STATEMENT ON

CONDITIONS IN THE LEGAL FRAMEWORK OF THE
AMERICAN FINANCIAL SYSTEM AND SERVICE INDUSTRY

PRESENTED TO

SUBCOMMITTEE ON COMMERCE, CONSUMER, AND MONETARY AFFAIRS
COMMITTEE ON GOVERNMENT OPERATIONS
HOUSE OF REPRESENTATIVES

BY

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9:30 a.m.
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Room 2154, Rayburn House Office Building

Mr. Chairman:

I am pleased to have this opportunity to discuss what your invitation described as the "massive confusion" in our financial services markets. The basic framework of our banking laws was constructed 50 years ago in an environment substantially different from today.

Like the DC-3 aircraft, which was the commercial aircraft marvel of the day, our banking laws have given yeoman service, but bankers, unlike aircraft manufacturers, have been constrained by these laws in their efforts to respond to technological change and changing public needs. Today's aircraft employs the same aerodynamic principle which enabled the DC-3 to fly but is far more efficient in every way. It's interesting to speculate on what our banking industry would look like today if the banking laws of the thirties had been structured to preserve the principles of safety and soundness but still permit the flexibility for our depository institutions to respond to changing market needs. The interrogatories which accompanied your invitation highlight the diverse ways in which the industry has responded to these legal constraints. Our response to the interrogatories is attached to this statement.

Mr. Chairman, it is our judgment that Congress needs to move decisively to end the confusion in our financial markets although we understand full well the problems you face in doing so. Our depository institutions find themselves at a competitive disadvantage with nonbank providers of financial services which will definitely weaken them over a period of time. We are concerned that the deregulation of their liabilities -- now almost complete -- without a concommitant deregulation of assets and services -- which will enable them to compete effectively in providing consumer services -- is a prescription for disaster. A moratorium is no answer.

You are aware, of course, that the Administration has now submitted its Financial Institutions Deregulation Act. FDIC supports the basic thrust of this proposal although we have a number of problems with it which we will be working to resolve.

But, Mr. Chairman, you have a unique opportunity for service in this Subcommittee because of the very broad responsibility to which you refer in your letter. Although the issue of broadened powers for our depository institutions is important there are other matters which the FDIC considers of equal importance and which we believe should be considered in conjunction with broadened powers.

First is the matter of regulatory reform. Your Subcommittee has investigated some of the recent bank failures and we would hope that you would agree with us that the present regulatory structure is outmoded and inefficient. We are working actively with Vice President Bush's Task Group in an effort to develop a workable proposal to present to the Congress at the earliest possible date.

We are also most anxious that Congress consider revisions to our deposit insurance system. Pursuant to the Garn-St Germain Act we recently submitted to the Congress a report entitled "Deposit Insurance in a Changing Environment." We outline there our recommended changes in the deposit insurance system which we think are workable and would be effective in bringing about greater market discipline in our financial markets. We are currently drafting the legislation necessary to accomplish these changes.

We are also concerned about the current state of our antitrust laws and the manner in which they are administered. We think it very strange that two financial giants operating nationally can acquire each other while we must turn down a merger of two small banks in an underpopulated county in a remote part of the country. Current concepts of "market-share," "geographic markets," and "lines of commerce" are simply outmoded in today's environment. And, we think the administration of the laws should not be fractionalized as at present but should rest with the Justice Department.

I could go on and talk about McFadden and other matters. The point I want to make is that there are a broad array of issues involving major public policy issues which demand the attention of Congress. They are interrelated and should be considered together. Unless Congress takes an overview with the object of achieving some coordination the confusion will continue. We applaud your efforts to do this.

Attachment

General Counsel's Responses to Interrogatories - Hearings Before the House Subcommittee on Commerce, Consumer, and Monetary Affairs

I. Nonbank Banks and the Bank Holding Company Act

B. The Business of Making Commercial Loans

Question (1): Is the above background an accurate summary of developments respecting "commercial loans" on the date of the hearing? What points of a legal nature would you add or correct?

Response: The facts presented in the above summary are substantially accurate, except that the FDIC letter quoted on page 3 as challenging the Federal Reserve's opinion is dated December 29, 1982 and not January 3, 1983. As additional background, it should be noted that a number of other opinion letters have been issued by the Federal Reserve Board in the past decade repeatedly articulating the Board's narrow definition of "commercial loans" and specifically excluding from the definition the purchase of United States government and agency obligations, certificates of deposit and time deposits, and repurchase agreements of financial institutions (See, e.g., letter to attorneys for Chrysler Corporation/Automotive Financial Services, Inc., dated March 11, 1981).

Question (2): Under the Change in Bank Control Act, was the FDIC's position, in allowing Dreyfus to acquire Lincoln State Bank of New Jersey, sound?

Response: Under the Change in Bank Control Act of 1978 ("CBCA") the FDIC clearly is the appropriate Federal banking agency designated to review the Notice of Change in Control of state nonmember banks, supervised by the FDIC. Once a substantially accurate and complete Notice of Change in Control is received by the FDIC, the CBCA Act allows the agency only sixty days (with a possible thirty-day extension) to make its determination whether the acquisition can be disapproved based upon any of the five statutory criteria enumerated in section 7(j)(7) of the FDI Act (12 U.S.C. §1817(j)(7)). A further extension is allowed only if the Notice is not accurate or is incomplete (12 U.S.C. §1817(j)(1)). When the statutory time period expires, the acquisition is deemed not to be disapproved unless the supervisory agency has issued a notice disapproving the proposed acquisition.

In the case of Lincoln State Bank, the disapproval period was to expire on December 30, 1982. The FDIC had taken the permissible thirty-day extension at the request of the Federal Reserve Board. The FDIC undertook a thorough analysis of the applicable statutes and regulations and concluded that none of the enumerated statutory bases for disapproval applied. If the FDIC had not responded to the Notice by the deadline, The Dreyfus Corporation could have legally proceeded with the proposed acquisition and the FDIC might have forfeited any opportunity to secure certain conditions volunteered by The Dreyfus Corporation in consideration of FDIC not issuing a notice disapproving the proposed acquisition of control.

The CBCA requires that the written notice of a proposed acquisition of control be given to "the appropriate Federal banking agency." Since the FDIC is the primary supervisory agency of Lincoln State Bank, it was appropriate for Lincoln State Bank to file its Notice of Acquisition of control with the FDIC. The CBCA clearly states that the Act "shall not apply to a transaction subject to section 3 of the Bank Holding Company Act of 1956." (12 U.S.C. §1817(j)(16)). The FDIC must defer to the Federal Reserve Board for the review of bank acquisitions whenever the Board has jurisdiction under the BHCA. The CBCA requires the FDIC to immediately furnish the other banking agencies with a copy of any notice of change in control. As required, and the FDIC provided the Federal Reserve Board with a copy of the Dreyfus notice allowing the Federal Reserve Board sufficient time to promulgate an official opinion on its definition of "commercial loans." In its December 13, 1982 letter of intent not to disapprove, the FDIC cited section (7)(j)(16) of the CBCA stating that the CBCA does not apply to a transaction subject to section 3 of the BHCA and referred the Dreyfus attorneys to the Federal Reserve Board's December 10, 1982 letter to Chairman William Isaac. Even though the FDIC was required to act on the Notice before it, if the Federal Reserve Board had determined that the Bank Holding Company Act was violated by the acquisition, it could have taken independent and determinative action against Dreyfus.

It has similarly been the practice of the FDIC when issuing letters concerning the acquisitions of control of nonbank banks, or other transactions which may fall within § 3 of the BHCA, to indicate that the issuance of FDIC's intent not to disapprove is not sufficient to allow the transaction to proceed without securing the necessary approval, if any, under the Bank Holding Company Act. (See for example June 27, 1983 letter to Prudential Life Insurance Co. of America concerning acquisition of Capital City Bank of Hapeville, Georgia).

<u>Question</u> (3): <u>Under the Change in Bank Control Act and in light of the Comptroller's general position in chartering a new national bank for Dreyfus Corporation, would the Comptroller be entitled to authorize the acquisition of an existing national bank? Would he be compelled to, assuming other requirements of the Change in Bank Control Act were met?</u>

<u>Response</u>: The Change in Bank Control Act establishes a statutory framework for the Comptroller similar to that established for the FDIC. In our opinion the Comptroller would be authorized to issue an intent not to

disapprove the acquisition of control of an existing national bank if the transaction was not subject to section 3 of the BHCA and no basis for disapproval under the CBCA exists.

Question (4): What are the key differences, from a precedential point of view, between industrial banks--which can be insured by the FDIC under the Garn-St Germain Act; are long-standing, permitted activities for bank holding companies under 4(c)(8) of the BHCA; and do invest in money market instruments --and nonbank banks?

Response: Industrial banks are a form of "nonbank bank" in that they generally neither accept demand deposits nor make commercial loans. The differences between industrial banks and the other forms of "nonbank banks" which have been the subject of recent controversy lie more in the size and the scope of their operations rather than legal differences. Industrial bank powers vary somewhat depending on state law but industrial banks are primarily engaged in the business of making consumer installment loans and accepting some form of savings deposit from members of the public. Their average size is far smaller than that of the average bank and the scope of their operations is generally limited to their immediate geographic area. They are largely consumer oriented in their deposit and their loan functions. Thus, their scope of operations and economic impact are more restricted than those of other "nonbank banks" which in their operations tend to resemble commercial banks that have shed only their demand deposit or commercial lending activities, but still serve many of the the same types of customers as commercial banks.

As indicated in the background statement under I(A) of these interrogatories, and in II(A) thereof, the "nonbank bank" concept evolved as a result of large entities such as securities firms and others seeking to charter or acquire banks to carry out specific functions for the parent. These included trust functions and securities functions. They have also been established to engage in banking functions in other jurisdictions such as credit card functions. The nature of these functions brought the "nonbank bank" closer to the traditional domain of commercial banks which, in addition to demand deposit and commercial lending business, engage in broad full-service banking. It is the use of the "nonbank banks" to expand powers and geographic operations of holding companies that has brought them into conflict with the purpose of the BHCA to restrict bank holding company operations functionally and geographically.

Question (5): Would the definition of "commercial loan" in the Federal Reserve's proposed revision of Regulation Y bind the FDIC and the Comptroller in light of the Federal Reserve's power at 12 U.S.C. 1844(b) to

"...issue such regulations and orders as may be necessary to enable it to administer and carry out the purposes of this Act and prevent evasions thereof."?

Response: The FDIC has never questioned the authority of the Federal Reserve Board to issue regulations interpreting the BHCA and define the terms contained therein. If any federal agency or private party wished to challenge the revised definition after final rulemaking, it would have to resort to the courts or to Congress for a statutory amendment. There may be a question whether such a broad expansion of the jurisdiction of the Federal Reserve Board over non-traditional "banks" and quasi-banking institutions is beyond the purpose of the BHCA and, therefore, beyond the authority granted to the Federal Reserve Board through 12 U.S.C. 1844(b).

Question (6): Have the diverse opinions of the FDIC, Comptroller, and Federal Reserve on the meaning of "commercial loan" been matters solely of administrative discretion, or are there statutes or matters of legislative history which have necessitated this diversity?

Response: As stated above, it is a proper exercise of administrative discretion for a federal agency to issue regulations and agency opinions defining terms contained in its enabling statutes. Since the BHCA offers no definition of the terms "commercial loan" or "demand deposit", the financial services industry has come to rely solely on the definitions articulated by the Federal Reserve Board in the numerous opinion letters they have published subsequent to the 1970 amendment to the BHCA definition of "bank".

Notwithstanding the Federal Reserve Board's authority to define the term commercial lending, in our opinion the BHCA's legislative history, offers no sound basis to justify the Federal Reserve Board's new, expansive definition of "commercial lending." The legislative history repeatedly emphasizes that the purpose of the BHC Act is "to restrain undue concentration of commercial banking resources and to prevent possible abuses related to the control of commercial credit." (S. Rep. No. 1084, 91st Cong., 2d Sess. (1970) reprinted in 1970 U.S. Code Cong. & Admin. News 5519, 5541). There is nothing in the legislative history to indicate that Congress was concerned that all institutions engaged in commercial funding activities such as the purchase of commercial paper and certificates of deposit, the extension of brokers call loans, and the role of federal funds, might have the ability to control credit allocations and compel unwanted tying arrangement and, hence, are "engaged in the business of making commercial loans."

Question (7): Do you believe this diversity has impaired the fairness of the ground rules for engaging in the depository business?

Response: Yes. We are hoping that the efforts undertaken by the Bush Task Force, in which the FDIC is participating, will result in a recommendation for a solution to the inequities that have arisen in the supervision of financial institutions.

Question (8): Should Congress more specifically define "commercial loan," direct the Comptroller, FDIC, and Federal Reserve to reach a uniform definition, or empower the Federal Financial Institutions Examination Council to reconcile differences in this area as well as others when there is severe inability to agree on crucial points?

Response: The FDIC believes that the new definition of "commercial loan" promulgated by the Federal Reserve Board is such a radical departure from the traditional view of what constitutes a commercial loan that the redefinition raises issues beyond the scope of unilateral regulatory interpretation. We do not believe it is wise to grant rulemaking authority in this area to the Federal Financial Institutions Examination Council. We are of the opinion that Congress should redefine the term "bank" in the course of addressing the larger issues raised by the restructuring of the financial services industry.

C. Accepting Demand Deposits

Question (1): Is the above background an accurate summary of developments respecting "demand deposits"? What points of a legal nature would you add or correct?

Response: The background appears to be essentially accurate.

Question (2): In your view, is it proper to interpret a NOW account as a "demand deposit"? Why or why not?

Response: Although there is a legal distinction between a NOW account and a demand deposit because a financial institution may reserve a 14-day notice requirement with the former, for all practical purposes a NOW account is the functional equivalent of a demand deposit.

Question (3): In cases where the institution plans to offer nothing resembling a "demand account", can the Board's authority under 12 U.S.C. 1844(b), allowing it to issue regulations to prevent evasions of the BHCA, stretch to cases of very short term certificates of deposit? For example, could the Board declare a 30 day certificate of deposit to be equivalent to a "demand deposit" for purposes of the BHCA?

Response: It seems highly unlikely that a deposit with a fixed maturity could be defined as a demand deposit.

II. Banks, Nonbank Banks, the Bank Holding Company Act, and the Glass-Steagall Act.

Question: (1) Is the above background an accurate summary of the developments respecting banks, nonbank banks, the BHCA and the Glass-Steagall Act on the date of the hearing?

Response: Although the background discussion would appear to be fairly accurate, we would make the following observations, comments, and corrections. To the best of our knowledge, there is presently pending in Federal District Court in the state of New York a challenge to the Federal Reserve Board's approval of the Schwab acquisition. We have no further information regarding that challenge.

FDIC's Board of Directors adopted a proposed regulation for comment on May 9, 1983 which deals with securities activities of subsidiaries of insured nonmember banks and bank transactions with affiliated securities companies. The proposal, which was published in the Federal Register on May 17, 1983 for a 60-day comment period, builds upon FDIC's August 23, 1982 policy statement concerning the applicability of the Glass-Steagall Act to bona fide subsidiaries of insured nonmember banks. Having concluded that the Glass-Steagall Act does not reach the securities activities of bona fide subsidiaries of insured nonmember banks, the FDIC by this proposal is seeking to address safety and soundness and conflicts of interest concerns that can be associated with such activities. The proposal would affect all insured nonmember banks (including savings banks) that are authorized under state law to establish or acquire a subsidiary that engages in securities activities, (assuming of course that some other Federal law does not prohibit the conduct of such activities). The proposal does not confer the authority to establish or acquire a securities subsidiary.

On April 13, 1982 the Investment Company Institute filed a petition with the FDIC alleging, among other things, that the proposed establishment by Boston Five Cents Savings Bank, Boston, Massachusetts of two wholly-owned subsidiaries to advise and distribute shares in a mutual fund was in violation of §21 of the Glass-Steagall Act. The Investment Company Institute requested, among other things, that the FDIC institute cease-and-desist proceedings against the bank. FDIC's Board of Directors declined to entertain the petition citing its total discretion in enforcement matters and indicating that it would monitor the situation.

The Institute filed suit on May 21, 1982 alleging that FDIC violated the Administrative Procedure Act and the Sunshine Act by the manner in which it disposed of the petition. Investment Company Institute v. FDIC, et al., No. 82-1408 (D.D.C. May 21, 1982). The suit was stayed on June 30, 1982 by order of the United States Court of Appeals for the District of Columbia. The stay had been sought by the FDIC so that the Court of Appeals could review an order entered by the lower court arising out of a discovery dispute. Oral argument on the appeal was heard on February 3, 1983. Investment Company Institute v. FDIC, et al., No. 82-1721 (D.C. Cir. June 29, 1982).

On September 9, 1982 the Investment Company Institute filed suit challenging FDIC's policy statement referred to above. Investment Company Institute v. United States of America, FDIC, et al., No. 82-2532 (D.D.C. September 9, 1982). The suit, which involves a substantive challenge to FDIC's interpretation of §21 of the Glass-Steagall Act, is presently under a stay order that will expire on September 20, 1983, or sooner, upon motion of the court or any party or upon disposition by the Court of Appeals of the pending appeal.

Lastly, the Committee should note that although Boston Five Cents Savings Bank is still an insured nonmember bank, effective April 7, 1983 the bank changed from a state to a federal charter. As a federal mutual savings bank, the institution is primarily subject to the supervision of the Federal Home Loan Bank Board. With only limited exceptions, FDIC's sole role with regard to the bank is that of insurer.

Question (2): Was the July 20, 1981 letter by Robert McConnell, Assistant Attorney General for Legislative Affairs, legally sound in its conclusion that funds held by money market mutual funds are not "deposits" within the meaning of §21 of the Glass-Steagall Act?

Response: We find Mr. McConnell's conclusions to be legally sound and would concur that, strictly speaking in a legal sense, a deposit creates a debtor/creditor relationship whereas funds held by money market mutual funds represent equity investments.

Question (3): In light of Mr. McConnell's conclusions, does the "separation" enacted by Glass-Steagall continue to make cogent law?

Response: We will assume that the Committee, given the substantial functional equivalency between bank deposits and money market mutual fund "deposits", is asking whether §21's reliance on the term "deposit" to draw a line between banking and securities activities is outmoded? We agree with the question's implication that the validity of the Glass-Steagall Act and the manner in which it legislates the "separation" should be reviewed by Congress. We urge Congress to do so especially in view of the rapid changes that are overtaking the financial services industry.

Question (4): What is the current status of Investment Company Institute v. FDIC (No. 82-1721) and how likely is FDIC to prevail in its interpretation of §21 of the Glass-Steagall Act?

Response: As indicated above, both suits brought by the Investment Company Institute have been stayed. We are presently awaiting a decision from the Court of Appeals on FDIC's interlocutory appeal. We must decline to respond to the remainder of the Committee's question due to the pending nature of the litigation.

Question (5): What is the potential for insured nonmember banks to take advantage of "leeway" investment provisions to establish or acquire securities subsidiaries?

Response: The FDIC is aware that such states as New York, Massachusetts, Maine, Connecticut, and Washington have leeway investment provisions. FDIC's position is merely that should a state authorize an insured nonmember bank to establish or acquire a securities subsidiary, the activities must take place within certain safety and soundness guidelines.

Question (6): How likely is the plaintiff in A.G. Becker to ultimately prevail and establish that short-term commercial paper is a security for the purposes of the Glass-Steagall Act?

Response: We feel that it is inappropriate for this agency to comment on the likelihood of either party prevailing in the litigation and therefore decline to comment further.

Question (7): Why is Glass-Steagall suddenly being subjected to a rising tide of litigation and differences of interpretation among the regulatory agencies such as those now splitting the FDIC, Comptroller, and Justice Department from the Federal Reserve as to the meaning of §21?

Response: Although we are not sure just what the differences of opinion are concerning §21 to which the Committee refers, we would simply observe that FDIC's position concerning the scope of §21 is longstanding. As we have indicated in previous testimony, the FDIC has been approving insurance and change in bank control applications involving the affiliation of securities companies and insured nonmember banks since 1969. The FDIC did so on the basis of the same reasoning set forth in its August 23, 1982 policy statement on the applicability of the Glass-Steagall Act to subsidiaries of insured nonmember banks. We speculate that the issue has come to the fore in more recent years due to the rapidly changing nature of the financial services industry and increasing cross industry competition.

Question (8): If the Glass-Steagall Act is subject to such controversy, should Congress "tighten" the statute to clearly identify the separation of commerce and banking or should that separation be relaxed? If the latter, what qualifications would you suggest be placed on the relaxation?

Response: FDIC supports expanded powers for banks, particularly in the area of brokerage activities, which are financial services with limited risk to banks. Other kinds of activities, such as underwriting, may increase the risks to which banks are subject. FDIC's proposed regulation is designed to limit those risks. While the the FDIC favors allowing banks to offer a broad range of such financial services as banking, insurance, and securities activities provided that certain safeguards, including a strengthened anti-trust law are put in place, we do not support the mixing of banking and commerce.

III. Banks, Their Insurance Activities, and the Bank Holding Company Act

Question (1): Is the above an accurate summary of developments regarding banks, their insurance activities, and the Bank Holding Company Act?

Response: The summary appears to be an accurate summary of banks and their insurance activities under the BHCA. The extent to which State laws authorize insurance activities by State-chartered banks, however, is not known because we have not undertaken any comprehensive study of such State laws.

Question (2): Could the Board halt the insurance activities of subsidiaries of state bank--which banks are, in turn, the subsidiaries of, say, an out-of-state bank holding company--under Section 4 if the banks would be permitted to engage directly in those insurance activities by state law?

Question (3): Could the Board halt the direct insurance activities of state banks themselves where: no insurance subsidiaries are involved; state law clearly allows the activity for the bank; and the application to become part of a bank holding company only involves Section 3 of the BHCA? Could Section 5 of the BHCA, granting the Board authority to "issue such regulations and orders necessary to enable it to administer and carry out the purposes of this Act and prevent evasion thereof" be used to this purpose? and

Question (4): Assuming a state bank that divest itself of its "commercial loans," however, defined, asserts nonbank status, claims escape, thereby, from the entire BHCA, and is in a jurisdiction permitting a high degree of insurance activities for state banks, what would be the Board's legal positions be in halting the insurance activities of the nonbank bank or its subsidiaries if the nonbank is owned by a company which in no other way could potentially be considered a bank holding company?

Response to Questions (2), (3) and (4): The matters discussed in these questions relate to powers of the Board of Governors under the BHCA and are not within the powers exercised by the FDIC. Likewise, there are no comparable powers delegated to the FDIC. Accordingly, we do not feel that we are in a position to express legal opinions as to the powers of the Board of Governors or its probable legal positions.

IV. Bank and Nonbanks with Respect to Interstate Operations under the Douglas Amendment to the Bank Holding Company Act

Question (1): Is the above background an accurate summary of development respecting banks and nonbank banks under the Douglas Amendment to the BHCA? What points of a legal nature would you add or correct?

Response: Without commenting on the specifics of the Citizens or the Dimension cases (which are not before the FDIC) it may be said that the background statement is accurate in that the Douglas Amendment to the BHCA allows interstate bank holding company operations only if state law specifically permits an out-of-state bank holding company to operate a bank within the state. For purposes of the BHCA, a "bank", in general, is an institution which accepts demand deposits and engages in the business of making commercial loans.1/ (12 U.S.C. 1841(c)). It is possible to avoid the restrictions of the Douglas Amendment by acquiring a bank which has been divested of either the demand deposit function or the commercial lending function, or both, thus placing the acquired bank outside the definition of "bank" in the BHCA. The restrictions may also be avoided where a state passes a specific law allowing the acquisition of a bank by an out-of-state bank

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1/ As referenced above the Federal Reserve Board is proposing to revise Regulation Y regarding the definition of "commercial lending". This would necessarily impact upon interpretation of the definition of "bank" in the BHCA.

holding company. In this event, depending upon the state law, no divestiture of either the demand deposit function or the commercial lending function, or both, would be necessary. Where a bank holding company, its subsidiary, or another entity acquires an out-of-state bank, approval under the Douglas Amendment by the Federal Reserve Board is required. Where an existing nonbank is acquired, approval by the appropriate Federal supervisory agency would be required under the Change in Bank Control Act (12 U.S.C. 1817(j)): the acquisition of an existing nonbank that is a state-chartered nonmember would require approval by the FDIC, the acquisition of an existing nonbank having a national charter would require approval by the Comptroller, and the acquisition of an existing state-chartered member nonbank would require the approval of the Federal Reserve Board. The acquisition of a new nonbank would need to be approved by the appropriate Federal supervisory agency, which is the FDIC in the case of state-chartered nonmember, the Federal Reserve Board in the case of a state-chartered member,[2/] and the Comptroller where a national charter is sought.

Other considerations re: interstate acquisitions by foreign banks of failing U.S. banks

Section 5 of the IBA[3/] provides in pertinent part, that a foreign bank may not directly or indirectly acquire voting shares, an interest in, or substantially all the assets of a bank located outside its home state if such acquisition would be prohibited under section 3(d) of the BHCA if the foreign bank were a bank holding company the operations of whose subsidiaries were principally conducted in the foreign bank's home state. (A home state may be elected by the foreign bank, or in default of such election, may be determined by the Federal Reserve Board.)

2/ State approval is required to obtain a state charter. Under the Change in Bank Control Act, a state has the opportunity to submit comments to the appropriate Federal supervisory agency passing on the acquisition of an existing institution.

3/ Section 5(a)5 of the International Banking Act (12 U.S.C. 3103(5)(a)).

Section 13 (f)(4)(i) of the FDI Act[4/] provides in pertinent part, that notwithstanding Section 3(d) of the BHCA or other provision of State or Federal law or a State constitution, an institution that merges with or acquires a failing bank may be operated as a subsidiary of an out-of-state bank or bank holding company if state law of the state in which the failing bank is located specifically authorizes it.

The Douglas Amendment contains an exception for transactions under Section 13(f) of the FDI Act, however, the appropriate section of the IBA was not similarly amended. Despite, this, it may be concluded that a foreign bank can participate in interstate acquisitions of failing banks to the same extent that a domestic bank holding company could participate under Section 13(f).

Question (2): In what manner could the Federal Reserve halt Dimension if the Comptroller elects to charter the national banks involved?

Response: The background statement indicated that Dimension, which is not a holding company, has applied to the Comptroller to establish 31 national banks in 25 states. The bank will not engage in the making of commercial loans, however that might be defined. If the Comptroller were to charter the banks, the Federal Reserve Board would not be empowered to stop Dimension under present law, as (i) Dimension is not a bank holding company required to obtain approval, (ii) the newly-chartered banks would not be "banks" within the meaning of the BHCA, as they would have been divested of the commercial lending function, (iii) Dimension would not become a bank holding company as a result of the transaction, and (iv) the Comptroller has the sole authority to charter national banks. While national banks are members of the Federal Reserve (i.e., of a federal reserve bank), any restrictions or requirements the Federal Reserve Board may apply to such membership should be unrelated to Douglas Amendment considerations.

Question (3): If the Federal Reserve Board cannot or will not halt Dimension, how seriously is the Douglas Amendment impaired? For example, could a company have banks in some states which took no demand deposits but made commercial loans in or from those states while also having banks in other states which took demand deposits in these other states but made no commercial loans in or from these other states? In other words, could there be a

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4/ Section 13(f)(4)(i) of the Federal Deposit Insurance Act, as added by the Garn-St Germain Depository Institutions Act of 1982 (12 U.S.C. 1823(f)(4)(i)). An "extraordinary acquisition" involves an interstate acquisition of a failing bank of $500 million or more.

"banking company" which arranged its affairs so that it had "commercial lending" nonbank in some states and "demand deposit taking" nonbank banks in other states?

Response: It would be possible to interpret the Douglas Amendment and the definition of "bank" in the BHCA to allow the functioning of a banking company that had commercial lending nonbank banks and demand deposit taking nonbank banks in the same or different states. A valid interpretation need not necessarily be considered an impairment of the statutory provision. To avoid the result described in the question, it would be necessary to amend the definition of "bank" and/or modify the Douglas Amendment.

V. Thrift Institutions and Commercial Banks in General.

Question (1): Is the above an accurate summary regarding recent, important developments related to thrifts and banks in general? What features of an important legal nature would you add or correct?

Response: The summary is accurate with two possible exceptions: (1) the assertion that Federal S&L's and Federal savings banks' powers are virtually on a par with, and not greater than, the powers of commercial banks (see answer to question (2)) and (2) the summary neglects to mention state mutual savings banks, chartered by their respective state governments, and insured by state insurance funds.

Question (2): Some have said that the Garn-St Germain Act really allowed thrifts to surpass commercial banks in terms of powers. Without discussing the adjunct questions of holding company and service company formats which are different for thrifts and for commercial banks, would you agree with that assertion? Please explain.

Response: The issue of the relative powers of federal thrifts vis-a-vis commercial banks has no definitive answer. Although federal thrifts do not have more powers than banks, in practical terms they may have as many. Our comments only focus here on the asset and liability powers of banks and thrifts. Other areas that are arguably relevant to this question, such as branching powers and the number and type of subsidiaries an institution can own outside of the holding company or service company context, differ from state to state and can differ from bank to bank depending upon which federal financial supervisory agency regulates the bank.

With regard to deposits, few real differences exist between banks and federal thrifts. Section 326 of the Garn-St Germain Act requires that the differential be phased out by December 31, 1983. NOW Account legislation has essentially given federal thrifts the demand deposit powers they lacked for all but commercial customers. Garn-St Germain further expanded demand deposits for federal thrifts by allowing them to offer the accounts to persons or organizations with which they have "a business, corporate, commercial, or agricultural loan relationship". 12 U.S.C. 1464(b)(1)(A). Furthermore, a federal thrift may also accept demand accounts from "a commercial, corporate, business, or agricultural entity for the sole purpose of effectuating payments thereto by a nonbusiness customer." 12 U.S.C. 1464(b)(1)(B).

The Garn-St Germain Act also increased the asset powers of federal thrifts. For example, as of January 1, 1984, they will be able to invest up to 10% of their assets in secured or unsecured commercial loans. 12 U.S.C. 1464(c)(1)(R). Up to 40% of their assets can be invested in secured loans on non-residential real estate. 12 U.S.C. 1464(c)(1)(B). These, along with other broadened powers, allow up to 75% of a federal thrift's assets to be placed in commercial investments.

In practice, a federal thrift might look very much like a bank. There are still some restrictions on the federal thrift in terms of the amount and type of commercial assets available for investment. On the deposit side, the thrift is still prohibited from offering demand deposits to individual consumers. Its ability to offer them to commercial accounts, however, may in practice be virtually that of a commercial bank. Although a federal thrift's powers technically are more limited, many federal thrifts will be virtually indistinguishable from many commercial banks.

VI. Thrift Institutions, the Savings and Loan Holding Company Act, Commercial Banks, and the BHCA

Question (1): Is the above an accurate summary of developments regarding thrift institutions, the Savings and Loan Holding Company Act, commercial banks, and the BHCA? What features of an important legal nature would you add or correct?

Response: The background description accurately summarizes the legal developments regarding thrifts, commercial banks and their respective holding companies. The summary correctly points out that while unitary savings and loan holding companies enjoy greater privileges of permissible activities than bank holding companies, the thrift institutions under unitary S&L holding companies are more limited in their asset powers than are the commercial banks under bank holding companies. Legally, it is advantageous for a savings and loan holding company to diversify its operations, for in doing so it is less restricted regarding debt (12 C.F.R. § 584.6), can avoid limitations on dividends (12 C.F.R. § 584.7) and enjoys certain exemptions under the 1981 amendments to Section 206 of the Depository Institution Management Interlocks Act.

Question (2): *Would you agree with the conclusion that, when the powers of federal savings and loan associations and federal savings banks, including their branching capacity, are added to the authorities under the Federal Savings and Loan Holding Act, the resulting conglomerate could outdistance, if full legal potentials were deployed, a conglomerate formed under the bank Holding Company Act, in terms of diversified services.*

Response: Yes, unitary savings and loan holding companies such as Sears, National Steel, Baldwin-United, and Household International, may engage in virtually any commercial activity. While multiple S&L holding companies and bank holding companies are more limited in their range of permissible activities, the Federal Home Loan Bank Board's broad interpretation of what is properly "incident to the operations" of S&L's has been largely responsible for granting greater privileges of doing business to multiple S&L holding companies than their banking counterparts enjoy under the Federal Reserve Board's interpretation of similar language in the banking statute.

Question (3): *In what ways can the asset composition test of Section 7701(A19) of the Revenue Code be interpreted so as to allow thrift organizations and their affiliates the structural advantages of the Savings and Loan Holding Company Act and other statutes allowing for diversification of activities, such as the emergency takeover provisions of the Garn-St Germain Act, without maintaining a commitment to housing? Could the thrift institutions calculate for the asset composition test only at the end of the year? Could they originate commercial loans and sell them off to a commercial lending subsidiary inside the overall thrift holding company apparatus?*

Response: In connection with the first part of the question which inquires as to how the asset composition test could be interpreted to allow thrift institutions the broadest possible powers without maintaining a commitment to housing, it should be noted that the statutory authority to do so is shared by the IRS and the FHLBB.

The FHLBB has expressed its intention to treat the IRS regulations as "informative, but in no sense controlling" in developing its own interpretation of what qualifies as an asset for purposes of the asset composition test. 48 Fed. Reg. 3937. In fact, the FHLBB has adopted regulations of its own. Id. at 3938. But an enterprising person seeking to stretch the limitations contained in the Bank Board's rules could theoretically satisfy the requirement of high concentration of assets in mortgage lending by extending consumer loans secured by residential real estate mortgages. While this ploy probably would not be employed on a wholesale basis, it nonetheless serves to demonstrate that an aggressive thrift *could* satisfy the asset test (and enjoy the attendant tax and other advantages) without maintaining a true commitment to housing.

The second portion of the question we believe is addressed in the FHLBB regulation adopted in January 1983 which grants the option to the institution to choose between averaging the assets over the taxable year or computing at the close of the taxable year under the IRS regulations. Id.

Regarding the third portion of the questions, this type of interpretation is properly within the purview of the FHLBB and we therefore decline to comment.

Question (4): Assuming there are decided advantages to being a federal stock savings bank or federal stock savings and loan association and falling under the Savings and Loan Holding Company Act while being exempt from the BHCA, what legal detriments and difficulties are involved in converting from a state or national commercial bank to these stock thrift forms, outside of those which might be connected to the above cited portion of the Internal Revenue Code?

Response: The Garn-St Germain Act limits the availability to voluntarily convert to a Federal Savings Bank to those institutions which are eligible to become a member of the FHLBank System (§313 Garn-St Germain, 12 U.S.C. 1464(i)) and to those that are state-chartered, FDIC insured mutual savings banks. (§112, Garn-St Germain, 12 U.S.C. 1464(o)). The types of institutions falling into the former category are state chartered S&Ls, building and loan associations, cooperative banks, homestead associations, insurance companies engaged in home mortgage lending, state chartered mutual savings banks, state-chartered stock savings banks and Federally chartered S&Ls. (12 U.S.C. 1424). Therefore, state chartered or national banks could not convert directly to a federal savings bank charter. However, the conversion can be accomplished indirectly by a state-chartered commercial bank if it first converts to a state stock savings bank then to a federal savings bank. The ability to do so depends upon whether state law allows state chartered stock savings banks.

Regarding national banks and state-chartered banks in states that do not allow stock savings banks, there is no clear direct authority for such a direct conversion. In this connection, it should be noted, however, that although the FHLBB has expressed no view on this topic, it enjoys plenary authority to charter thrift institutions under § 5(a) of the Home Owners Loan Act, which might be interpreted to allow such conversions. 12 U.S.C. 1464(a). These institutions also could convert indirectly by first obtaining a federal charter (and FSLIC insurance), capitalizing it, then purchasing the assets and assuming the liabilities of the commercial bank. The FDIC must approve this transaction under the Bank Merger Act. 12 U.S.C. 1828(c).

Question (5): With respect to savings banks which are not insured by the FSLIC or chartered by the FHLBB, to what extent are they subject to the BHCA?

Response: If the institution accepts demand deposits and makes commercial loans then in our view its parent company should be treated as a bank holding company under the BHCA.

VII. Thrift Institutions, Thrift Service Corporations, Commercial Banks and the Bank Service Corporation Act

Question (1): Is the above an accurate summary of developments regarding thrift institutions, thrift service corporations, commercial banks, and the Bank Service Corporation Act? What features of an important legal nature would you add or correct?

Response: We would make the following comments, observations, and additions. Bank service corporations (BSCs) are companies in which banks have invested in under authority of the Bank Service Corporation Act, 12 U.S.C. § 1861 et seq. Most insured nonmember banks rely on state law for authority to organize bank subsidiaries rather than the Bank Service Corporation Act. Those subsidiaries are therefore not "bank service corporations" and not subject to the Act. If a state forbade banks to form subsidiaries, the banks in that state could draw on the Bank Service Corporation Act's authority to organize the subsidiaries and those companies would be bank service corporations under the Act. Likewise, some states allow banks to invest in subsidiaries, but only for restricted purposes. If banks in those states want their subsidiaries to do more than state law allows, they could take advantage of the power granted by the Act and form companies that would be bank service corporations.

BSCs come in three varieties. Each has its own purposes and powers, and each is subject to its own supervisory requirements:

"Traditional" BSCs: These BSCs provide clerical services and other services of an essentially internal nature to federally-insured banks and thrifts. Banks do not need permission to invest in these companies. See 12 U.S.C § 1863.

"Banking" BSCs: These BSCs may do whatever their parent banks may do, except for taking deposits. They may pursue their activities only where the parent banks would be eligible to do so (e.g., county-wide or statewide), but do not need permission to do business at any particular spot. Banks must apply to their primary supervisor for permission to invest in "banking" BSCs. Each "banking" BSC is regulated by the banking agency that supervises the bank with the largest investment in the BSC. See 12 U.S.C. §§ 1864, 1865, & 1867.

"Banking holding company" BSCs: These BSCs may engage in any service that the Federal Reserve Board has declared, by regulation, to be a service that bank holding companies are allowed to provide. Banks must apply to the Federal Reserve Board for permission to invest in "bank holding company" BSCs, and the Federal Reserve Board must approve the services that the BSC plans to provide. As an ongoing matter, however, "bank holding company" BSCs, like "banking" BSCs, are regulated by the agency that supervises the BSC's largest investor. See 12 U.S.C. §§ 1864(f), 1865(b), and 1867.

The federal law governing thrift service corporations (TSCs) is much different from that governing BSCs. The most basic difference is that the Home Owners' Loan Act, 12 U.S.C. § 1464(c)(4)(B), does not limit the behavior of thrift service corporations and it does not prescribe any special regulatory obligations that federal thrifts must comply with in order to invest in such companies.

The Home Owners' Loan Act addresses the investment powers of federal thrifts,* and does list some requirements that a company must meet before a federal thrift may invest in the company. The requirements are, however, rudimentary. The company must be chartered by the federal thrift's home state and the company's stock must only be available for purchase by savings-and-loan associations chartered by that same state** and by federal thrifts whose home offices are located in that state. In other respects, the FHLBB has a free hand to fix the rules for investments by federal thrifts. The FHLBB has used its authority to give TSCs very broad powers. See 12 C.F.R. § 545.74(c). In addition, TSCs may obtain approval from the FHLBB for activities that are only "reasonably related to the activities of" federal thrifts.

Question (2): May thrift service corporations expand their activities on a case-by-case basis by application, even without the benefit of a specific, permissive, general regulation?

Response: Although we defer to the Federal Home Loan Bank Board for a more detailed response we will comment briefly. The FHLBB's current rules generally allow TSCs to engage in the activities listed in 12 C.F.R. § 545.74(c) without prior approval (with certain exceptions). It appears that a TSC that does not already engage in all the listed activities may expand its

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* The Home Owners' Loan Act does not confer any new powers on state-chartered thrifts, as does the Bank Service Corporation Act.

** Unlike the case of BSCs, the institutions that own TSCs need not all have federal deposit insurance.

services on a case-by-case basis, provided the TSC does not engage in an unlisted activity. TSCs may not engage in an unlisted activity unless the FHLBB gives specific approval to the activity.

The Conference Committee report on the Garn-St Germain Act declared that Congress specifically intends the FHLBB to cease authorizing any further activities for TSCs. The question thus remains open whether the FHLBB could authorize a new activity, either by rule or for a particular applicant. Nevertheless, the Garn-St Germain Act neither amended nor re-enacted the relevant provisions of the Home Owners Loan Act. It is not at all clear that the mere expression of intent on the part of Congress, absent a change in or re-enactment of the law concurred in by the Executive Branch, is sufficient to alter the authority of the Federal Home Loan Bank Board.

Question (3): If a thrift service corporation offers brokerage services, as with the case of "Invest", in your opinion is the service being offered in violation of §21 of the Glass-Steagall Act? Do you have any further views on the assertions made in Securities Industry Association v. Federal Home Loan Bank Board, No. 82-1920 (D.D.C. July 12, 1982) in which this §21 issue is also at stake?

Response: It is our understanding that the Federal Home Loan Bank Board's General Counsel in reviewing the "Invest" application determined that, even assuming §21 of the Glass-Steagall Act applies to thrift institutions (an assumption the General Counsel did not concede as thrifts did not accept deposits when Glass-Steagall was enacted), the Invest program was not in violation of Glass-Steagall as §21 does not reach entities affiliated by ownership with deposit-taking institutions. The General Counsel further determined that the Invest services would, in fact, be offered by an entity legally separate from any thrift institution. We do not wish to comment on whether the service corporation is in fact a separate legal entity. We do, however, agree with the Federal Home Loan Bank Board's reading of §21 i.e., §21 does not reach bona fide subsidiaries of deposit-taking institutions. In so far as the Federal Home Loan Bank Board's General Counsel's opinion indicated that "discount brokerage" is a permissible activity for thrift institutions, we would point out to the Committee that the FDIC's General Counsel recently issued an opinion (General Counsel's Opinion No. 6) concluding that a discount brokerage program conducted by an insured nonmember bank would not be found to violate Glass-Steagall if it met the following: (1) the bank clearly acted solely at the customer's direction; (2) the transactions are for the account of the customer and not the account of the bank; (3) the transactions are without recourse; (4) the bank makes no warranty as to the performance or quality of any security; and (5) the bank does not advise its customers to make any particular investment decision.

As we have only limited familiarity with Securities Industry Association v. Federal Home Loan Bank Board or the details of the Invest program, and it is further our understanding that the issues in the litigation are primarily focused on the Home Owners' Loan Act, we decline to comment further.

Question (4): How can the competitive imbalance between bank service corporations and thrift service corporations be corrected?

Response: The competitive balance between BSCs and TSCs cannot be corrected without revising the basic structure of the Bank Service Corporation Act and the Home Owners' Loan Act. The constraints on BSCs are fixed by statute, and are highly detailed. The constraints on TSCs are only regulatory ones, and are inherently flexible. As a result, TSCs have gained powers far exceeding those that Congress has conferred on BSCs. Congress should correct the disparity by creating a common statutory framework for BSCs and TSCs. A common framework would make it easier for the regulators to preserve the competitive balance among BSCs and TSCs, and among their parent institutions.

VIII. Miscellaneous Questions

Question (1): Are the general antitrust laws adequate to prevent anti-competitive developments in the context of a changing and, presumably, highly concentratable financial services industry? Would you suggest changes in the Bank Holding Company Act, the Bank Merger Act, the Savings and Loan Holding Company Act, the McFadden Act, the Sherman Act, the Clayton Act, or the Depository Institutions Management Interlocks Act?

Response: The potential competition doctrine of antitrust law, as construed by the Supreme Court, is very nearly a nullity insofar as it relates to banking (and, by a parity of reasoning, insofar as it relates to thrift institutions and to other industries where market entry is restricted by law). See United States v. Marine Bancorporation, 418 U.S. 602 (1974). This gap in the law is conducive to the perpetuation of existing, and the development of additional, local oligopolies; moreover, it is an issue deserving paramount attention when considering proposals to allow regional or interstate expansion by financial institutions.

The responsibility for passing judgement, under the several relevant Acts, on the question whether or not a proposed amalgamation of financial institutions would be anticompetitive ought to lie with the Justice Department, rather than with the regulatory agencies. In such case, the law could be applied in a more uniform manner and the regulatory agencies, which are responsible for the safety and soundness of the institutions that they supervise, would not be faced with the conflicting choices that are engendered by a simultaneous responsibility for preserving and promoting competition.

If the foregoing suggested transfer of responsibility for rendering judgement on competitive effects of amalgamation is not adopted, the Bank Merger Act ought to be amended to eliminate the requirement for competitive factor reports, except by the Attorney General. In addition, changes should be adopted that would: (i) allow certain innocuous transactions (including "phantom" mergers) to be exempted from the Act by rule unanimously agreed upon by the cognizant agencies and the Attorney General; (ii) make it clear that the "emergency" and "probable failure" provisions apply to bank acquisitions of floundering or failing nonbank institutions (such as credit unions and S&Ls); and (iii) make the competitive touchstone of subsection (c)(5)(A) "any part of trade or commerce" (as in Section 2 of the Sherman Act, from which the provision is drawn) rather than "the business of banking", to allow the "monopolization" prohibition clearly to extend to amalgamations of banks and nonbanks.

Question (2): Are anti-tying provisions of the Bank Holding Company Act at 12 U.S.C. 1971-78 and of the Garn-St Germain Act, now codified at 12 U.S.C. 1464(q), adequate to protect the consumer from predatory practices of conditioning credit on the purchasing of other services?

Response: The anti-tying provisions purport to preclude a bank from extending credit (or furnishing other services) on the condition or requirement that the customer obtain from such bank some additional credit, property or service but, at the same time, they exclude unqualifiedly from that prohibition "a loan, discount, deposit, or trust service", thereby throwing doubt on the meaningfulness of the prohibition. The anti-tying provisions also undertake to preclude a bank from extending credit (or furnishing other services) on the condition or requirement that the customer engage in transactions with "a bank holding company of such bank" or with "any other subsiding of such bank holding company" or with "a competitor of such bank". Thus, the anti-tying provisions, if strictly interpreted, may not in themselves be sufficient to preclude a bank from extending credit (or furnishing other services) on the condition or requirement that the customer engage in transactions with entities other than those specified.