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STAFF MEMORANDA

THE MEETING OF PASSION AND INTELLECT: A HISTORY OF THE TERM "BANK" IN THE BANK HOLDING COMPANY ACT

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FEDERAL RESERVE BANK OF CHICAGO

The Meeting of Passion and Intellect: A History of the term "Bank" in the Bank Holding Company Act

by

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EXECUTIVE SUMMARY

This paper examines the term "bank" as it has been defined in the Bank Holding Company Act. The Bank Holding Company Act of 1956 was enacted to effectively limit the concentration of control over banking resources by bank holding companies and to separate banking from nonbanking interests. Critical to the accomplishment of these purposes is an understanding of what a "bank" is.

At the time the act was passed there was little debate on what constituted a bank. In fact, the act employed a chartering test to separate banks from nonbanks. However, this simple chartering test was found to be largely inconsistent with the purposes of the act. Through amendments to section 2(c) of the Bank Holding Company Act, the definition of the term "bank" has been narrowed to where an institution must now satisfy a two part activities test to be called a bank. The activities which make an institution a "bank" are (1) accepting demand deposits and (2) engaging in commercial lending activities.

A review of letters and orders of the Board of Governors of the Federal Reserve System and its staff reveals that:

*"Commercial loans" are considered to be all loans to individuals or businesses, secured or unsecured, except loans the proceeds of which are used for personal, household, family, or charitable purposes. The term also includes the purchase of such instruments as commercial paper, bankers acceptances, certificates of deposit and similar instruments.

*To be "engaged in the business of making commercial loans", an institution needs to conduct a regular commercial loan business on a more or less unlimited basis with such business constituting a significant portion of the institution's total business.

*The term "demand deposits" represents any deposit available to the general public which is accessible through checks or drafts payable to third parties.

*The term "bank" contemplates a single institution. However, assurances must be given to insure that affiliate organizations are truly separate organizations and that the deposit-taking activities of one affiliate are not supporting the commercial lending activities of another affiliate.

This paper also reviews the issue of bank/thrift affiliation and asks, "Are thrifts banks for the purposes of the Bank Holding Company Act?" Thrifts have typically been distinguished from banks as a result of their limited ability to offer services to commercial enterprises. Recent legislative initiatives have increased the commercial lending authority of federally chartered thrifts. Based on previous rulings, the Board would have had to reevaluate its position. Congress was cognizant of the dilemma that the Board would have faced and in the Garn-St. Germain Depository Institutions Act of 1982 explicitly excluded federally chartered or insured savings and loan associations and savings banks from the definition of "bank". Although thrifts begin to resemble banks to a marked degree, they are not deemed to be "banks" for Bank Holding Company Act purposes. But whether institutions possessing the powers of federally chartered thrifts but are not federally chartered or insured are "banks" remains an open question.

The Board has indicated that it is prepared to recommend changes in the definition of "bank" to Congress. The Board views the acquisition of "consumer banks" or "nonbank banks" by nonbanking companies as attempts to evade the requirements of the Bank Holding Company Act. The attempts by Dreyfus Corporation, a mutual fund manager, to acquire a bank in New Jersey and to establish a de novo bank in New York provide recent confirmation of this trend. The recommendations to Congress have still to be formulated.

Whatever the recommendation it is imperative that they be judged against the purposes of the act.

It has become increasingly difficult to separate banks from nonbanks. These difficulties arise as a result of financial innovation spurred by the desire of institutions to avoid costly regulation. With increasing technological change, the term "bank" may become an anachronism. In order to maintain the integrity of the Bank Holding Company Act, it is essential that consideration be given to revising the term "bank" so as to accomplish the purposes of the act without causing undue economic dislocations.

The Meeting of Passion and Intellect: A History of the term "Bank" in the Bank Holding Company Act

Section I. Introduction

In 1960, in Cleveland Heights, Ohio, a manager of a movie theater was convicted of violating an obscenity statute by possessing and exhibiting a French film entitled "Les Amants" ("The Lovers"). The case eventually reached the U.S. Supreme Court on appeal. The Court ruled in the manager's favor, declaring that the film was not obscene. In a separate concurring opinion, Justice Potter Stewart highlighted the great difficulty in defining material to be obscene:

> "...under the First and Fourteenth Amendments criminal laws in this area are constitutionally limited to hard-core pornography. I shall not attempt to define the kinds of material I understand to be embraced within that shorthand description; and perhaps I could never succeed in intelligibly doing so. But I know it when I see it, and the motion picture involved in this case is not that."[1]

The "know it when I see it" principle also has adherents in the financial community. In a series of articles appearing in Euromoney,[2] three banking luminaries, Walter Wriston (Citibank), Samuel Armacost (Bank of America), and Willard Butcher (Chase Manhattan) discussed banking and its future.

For Wriston, the banks of the 1990's are already here. The only trouble is that bankers are not running them. Wriston suggests that nonbank companies can do everything a bank does--and more. The view espoused by Wriston reduces to a set of simple propositions: Banks and bank holding companies are highly regulated entities. Nonbank companies have been expanding into areas that had traditionally been the domain of banks. These nonbank companies are not nearly as highly restricted in

what they may offer customers or where they may make the offering. That is, relative to banks, these nonbank concerns have the advantage of a wider diversity of products (services) which may be offered to customers without geographical restriction. Accordingly, in the view of Wriston, bank and bank holding companies are at a significant competitive disadvantage relative to their financial nonbank adversaries.

If nonbank financial institutions can do everything a bank can do, why are they not referred to as "banks"? Or, more importantly, why are such nonbank financial institutions relieved of the regulatory burdens to which banks and bank holding companies are subjected? Is banking by its nature so mutable that it defies definition, leaving one to rely on the "know it when I see it" principle?

Without establishing a context in which the term "bank" is to be used, it would be nearly impossible to define a bank or banking per se. Accordingly, this article examines the term "bank" as it is defined in the Bank Holding Company Act of 1956 (the BHCA). Inasmuch as the Board of Governors of the Federal Reserve System (the Board) has the responsibility of administering the BHCA, it is pertinent to determine its views on what is or is not a bank in carrying out the purposes of the BHCA. Because the question of whether an institution is a bank for purposes of the BHCA has been litigated only once,[3] the Board's views on the subject possess enormous weight.

Section II of this article establishes the legislative background of the BHCA and the term "bank" as used therein. Section III addresses the Board's statements in interpreting the BHCA definition of "bank" and its application of the term in Board Orders regarding bank holding company applications. Section IV reviews the Board's policy respecting

bank/thrift affiliation and asks, Are thrifts banks within the meaning of the BCHA? Finally, the enormous changes expected in the nation's financial structure and the Board's response to those changes are discussed in the context of administering the BHCA.

Section II. The Legislative History

Banks, like other financial institutions, act as intermediaries between borrowers and lenders, creating assets and incurring liabilities to creditors (including deposit holders). As Samuelson notes:

> "[b]anking is a business much like any other business. The commercial bank is a relatively simple business concern. A bank provides certain services for its customers (depositors and borrowers) and in return receives payments from them in one form or another. It tries to earn a profit for its stock owners"[4]

However, at the time Congress was debating whether or not to subject bank holding companies to effective regulation by the Federal Reserve, banks were considered to be "unique" institutions, unique enough to at least distinguish them from other financial intermediaries. The uniqueness was their ability to create liabilities (demand deposits) that are used as a transaction medium. Samuelson states that:

> "[b]y definition, [commercial banks] are the only organizations able to provide "bank money," i.e., checkable deposits that are conveniently usable as a medium of exchange."[5]

This distinguishing feature gives banks a key role in the payments mechanism. Furthermore, banks also provide commerce and industry with the credit needed to function efficiently. Indeed, commercial banks are the primary source of short-term credit to commercial and industrial firms.[6]

Because of their preeminent role in the nation's payments system, banks became subject to stringent federal regulation. The regulatory framework

that developed was one designed primarily to protect the integrity of the payments mechanism and to protect holders of bank deposit liabilities. However, regulation of bank holding companies lagged the development of comprehensive bank regulation by several decades.

The call by the Board to regulate bank holding companies was made a decade after the bank failures of the late 20's and early 30's. The Board in its Annual Report of 1943 noted that its existing authority to supervise bank holding companies under the Banking Act of 1933 was severely limited and that:

> "[a]ccepted rules of law confine the business of banks to banking and prohibit them from engaging in extraneous businesses such as owning and operating industrial and manufacturing concerns. It is axiomatic that the lender and borrower or potential borrower should not be dominated or controlled by the same management."[7]

Furthermore, the Annual Report noted that:

> "[t]here is now no effective control over the expansion of bank holding companies either in banking or in any other field in which they choose to expand ... The Board believes, therefore, that it is necessary in the public interest and in keeping with sound banking principles that the activities of bank holding companies be restricted solely to the banking business and that their activities be regulated, as are the activities of banks themselves."[8]

Thus, the Board was proposing a regulatory framework which would prohibit the use of the holding company device to do indirectly what the bank could not do directly.

Not until 1956 were the Board's wishes satisfied by the enactment of the BHCA. The purpose of the BHCA was twofold. First, there was the desire to prevent undue concentrations of banking control by bank holding companies. Secondly, the BHCA evidenced Congress' concern with the commingling of banking and nonbanking interests.

The potential adverse consequences of commingling banking with nonbanking interests preyed on the minds of the legislators framing the

BHCA. Bank holding companies might, for example, insist on making unsound loans to the holding companies' nonbank affiliates to the eventual detriment of the bank, its depositors, and the public. Or, they might deny credit to or discriminate unfairly against the competitors of the nonbank affiliates of the holding company. There was also the possibility of tie-in arrangements in which an individual or business would be required to purchase additional services offered by the bank holding company as a condition of receiving bank credit.

All three consequences revolve around the use of bank credit to create an unfair competitive advantage for the holding company and its subsidiaries. Whether holding companies would be expected to use the credit weapon in such a fashion is debatable. Nevertheless, concern was fairly widespread that the unfair use of credit by holding companies had occurred in the past and it was therefore reasonable to protect against its possible misuse in the future.

Original Act - A Chartering Test

The original definition of bank in section 2(c) of the BHCA employed a chartering test. "Bank" was defined to include:

> "Any national banking association or any state bank, savings bank, or trust company, but shall not include any organization operating under section 25 or 25(a) of the Federal Reserve Act, or any organization which does not do business within the United States."

The Senate Report accompanying the bill stated:

> "The Committee is of the opinion that the definitions in this bill will adequately cover the organizations which should be included in the scope of the bill without unnecessarily encompassing organizations that need not be included in order to accomplish the purpose of the bill."[9]

As Amended - The Activities Test

As originally enacted, the term "bank" was too broadly defined to accomplish the purposes of the legislation. To remedy this defect, when

the BHCA was amended in 1966, the definition of bank in section 2(c) was amended to read:

> "'Bank' means any institution that accepts deposits that the depositor has a legal right to withdraw on demand ...."

In explaining the change from a chartering test to an activities test the section-by-section summary of the reported bill reads:

> "Section 2(c) of the [BHCA] defines "bank" to include savings banks and trust companies, as well as commercial banks. The purpose of the [BHCA] was to restrain undue concentration of control of commercial bank credit, and to prevent abuse by a holding company of its control over this type of credit for the benefit of its nonbanking subsidiaries. This objective can be achieved without applying the [BHCA] to savings banks, and there are at least a few instances in which the reference to "savings bank" in the present definition may result in covering companies that control two or more industrial banks. To avoid this result, the bill redefines "bank" as an institution that accepts deposits payable on demand (checking accounts), the commonly accepted test of whether an institution is a commercial bank so as to exclude industrial banks and nondeposit trust companies."[10]

Given Congress' concern with the possible abuse of bank business credit, it is unclear why the definition of "bank" adopted in 1966 made no mention of the credit activities of the organizations to be defined. It seems reasonable that if one were to control the possible abuse of bank credit activities that any definition might encompass the activities related to that concern. Presumably, under section 2(c), an institution which accepted demand deposits yet did not engage in extending commercial credit would fall within the ambit of the BHCA, a result clearly at odds with the purposes of the BHCA.

Accepts Demand Deposits and Makes Commercial Loans

In 1970, section 2(c) was again amended. The definition of "bank" was narrowed to include:

> "any institution ... which (1) accepts deposits that the depositor has a legal right to withdraw on demand, and (2) engages in the business of making commercial loans."

The added requirement that an institution be engaged in commercial lending was introduced by Senator Edward Brooke (R., Mass.). While not explained, the amended definition appears to be consistent with the original intent of the BHCA. In a letter to Senator John Sparkman (D., Ala.), Chairman of the Committee on Banking and Currency, J. L. Robertson, member of the Board of Governors, wrote:

> "... S. 3823 would amend the definition of "bank" to exclude banks that make no commercial loans. To the best of our knowledge, this amendment would have very limited application at present, possibly affecting only one institution. Since there is less need for concern about preferential treatment in extending credit where no commercial loans are involved, and in view of the very limited application of the amendment, the Board would have no objection to its adoption."[11]

Section 2(c) was most recently amended by enactment of the Garn-St. Germain Depository Institutions Act of 1982 (P.L. 97-320). The act excludes from the definition of "bank" any institution that is insured by the Federal Savings and Loan Insurance Corporation or chartered by the Federal Home Loan Bank Board. (The significance of this exclusion is fully discussed in the following section entitled "Are Thrifts Banks?")

A Narrowing of Definitions

With each successive amendment of section 2(c), the definition of "bank" has been narrowed, having moved from a chartering test in 1956 to an activities test in 1966 and 1970. Unfortunately, Congress left little more than the definitions cited as a guide in the administration of the BHCA. Of course, the Board can rely on the purposes and objectives of the BHCA in carrying out its mandate. This course of action is not without pitfalls, for it may be the case in certain situations that the BHCA's literal language and Congressional intent are not in harmony. In these circumstances, the Board has given relatively greater weight to the BHCA's purposes.

Section III. Board Administration of the BHCA and the Definition of "Bank"

The recent (1982) decision by the Comptroller of the Currency approving the application of McMahan Valley Stores of Carlsbad, California, to establish banking units in its retail furniture stores is one in a series of events which raise the issue of the proper definition of "bank" for BHCA purposes. Reportedly, the establishment de novo of Western Family Bank by McMahan Valley Stores marks the first time the Comptroller's office has granted a nonfinancial institution permission to open a bank.[12] Other initiatives in the recent past also have important ramifications for the financial system and the Board's administration of the BHCA and its interpretation of the term "bank." Among these are the acquisition of Valley National Bank of Salinas, California, by Household Finance Corporation and the acquisition of Fidelity National Bank, Concord, California, by Gulf & Western Corporation.

All three of the "bank" acquisitions have been by nonbank holding companies. Since, by definition, a company that owns or controls a bank is a bank holding company and therefore subject to regulatory review of its activities and acquisitions, why were these bank acquisitions not subject to official Board review and approval? Why aren't Gulf & Western, McMahan, and Household Finance deemed to be bank holding companies pursuant to the BHCA? The answer to these questions lies in the definition of the term bank in section 2(c) of the BHCA and action taken by the acquirers of these institutions (which, for lack of a better term, may be termed "consumer banks") to substantially alter the institutions' activities so they fall outside the reach of that definition.

The definition of bank as contained in section 2(c) of the BHCA is 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, except an institution the accounts of which are insured by the Federal Savings and Loan Insurance Corporation or an institution chartered by the Federal Home Loan Bank Board, 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. Such term does not include any organization operating under section 25 or section 25(a) of the Federal Reserve Act, or any organization which does not do business within the United States except as an incident to its activities outside the United States. "District bank" means any bank organized or operating under the Code of Law for the District of Columbia. The term "bank" also includes a state chartered bank or national banking association which is owned exclusively (except to the extent directors' qualifying shares are required by law) by other depository institutions or by a bank holding company which is owned exclusively by depository institutions and is operated to engage exclusively in providing services for other depository institutions and their affiliates, directors, and employees."[13]

The section 2(c) definition of a bank is composed of three elements: (1) location; (2) the acceptance of demand deposits; and (3) the engagement in commercial lending activities. The definition does not expressly include certain institutions but it does exclude those organizations whose major purpose it is to finance and facilitate international and foreign trade such as Edge Act and Agreement Corporations. In addition, federally chartered or insured savings and loan associations and savings banks are excluded from coverage. The location element has raised few interpretative problems since its administration. But, elements (2) and (3) are investigated because they serve to define those activities which make an institution a "bank" for purposes of the BHCA.

One note of caution is in order. The Board or its staff, at times, makes pronouncements regarding what are considered to be "commercial loans", to be "engaged in the business of making commercial loans", and

to be "demand deposits" within the meaning of section 2(c). These interpretations and postures by the Board are usually developed within a framework of particular applications or proposals, each with their own set of unique circumstances. Therefore, not only is it important to read the Board's words at their face value, it is also of paramount importance to understand the circumstances surrounding the words.

Section III. (A) Commercial Loans and Engaging in Making Commercial Loans

(1) Greater Providence

The Board's earliest pronouncement under the 1970 definition of bank in section 2(c) is contained in its letter of July 1, 1971, regarding Greater Providence Deposit Corporation. Greater Providence was at the time a bank holding company by reason of its ownership of Greater Providence Trust Company, an uninsured commercial bank. A question arose as to the bank's status upon plans to dispose of its commercial loan business. Specifically, would Greater Providence Trust Company continue to be a "bank" upon divestiture of its commercial loan business, while still accepting demand deposits? In response to the proposal, the Board stated that it:

> "... is of the view that "commercial loans," as used in section 2(c), must be regarded as including all loans to a company or individual, secured or unsecured, other than a loan the proceeds of which are used to acquire property or services used by the borrower for his own personal, family, or household purposes, or for charitable purposes."[14]

The letter further states that:

> "... if your commercial bank ceases to engage in the business of making commercial loans of this type either directly or indirectly by channeling deposits to an affiliated institution which does make loans of this type, it would not fall within the definition of "bank"..."[15]

The Board thus fashioned a rather broad definition of the term "commercial loans". Furthermore, if institutions sought to divest themselves of their commercial loan business, the Board would require assurances that deposits gathered at the deposit-taking institution would not be used to support the commercial lending functions of affiliates of the deposit-gathering institution. In Greater Providence, the Board's conclusion was conditioned upon the resulting demand deposit-taking institution not supplying or maintaining the availability of funds (except through dividends) to any affiliate that makes commercial loans. Indeed, the Board reserved the right to examine the books of the institutions in question to insure the separability of the demand deposit-taking and commercial lending functions in affiliated organizations.

In a later letter to Greater Providence Deposit Corporation, the Board explained certain terms used in the July 1, 1971 letter.[16] Specifically, the term "funds" as used in the letter was deemed to apply to "any and all funds from whatever source derived and in whatever form they may be shown on the balance sheet of [Greater Providence Trust Company]." That is, the separability of the deposit-taking institution was to be complete--it could not supply or maintain funds derived from its acceptance of demand deposits or from other sources to any commercial lending affiliate. The basis for this total separation and broad application of the term "funds" is dictated by section 2(c), which "contemplates a single 'institution,' and which is inapplicable only where there are two truly separate entities."[17]

It is of some significance that the Board did not require Greater Providence Trust Company to divest itself of its existing portfolio of commercial loans.

(2) Boston Safe Deposit

The Board was soon confronted with another circumstance which called for an elaboration of the phrase, "engages in the business of making commercial loans". In this instance, Boston Safe Deposit and Trust Company, a subsidiary of the Boston Company, Inc., was primarily engaged in a trust business. Boston Safe Deposit and Trust Company both accepted demand depcsits and made loans to individuals. The proceeds of some of these loans had been used for business purposes by the borrowers. The factual circumstances posed two immediate questions for the Board: (1) Are such loans commercial loans within the meaning of section 2(c)? and (2) Did Boston Safe Deposit and Trust Company engage in the business of making commercial loans, assuming an affirmative answer to (1)?

The Board decided that for the purpose of section 2(c) loans made by Boston Safe Deposit and Trust Company to individuals and secured by nonbusiness assets, but ultimately used for business purposes were within the meaning of the term "commercial loans."[18] Having decided that Boston Safe Deposit and Trust Company made commercial loans, the Board next addressed the question of whether it was engaged in the business of making such loans. An affirmative answer to this interrogatory would necessitate Boston Safe Deposit and Trust Company being termed a "bank" because, in addition to its commercial lending activities, it also accepted demand deposits. The Board concluded after studying the lending function at Boston Safe Deposit and Trust Company that it was not engaged in the business of making commercial loans. The basis for this determination was fourfold:

(1) Boston Safe Deposit and Trust Company did not make commercial loans except on a limited and occasional basis;

(2) the loans it made were to its trust customers as an accommodation;

(3) in any event, such loans were not in an amount in excess of two percent of Boston Safe Deposit and Trust Company's total assets;[19]

and

(4) Boston Safe Deposit and Trust Company did not solicit commercial loan business and did not maintain a credit department.

The Board also noted in relation to the Boston Safe Deposit case that the sale of Fed funds constitutes an unsecured loan, but that the sale of Fed funds by Boston Safe Deposit and Trust Company is not tantamount to the making of a commercial loan for purposes of the BHCA.[20] Whether the sale of Fed funds in other circumstances would constitute a commercial loan for BHCA purposes is unclear for the Board did not specify the circumstances which might serve to distinguish Boston Safe Deposit from other cases in this respect.[21]

(3) Gulf & Western

With these two earlier Board decisions in mind, it is understandable how the Board decided that Fidelity National Bank, Concord, California (Fidelity), was not a "bank" and that Gulf & Western, which had indirectly acquired it, was not a bank holding company.

Fidelity divested itself of all of its commercial loans prior to its acquisition by Gulf & Western. Fidelity also committed to limit its lending to loans for personal, family, household, or charitable purposes. In addition, it intended to document its compliance with the above commitments and, most importantly, agreed to separate completely its deposit-taking activities from any commercial lending activities of its affiliates.[22] Given the precedents established by the Greater Providence

and Boston Safe Deposit cases, the Board could not very well require Gulf & Western to seek the prior approval of the Board of its acquisition of Fidelity since Fidelity would not be a "bank."

(4) Dreyfus Corporation

The Board's most recent (1982) statement regarding the meaning of "commercial loans" and "engages in the business of making commercial loans" is contained in its response to a Change in Bank Control notification filed with the Federal Deposit Insurance Corporation by Dreyfus Corporation, New York, New York.[23] Dreyfus Corporation proposed to acquire Lincoln State Bank, East Orange, New Jersey, a full-service commercial bank. The bank was to divest its commercial loan portfolio and to cease making commercial loans. However, the bank was expected to place funds in certificates of deposit and similar market instruments.

The Board's letter indicates that, after studying the various types of extensions of credit for the purposes of identifying the lending activities that qualify an institution as being "engaged in the business of making commercial loans", it concluded that the definition of "commercial loans" is:

> "broad in scope and includes the purchase of such instruments as commercial paper, bankers acceptances, and certificates of deposit, the extension of broker call loans, the sale of federal funds, and similar lending vehichles."[24]

The Board concluded that because Lincoln State Bank would continue to accept demand deposits and use its deposits to purchase market instruments such as those mentioned above, that it would be "engaged in the business of making commercial loans" and thus be a "bank" under the BHCA. As such, the Board determined that Dreyfus Corporation's notification to the FDIC was improperly filed and that the acquisition is subject to the BHCA.

The Board has provided guidance in its statements regarding the interpretation of "commercial loans" and "engages in the business of making commercial loans." A "commercial loan" is considered to be all loans to companies or individuals, either secured or unsecured, except for loans where the proceeds are used to acquire property or services for personal, family, or household, or charitable purposes. A demand deposit-taking organization can make commercial loans and still not be classified as a bank under section 2(c) so long as it is not engaged in the business of making such loans. It appears that such an organization would not be engaged in the business of making commercial loans if:

(1) it does not conduct a regular commercial loan business;

(2) its commercial loan transactions are on a limited basis; and

(3) its commercial loans are insignificant in relation to its total business (e.g., less than two percent of total assets).

Finally, according to the Board, section 2(c) contemplates a single institution both making commercial loans and accepting deposits, and two entities apparently would not be treated as one institution under section 2(c) provided they are truly separate entities. This separation requires:

(1) the deposit-taking institution not supplying or maintaining the availability of funds (other than through dividends) to any affiliate engaged in commercial lending;

(2) separate corporate identities; and

(3) measures undertaken which would insure true separation, such as regular reporting requirements and examinations.

Section III. (B) Accepting Demand Deposits

In order to be a bank within the meaning of section 2(c), an institution, in addition to being engaged in commercial lending, must also accept deposits that the depositor has a legal right to withdraw on

demand. The legislative history of section 2(c) reveals that Congress used the term "demand deposits" and "checking accounts" interchangeably. Accordingly, it would appear reasonable to interpret the section to encompass any organization that offered checking accounts to the general public as being embraced under this element of section 2(c).

(1) Wilshire

The case of Wilshire Oil Company of Texas v. Board of Governors, 668 Fed. 2d 732 (3d Cir. 1981), is the only case involving a judicial interpretation of the term "bank" under the BHCA. And revolving as it does around the proper definition of the term "demand deposits", it is invaluable to any understanding of how that term is applied by the Board.

The Wilshire case involved Wilshire Oil Company of Texas, Jersey City, New Jersey, which became a bank holding company on December 31, 1970, as a result of the 1970 Amendments to the BHCA. These amendments, among other things, subjected one-bank bank holding companies to the provisions of the BHCA.[25]

At the time Wilshire Oil Company became a bank holding company by virtue of its ownership of Trust Company of New Jersey, Jersey City, New Jersey (Trust Company), it also engaged in various nonbank activities deemed impermissible for bank holding companies. Pursuant to section 4(a)(2) of the BHCA, Wilshire Oil Company was required by December 31, 1980, either to cease engaging in the impermissible nonbank activities or to divest itself of its commercial bank.

Wilshire Oil Company informed the Board that it intended to retain its nonbanking interests. However, it would comply with the BHCA and cease to be a bank holding company through a plan whereby Wilshire Oil Company would alter the demand deposit-taking activities of Trust Company.

The plan called for Trust Company to notify its demand deposit holders of Trust Company's reservation of the right to require 14 days' prior notice of withdrawal from such accounts. It was believed that this reservation of right to prior notice would legally remove the affected accounts at Trust Company from the definition of demand deposit in section 2(c).

The Board, in its Final Decision and Order of April 2, 1981, rejected Wilshire Oil Company's contention that the reservation of the right to require prior notice would effectively remove Trust Company from the definition of bank contained in section 2(c). The Board concluded that Trust Company was a "bank"; that Wilshire Oil Company was a bank holding company; and that the retention of Trust Company beyond 1980 resulted in a violation of the BHCA.

The Board's reasoning, as reflected in the Final Decision and Order, was that the reservation of the right to require 14 days' prior notice was a sham transaction intended solely to evade the BHCA's requirements. It noted that Trust Company had offered to both commercial and individual customers deposit accounts that were immediately accessible through checks or drafts payable to third parties. The Board noted further that:

> "In interpreting the meaning of the term "bank" as used in a federal statute such as the [BHCA], the Board is not bound by the labels that parties to a private contract may place on a transaction or by the superficial form of the activity involved; rather the Board must look to the substance of the transaction to determine if the activity comes within the meaning and purposes of the [BHCA]." (Emphasis added)[26]

> "...the Board believes that, while the language of the statute is the proper starting point, any inquiry into the meaning of "bank" may properly consider the context in which the language is employed in the [BHCA] as a whole as well as the overall purpose of the [BHCA]."[27]

Thus, it was the Board's belief that a literal interpretation of section 2(c) would frustrate the purposes of the BHCA. Accordingly, the Board ignored the form of the transaction (i.e., the conversion of demand deposit accounts into accounts which nominally required 14 days' prior notice of withdrawal) and emphasized its economic reality.[28]

Wilshire Oil Company petitioned the Court of Appeals for the Third Circuit for review of the Board's action, centering its position on a literal reading of section 2(c). Wilshire Oil Company's position was straightforward: the statutory definition must be applied in accordance with the plain meaning, which compels the conclusion that Trust Company is not a "bank" because it does not accept demand deposits; it is the legal relationship, not the functional one, which is important under the BHCA. In Wilshire Oil Company's view, allowing the Board the type of authority it asserted was to permit administrative usurpation of the legislative role. To Wilshire Oil Company, the Congressional words were clear and unambiguous, and to be faithful to Congressional will, Trust Company should not have been declared to be a "bank".[29]

The Court of Appeals decided in favor of the Board, stating, in what amounted to a paraphrase of the Board's Final Decision and Order, that:

> "[w]hile the language of the [BHCA] may be the starting point in construing the statute, we may look beyond the plain language, if necessary, to ensure that application of the literal terms does not destroy the practical operation of the statute."[30]

The Court of Appeals concluded that Trust Company is the type of institution that Congress meant to include within the definition of bank under section 2(c) because Trust Company had made no functional change in its banking operations and the reservation of a right to require notice had no practical effect on the bank's deposits.[31]

Wilshire Oil Company's petition for a rehearing in banc by the Court of Appeals was denied, as was its petition for a writ of certiorari to the U.S. Supreme Court. Thus, the Circuit Court's decision stands as the only judicial interpretation of the scope and applicability of section 2(c) and the limits of the Board's authority with respect thereto.

(2) Credit Balances

The issue of whether certain credit balances may be designated as being the functional equivalent of demand deposits has come before the Board on several occasions in connection with the operation of companies organized under Article XII of New York State Banking Law (so-called Article XII Investment Companies).[32] In New York, such companies possess most of the powers of commercial banks with the exception that they cannot accept deposits. The activities of such concerns are so like those undertaken by commercial banks that there is a question whether they should be regarded as "banks" for purposes of the BHCA.

Under state law, New York Investment Companies may, among other things, borrow and lend money; acquire and dispose of bills of exchange, drafts, notes, acceptances, and other obligations for the payment of money; issue letters of credit; buy and sell foreign exchange; receive funds for transmission to foreign countries; and receive and maintain credit balances incidental to, or arising out of, the exercise of its lawful powers.[33] Traditionally, New York Investment Companies have served as an entry vehicle for foreign organizations seeking to enter the U.S.

In Banque National de Paris,[34] the Board entertained an application by a bank holding company to retain the shares of French American Banking Corporation (French American), a New York Investment Company, pursuant to section 4(c)(9) of the BHCA.[35] The Board determined that, for the purposes of the BHCA, French American was not a "bank" because it did not

accept demand deposits. In effect, the Board concluded that credit balances of New York Investment Companies were not the equivalent of demand deposits.

The Board's decision in the matter of Banque National de Paris is based on one major consideration: credit balances at French American arise only incidentally to transactions that it is legally permitted to perform for its customers. French American is not generally authorized to solicit or accept deposits of idle funds and credit balances are not permitted to be used in the manner of a checking account for personal or business transactions other than to make payments in connection with the importation or exportation of goods.

In essence, credit balances lack the convenience characteristics of general checking account facilities. This distinction, which, according to the New York Superintendent of Banks, is "meaningful" and "administrable" and the fact that French American is principally engaged in financing or facilitating transactions in international or foreign commerce led the Board to decide that French American was not a "bank" for purposes of the BHCA.[36]

Another section 4(c)(9) application, this time filed by The Bank of Tokyo, Ltd.,[37] occasioned the Board's reconsideration of the distinction between demand deposits and credit balances. In this instance, The Bank of Tokyo, Ltd. sought to organize Tokyo Bancorp International (Houston), Inc. (TBI), under a general charter as a Texas nonbanking corporation. TBI's business, like that of New York Investment Companies, would be primarily international in character. And, like such companies, TBI would receive so-called "due-to-customer accounts", which are similar to credit balances at New York Investment Companies, serving many of the same functions as demand deposits in commercial banks.

The Board, in denying the application, stated that TBI is not necessarily a bank within the meaning of section 2(c). However, because of the close resemblance of TBI to a "bank", approval of the proposal would be inconsistent with the purposes of section 3(d) of the BHCA, the so-called Douglas Amendment, which generally limits the acquisition of additional banks by bank holding companies to the state in which they principally conduct their banking business. Since The Bank of Tokyo, Ltd. already had banks operating in California and New York, the Board believed that it would somehow violate the spirit, if not the letter, of section 3(d) to permit the establishment of TBI.

Thus, with The Bank of Tokyo, Ltd. a dichotomy developed. On one hand, the Board had determined that although TBI closely resembled a "bank" that it, in fact, might not be a bank within the meaning of section 2(c). Yet, on the other hand, the Board concluded that, in effect, TBI was a bank for purposes of section 3(d) of the BHCA. Had TBI been established in California or New York, the location of existing bank subsidiaries, it is uncertain how the Board would have reacted.

An application filed by European-American Bancorp to retain the shares of European-American Banking Corporation, a New York Investment Company, pursuant to section 4(c)(8) of the BHCA provided the Board with a major opportunity to clarify its position regarding the equivalence of credit balances to demand deposits and the resemblance of New York Investment Companies and similar organizations to commercial banks.[38]

In European-American the Board again decided that credit balances should not be regarded as demand deposits for purposes of section 2(c). Noting the fact that credit balances at New York Investment Companies are in many respects the functional equivalent of demand deposits and that

such balances should be subject to federal banking regulation, including reserve requirements and interest rate controls, the Board nonetheless concluded that New York Investment Companies are not "banks." This conclusion rests on three main pillars:

(1) The legislative history of the BHCA indicates that the provision of checking accounts is one of the features distinguishing commercial banks from other financial institutions;

(2) There exist historical, legal, and administrative distinctions between credit balances and deposit accounts in New York; and

(3) Congress had exhibited a general intent to exclude international banking corporations from the BHCA's definition of "bank".

Accordingly, so long as European-American Banking Corporation continued to engage primarily in international banking activities, the Board would not extend the definition of "bank" to cover it. The Board thus sustained its 1971 ruling in Banque National de Paris.

However, the Board's approval in European-American was conditioned on, among other things, the divestiture of European-American Banking Corporation's two California branches. In the Board's view, Congress had not intended section 4(c)(8) to authorize the ownership of companies by domestic bank holding companies which would allow an international banking business to be conducted on a multi-state basis outside of the explicit legal framework established by Congress in section 25 and section 25(a) of the Federal Reserve Act (Edge and Agreement Corporations). Because the California offices were not subject to the restrictions on domestic business imposed on Edge and Agreement Corporations, European-American Bancorp was seen as having an unfair competitive advantage.

Governor David M. Lilly dissented in European-American based on his view that European-American Banking Corporation should be regarded

as a "bank". In his dissent, Governor Lilly noted the anomaly that, for monetary policy purposes, the Board views the equivalence of credit balances to demand deposits as being so strong as to include credit balances in the definition of the narrow M-1 money supply. Indeed, subsequent to the European-American decision, the Board defined credit balances to be deposits for purposes of Regulation D, which was revised to implement the reserve requirement provisions of the Depository Institutions Deregulation and Monetary Control Act of 1980 (the Monetary Control Act).[39]

The Board's concern with nonbank proposals that would have the effect of complicating or confounding monetary control is also voiced in European-American. The Board stated that:

> "[A]ny proposal under section 4(c)(8) that would have the effect of diminishing the reserve base either by facilitating the acceptance of reserve-free credit balances or encouraging a shift from reservable deposits to such balances would entail serious adverse effects."[40]

Monetary policy concerns have surfaced in more recent proposals by bank holding companies seeking to acquire thrift institutions.[41]

Section IV. Are Thrifts "Banks"?

The general public has a tendency to agglomerate savings and loan associations, savings banks, and commercial banks into one homogeneous mass comprising a significant part of the financial services industry in this country. For many individuals, patronizing a savings and loan association is the equivalent of patronizing a commercial bank. For many users of financial services, savings and loan associations and savings banks are reasonably good substitutes for commercial banks. Nevertheless, for certain customers, business and commercial enterprises, there had existed major distinctions between commercial banks and thrifts prior to enactment of the Garn-St. Germain Depository Institutions Act of

1982 (Garn-St. Germain). These distinctions arose due to the legal restrictions placed upon thrifts in performing services for the commercial enterprise. However, the distinctions had been slowly eroding and, indeed, Garn-St. Germain may have obliterated any meaningful distinction between thrifts and commercial banks.

With the thrifts' increasing commercial lending powers the question faced by the Board is: Should thrifts be regarded as banks within the meaning of section 2(c)? The response to this question has broad implications for the future development of the financial services industry. As one example, if thrifts were deemed to be "banks" any company owning or controlling such a thrift would be subject to the BHCA. As it stands, under the Savings and Loan Holding Company Act[42] companies owning but one savings and loan association are not subject to extensive regulation regarding the activities in which they may permissibly engage. However, should savings and loan associations qualify as "banks", their holding companies would be subject to the BHCA's restrictions regarding permissible nonbank activities.

The history of bank/thrift affiliation is a tangled web of public policy concerns which have been addressed in previous Board Orders. With the 1970 Amendments to section 4 of the BHCA, the Board was authorized by Congress to consider proposals by bank holding companies to engage in nonbanking activities. Section 4(c)(8) of the BHCA establishes a balancing test to be utilized by the Board in assessing the permissibility of nonbank proposals. Specifically, section 4(c)(8) exempted from the general nonbank prohibitions of section 4:

> "shares of any company the activities of which the Board...has determined (by order or regulation) to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. In determining whether a particular activity is a proper incident to banking or managing or controlling banks the Board shall consider whether its performance by a bank holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition or gains in efficiency that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices."

Under the authority granted in section 4(c)(8), the Board has determined that certain nonbank activities are permissible for bank holding companies, such as operating a mortgage banking concern, trust company, or finance company.[43] The Board announced in 1972 that it did not intend to include the operation of a savings and loan association to the list of permissible activities.[44] The reasons offered at the time were based on the proposition that savings and loan associations were governed under a different statutory framework than banks and that Congress intended such institutions to be preserved as specialized lenders to the housing industry. The Board believed that affiliation with bank holding companies would tend to blur the structure established by Congress. Because of the broad public policy issues involved in bank/thrift affiliation the Board felt that Congress should address the issue. This theme later surfaced in a number of Board decisions.

The Board in 1974 entertained an application by American Fletcher Corporation, Indianapolis, Indiana, to acquire Southwest Savings and Loan Association, Phoenix, Arizona, under section 4(c)(8).[45] In American Fletcher, the Board appeared close to settling the public policy issues it desired Congress to consider. Specifically, with respect to the issues of housing finance, statutory separation, and regulatory framework, the Board stated:

> "[It] has also considered whether the affiliation of Southwest with [American Fletcher] would adversely affect the flow of funds into any housing market. The record contains no evidence supporting assertions to that effect... The combined effect of statutory and regulatory prohibitions against, and limitations upon, Southwest's transactions with [American Fletcher] and its subsidiaries and effective supervision by the appropriate agencies would effectively bar any significant diversion of funds from Southwest to [American Fletcher] and any adverse effect upon the flow of housing funds in the area served by Southwest."[46]

In American Fletcher the Board considered, as required, whether the operation of a savings and loan association was "closely related to banking". The Board concluded that such activities are closely related to banking and, further, commented on the trend toward lessening distinctions between commercial banks and savings and loan associations:

> "Geographic restrictions on mortgage lending by savings and loan associations have been liberalized. Recently, savings and loan associations were permitted by the Federal Home Loan Bank Board to participate in the Federal funds market, previously dominated by commercial banks. Savings and loan associations recently were authorized to offer large negotiable certificates of deposits. The role of savings and loan associations in the nation's payments mechanism is growing. The President's Commission on Financial Institutions and others have made proposals to expand the powers of savings and loan associations. The close relationship between banking and operation of savings and loan associations would become even closer should these proposals be implemented. Should this trend continue to the point where savings and loan associations both accept demand deposits and engage in the business of making commercial loans, savings and loan associations would actually become "banks" for purposes of the [BHCA]."[47]

The Board in American Fletcher was not yet ready to bestow the title of "bank" upon savings and loan associations. The prohibitions of section 3(d) were inappropriate to the acquisition of Southwest, an Arizona savings and loan association, by American Fletcher, an Indiana bank holding company. A reading of the Board's Order gives every indication that but for financial concerns and a Board "go slow" policy respecting nonbank acquisitions, the Board was prepared to sanction cross-industry

and interstate acquisitions of this kind.

However, any such interpretation was voided in the Board's decision regarding an application by D.H. Baldwin Co., Cincinnati, Ohio, to retain the shares of Empire Savings, Building and Loan Association, Denver, Colorado, a state-chartered savings and loan association.[48] In D.H. Baldwin the Board went beyond the narrow question of the facts unique to the particular case and considered whether bank holding company affiliation with savings and loan associations would in general be a "proper incident to banking". The Board reaffirmed its decision in American Fletcher that the operation of a savings and loan association is closely related to banking. However, the Board was unable to conclude that such operations were a proper incident to banking. In support of its conclusion in this regard, the Board voiced several concerns relating to: (1) the issue of regulatory conflict and the problem of determining the permissible scope of savings and loan association activities as conducted by a bank holding company affiliate; (2) the possible erosion of institutional rivalry between banks and savings and loan associations under common ownership; and (3) the possible undermining of the prohibitions on interstate banking contained in section 3(d) of the BHCA.

Again, as it did in 1972, the Board left it for Congress to decide whether bank and savings and loan association affiliation is permissible and whether such near-banks as savings and loan associations should be treated as "banks" or "nonbanks" for purposes of the BHCA.

The issue as to whether thrifts should be regarded as "banks" or "nonbanks" for purposes of the BHCA remained dormant after D.H. Baldwin until 1980. Such institutions were granted expanded powers pursuant to the Monetary Control Act. Under the act, federally chartered savings and

loan associations were authorized to issue NOW accounts, which function as the equivalent of a checking account at a commercial bank. Morever, the asset powers of thrifts were also expanded. Savings and loan associations were empowered to: (1) invest up to 20 percent of their assets in commercial real estate loans, commercial paper and corporate debt securities, and loans for personal, household, or family purposes; (2) engage in credit card operations; and (3) apply for trust powers. Further, the Monetary Control Act authorizes federal mutual savings banks to make commercial, corporate, or business loans up to 5 percent of assets and to accept demand deposits in connection with such loan relationships.[49]

Given these expanded powers of thrifts, was the Board willing to regard them as "banks" under the BHCA? The answer to this query came in the Board's discussion in the Interstate/Scioto case.[50] In Interstate/Scioto, a bank holding company sought to acquire a state-chartered savings and loan association. Two significant aspects of the Order are worthy of note. First, the Board asserted, in line with its reasoning in First Bancorporation/Beehive (infra) that, for purposes of the BHCA, NOW deposits are the equivalent of demand deposits, notwithstanding the fact that institutions accepting such deposits usually reserve the right to prior notice of withdrawal, a right, which, in practice, is not often exercised. Thus, in conformance with its obligation to "look to the substance of the transaction", the Board could no longer justify maintaining a regulatory distinction between NOW deposits and demand deposits for BHCA purposes.

Secondly, Scioto agreed to limit its commercial lending activities so as to achieve parity with federally chartered thrift institutions. By so doing, the Board's consideration of the application could proceed under

the standards contained in section 4(c)(8).

In acting upon the application, the Board was forced to reconsider its position relative to the potential adverse effects of bank/thrift affiliation. In approving the application, the Board stated that its decision "does not overrule its conclusion...that, as a general matter, the operation of a thrift institution by a bank holding company is not a proper incident to banking."[51] The Board found compelling public benefits serving to outweigh the possible adverse effects of bank/thrift affiliation. Absent these public benefits, it is unlikely that such an application would have been entertained by the Board in the first instance.[52]

The Board's declaration that NOW deposits are "demand deposits" for BHCA purposes was first articulated in First Bancorporation/Beehive,[53] wherein a bank holding company sought to acquire a Utah industrial loan company. Beehive proposed to engage in lending activities, including commercial lending activities, and to accept NOW deposits, such powers having been authorized for Utah industrial loan companies. Under Regulation Y, the acquisition of an industrial loan company is permissible so long as the institution does not both accept demand deposits and engage in commercial lending.[54] Thus, the issue raised was whether an institution that accepts NOW deposits and engages in commercial lending should be a bank under section 2(c).

The Board noted that while institutions accepting NOW deposits reserve the right to require between 14-30 days' prior notice of withdrawal, in practice the right is rarely invoked: "Indeed, for purposes of section 2(c), the Board believes that until the institution invokes the notice requirement, the depositor has a right to withdraw funds on demand."[55] Accordingly, a nonbank subsidiary of a bank holding company may not

accept NOW deposits and also engage in the business of making commercial loans, for such institutions are "banks" for BHCA purposes.

Having concluded that the combination of accepting NOW deposits and making commercial loans would qualify an institution as a "bank", the Board sought to distinguish the activities of savings and loan associations and savings banks from commercial banks. The basis on which savings and loan associations and savings banks were distinguished from "banks" reflected the fact that such institutions had historically concentrated their lending in home mortgages and, as a result, their involvement in commercial lending activities was generally quite limited.[56] Of course, the Board's rationale in the matter implies that in particular circumstances savings and loan associations and savings banks might be deemed to be "banks". Morever, what would serve to distinguish state-chartered savings and loan associations and savings banks from "banks" in those states which confer on such institutions broader lending powers than those possessed by federally chartered thrifts? Apparently, in harmony with the Board's decision in First Bancorporation/Beehive, any NOW deposit-taking thrift that engages in commercial lending activities beyond those of federally chartered thrifts is a "bank" for BHCA purposes.

As in Interstate/Scioto, the Board in First Bancorporation/Beehive narrowed the scope of its approval by conditioning the decision. The Board stipulated that NOW deposits to be accepted by Beehive would be subject to interest rate limitations and reserve requirements that apply to organizations covered by the Monetary Control Act, for to do otherwise would undermine the objectives of the act by encouraging the growth of transaction balances outside the purview of Regulations D and Q. The

Board was concerned that the acceptance of NOW deposits by affiliates of bank holding companies would divert deposits away from institutions affected by such Regulations.[57]

Following both First Bancorporation/Beehive and Interstate/Scioto, the Board considered the application by BankEast Corporation, Manchester, New Hampshire, to acquire Portsmouth Trust Company, Portsmouth, New Hampshire, a New Hampshire guaranty savings bank.[58] Guaranty savings banks are unique to New Hampshire. They possess many of the same powers as mutual savings banks, except they have, under state law, broader commercial real estate lending powers than those of federally chartered thrifts.[59] Given the precedents of First Bancorporation/Beehive and Interstate/Scioto, the Board indicated that it would approve the acquisition of Portsmouth Trust Company under section 4(c)(8) only on the condition that Portsmouth limit its commercial lending activity to that currently permissible for federally chartered thrift institutions.[60]

The most recent statement by the Board regarding the issue of bank/thrift affiliation came in Citicorp/Fidelity.[61] The Board, in conditionally approving the proposal by Citicorp, New York, New York, to acquire Fidelity Federal Savings and Loan Association of San Francisco, San Francisco, California, again reiterated its position that thrifts are not "banks" under the BHCA. In Citicorp/Fidelity the Board supported this position through reliance on two main arguments.

First, the Board noted that the lending activities of federal savings and loan associations have historically been highly specialized. Further, under the existing statutory and regulatory provisions (i.e., pre-Garn-St. Germain), such institutions continue to have their loan portfolios concentrated in home mortgages.

Secondly, the Board noted the design by Congress of a separate and independent statutory structure for regulation of federal savings and loan associations and their holding companies. Moreover, Congress, in constructing the BHCA, included federal savings and loan associations within the definition of thrift institution under section 2(i) of the act. This, the Board stated, provided evidence of Congress' intent not to have federal savings and loan associations regarded as "banks" under the BHCA.[62]

As in Interstate/Scioto, it is unlikely that the Board would have approved the Citicorp application had it not been for the fact that Fidelity Federal Savings and Loan Association was a failed institution. By its acquisition, Citicorp was to breathe new competitive vigor into a dormant institution. Absent the compelling public benefits found by the Board, the application would probably have been denied.[63]

Now that the Board's focus has shifted to the commercial lending capabilities of thrifts (NOW deposits being viewed as the equivalent of demand deposits), what would be the impact of legislation that broadens further the commercial lending powers of thrifts?

Garn-St. Germain provides for new lending powers for federally chartered thrifts.[64] Under the legislation, savings and loan associations are permitted to originate commercial loans up to 5 percent of their assets up to January 1, 1984. A federally chartered savings bank is authorized to originate commercial loans up to 7.5 percent of assets. After January 1, 1984, both savings and loan associations and savings banks would be able to commit up to 10 percent of assets in direct commercial loans.

Since the Board's position articulated in Interstate/Scioto, First Bancorporation/Beehive, BankEast/Portsmouth, and Citicorp/Fidelity revolves around the then existing limited commercial lending powers of federally chartered thrifts as being determinative as to the proper classification of "banks" and "nonbanks" under the BHCA, any legislation that broadens thrift powers would necessitate that the Board reevaluate its position. Indeed, it might well have been that enactment of the legislation would have undermined the basis for the existing exemption of thrift holding companies from the BHCA. It appeared in keeping with previously enunciated Board principles, that "to the extent regulation is necessary at all, institutions providing the same services should be subject to substantially the same regulation in providing these services, regardless of their form of organization".[65] Legislation seeking to significantly broaden the commercial lending powers of thrifts would occasion the Board's reappraisal of the applicability of the BHCA to companies owning thrifts in view of the BHCA's purposes of maintaining a separation between banking and commerce and in preventing undue concentrations of banking resources.

Congress, apparently, was aware of the dilemma the Board would have encountered had it merely expanded the commercial lending powers of thrifts without indicating an intent to exclude federal thrifts from the definition of "bank". Thus, Congress amended section 2(c). Section 333 of Garn-St. Germain expressly excludes from the definition of "bank" "an institution the accounts of which are insured by the Federal Savings and Loan Insurance Corporation or an institution chartered by the Federal Home Loan Bank Board". Even though thrifts, exercising all the powers authorized under Garn-St.Germain, may begin to resemble commercial banks to a significant extent, they would not be deemed "banks" for the purposes of the BHCA.[66]

Section V. Conclusion

The history of what is a "bank" under the BHCA has reflected a number of significant factors. First, the Board appears to strive to remain faithful to the purposes and objectives of the BHCA. As noted, the major purposes were to prevent an undue concentration of resources, especially business credit, and to maintain the separation of banks from companies not closely related to banking.

Secondly, this review has highlighted the difficulties encountered by the Board in assessing proposals by bank holding companies to acquire bank-like organizations. This difficulty is revealed in Board rulings, that, in some instances, define an organization to be a "nonbank", yet suggest that permitting its establishment or acquisition may run counter to the interstate banking prohibitions of the BHCA.

The Board's assessments of nonbank proposals appear to be greatly influenced by considerations relative to monetary policy. Any proposal which has the effect of making monetary control more difficult is unlikely to be approved absent compelling public benefits. This view is projected in First Bancorporation/Beehive wherein the industrial loan company was subjected to reserve and interest rate requirements similar to those for NOW deposits held by depository institutions under the Monetary Control Act, notwithstanding the fact that Congress did not see fit to extend such requirements to industrial loan companies offering such accounts.

This article has captured some sense of the "regulatory dialectic." According to Edward Kane, the regulatory dialectic contemplates the interaction of political and economic forces in a regulated environment. Within this context, the regulatee seeks to avoid or circumvent costly regulation, which, in turn, calls for re-regulation on the part of the regulators.[67]

Wasn't Gulf & Western seeking to avoid the regulatory burden of becoming a bank holding company by structuring its acquired bank's activities so that it should not be deemed a "bank"? Wasn't Wilshire Oil Company also seeking to escape the BHCA's requirements by attempting to convert its bank's accounts into something other than demand deposit accounts? These are but a few examples of the ongoing regulatory dialectic.

Determining what is a "bank" is likely to become more and more difficult as the winds of financial innovation buffet the waves. The increasing rate of financial innovation is a product of many factors, significant among which are: (1) the response of individuals in and out of the financial sector to high rates of inflation; (2) the increasing rate of technological innovation, which has an impact on the speed at which information is processed and communicated; and (3) the prevailing, yet evolving, regulatory structure, a structure which is rooted in the theology of the 1930's.

The forces influencing financial innovation are not likely to abate. Nonbank institutions may become more bank-like. As this occurs it will become increasingly difficult for the Board to maintain the integrity of the BHCA. Difficulties arise when the deposit-taking and commercial lending functions are lodged in separate affiliates. This creates supervisory problems in maintaining the separability of the affiliates. These problems are likely to grow more intractable given the rate of technological innovation and the desire on the part of institutions to avoid costly regulation.

Footnotes

[1]Nico Jacobellis v. Ohio 378 U.S. 184, 197 (1964).

[2]Walter B. Wriston, "Bank 'n' Burger"; Samuel H. Armacost, "The Fettering of American Banking"; and Willard C. Butcher, "When is a Bank not a Bank." All articles appeared in Euromoney (October 1981).

[3]See: Wilshire Oil Company of Texas v. Board of Governors of the Federal Reserve System, 668 Fed. 2d 732 (3d Cir. 1981).

[4]Paul A. Samuelson, Economics, Ninth Edition, (McGraw-Hill, 1973), p. 294.

[5]Ibid., p. 292.

[6]In a different context, the U.S. Supreme Court attested to the "uniqueness" of commercial banks in deciding upon the legality of a bank merger under the federal antitrust laws. The Court noted banks' unique ability to accept demand deposits and the role banks play in the provision of business credit. In determining that the cluster of products and services denoted by the term "commercial banking" composed a distinct line of commerce for bank merger analysis, the Court stated:

> "Some commercial banking products or services are so distinctive they are entirely free of effective competition from products or services of other financial institutions; the checking account is in this category."

(U.S. v. The Philadelphia National Bank, 374 U.S. 321, 356 (1963).)

[7]See: Board of Governors of the Federal Reserve System, 30th Annual Report, 1943 (1944), p. 36.

[8]Ibid., p. 37.

[9]Bank Holding Company Act of 1956, S. Rept. 1095, 84 Cong., 1st Sess.

[10]Bank Holding Company Act Amendments of 1966, S. Rept. 1179, 89 Cong., 2d Sess.

[11]See letter dated June 1, 1970, from Governor Robertson to Senator Sparkman.

[12]Wall Street Journal, August 10, 1982, p. 38.

[13]In addition to the BHCA, the Board has the responsibility of administering other legislation which necessitates from time to time a definition of certain terms such as "demand deposits". (See, for example, Regulations D and Q.) Because these other Regulations administered by the Board were formulated for different purposes, it is possible for the term "demand deposits" to be defined one way for purposes of the BHCA and in some other manner for other regulatory purposes.

[14]See letter dated July 1, 1971, from Kenneth A. Kenyon, Deputy Secretary, Board of Governors, to Biaggio M. Maggiacomo, President, Greater Providence Deposit Corporation.

[15]Ibid.

[16]See letter dated July 29, 1971, from Thomas J. O'Connell, General Counsel, Board of Governors, to Ernest N. Agresti, Esq.

[17]Ibid.

[18]See letter dated June 8, 1972, from Michael A. Greenspan, Assistant Secretary, Board of Governors, to Laurence H. Stone, Vice President and General Counsel, Federal Reserve Bank of Boston.

[19]Commercial loans comprised only 1½ percent of Boston Safe Deposit and Trust Company's assets at December 31, 1971.

[20]Boston Safe Deposit and Trust Company had $8 million in Fed funds sold at December 31, 1971.

[21]Another case involving Boston Safe Deposit and Trust Company is of some importance. Boston Safe Deposit and Trust Company planned to implement a so-called Trust Banking Program, which would provide individual clients with various personal financial services, including a personal unsecured line of credit drawn upon by check. In addition, the line would be offered in connection with the American Express Card Program, whereby the line would be used to pay charges incurred through the use of the American Express Card. This service was to be offered to individuals with a maximum line of credit of $5,000.

The Board decided that Boston Safe Deposit and Trust Company would not be a "bank" upon implementation of the program because (1) the maximum amount of such loans under the program would be only $5,000 and (2) Boston Safe Deposit and Trust Company planned to take measures to ensure that the proceeds of loans under the program would be used only for personal purposes (i.e., noncommercial purposes). (See letter dated May 19, 1978, from Neal L. Peterson, General Counsel, Board of Governors, to Joshua M. Berman, Esq.)

[22]See letter dated March 11, 1981, from James McAfee, Assistant Secretary, Board of Governors, to Robert C. Zimmer, Esq.

[23]Letter dated December 10, 1982, from William W. Wiles, Secretary, Board of Governors, to William M. Isaac, Chairman, Federal Deposit Insurance Corporation.

[24]Ibid. The Board also concluded that the acquisition of "nonbank banks" had become a vehicle to evade the BHCA and that it was necessary to limit the scope of such acquisitions by broadening the meaning of "commercial loans" as quoted in the text.

[25]Under the original BHCA, a company had to own or control two or more banks to qualify as a bank holding company. The 1970 Amendments to the BHCA eliminated this loophole.

[26]Final Decision and Order, p. 13.

[27]Ibid., p. 18.

[28]The Board's emphasis on economic reality has implications for thrifts. Whether thrifts are "banks" is discussed in the following section.

[29]Wilshire Oil Company of Texas v. Board of Governors. Brief for Petitioner.

[30]Wilshire Oil Company of Texas v. Board of Governors, 668 Fed. 2d at 735.

[31]Ibid. at 738. The Court of Appeals distinguished this case from the circumstances surrounding the Gulf & Western acquisition. In the Gulf & Western case, Fidelity, the acquired bank, made a substantial change in its banking operations by divesting its commercial loan portfolio and by committing not to engage in making commercial loans. Thus, the Court apparently sanctioned ex post the Board's decision in Gulf & Western that Fidelity is not a "bank" for BHCA purposes.

[32]Credit balances arise from, and may be used to settle, a variety of transactions. Sources of such balances may include, for example, the purchase of bills of exchange from customers, the collection of bills of exchange, the sale of securities by customers, the collection of interest payments and dividends on securities held for customers' accounts. Credit balances are primarily distinguishable from demand deposits because they arise only from customers who utilize other services of the New York Investment Company. As such, they are said to be "incidental to" those other services. (Credit balances at New York Investment Companies bear a striking resemblance to the deposit-taking capabilities of trust companies under section 225.4(a)(4) of Regulation Y. Trust companies thereunder may not accept deposits other than those that may be incidental to their trust activities.)

[33]The general powers of New York Investment Companies are enumerated at section 508 of Article XII of the New York Banking Law. (4 McKinney's Consolidated Laws of New York, pp. 563-66). Section 509 of Article XII provides that:

> "... nothing contained in this article shall prevent an investment company from maintaining for the account of others credit balances incidental to, or arising out of, the exercise of its lawful powers..."

[34]58 Federal Reserve Bulletin 311-13 (March 1972).

[35]Section 4(c)(9) exempts from the general nonbanking prohibitions of section 4 of the BHCA investments or activities of foreign bank holding companies that conduct the greater part of their business outside the U.S.

[36]See letter dated November 8, 1971, from Tynan Smith, Secretary, Board of Governors, to H. B. Jamison, Assistant Vice President, Federal Reserve Bank of San Francisco.

[37]61 Federal Reserve Bulletin 449-51 (July 1975).

[38]63 Federal Reserve Bulletin 595-603 (June 1977).

[39]66 Federal Reserve Bulletin 759 (September 1980).

[40]63 Federal Reserve Bulletin 599 (June 1977).

[41]Monetary policy concerns have been important factors in bank holding company proposals aside from the acquisition of thrifts. See, for example, the Board's Order regarding a proposal by Orbanco Financial Services Corporation, Portland, Oregon, to issue market certificates that would possess certain transaction account features under the proposal's implementation (68 Federal Reserve Bulletin 198-200 (March 1982)). Also, see Citicorp /Citi Services, Inc., 63 Federal Reserve Bulletin 416-19 (April 1977).

[42]Section 408 of the National Housing Act (12 U.S.C. section 1730a).

[43]See section 225.4(a) of Regulation Y for the list of permissible nonbank activities.

[44]58 Federal Reserve Bulletin 717 (August 1972).

[45]60 Federal Reserve Bulletin 868-74 (December 1974).

[46]Ibid., p. 871.

[47]Ibid., p. 869.

[48]63 Federal Reserve Bulletin 280-87 (March 1977).

[49]See: Economic Perspectives, September/October 1980, Federal Reserve Bank of Chicago, especially pp. 18-22.

[50]68 Federal Reserve Bulletin 316-18 (May 1982).

[51]Ibid., p. 317.

[52]Indeed, the public benefits associated with the proposal center on the fact that Scioto was in jeopardy of failure, posing a threat to the Ohio Guarantee Fund as the insurer of Scioto's deposits, and the Ohio economy. The Board also imposed other conditions on the operations of Scioto which would tend to narrow the scope of the Board's decision. (See: ibid., pp. 317-18.) It has been suggested that the Board's action in this regard is a result of the political sensitivity of the bank/thrift affiliation issue. (See: John D. Hawke, Jr., "Humpty Dumpty Syndrome Alive and Well at the Fed," Legal Times, April 19, 1982.)

[53]68 Federal Reserve Bulletin 253-55 (April 1982).

[54]Section 225.4(a)(2) of Regulation Y.

[55]68 Federal Reserve Bulletin 253 (April 1982).

[56]Ibid., p. 254, note 5.

[57]As noted by Hawke, op. cit., the Order ends without the Board explaining why it is any more "adverse", or subversive of the goals of the Monetary Control Act, for a bank holding company to own an industrial loan company that offers NOW accounts free of Regulations D and Q, than it it for such a company not affiliated with a bank holding company. We note that the Board's theme since passage of the MCA has been that all transaction accounts wherever located should be subjected to the requirements of Regulations D and Q. Within this theme the Board has argued for legislation that would impose reserve requirements on money market mutual funds that possess transaction-type characteristics. (See: "Financial Innovation and Monetary Policy", Federal Reserve Bulletin, vol. 68 (July 1982), pp. 393-400.)

[58]68 Federal Reserve Bulletin 379-82 (June 1982).

[59]Guaranty savings banks are authorized to invest up to 90 percent of deposits in commercial real estate loans compared with the then existing 20 percent ceiling on federally chartered thrifts (4 New Hampshire Revised Statutes Annotated, Chapter 387 (1979).) (The ceiling on federally chartered thrifts is a percentage of assets, not deposits, but asset and deposit totals for such organizations should bear a strong correlation with one another.)

[60]The Board, in approving the acquisition, was not contravening its position taken in D.H. Balwin regarding bank/thrift affiliation. The Board had previously noted the unique structural and competitive circumstances existing in New Hampshire and has sanctioned bank/thrift affiliations in that context. (See: Profile Bancshares, Inc./First National Bank of Rochester, 61 Federal Reserve Bulletin 901-3 (December 1975).)

[61] 68 Federal Reserve Bulletin 656-71 (October 1982).

[62]Ibid., pp. 660-61.

[63]The conditions placed on Fidelity Federal Savings and Loan Association's operations were designed to insure its separate operation as a savings and loan association. (See ibid., p. 659.)

[64]See Title III of the act, section 325.

[65]"Statement by Paul A. Volcker, Chairman, Board of Governors, before the Committee on Banking, Housing, and Urban Affairs, October 29, 1981," Federal Reserve Bulletin, vol. 67 (November 1981), pp. 835-45.

[66]In addition to the expanded commercial lending powers already referred to, Garn-St. Germain authorizes, among other things, the acceptance of demand deposits; investment in nonresidential real property up to 40 percent of assets; investment in consumer loans up to 30 percent of assets; and investment in personalty up to 10 percent of assets.

[67]Edward J. Kane, "Accelerating Inflation, Technological Innovation, and the Decreasing Effectiveness of Banking Regulation," The Journal of Finance, vol. 36 (May 1981), pp. 355-67.