearly does prohibit "classic" nonbank banks, namely those which are banks under a charter test, but which are not "banks" under the BHCA definition. Its effect on "crossovers" between commercial and investment banking activities is less straightforward, since a number of significant nonbank bank acquisitions by securities firms have survived the enactment of the legislation. However, if a holding company is looking to "position" itself within the state, against the possibility of future (favorable) regulatory developments at the state or federal level, the act does not appear to prohibit the acquisition of, for example, a savings bank, an S&L or a

limited trust company. Such institutions are, functionally, yet another type of nonbank bank, one that may be called a "nonbank *nonbank* bank," namely, one which is not a bank under either the charter test or the BHCA definition, but which functions like a bank.

Nonbank banks may be viable businesses as they stand, but at the most general level, they are often linked to a long-term "positioning" strategy. If it is possible that banking will be subject to further deregulation, then it makes sense to have some sort of an entity positioned to convert into a full-service banking subsidiary when the regulatory environment eventually turns more favorable.[301] With this future-oriented strategy, it matters little whether the nonbank bank in its current configuration is a "classic" nonbank bank, or a nonbank *nonbank* bank.

In addition, there may be some question of the constitutional validity of the restrictions imposed by legislation such as that enacted in New Jersey. Nonbank banks are legally created entities that validly escape federal BHCA regulation, and, as the Supreme Court has recently emphasized, it is for Congress alone to change this situation.[302] That being so, does the federal scheme of regulation of BHC's preempt the state prohibition of nonbank banks?[303] In light of the Supreme Court's decision in *Northeast Bancorp, Inc.*,[304] upholding "regional interstate banking arrangements" under state legislation, it would seem that states are not preempted from limiting entry into their respective banking markets through BHC acquisitions. This result is dictated by the explicit provision in the BHCA allowing states to continue to regulate BHC's despite the imposition of the federal regulatory scheme under the BHCA.[305]

However, the BHCA allows states to continue to regulate *BHC*'s, presumably, as defined in the BHCA. Acquisition of a nonbank bank does not make a company a BHC as defined in the BHCA. Accordingly, it may be argued that the permissive provision in the BHCA does not extend to state regulation of holding companies of such entities. This reasoning, it may be argued, contains a

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301 *See generally* Silver & Norman, *supra* note 33.

302 *See* Bd. of Governors of the Federal Reserve System v. Dimension Financial Corp., — U.S. —, 54 U.S.L.W. 4101 (1986).

303 *See generally* Note, *Jurisdiction over State Banks:Does the Bank Holding Company Act Preempt State Regulation*, 36 OHIO S.L.J. 114 (1975).

304 *See* text and accompanying notes 286-88, *supra*.

305 *See* 12 U.S.C. § 1846 (1982).

false premise. If the BHCA itself does not purport to affect control of nonbank banks, then there is no preemptive confrontation of state and federal law on the issue. In any event, the issue is probably moot, since almost all of the proposed nonbank banks would be controlled by companies that are already BHC's under the BHCA,[306] and so the permissive provision would apply to protect the state regulation.

On its own terms, legislation such as that enacted in New Jersey would prohibit the acquisition of control of a *de novo* nonbank bank in New Jersey even if the entity were chartered under the NBA. Would this intervention of state regulation in the chartering decisions of the Comptroller raise preemption questions? This issue may also be a false one. The direct impact of the legislation falls upon the control by the holding company of the entity, not directly on the chartering decision. The permissive provision of the BHCA should shield the state legislation from this sort of preemption argument.[307]

Preemption analysis may be further complicated by the new Treasury proposal.[308] At this writing, the precise shape of the proposal is entirely a matter of speculation. If the result was a federal statute specifically confirming the validity of nonbank banks, and directing that federal regulators favor the use of the device in certain instances (such as, to avoid the failure of a troubled institution), the stage might be set for federal preemption of state prohibitions of at least certain types of nonbank banks.

Other constitutional concerns may be raised under the Commerce Clause. Legislation of the type enacted in New Jersey prevents entry of an out-of-state holding company into the state's banking market. In that sense, it would clearly have the effect of negating the interstate banking advantage which nonbank banks afford to their holding companies. State regulation of BHC's, though

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306 *See, e.g., Indep. Bankers Ass'n of America, supra* note 37, at 90,530.

307 *See, e.g.*, Whitney Nat'l Bank in Jefferson Parish v. James, 189 So.2d 430, 249 La. 759 (1966); Security Nat'l Bank & Trust Co. v. First W. Va. Bancorp., Inc., 277 S.E.2d 613 (W.Va. 1981), *app. dismissed*, 457 U.S. 1132 (1982). However, if the state attempted to extend its prohibition to plug the loophole for nationally chartered trust companies, the preemption argument might revive itself. At that point, the state legislation, it could be argued, would be frustrating the purpose of the NBA provision allowing the Comptroller to create limited-service national trust companies. *Cf. Security Nat'l Bank & Trust Co.*, 277 S.E.2d 613.

308 *See* note 51, *supra*.

not preempted by the BHCA, is still subject to Commerce Clause analysis.[309] While banking is a traditional area of state regulatory concern,[310] a direct or unbalanced impact on interstate commerce might still be constitutionally impermissible under the Commerce Clause.[311]

This argument is seriously undercut, however, by the Supreme Court's recent decision in *Northeast Bancorp, Inc.*, where it upheld a regional interstate banking scheme despite, *inter alia*, a Commerce Clause challenge.[312] Nevertheless, that scheme did provide for some measured degree of regulated interstate activity, and not an outright and absolute prohibition on entry.[313]

In the interim, therefore, legislation such as that enacted in New Jersey goes a long way towards maintaining the current situation in a holding pattern. It does not entirely eliminate the availability of certain specialized forms of nonbank banks, nor is it entirely without some legal uncertainty. It does at least represent an attempt to respond to this regulatory policy issue in a responsible way, which stands in sharp contrast to the "nonactivity activity" evident in the Congress so far.

Conclusion: Some Suggestions For Reform

If the statutory definition of "bank" has, in some fundamental sense, become inadequate to deal with regulatory concerns surrounding the policy purposes of the BHCA, a legislative solution is obviously essential. In the broadest policy terms, the most effective solution is therefore a federal one.

At this juncture, several potential inadequacies in the current definition may be apparent. First, the factual predicates with respect to the use of bank holding companies have shifted significantly since 1970. The corporate powers of thrift institutions have expanded.[314] The drive within the commercial banking busi-

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309 *See* Lewis v. BT Investment Managers, Inc., 447 U.S. 27 (1980).

310 *See id.* at 35-36, 38.

311 *See* note 279, *supra*.

312 Northeast Bancorp Inc. v. Bd. of Governors, 472 U.S. —, 105 S. Ct. 2545, 2553-54 (1985).

313 *But cf. id.* at 2554: "When Congress so chooses, state actions which it plainly authorizes are invulnerable to constitutional attack under the Commerce Clause." *See generally* Note, *Regional Banking Laws: An Analysis of Constitutionality Under the Commerce Clause*, 60 N. DAME L. REV. 548 (1985).

314 *Cf.* Geographic Restrictions Report, *supra* note 20, at 2: "What was once a

ness itself towards interstate markets has increased.[315]

Second, there is a real possibility that the policy purposes embodied in the BHCA are no longer adequately served by the current definition of "bank." The nonbank bank device has allowed at least a tentative—and probably unforeseen—connection between "banking" and commerce to reemerge.[316] The device has also fostered the aggregation of interstate banking combines which may be a threat to the BHCA's policy bias against concentration of commercial banking activities.

The discussion which follows will suggest some alternative approaches to reform. These suggestions are intended, to varying degrees, to eliminate the availability of the nonbank bank device, and to realign current practices with the policy purposes behind the BHCA. However, a preliminary word of caution may be in order. It is possible that events have already moved beyond the stage where the nonbank bank should be a serious policy concern. Litigation has certainly slowed the proliferation of nonbank banks. The emergence in particular of the regional interstate model[317] may have dissipated much of the momentum behind the nonbank bank phenomenon.

One Step Forward, Two Steps Back: A "New" Definition?

One approach to this problem of definition is instrumental, though it may be conceptually unsatisfying. That is to say, it may be time for a return to some version of the "charter test."[318] This

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segmented *product* market has been replaced by head-to-head competition between [commercial] banks and various non-bank institutions; indeed, there is no longer a single service or product line offered exclusively by commercial banks." (Emphasis in original.) *But see* United States v. Connecticut National Bank, 418 U.S. 656 (1974) (commercial banks and thrift institutions still distinct product markets for antitrust purposes). *Cf.* Lapidus, *supra* note 26.

315 *Cf.* Geographic Restrictions Report, *supra* note 20, at 2: "What was once a financial system consisting of highly segmented *geographic* markets has, for many kinds of banking services, been transformed into a competitive nationwide marketplace." (Emphasis in original.) *See also* Marquette Nat'l Bank v. First Omaha Serv. Corp., 439 U.S. 299, 317-19 (1978) (credit market increasingly nationwide in scope).

316 *See generally* Wilson, *Separation Between Banking and Commerce Under the Bank Holding Company Act—A Statutory Objective Under Attack*, 33 CATHOLIC U.L. REV. 163 (1983).

317 *See* text at notes 285-89, *supra*.

318 *See* text and accompanying note 223, *supra*.

may be useful in rationalizing current practices in light of the policy purposes behind the BHCA.

A commercial "bank" is one which has received its corporate charter from the federal or state authorities empowered to create such banks under applicable law. Applying the BHCA to those institutions granted a charter under such laws is sensible from the point of view of regulatory analysis, since all depository institutions are essentially creatures of their constitutive statutes. By and large, one essential term of reference in any legal problem in this area is the identity of the regulator to whom the institution is subject. There is a certain practical appeal, therefore, to reliance on an instrumental definition of these entities which focuses upon the source of their corporate existence. The fact that such an institution forbears, for whatever its own reasons, to exercise some of the powers traditionally associated with its type of depository institution then becomes of less importance.[319]

The advantage of the charter test approach is that it would ensure regulatory uniformity with respect to all institutions of a particular statutory type. Even this elementary degree of uniformity is now absent as a result of the rise of the nonbank bank. The major disadvantage of this approach is that it would ignore the degree of overlap among differing statutory types of depository institutions, as, for example, between commercial banks and S&L's.[320] Further expansion of the charter test to bring overlapping institutions within the regulatory regime of the BHCA may simply render the test itself so general and unpredictable in its effects as to be worse than the problem it is intended to address.

The "Depository Institution": A New Technical Vocabulary

In seeking to understand the contemporary system for the provision of financial services to the public, a new vocabulary has recently come to the fore. It may be argued that the new generic terminology would have been of marginal utility in describing the system as it existed until the 1960's. The system of that period was typified by "distinct kinds of financial institutions, offering

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319 Assuming, of course, that the regulator is in fact empowered to grant a charter for such artificially limited purposes. *Cf., e.g.*, text and accompanying notes 175-86, *supra*.

320 *Cf.* text and accompanying note 26, *supra*.

distinct financial products, generally in limited geographic areas."[321] Today the "financial services industry" exhibits a considerable degree of coalescence among the formerly distinct kinds of institutions, in terms of the general types of products offered and the geographic markets services.[322] The emerging pattern of this industry presents a situation in which a wide range of "financial intermediaries"[323] are in more or less direct competition for the consumer's funds.

In a sense, both the St. Germain proposal, H.R. 20, and the New Jersey act attempt to focus upon a more useful generic regulatory term (namely, the "insured bank") as the trigger for bank holding company regulation. However, nonbank bank prohibitions that only focus upon "insured bank" as the operative term still leave other nonbank institutions available, including S&L's and savings banks. In this regard, H.R. 20 is preferable to the New Jersey approach, since it does make adjustments in the parallel regulation of S&L holding companies at the same time that it addresses the BHCA directly.[324] In addition, it conditions exemption of such thrift institutions as savings banks from the proposed amendments of the BHCA upon strict limitations on the expansion of the activities of such institutions.[325]

Nevertheless, H.R. 20 still leaves in place, at least as a formal matter, the artificial distinction between the regulatory regimes imposed upon commercial banks and thrift institutions respectively. Furthermore, to the extent that the bill is essentially a loophole-closing exercise, it does not adequately address some of the regulatory constraints that prompted the development of the nonbank bank phenomenon in the first place. These constraints include such problems as the artificial geographical limitations on commercial banking markets and the relatively severe restrictions on the nonbanking activities of commercial banks.

At a broad level, it may be interesting to consider the possibility of constructing public policy that coherently balances and regulates all of the various elements of this industry of financial intermediaries. However, a more obvious and pressing need ex-

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321 Geographic Restrictions Report, *supra* note 20, at 2.
322 *See* notes 314-15, *supra*.
323 *Cf.* note 9, *supra*.
324 *See, e.g.* text and accompanying notes 269-72, *supra*.
325 *See, e.g.*, note 265, *supra*.

ists to rationalize the regulatory policy that affects one important subset of this industry; namely, the depository institutions.

With the increasing expansion of the powers of the once highly specialized thrift institutions[326] and the consequent blurring of distinctions between these entities and "full-service" commercial banks, the notion of the "depository institution" has become a significant category in regulatory policy. While its factual significance was assured once distinctions based on differences in services offered became blurred, the technical legal significance of the term was not secured until 1980, with the passage of the Depository Institutions Deregulation and Monetary Control Act of 1980.[327]

Title I of the act, the Monetary Control Act ("MCA"),[328]marked a significant step in deregulation of the products offered by such institutions.[329] The MCA also contained a formal statutory definition of the term "depository institution" as including:

- any commercial bank the deposits of which are federally insured[330] or eligible for federal insurance;[331]
- any mutual savings bank[332] which is federally insured or eligible for insurance;[333]
- any stock savings bank[334] which is federally insured or eligible for insurance;[335]
- any credit union[336] which is insured or eligible for insurance;[337]
- any member of the Federal Home Loan Bank System;[338] and,

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326 *See* generally Geographic Restrictions Report, *supra* note 20.

327 Pub. L. No. 96-221, 94 Stat. 132 (1980).

328 *Id.*, tit. I.

329 *See generally* Geographic Restrictions Report, *supra* note 20, at 9-10.

330 *Cf.* note 261, *supra*.

331 12 U.S.C. § 461(b)(1)(A)(i) (1982). *Cf. id.* § 1815 (1982) (eligibility to make application for federal deposit insurance).

332 *See id.* § 1813(f) (1982) (defining "mutual savings bank").

333 *Id.* § 461(b)(1)(A)(ii) (1982).

334 *Cf. id.* § 1813(g) (1982) (defining "savings bank" as other than "mutual savings bank").

335 *Id.* § 461(b)(1)(A)(iii) (1982).

336 *See id.* § 1752(7) (1982) (defining "insured credit union").

337 *Id.* § 461(b)(1)(A)(iv) (1982). *Cf id.* § 1781 (1982 & Supp. III 1985) (eligibility to make application for federal deposit insurance).

338 *Id.* § 461(b)(1)(A)(v) (1982). *Cf. id.* § 1422 (1982) ("member" of system de-

— any thrift institution which is insured or eligible for insurance.[339]

The advantage of this definition from the point of view of consistent formation of regulatory policy is that it provides a legally cognizable, generic category to cover a wide range of banking and bank-like institutions. As a technical matter, however, this generic concept is directly applicable to regulatory policy with respect to reserve requirements,[340] which will be fully subject to regulation by the Federal Reserve Board upon the conclusion of an eight-year transitional period.[341] Nevertheless, the technical acknowledgment of this generic concept will doubtless result in at least the heightened awareness of its pertinence as a term of reference for regulatory policy making.[342]

Ideally, then, regulatory issues should be resolved in terms of consistency and coherence with respect to the full spectrum of depository institutions taken as a class.[343] In addition, this relatively new definitional term represents a more realistic and useful taxonomic device than other such terms encountered in the provisions of federal banking and securities laws.[344]

The term "depository institution" has several advantages over the use of the generic concept of the "insured bank." To the extent that it is more inclusive, it lessens the chance that other forms of "nonbank banks" will come into vogue to avoid the restrictions of holding company regulation. Its use would also give cognizance to the practical fact that all the institutions included within the term are, to one degree or another, competitors. Further, at a more technical level, inclusion of an institution within the scheme of regula-

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fined). Institutions eligible for membership include building and loan associations, savings and loan associations ("S&L's"), cooperative banks, homestead associations, insurance companies and savings banks. *See id.* § 1424(a) (1982).

339 *Id.* § 461(b)(1)(A)(vi) (1982). *Cf. id.* §§ 1724(a) (1982) ("insured institution" defined); 1726(a) (1982) (eligibility for federal deposit insurance).

340 *See id.* § 461(b)(8) (1982).

341 *See id.* § 461(b)(8)(A) (1982).

342 *See, e.g.*, the Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 14 (1982).

343 To some extent, of course, the various agencies have always sought at least a general degree of policy coordination with respect to the particular types of depository institutions subject to their supervision. However, this coordination has sometimes been halting and incomplete. *See generally* Malloy & Pitts, *supra* note 17.

344 *Cf.* note 38, *supra*.

tion on the basis of its *eligibility* for insurance,[345] rather than the institution's actual inclusion within the insurance program,[346] would place the applicability of the holding company regulatory scheme beyond the voluntary choice of the regulated institution itself.

Nevertheless, basing the application of the federal regulatory scheme for holding companies on the definitional concept of "depository institution" is not without its own disadvantages. Changing the focus of the BHCA from "bank"—however defined—to "depository institution" would represent a fundamental and dramatic realignment of the regulatory scheme itself. Among other things, this realignment would coopt the role of the federal Savings and Loan Holding Company Act. It would also require delicate determinations, either by statutory provision or through delegated administration, of the degree to which the application of the BHCA should be modified in light of the marked variety and size of institutions included within the scope of the regulation.[347] Finally, it would still leave the equally daunting task of deciding such underlying regulatory questions as the extent to which restrictions on geographic expansion of markets should be modified or eliminated.

If there is any lesson to be drawn from the experience to date with the nonbank bank phenomenon, it is that regulatory policymakers should not allow the system of regulation to be shaped or modified, by default, by the subjects of that regulation. Adjusting the BHCA definition of "bank" may be a useful if modest first step towards regaining control of the regulatory system. However, to the extent that congressional and administrative approaches to regulatory reform remain essentially reactive, the regulatory system will continue to be subjected to novel and unexpected distortions by its participants.

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345 *See, e.g.*, text and accompanying note 332, *supra*.

346 *See, e.g.*, H.R. 20, 99th Cong., 1st Sess. § 2(a) (1985); 1985 N.J. Laws 58, § 1(a).

347 *Cf.* text at notes 20-22. Such delicate determinations have in effect been made, to an extent, with respect to the application of reserve requirements to smaller depository institutions. *See* 12 U.S.C. § 461(b)(2)(A)(i) (1982). *Cf. id.* § 461(b)(11)(A) (1982).